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# Introduction

The EMEA Legal Insights Bulletin is a quarterly publication that explains select case laws and regulatory changes at both regional and local jurisdiction levels in Europe, the Middle East and Africa (EMEA). It also provides analyses and commentaries on legal developments in the region and their possible impact on business.

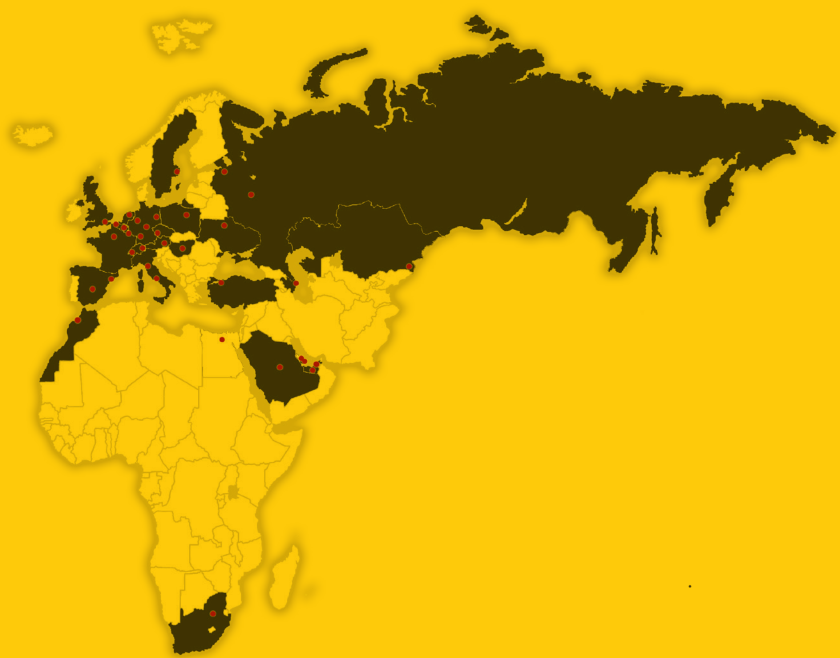
If you have comments and suggestions, please feel free to send them to EMEAPublications@bakermckenzie.com.

Seeking to reduce antitrust law violations and at the same time encourage compliance among companies, Italy decided to use both carrot and stick with its updated competition guidelines. These revamped rules are aligned with the European Commission's guidelines when it comes to fining violations but differ from the latter in many other aspects including the adoption of a compliance programme. A somewhat similar move was taken by the Egyptian Competition Authority when it amended the country's competition law to align it with global competition practices and rules. Baker & McKenzie Competition lawyers elaborate on these two countries' regulatory updates on the antitrust and competition front in this edition's main feature piece and in an article under the section for Egypt, respectively.

Other major regulatory developments within the region include: new Spanish anti-money laundering rules; Hungary's amendments to its electricity and natural gas supply laws, which now impose strict requirements for certifying organisations; Kazakh tax amendments relating to VAT application and cash refunds to VAT payers; Russia's new waste disposal law making manufacturers and importers responsible for the waste generated by their products, and imposing penalties on those that do not comply with the new law; and Switzerland's proposed financial market acts that would comprehensively redesign the Swiss financial market architecture.

Meanwhile, this edition also covers case laws from Spain on employment redundancies; from Switzerland on intra-group loan arrangements and the arbitral tribunals' application of the res judicata principle; and from Turkey on hosting providers' liability in relation to online selling of counterfeit goods.

Flip through this edition to learn more about these developments comprehensively tackled by our lawyers across the region.



# Contents

# Feature

## Fining guidelines may boost compliance programmes and cartel self-reporting

Andrea Cicala and Grant Murray outline the key components of updated competition law guidelines which see Italy take a "carrot and stick" approach to compliance.

> "…Italy has taken the enlightened step of treating the adoption and enforcement of an adequate compliance programme as a mitigating factor…"

The Italian Antitrust Authority recently published its guidelines on calculating fines for serious breaches of national or EU competition law.

In line with the decisional practice of the Authority, the guidelines indicate that the fine will be determined by calculating a starting amount (based on the affected sales) which will then be adjusted according to various criteria, including mitigating and aggravating factors.

The guidelines are broadly in line with the European Commission's Fining Guidelines, save for a number of features.

One striking difference is that the Authority has taken the enlightened step of treating the adoption and enforcement of an adequate compliance programme as a mitigating factor. Italy appears to be one of a growing number of antitrust agencies that are taking this approach (see the accompanying Global snapshot).

To assist companies, the guidelines set out a number of characteristics that the Authority highlights as being of critical importance – and which it would expect to see reflected in a compliance programme in order for it to be regarded as "adequate."

The new Guidelines also introduce a form of "leniency plus" whereby a company that is under investigation for one violation can obtain a (further) reduction of up to 50 percent of the starting amount where it is able to bring another so far undetected cartel to the attention of the Authority and obtain immunity for that additional violation. This type of mechanism has proven to be extremely successful in certain countries, most notably, the United States.

### Calculating fines

The starting amount of the fine is obtained by multiplying by the number of years for which the violation lasted, a percentage (maximum 30 percent) of the value of sales (net of VAT) of the goods or services which are the direct or indirect object of the violation for in the last full year of participation in the latter. For more serious competition restrictions (secret horizontal cartels), the percentage

## Global snapshot: compliance as a mitigating factor

- In Australia, Canada, Chile, France, India, Israel, Malaysia, Singapore and the UK, antitrust agencies are able to treat the existence of a compliance programme as a mitigating factor in so far as it evidences a genuine compliance culture.
- In France, a reduction (typically 5 percent, exceptionally 10 percent) is available for settling companies that either did not have a programme but commit to setting one up, or which commit to upgrading an existing programme according to best practice.
- In Brazil, the antitrust authority is considering issuing regulations related to compliance programmes, which might reward effective programmes with a lower fine.
- In Italy, companies should now take the opportunity to ensure their competition compliance programmes meet the required standard. Indeed, monitoring the future practice of the Authority will shed more light on the extent of this seemingly "Copernican" evolution in the compliance world.

of the value of the sales will be more than 15 percent.

The Authority may also consider including in the starting amount an "entry fee" of between 15 and 25 percent of the value of sales.

Specific rules are provided to determine the value of sales for violations involving collusion in the context of public tender procedures.

The starting amount may be increased or decreased in order to take aggravating or mitigating circumstances into account. Each factor can increase/decrease the starting amount by up to 15 percent (up to a cap of 50 percent).

In case of recidivism, the starting amount may be further increased up to 100 percent.

Examples of aggravating circumstances largely mirror those contained in the European Commission's Fining Guidelines. However, the Authority takes a narrower approach than the Commission in connection with recidivism: only identical/similar violations that have been sanctioned by the Authority or by the Commission in the previous five years will be taken into account. As mentioned, recidivism may justify an increase of 100 percent of the starting amount.

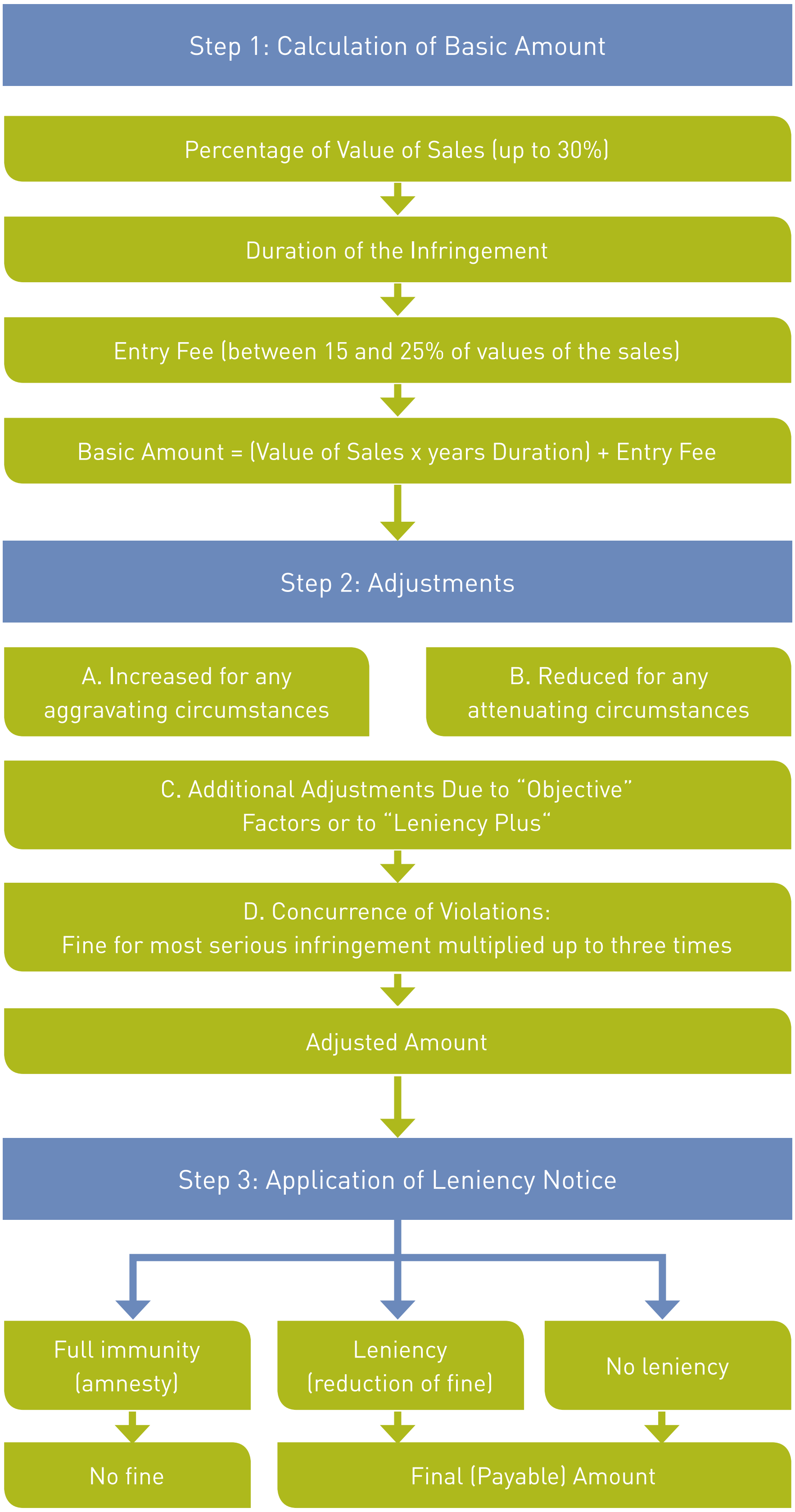
### Compliance programme

In relation to mitigating circumstances, the most notable development is that the adoption and enforcement of a specific and adequate compliance programme (in line with the best European and national practices) may count as a mitigating factor.

The mere existence of a compliance programme will of course not be considered as a mitigating factor. The Guidelines explain that an "adequate" compliance programme would, by way of example:

- imply full involvement of the management in promoting competition law compliance;

Italian Competition Authority's Method of Setting Fines




- identify the personnel responsible for the programme;
- be based on a risk assessment, taking into account the company's activities;
- involve training programmes taking into account the company's size;
- establish incentives to encourage compliance with the programme and a system to deter non-compliance; and
- include monitoring and auditing systems.

Significantly, the guidelines indicate that the fine can be further reduced up to a 50 percent of the starting amount if a company provides information and documents relating to another infringement, and is eligible to receive immunity from fines as regards that "additional" infringement.

The Authority may increase the fine by up to 50 percent if the infringing company generated a particularly high total worldwide turnover (compared with the value of the affected sales); or the infringing company belongs to a group which has a "significant economic dimension."

> "... repeat offenders are on notice as recidivism may justify an increase of 100 percent of the starting amount..."

“

...a company under investigation for one violation can obtain fine reductions where it is able to bring another so far undetected cartel to the attention of the Authority...

”

The Authority may also increase the fine (without indication of any maximum percentage) in order to take into account the profits made by the infringer.

Another important difference from the European Commission's Fining Guidelines relates to the treatment of same conduct which breaches both Articles 101 and 102 TFEU (or of the equivalent provisions of Italian Competition Law 287/90) or situations where same conduct gives rise to multiple breaches of the same provision ascertained by the same decision. In these scenarios, the Authority will impose a fine for the most serious breach increased up to three times.

Companies which have a limited ability to pay the fine may benefit from a reduction provided that comprehensive, reliable and objective evidence is produced showing that the levying of the fine would irreversibly jeopardise the economic viability of the company, causing its actual withdrawal from the market. This approach appears more stringent when compared to the Authority's decisional practice, and appears in line with Commission's position.

In the final and transitional provisions, the guidelines state that the specific circumstances of a given case or the need to achieve a particular deterrent effect may justify derogations from the application of the principles set out in the draft.

Fines cannot exceed 10 percent of the total worldwide turnover generated by the involved undertaking prior to the communication of the infringement.

The guidelines represent a genuine turning point in terms of Italian competition law enforcement.

The Authority may now adopt the so-called "carrot and stick" approach. On one hand, the guidelines indicate that the Authority intends to impose heavy fines on the most serious breaches of competition law. On the other hand, the Authority opens the door to a system whereby the most virtuous companies which invest in a culture of compliance designed to prevent violations of competition law may be rewarded in some way. The Authority's approach may inspire other enforcement agencies to follow suit.

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# Azerbaijan

## Rules change regarding enterprise audits and migration

Altay Mustafayev and Nurlan Mammadov outline a series of changes introduced around business audits and the process of registration for foreign nationals visiting Azerbaijan.

> “...Organisations doing business in Azerbaijan should familiarise themselves with the changes affecting migration and company audits...”

On 31 October 2014, the Azerbaijani President issued a Decree amending Presidential Decree No. 790 dated 28 September 2002 on Prevention of Interferences Hindering Business Activities. Pursuant to the Decree, participation of representatives of the Azerbaijani Ministry of Economy and Industry in audits of enterprises held by competent authorities is no longer required. The Decree came into effect on 1 November 2014.

Moreover, on 31 October 2014, the President issued another Decree concerning the application of the Azerbaijani Law on Regulation of Audits of Enterprises and Protection of Entrepreneurs' Interests. Specifically, the Decree defines "Direct and significant danger or significant damage/harm/injury to human life or health, the environment, proprietary interests of the state" referred to in the Law. The Decree came into effect on 2 November 2014.

The Law came into effect on 1 March 2014 and sets the goals and principles of audits of enterprises in Azerbaijan, the rules for conducting audits, the rights and obligations of auditing authorities and their officials, and requirements for the protection of entrepreneurs' rights and interests. The Law applies to various types of audits, including on-site audits, inspections, and monitoring. However, except for a few articles, the Law does not apply to tax audits and visits and checks of state-owned monopolist service providers (e.g., utilities companies).

In a separate initiative the Azerbaijani Migration Code has also been amended with the changes in effect since 6 November 2014.

Now under Article 15(3) of the Code, in certain cases which are still to be determined by the Azerbaijani President, foreign nationals and stateless persons may come to Azerbaijan without a visa.

Moreover, now under Articles 21(1) and 21(2) of the Code, foreign nationals and stateless persons visiting Azerbaijan for more than 10 days must be registered at their residence in Azerbaijan. An application for registration must be submitted to the Azerbaijani migration authorities within 10 days of a foreign national's or a stateless person's entry into the country. Previously only three days were allowed to elapse before registration was required.

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# Egypt

## Recent amendments to the Egyptian Competition Law: An overview

Waleed Shoukry reports on the amendments to the Egyptian Competition Law and characterises the 2014 amendments as a step towards achieving the autonomy of the Egyptian Competition Authority.

> "...The increase in fines was perceived by the business community to constitute a threat of bankruptcy..."

In the early 2000s, the National Democratic Party (NDP) adopted a reform plan by introducing big market players to the political arena through parliament elections or by granting them influential positions within the NDP decision-making circles. This was labelled by the political opposition as the marriage of wealth and power. In mid-February 2005, the Egyptian parliament enacted the Law on Competition Protection and Prohibition of Monopolistic Practices (the Competition Law). Since its early days, the Egyptian Competition Law has faced frequent criticism from both the opposition parties and the legal community.

The political opposition deemed that this law was tailored to serve the interests of businessmen who were either in power or close to policy-making circles and to protect their businesses against good competition practice. Other criticisms were levelled by the legal community. These mainly revolved around certain deficiencies in the provisions of the law and in particular, the room for state intervention in the appointment of the board of the Egyptian Competition Authority (ECA), the referral of violations to the Public Prosecution Office for interrogations, and the amicable settlement mechanism.

### The 2008 amendments to the Competition Law

In the 2005 version of the Competition Law, the board of directors managing the ECA was appointed by virtue of a prime ministerial decree. The decree on the formation of the board of directors also set out the remuneration of the chairperson and board members. Further, where the ECA found a violation to the law, it was to be referred to the prime minister for him to decide whether to initiate criminal procedures or any further procedures. The 2005 Competition Law provided for a rather cynical amicable settlement mechanism, where the prime minister, or the person delegated by him may settle any violation and waive the criminal procedures, in return for the payment of an amount not less than double the minimum fine and not exceeding double its maximum, provided that such settlement takes place before a final judgment is rendered.

In 2008, amendments were introduced twice to the 2005 law. These amendments increased the penalties for violations relating to horizontal agreements to fix prices, market division (which was per se illegal at that time), anti-competitive vertical arrangements and abuse of dominance. The minimum fine was increased from EGP30,000 to EGP100,000 and the maximum fine was increased from EGP10 million to EGP300 million. The amendments also introduced a post-acquisition notification obliging any party with a EGP100 million annual turnover (in its last balance sheet) to notify the ECA of any acquisition of assets, property rights, usufruct, shares, setting up of unions, mergers or amalgamations. The amendments also introduced partial immunity for whistle-blowers by adding a new provision to the law whereby a court may exempt, by up to the half of the sanction decided thereby: (i) violators who take the initiative to inform the ECA of the offence and submit the supporting evidence, and (ii) those whom the court considers to have contributed to disclosing and establishing the elements of the offence at any stage of inquiry, search, inferences gathering, interrogation and trial processes.

The increase in fines was perceived by the business community to constitute a threat of bankruptcy as a fine may be multiplied by the number of individuals sentenced for that offence. Also, the notification requirement created confusion about who is obliged to notify in sophisticated corporate transactions and mergers. In addition, certain concerns about the introduction and use of an immunity element were raised. The first of these concerns is that in recent years cartels have become extremely sophisticated and participants have shown remarkable skills when forming and operating cartels. It is not difficult to imagine how cartelists can adapt their behaviour to an immunity mechanism and exploit this mechanism after making considerable gains from the cartel.

Second, it was considered objectionable on moral grounds to allow a cartel participant to escape a penalty when their activities contributed to what is regarded in terms of competition law as the most harmful conspiracy against consumers.

The leniency system was also criticised for not including the following rules for leniency that the competition regimes of other jurisdictions usually do include:

- the applicant must be or must have been party to a cartel;
- the applicant admits that its conduct in respect of the cartel may constitute an infringement of the law;
- the applicant is the first person to apply for immunity in respect of the cartel;
- the applicant has not coerced others to participate in the cartel and was not the clear leader in the cartel;
- the applicant has either ceased its involvement in the cartel or indicates to the authority that it will cease its involvement in the cartel; and
- the applicant must provide full disclosure and cooperation to the authority until prosecution of the other cartel members is successful.

## The 2010 amendments to the Competition Law

In 2010, further amendments were introduced aiming to remedy the failings of the Competition Law. However, the amendments did not succeed in this, mainly because they failed to give the desired independence of the ECA from governmental intervention in the appointment of its board of directors and the referral of violations decided by ECA's board to criminal proceedings. Further, the amendments failed to grant the ECA any authority to review legislations or coordinate with administrative authorities issuing decrees intersecting with the market practices. Although these amendments were based on theoretical and scholarly analysis

> …The past three years have been a period of political cynicism, unprecedented violence and economic dislocation in Egypt…

at the time, their deficiencies have been revealed in the years since President Mubarak's departure.

## Recent ECA investigations

The past three years have been a period of political cynicism, unprecedented violence and economic dislocation in Egypt. Competition law was one of the tools that was used to target businessmen and market players who were close to the presidential palace. The deficiencies of the Competition Law, especially those relating to the independence and autonomy of the ECA, were underlined in two landmark cases concerning dairy products and the steel industry.

### Dairy products

The first case concerns the request of the minister of trade and industry to the ECA in 2007 to study the market in dairy products following various complaints by farmers. The ECA initiated an investigation into the packaged milk sector, which determined that milk producers were engaging in price fixing in violation of article 6 of the Competition Law, despite the fact that the price-fixing conduct was the result of a series of ministerial decrees forming a joint committee of farmers and packaged milk producers to agree on a recommended pricing formula for raw milk and obliging packaged milk producers to abide by the decisions of such committees. In 2011, on the ECA's recommendation, the minister of trade agreed that considering the element of state compulsion, the case should be settled with a minimum fine imposed on each milk-producing company found in violation of the Competition Law.

### Steel

In the second case, the ECA received a request in July 2006 from the minister of trade and industry to study the reasons for the increase of steel prices and to detect whether that increase was due to a violation of Competition Law. After lengthy investigations and data collection from all the relevant parties in the steel market, the investigations were narrowed to focus on one dominant steel manufacturer in the Egyptian market, Ezz Steel. The investigation team concluded that Ezz Steel was abusing its dominant position, however, the ECA's board of directors, after reviewing the draft report, decided that the finding was groundless and that further investigations must be undertaken. In December 2009, after additional investigations and obtaining foreign expert opinions on Ezz steel's practices, the ECA's board of directors decided that there were no violations of the competition law and that there was no abuse of dominance on the part of that manufacturer.

After the 2011 revolution, and as part of the hunting down the political figures associated with the Mubarak regime, the Public Funds Crimes Prosecution Office requested the ECA to investigate the practices of Ezz Steel in the market during the period following the first investigation. Again, the ECA initiated its investigations of the steel market and decided that there were no violations of the competition law. However, the Public Funds Crimes Prosecution Office disregarded the two decisions issued by ECA and requested the minister of trade to initiate criminal proceedings against Ezz steel for abuse of dominance. Influenced by the political environment and media pressure, the minister also disregarded the decisions of the ECA board and initiated criminal proceedings. The Public Prosecution Office, after investigating the matter has referred the case to the criminal court and currently the case is being reviewed by the Egyptian Court of Cassation.

The ECA's lack of independence was, however, partially compensated in late 2011 when the prime minister delegated his powers under the Competition Law to the chairperson of the ECA via the minister of trade.

## The 2014 amendments to the Competition Law

In 2014, and after increasing demands to isolate the ECA's decision-making process from any political or governmental interventions, one of President Sisi's first acts was to amend the Competition Law once more to achieve this.

These amendments were seen by the legal community and competition law practitioners as a step towards harmonisation with global practices and regulations in the arena of competition law. Nevertheless, these amendments are not free from loopholes and shortcomings.

Among the amendments introduced by this presidential decree the most significant are the following:

- Article 6 of the Competition Law prohibits certain horizontal agreements and formerly considered them per se violations. After the 2014 amendments, a rule-of-reason analysis was introduced, where the ECA, at the request of the relevant parties, may exempt from the prohibition certain agreements that aim to achieve economic efficiency and if it was proven to the ECA that such an agreement will achieve benefits for consumers that exceed its anti-competitive effect. The criteria for exemption are yet to be determined in the Executive Regulations of the Competition Law.
- Article 11 of the Competition law was amended to grant the ECA power to opine on legislation, policies or decrees that may impede competition. This power will be primarily exercised by the ECA or, at the request of the Cabinet of Ministers, ministries or other relevant authorities. The amendment also obliges the relevant authorities to request the ECA's opinion in any future legislation relating to competition regulation. However, the amendment does not oblige the competent authorities to abide by the ECA's opinion.
- In a major step towards independence, article 21 of the Competition law was amended to grant the ECA chairperson the authority to decide on whether to initiate criminal procedures in relation to violations of the Competition Law. Formerly, this was the responsibility of the prime minister or a person delegated by the prime minister. The amended article 21 also requires the approval of the majority of the ECA's board members to initiate such actions.
- The authority to amicably settle violations of the Competition Law is also now vested in the ECA's chairperson provided that the majority of the board members approve such settlement. In addition, the settlement thresholds became more appealing than the irrational sums set out in the earlier versions of the Law. The settlement threshold is currently being linked to the status of the violation claim. If the settlement took place before the initiation of a criminal claim or the pursuit of any criminal procedures, the settlement amount shall not exceed the minimum fine accorded for the violation. In the case of a settlement for violations during the period between the initiation of a criminal claim and a final judgment, the threshold shall be a fine of not less than three times the minimum fine accorded to the violation and shall not exceed the maximum fine.
- Article 22, which sets out the fines for violations of articles 6-8 of the law was also amended. Instead of the fixed-penalty approach, the penalty is now based on a percentage of turnover of the products

relevant to the violations. The percentages are determined as follows:

a. for violations of article 6 on horizontal agreements, a fine of between 2 and 12 per cent of the turnover for the product concerned during the violation period. If the total turnover of the relevant product cannot be ascertained, then the fine shall not be less than EGP500,000 and not more than EGP500 million;

b. for violations of article 7 on vertical arrangements or article 8 on abuse of dominance, the fine shall be 1 and 10 per cent of the turnover of the product concerned during the violation period. If the total turnover of the concerned product cannot be ascertained, then the fine shall not be less than EGP100,000 and not more than EGP300 million; and

c. the fine shall be doubled in events of recurrence.

One of the criticisms of the the above-mentioned amendment to article 22 is that the fine is still multiplied by the number of individuals responsible for the violation and the company is jointly responsible for the payment of the sentenced fine. The article also disregards the violator's ability to pay the fine without jeopardising its economic viability. Article 26, on leniency, was also amended to address the criticisms of the former language of the said article. There is now a full immunity regime in favour of the first whistle-blower violator who reveals an anti-competitive practice under article 6 of the law to the ECA. The immunity is conditional on revealing the violators and providing the ECA with sufficient evidence to prove the violation. The remaining violators may benefit from a partial immunity regime, where the court may decide to exempt them from half the fine accorded for violating article 6 of the law if the court deems that they have provided data and information that assisted in revealing the violation in any of the investigations, interrogations by public prosecution or during trial. The amendments to the immunity regime do not apply to entities that have violated articles 7 and 8 of the Competition Law.

Although the above-mentioned amendments may be seen as a step towards harmonisation with international norms and achieving autonomy for the ECA, their effect is yet to be seen.

(Note: This article is an extract from The African and Middle Eastern Antitrust Review 2015 - www.GlobalCompetitionReview.com.)

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# France

## Court harmonises tax regime for share redemptions

Stéphanie Auféril and Sophie Jouniaux report on the modification of the tax regime applicable to sums distributed to shareholders, either individuals or legal entities, when a company redeems its own shares.

> "...the net gains from companies' redemptions of their own shares will be governed by a single regime; the regime for capital gains on shares..."

In June 2014, the French Constitutional Court (*Conseil Constitutionnel*) in its decision no. 2014-404 QPC declared unconstitutional the provisions of Article 112-6° of the French Tax Code (FTC), which provided for a specific tax regime for share redemptions within the framework of attributions to employees or share redemption plans (Articles L. 225-8 to L. 225-112 of the French Commercial Code).

Although, as a general rule, the portion exceeding share capital contributions resulting from share redemptions performed by individual shareholders were categorised as distributed income and, in certain situations and for a residual fraction of profits, as capital gains on shares, the amounts paid under the share redemption plans mentioned in Article 112-6° of the FTC were fully taxed as capital gains.

The legislature wished to harmonise the tax regime of share redemptions, including for legal entities, so that the net gains from companies' redemptions of their own shares would all be governed by a single regime, the regime for capital gains on shares.

The consequences of this modification are important because, as of 1 January 2015, the portion exceeding share capital's contributions paid to shareholders in share redemptions will no longer be subject to the 3 percent contribution on income. The same goes for the withholding tax, which will no longer be applicable to share redemptions performed with non-resident shareholders, either individuals or legal entities. Lastly, in share redemptions involving individual shareholders, the allowances for minimum holding period enacted by the 2014 Finance Act will be applicable to net gains resulting from redemptions.

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# Hungary

## Strict invoicing rules hit home for energy providers

Balázs Hegedüs and Sándor Zórád report on the legislative changes relating to Hungarian Energy Law introduced during the fall of 2014.

> "...an invoice issued from a system that has not been properly certified shall be deemed invalid as of 1 January 2015..."

Hungarian domestic energy law underwent various important changes during the fall of 2014. Several significant legislative amendments entered into force during that period which are of consequence to industry participants.

Laws on electricity and natural gas supply were amended effective as of 7 October 2014. The legislator, as part of these modifications, introduced strict requirements relating to organisations' certifying IT systems used for the issuance of invoices at certain service providers. Consequently, certifying organisations are required to meet the new minimum requirements; in particular they must be accredited for a minimum of three consecutive years, must have at least three references, at least two adequately educated/trained professionals having at least two years of certification experience and must have a site security certificate. An invoice issued from a system that has not been properly certified shall be deemed invalid as of 1 March 2015, in case of organisations issuing monthly more than 200,000 pieces of invoices, and as of 1 July 2015, in case of organisations issuing monthly maximum 200,000 pieces of invoices.

In addition, the amendment of the Act on uniform image of invoices of public service providers also entered into force on 7 October 2014, which introduced smaller technical changes relating to mandatory content requirements of the invoices issued by public service providers (i.e., certain invoices had to be supplemented by indicating the date when the certification of the meter measuring consumption expires and the planned schedule for changing the meter). The aim of this amendment is to facilitate the easier identification of invoices and to assist in the provision of a wider range of information. Industry participants are obliged to harmonise their billing practices with the new requirements, as failure to comply could result in serious sanctions against infringers.

### Network access

As of October 2014, the network access fee is regulated by a single decree issued by the president of the Hungarian Energy and Public Utility Regulatory Authority (HEPURA). Under the previous legal provisions, a two-tier regulatory system applied to the network access fee and regulatory competence was divided between the competent minister and the president of HEPURA, which made regulatory transparency quite problematic. The legislator, in order to remedy this situation, at the suggestion of the Hungarian Energy Consumer Association, discontinued the two-tier regulatory system.

> ...in 2015 the Hungarian Government intends to establish a national utility holding company...

On 14 November 2014, certain modifications entered into force in relation to licensees issued pursuant to the Act on natural gas supply. On the one hand, the property right over the natural gas stored in natural gas storage operated as a public customs warehouse may now be freely transferred, and neither a natural gas-trading licence nor a limited natural gas-trading licence is required. On the other hand, as a result of the supplementation of the list of activities requiring licensing, natural gas companies, without transmission system operational licences, are now eligible to perform transmission pipeline establishment/building business activities – the primary purpose of this modification appears to be to simplify and facilitate the construction of the Hungarian section of the South Stream natural gas pipeline.

The domestic energy market is facing major changes in the short and mid-term, and this presumably will result in the subsequent modifications of energy laws.

On the domestic level, it might be significant that in 2015 the Hungarian Government intends to establish a national utility holding company. A Government Decree published on 29 September 2014 appears to support these intentions as it calls upon the Minster leading the Prime Minister's Office to examine the options the Hungarian Government has to enter the electric supply and district heating market (as a universal service provider). The Minister, in accordance with the requirements of the national public utility system, is obliged to introduce to the Hungarian Government a proposal, containing the most viable options.

It is also important from the domestic energy market and energy law perspective that the European Counsel on 24 October 2014 approved the policy framework for climate and energy up to 2030 proposed by the European Commission, which describes concrete goals in relation to the member states and the European Union as a whole (relating to issues such as the reduction of greenhouse gas emissions and the increase of the ratio of the use of renewable energy).

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# Kazakhstan

## Overhaul of tax laws spur changes for enterprises and foreign CEOs

Igor Kolupayev and Curtis Masters summarise the most important tax amendments arising from legislative updates.

> ...local VAT will apply only to sales by foreign companies to the extent that the local branch is directly involved in such sales...

On 28 November 2014, Kazakhstan adopted certain amendments to its tax legislation most of which came into effect on 1 January 2015.

Under the tax amendments, taxpayers will be released from liability to pay tax fines and default interest on any unpaid (underpaid) taxes which had accrued before 1 January 2014 and which had not been paid to the tax authorities by 1 October 2014.

The procedure of applying this exemption has to be determined by the Committee on State Revenues of the Ministry of Finance. At time of writing this was not available.

This exemption does not apply to certain categories of taxpayers, such as subsoil users, major taxpayers (according to a Government list), and taxpayers which initiated international arbitration proceedings against Kazakhstan in connection with their tax liabilities.

The changes mean that foreign CEOs of local companies and foreign heads of local branches and representative offices of foreign companies had to register for tax purposes in Kazakhstan and obtain a Kazakhstani individual identification number (IIN) by 1 January 2015. Following that, their legal entity, branch or representative office should update its tax registration details accordingly. While the authorities claim that this change is aimed at simplifying the introduction of electronic VAT invoices in Kazakhstan in the absence of further detail, the relationship between these two concepts is unclear.

What is clear, however, is that obtaining the local IIN will not result in additional tax implications for foreign managers, such as creating a tax residence in Kazakhstan or an obligation to pay tax on income from non-Kazakhstani sources.

A failure to comply with the requirement may lead to a relatively small fine on the foreign CEO/head. More importantly, entities, branches and representative offices which do not ensure that their CEO/head is duly registered will cease to be VAT payers from 1 January 2015 (which in some situations may adversely affect their VAT position).

Before the tax amendments were adopted, there was some uncertainty as to whether local VAT applies to sales of certain services (e.g., financial services) by foreign companies which have branches in Kazakhstan, but where sales do not involve such branches in any respect. A technical reading of the law suggested that worldwide sales of foreign companies with local branches would be subject to local VAT.

To address this issue, the tax amendments clarify that local VAT will apply only to sales by foreign companies to the extent that the local branch is directly involved in such sales. This would be the case where the branch would sign a contract with the customer (or would be indicated in the contract as the service provider), issue by the branch an invoice or act of acceptance to the customer (or where the act issued by the foreign parent indicates the branch as the provider of the relevant services), or where the local branch would receive the service fees.

Another change involves a further postponement of cash refunds. Before the Tax Amendments were adopted, the introduction of a cash refund of the difference between "input VAT" (i.e., VAT paid to suppliers) over "output VAT" (i.e., VAT charged to customers) to VAT payers was planned for 2016. The tax amendments extend this deadline to 1 January 2017. Until then, VAT will continue (with certain limited exceptions) to be available only for set-off but not for cash refund.

Finally, before the tax amendments, Kazakhstani entities which were engaged in financial leasing business were exempt from corporate income tax on interest payments under financial lease agreements. The exemption applied regardless of the types of leased assets.

The tax amendments limited the scope of the tax exemption to financial leases of agricultural and biological assets which provide for transfer of title to the leased assets to the lessee upon expiration of the lease.

> "...amendments limit corporate income tax exemptions for financial leasing businesses..."

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# Russia

## Authorities clarify waste disposal rules and how levies will be imposed

Max Gutbrod reviews Russia's new waste disposal rules and their likely impact on manufacturers and importers.

> "...manufacturers and importers must take responsibility for recycling and waste disposal related to their products either directly, through an industry association, or a contracted arrangement with a third party..."

With the 23 December 2014 passing of the Federal Law "On Changes to the Federal Law 'On Wastes Generated in the Manufacturing and Consumption of Products,' Several Legislative Statutes," and after controversial debate, changes have been made to Russian Federal legislation covering waste generated in the manufacturing and consumption of products. Most of the changes to the law "On Waste Generated in the Manufacturing and Consumption of Products" (the "Law") entered into force on 1 January 2015.

To summarize the general direction of the new legislation, despite the lobbying in particular of foreign business and despite similar levies having proven inefficient, a levy on the production that leads to waste coming into circulation has been introduced. Whilst earlier attempts to monopolise waste disposal in the hands of a single company have been turned down, there will be single designated companies at the municipal level. Finally, legislation leaves wide discretion to for implementation to the government and government bodies.

### Standards for dealing with waste

More in detail, the Law states that manufacturers and importers of goods must themselves provide for the recycling, salvage, reclamation, and disposal of waste generated from the use of such goods, that is, waste generated by products and packaging which are no longer of value to consumers. A list of specific goods and packaging subject to recycling, normative recycling standards, and the procedures for submitting reports on compliance with the normative standards are to be established by the Government of the Russian Federation.

Normative standards for recycling should be established by the Government for each group of goods as a percentage of the overall quantity of goods put on the market for internal consumption on the territory of the Russian Federation during a given calendar year, depending on the mass/weight of the finished products or the number of units thereof, or the mass/weight of the packaging used for the production of such goods. Normative standards for recycling are to be established with regard for economic conditions and the potential dangers to human health and the environment posed by the waste, and with regard for the technological feasibility of recycling said goods; these standards will be subject to review every three years. If the packaging of the product is manufactured using secondary raw materials, a lowered coefficient shall be applied, to be calculated as the difference between the item and the quantity of secondary raw material used in the manufacture of said packaging.

Manufacturers and importers must themselves ensure the implementation of recycling standards and practices by either organising their own infrastructure (that is, to themselves carry out the collection, processing, and recycling of waste) or signing contracts with municipal solid waste removal contractors (including regional contractors).

Normative recycling standards may also be met by creating a corresponding association of manufacturers or importers. Such associations may also sign contracts directly with the contractors for the purpose of ensuring that recycling takes place.

The manufacturers or importers may carry out their recycling obligations throughout the entire territory of the Russian Federation, regardless of the federal subject (region, oblast, etc.) the manufacturer or importer has its business operations.

If the manufacturer or importer of goods does not itself ensure recycling in compliance with the established standards and practices, it will be required to pay an ecological levy. The ecological levy is classified as non-tax state budgetary revenue, and the levy amount shall be determined by the Government of the Russian Federation.

The ecological levy shall be calculated by multiplying the ecological levy index/rate by the mass (weight) or number of units of finished goods put on the market on the territory of the Russian Federation (or the mass/weight of the packaging used in the production of the goods), and by the normative recycling standard.

If the normative standards for recycling are not reached by the manufacturers or importers which took on the obligation to independently recycle wastes but did not fully achieve the required standard, the ecological levy will be assessed in the following way: the ecological levy index/rate is multiplied by the difference between the required quantity of recycled waste and the quantity actually achieved, by the mass/weight of finished goods or number of units of finished goods subject to recycling and put on the market on the territory of the Russian Federation (or mass/weight of the packaging used in the production of the goods), and by the unachieved normative standard of recycling, expressed in relative units.

The ecological levy index/rate is based on the average expenditure for the collection, transport, processing and recycling of a single item, or of one unit of mass/weight, of a product that is no longer of value to consumers. The ecological levy index/rate may include a separate amount representing expenditure on creating recycling infrastructure facilities. The ecological levy rates for each category of goods subject to recycling after they are no longer of value to consumers are to be determined by the Government of the Russian Federation.

"...standards for recycling are to be established taking account of economic conditions, human health, the environment and technology and will be reviewed every three years..."

The procedures for reporting on compliance with normative recycling standards should be set by the Government. Monitoring and supervision of the correct calculation and payment of ecological levies will be carried out by a Government-authorised executive agency.

The revenue paid into the state budget in the form of ecological levies should be used to provide subsidies to Russian Federal subjects carrying out measures related to waste recycling. Thus, the ecological levy has become, along with payments for negative impacts on the environment and recycling levies, yet another type of payment into the state budget related to waste recycling.

### Waste and levies

Producers of solid municipal waste should conclude contracts for the recycling of such waste with regional contractors. A regional contractor will be designated in each Russian federal subject by tender. Regional contractors, as well as owners of residential property, are required by law to sign contracts for recycling services with producers of solid municipal waste, which means that in a given federal subject the regional contractor will essentially be a monopolist in the provision of services for recycling solid municipal waste.

> "...if the manufacturer or importer of goods does not itself ensure recycling in compliance with the established standards and practices, it will be required to pay an ecological levy..."

Several types of activity in the sphere of handling solid municipal waste will be regulated by the authorities (processing, decontamination, storage, handling services provided by the regional contractor); and fees will be set for such activities.

As indicated, the services of handling solid municipal waste may only be provided to the producers of such waste by a regional contractor. Other types of activity may be carried out by other contractors even if regulated. Each Russian federal subject will appoint a regional contractor whose responsibilities will include handling solid municipal waste. Regional contractors may also sign contracts with manufacturers and importers to ensure that targets are met for recycling waste from product usage.

In order to determine the quantity of goods subject to recycling in 2015, as well as for the calculation of ecological levies, data will be used on the amount of goods put on the market on the territory of the Russian Federation, including packaging, for nine months in 2015.

If the manufacturers and importers of goods do not themselves provide for the recycling of waste, then the ecological levy for the first nine months of 2015 will be subject to payment before 15 October 2015. The ecological levy for October, November, and December 2015 must be paid before 1 February 2016.

If the manufacturers and importers themselves provide for the recycling of waste then their 2015 accounts will have to be submitted to the authorised Government body before 1 April 2016.

### Outlook

As at the time of this writing (end of February 2015), drafts of implementing legislation are being published and it is becoming clearer what recycling obligation will apply to which product, producers are starting to look for options to diminish the burden of the levy by putting in place or adapting their use of waste. Typical questions arising in this context are whether and how the increase of the utilization rate is to be documented, whether the use of waste by a producer that did not produce the product that caused the waste but rather only a competing product can be counted as increasing the utilization rate, whether, in particular if there are no other options, how far the activities of regional contractors, if they lead to utilization and in particular if regional operators act at the request of producers, are to be counted for the purposes of the calculation of the levy, whether regional operators have to engage in related activity and whether there will be competition between neighboring regional operators, and how stability of regulations and their implementation as required for major investment can be ensured.

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# Amendments to Russian thin-capitalization rules and interest deductibility caps address the devaluation of the ruble

Kirill Vikulov outlines the implications of the recent amendments to the Russian Tax Code affecting thin capitalization rules and interest deductibility caps.

> "...Because of the drastic ruble devaluation in 2014–2015, many Russian borrowers having foreign currency denominated loans from related parties faced thin capitalization issues..."

On 8 March 2015, the President of the Russian Federation signed Federal Law No. 32-FZ "On Amending Part Two of the Russian Tax Code," establishing a fixed ruble exchange rate to be applied to thin capitalization and extending the use of interest deductibility caps (the "Law").

## Implications for taxpayers

The new amendments should help Russian borrowers obtain interest deductions on the related-party loans denominated in a foreign currency, which had fallen under thin capitalization restrictions due to the drastic devaluation of the ruble, by fixing an artificial exchange rate. The Law fixes ruble exchange rates as of 1 July 2014 for the purposes of calculating the thin capitalization debt-to-equity ratio, thus placing some of the foreign currency loans outside the class of tainted debts.

The Law also extends the application of the new safe harbours for allowed interest rates, currently available only for transactions with banks, to other related party loans for which companies do not want to go through the transfer pricing study. This could help taxpayers reduce costs on the tax administration and save on transfer pricing studies, especially on small loans.

## What the Law says

The Law (i) fixes ruble exchange rates for the purposes of applying Russian thin capitalization rules and (ii) extends and revises the new interest deductibility caps.

1. Fixing ruble exchange rates for thin capitalization rules

Because of the drastic ruble devaluation in 2014–2015, many Russian borrowers having foreign currency denominated loans from related parties faced thin capitalization issues, even on loans that were previously within the 3 to 1 debt-to-equity ratio and were extended on the arm's-length terms. Although this non-deductibility problem suggests that there are more fundamental issues with Russia's thin capitalization rules, the Russian authorities are aiming for a quick and temporary solution by artificially fixing ruble exchange rate. The fixed ruble exchange rate will apply (and no exchange rate differences will be considered) to calculating deductible interest accrued in the period from 1 July 2014 to 31 December 2015 on loans concluded before 1 October 2014.

The ruble exchange rates for thin capitalization purposes will be based on the Central Bank rates set on 1 July 2014 (USD1 - RUB33.8434; EUR1 - RUB46.1827).

2. Extension of safe harbour interest deductibility caps

As of 1 January 2015, historic interest deductibility caps based on the Central Bank refinancing rate (the "CBR") were eliminated in favour of applying transfer pricing rules, except for loans where one of the parties is a credit institution. Although the transfer pricing rules only apply to the related-party loans in the absence of a safe harbour rule, it is quite costly and impractical for Russian borrowers to prepare transfer pricing studies for small-scale loans.

The Law revises the application of the safe harbour interest rates to all controlled loans as of 1 January 2015. New safe harbour interest rates for ruble loans shall apply, and are mostly based on the Central Bank "key rate" (currently 15 percent), which is higher than the CBR (which is still fixed at 8.25 percent).

Finally, the Law introduces a temporary, wider safe harbour range applicable to ruble loans concluded between the related Russian entities for year 2015.

| Currency (period) | Safe-harbour range for interest rates on debt obligations between related parties | |
|---|---|---|
| | Minimum | Maximum |
| RUB (for loans granted from 1 to 31 December 2014) | 0% | 3.5 CBR (28.875%) |
| RUB (for 2015) | 0%[1] of the key rate | 180% of the key rate |
| | 75%[2] of CBR | |
| RUB (as of 2016) | 75% of the key rate | 125% of the key rate |
| EUR | EURIBOR + 4% | EURIBOR + 7% |
| Yuan | SHIBOR + 4% | SHIBOR + 7% |
| GBP | GPB LIBOR + 4% | GPB LIBOR + 7% |
| CHF | CHF LIBOR + 2% | CHF LIBOR + 5% |
| JPY | JPY LIBOR + 2% | JPY LIBOR + 5% |
| USD and other currencies | USD LIBOR + 4% | USD LIBOR + 7% |

[1] 0% - applicable to ruble loans concluded between the related Russian entities;

[2] 75% - applicable to ruble loans concluded with related foreign entities or offshore companies;

We summarise the safe harbour interest rates as revised by the Law in the table below (including temporary, more beneficial ranges).

Note that taxpayers may not rely on or deduct interest under the safe harbour rule when the interest rate on a controlled loan is outside the applicable minimum and maximum thresholds in the range; in such cases they must prepare and use the transfer pricing study.

## Actions to consider

- review the thin capitalization position of Russian borrowers for 2014-2015 in view of the artificial fixed ruble exchange rate; consider amendments to 2014 tax returns to increase interest deductions;
- review and revise the deductible interest amounts on current related-party loans which are not backed by transfer pricing documentation; consider the new safe harbours for future borrowings.

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# Spain

## Changes bring rescue of troubled businesses a step closer

Gemma Gaya, Lluís Félez, Enrique Silvente and Víctor Mercedes outline the amendments made to the Spanish Insolvency Act in 2014.

> "...relief procedures for viable companies' financial debt in order to avoid bankruptcy by eliminating the rigidity of the rules in refinancing agreements..."

More than 90 percent of bankruptcies in Spain go into liquidation, which is rather distant from the spirit of Spanish bankruptcy legislation, which was designed precisely to maintain companies and their production. Bankruptcy legislation has undergone various reforms over the last several years, though none has managed to correct this tendency.

In 2014, the Spanish Government undertook three new reforms to the Spanish Insolvency Act aimed to facilitate refinancing of economically distressed companies to avoid their insolvency; reaching and complying with creditors' arrangements; trading with the debt of companies in insolvency; and selling production units of bankrupt companies. In addition, the last amendment reformed the legal regime of the insolvency receiver.

On 9 March 2014, a reform of Law 22/2003, the Insolvency Act, came into effect, with the approval of Royal Decree-Law 4/2014, which adopted urgent measures for the refinancing and restructuring of corporate debt.

This reform was complex and represented one of the most daring developments in handling bankruptcy. It sought to work in depth on relief procedures for viable companies' financial debt in order to avoid bankruptcy by eliminating the rigidity of the rules in refinancing agreements.

The Royal Decree-Law applies to the pre-insolvency phase (that is, reporting the beginning of negotiations to reach a refinancing agreement or to approve of a proposed agreement), as well as the refinancing agreements and their content, requirements, effects, and authorisation.

The reform regulated the reserved application for pre-insolvency

> "...a new regime for court authorisation of refinance agreements was incorporated..."

meaning that it will not be published in the Bankruptcy Public Registry. Previously the broad public knowledge of pre-insolvency made refinancing companies in this early phase more difficult.

It also stopped new court seizures and the stay of those under way from the time of reporting until the agreement is formalised or, in any event, three months after the beginning of negotiations is reported.

The Tax Agency, the Social Security Administration, and other public creditors were not affected by these limitations.

The formal requirements for the approval of refinance agreements protected from rescission in bankruptcy proceedings changed so that an auditor's certificate of agreement among the majority creditors replaced the previous requirement of an independent expert's report, which became optional for the debtor.

A new type of refinance agreement was regulated, one not subject to rescission in insolvency proceedings. It does not require majorities of the debt-holders. The agreement must improve the debtor's equity and allow it to overcome insolvency by restoring a positive operating fund while a range of other specified conditions must also be met.

Finally, the debtor or the creditors may (but are not required to) request an independent expert's report, as provided in the regulations prior to the reform.

## Refinance agreements

The reform established the presumption that, unless proven otherwise, the creditors taking part in the refinance agreement will not be deemed *de facto* administrators of the debtor in the event of insolvency.

The fresh money granted within the framework of the refinance agreement will be considered claims against the insolvency estate (up to 50 percent of its value) in the event of subsequent bankruptcy, with preference as to collection over the other debts of the bankrupt company. This rule will not be applicable to income earned by the debtor or its quota-holders through a capital increase or loans.

Capitalisation of claims within the framework agreement is also encouraged.

Further, a new regime for court authorisation of refinance agreements was incorporated.

The majority necessary for a court to authorise a refinance agreement drops. It is no longer necessary for the agreement to be supported by 60 percent of the creditors to be unrescindable. A court's authorisation will be sufficient to make an agreement unrescindable, with no need for additional quorums.

The court's verification in the authorisation procedure was specified, aimed to make the agreement binding on dissident and non-participating creditors as well. This decision will be made on an urgent basis, within 15 days of a request, and will be published in the Bankruptcy Public Registry and the BOE (Official State Gazette). It shall take effect the following day.

In syndicated loans, those holding 75 percent of the claims representing the loan must approve the refinancing agreement, unless the rules of the syndication indicate otherwise.

The court authorisation extends the effects of the refinancing agreement to all the financial creditors according to a sliding scale.

Refinancing agreements may include the conversion of the bankrupt company's debt into capital in the debtor's company or participative loans with a term of between five and 10 years into convertible obligations or subordinate loans or into loans with capitalisable interest or into any other financial instrument with a rank, due date, or characteristics different from those of the original debt. The capital increase resolutions shall require the majorities indicated in the Companies Act. Creditors which have not signed the refinance agreement or which do not wish to capitalise may obtain an acquittance equal to the face value of the shares or quotas which it must subscribe or assume.

The reform allowed dation in payment in said agreements.

Finally, the Bank of Spain must establish and make public the criteria to qualify a debt as a normal risk in operations in which a refinancing agreement is reached.

### Insolvency proceedings

On 7 September 2014 the reform of the Insolvency Act, came into effect.

This amendment makes creditors' arrangements more flexible and attempts to favour the purchase of production units and the debt of insolvent companies.

> "...makes creditors' arrangements more flexible and attempts to favour the purchase of production units and the debt of insolvent companies..."

In Spain, most insolvencies end in liquidation, often because the arrangement reached with the creditors is impossible to fulfil. The fact that privileged claims are separated from the effects of the arrangement has on occasion made it difficult to fulfil. The new Law limits the prerogatives of those holding privileged claims in order to safeguard the effects of creditors' arrangements.

The scope of the special privilege is also limited. It may not exceed the value of the relevant guarantee. The value of the guarantee is 9/10 of the reasonable value of the good or right in question minus the amount of the debts pending payment with preferred guarantees. It cannot be less than zero or more than the amount of the privileged claim or the maximum agreed liability. Any other amount of the claim exceeding that limit will be classified according to its nature.

The content of the arrangement was made more flexible and creditors' arrangements, subject to a majority within each class of credits, were given the power of cramdown with respect to privileged creditors.

Dation in payment was allowed, and the capitalisation of debt was favoured for reaching the arrangement.

Proposed arrangements with creditors may also be presented by the Public Administration and the companies it controls in insolvency proceedings for companies holding concessions for public works or public services or which have contracts with the Public Administration.

Revision of arrangements with creditors adopted in keeping with earlier legislation was expressly allowed if violated within two years of the effective date of this reform, and qualified majorities must approve such revisions.

A market of claims held against insolvent companies was being promoted among different operators, not only financial institutions but also commercial entities. In general, these creditors will maintain their right to vote in the creditors meeting together with the creditors which acquired claims against a bankrupt company by *inter vivos* (living gifts) acts after the debtor was declared insolvent. Only those purchasers of credits particularly associated with the debtor will lose their right to vote.

Greater regulation was also imposed on the sale of production units with a series of new rules introduced.

### Refinancing and restructuring

On 2 October 2014, Law 17/2014 which adopted urgent measures for refinancing and restructuring corporate debt came into effect and it has been already applied by a local group of companies. The Parliament took advantage of a parliamentary procedure to amend the legal regime of the insolvency receiver in order to adapt that institution to the needs of insolvency proceedings and to spur quality and agility in the administration of insolvencies.

As a result the requirements for appointing insolvency receivers were amended. Insolvency receivers must be chosen from among those registered in the Insolvency Public Register who have stated their willingness to act as insolvency receivers within the area of competency of the court hearing the insolvency proceedings.

Distinction is made between small-, medium-, and large-scale insolvencies depending on criteria to be established through regulations. Medium- and large-scale insolvencies may have specific requirements for the naming of an insolvency receiver.

The need for the insolvency receiver to indicate an office in the municipality where the court hearing the proceedings is competent was eliminated.

A new chapter was included in the law, containing a catalogue of the powers and functions of the insolvency receiver, which are dispersed in different provisions of the Insolvency Act.

The remuneration of insolvency receivers was one of the main points of the reform with specific rules set for how remuneration is to be determined and performance judged.

The insolvency receiver may be removed from the position in the event of serious breach of duties or of challenges to the inventory or the list of creditors representing 20 percent or more of the assets or the liabilities.

> "...remuneration of insolvency receivers was one of the main points of the reform with specific rules set for how remuneration is to be determined and performance judged..."

A series of other amendments have been introduced affecting the authorisation of refinancing agreements while the concession of new financing was promoted through acknowledging that fresh money granted within the framework of a refinancing agreement will represent claims against the insolvency estate. This includes claims granted by the debtor or persons especially associated with the debtor, as well as capital increases. In the event the debtor is liquidated, claims granted under the viability plan within the framework of a creditors' agreement will also be considered claims against the insolvency estate. This is a temporary measure for fresh money coming in and will be in effect only until 2 October 2016.

Finally, the Law provided for the Government to develop a code of good practices with credit institutions for the viable restructuring or refinancing of small and medium-sized enterprises' corporate debt and of the high debt of self-employed workers which nevertheless remain viable.

*This is an abridged article – the comprehensive report is available on request.*

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# Spain applies new anti-money laundering regulations

Victor Mercedes and Enrique Silvente explain the new regulations intended to prevent money laundering in Spain.

A Regulation intended to adapt Spanish legislation to international standards on the prevention of money-laundering and the funding of terrorism, according to the Recommendations of the Financial Action Task Force (FATF) of which Spain is a member, came into effect on 6 May 2014.

The Regulation related to Law 10/2010, of 28 April, on prevention of money-laundering and the funding of terrorism.

> ...obligors must previously identify and verify the identity of individuals and legal entities with which they wish to establish business relations in any operation involving EUR 1,000 or more...

The reform also sought to update the former Regulation, dated 1995, to adapt it to Law 10/2010 and to the new products requiring specific regulations, such as electronic money, and new methods to prevent money-laundering and the funding of terrorism. It was also intended to correct the previous dispersion of the rules and regulations.

As in Law 10/2010, the Regulation focused on risk, depending on the operations undertaken, the clients involved, and the different jurisdictions, and sought to endow the regulations on money-laundering and the funding of terrorism with flexibility in view of the mix of persons affected.

The Regulation sought to adapt the applicable prevention measures to the dimension and business volume of the obligor's business. The obligor must analyse the risk associated with each operation and client, adopt the relevant measures of due diligence, and establish internal control procedures.

Finally, the Regulation proposed a total change of the institutional organisation involved in the prevention of money-laundering and the funding of terrorism.

One of the key changes was the establishment of quantitative thresholds for the regulated due diligence measures, which apply to both individual operations and several related operations. The application of these measures cannot be avoided by fragmenting operations.

It also included a list of normal due-diligence measures to prevent money-laundering and the funding of terrorism regarding formal identification, declaration of activity and continuous monitoring of a business relationship.

In terms of identification obligors must previously identify and verify the identity of individuals and legal entities with which they wish to establish business relations in any operation involving EUR1,000 or more.

The Regulation indicates the "reliable documents" considered suitable for proper formal identification.

In the situations indicated, obligors must also identify the real owner prior to establishing business relations.

The real owner is an individual for whom business relations are sought to be established; an individual who directly or indirectly controls 25 percent of the capital or the rights to vote of a legal entity or who manages the legal entity (in default of such an individual, the real owner shall be deemed to be the individual director); and individuals who hold or exercise control of 25 percent of the goods of an instrument or legal entity which administers or distributes funds (in default of such an individual, the real owner shall be deemed to be the individuals who are ultimately responsible for the direction and management of the instrument or legal entity).

Prior to beginning the business relationship, obligors must register the declared professional or business activity of the clients.

The Regulation introduced an obligation to verify the declared activity of the clients when there is evidence of above-average risk, whether due to regulatory provisions or after analysing the obligor's risks or when the client's operations are other than its declared activity or its known operations.

Obligors must also ensure that the operations carried out by their clients within the framework of their business relationship or with other companies of their group coincide with the declared activity or the client's known operations. This monitoring must be increased when there are above-average risks.

Periodic reviews must be conducted to verify that the documents, data, and reports obtained with due diligence measures are up-to-date.

## Due diligence

The Regulation sets forth simplified due-diligence measures to be applied to clients presenting reduced risk or with greater supervision with regard to money-laundering and the funding of terrorism.

The Regulation contains a list of products and operations to which the simplified due-diligence measures may be applied, even for clients without reduced risk. Key among these are:

- collections and payments arising from commissions generated by tourism reservations for no more than EUR1,000;
- consumer credit agreements for less than EUR2,500 when the repayment is made by debiting the debtor's account in a credit institution;
- syndicated loans in which the agent is a credit institution with its registered office in the EU or equivalent non-member countries; and
- credit card agreements for no more than EUR5,000, with repayment being made from an account opened in a credit institution with its registered office located in the EU or equivalent non-member countries.

> "...periodic reviews must be conducted to verify that the documents, data, and reports obtained with due diligence measures are up-to-date..."

In such cases the following simplified measures may replace the normal due-diligence measures:

- the client's identity may be verified after the establishment of the relationship when the quantitative thresholds have been exceeded;
- less frequent periodic document review and continual monitoring; and
- the information on the professional or business activity of the client need not be gathered.

The simplified measures will not apply when there are indications or certainty as to money-laundering or the funding of terrorism or when the risk is above-average.

The Regulation also contains toughened due-diligence measures which must be applied in addition to the normal measures with regard to clients and operations with a high risk of money-laundering or the funding of terrorism.

- These apply to private banking services; money-sending operations involving more than EUR3,000 per quarter;
- currency exchange operations involving more than EUR6,000; and the transfer of stock in companies incorporated without any real economic activity, to be transferred subsequently to third parties.

The Regulation includes a broad range of toughened measures based on obtaining more documentation and information on the operations carried out and the client's funds, more frequent monitoring of operations with the client, and limits on the amount and form of payment.

> "...simplified due-diligence measures to be applied to clients presenting reduced risk or with greater supervision with regard to money-laundering and the funding of terrorism..."

Limitations are imposed on the establishment of business relations or the execution of operations by phone, electronically, or telematically.

## Managing risk

The Regulation provides a list of countries, territories, and jurisdictions which are considered to be of high risk.

The Regulation indicates the obligors' duty to report periodically to the Executive Service of the Commission or to report indications of money-laundering or the funding of terrorism, as well as the obligation to conserve the documentation obtained under the due-diligence measures, which may be requested by the Commission or by the Criminal Investigation Department.

The Regulation includes internal control measures, consisting of the approval and application of policies and procedures for obligors to follow in order to prevent money-laundering and the funding of terrorism. These policies and procedures must be approved by the obligor's management or by the internal control body.

The internal control procedures will be based on a prior risk analysis made by the obligor.

> "...The Regulation provides a list of countries, territories, and jurisdictions which are considered to be of high risk..."

The internal control procedures will be documented in a prevention manual, the minimum content of which must be that indicated by the Regulation.

These internal control measures include the creation of an internal control body responsible for the application of the internal procedures.

The internal control measures must be reviewed and evaluated in an external expert report. The obligor's management must take corrective measures sufficient to end the deficiencies which the report has detected in the procedures.

Furthermore, an annual training plan to prevent money-laundering and the funding of terrorism must be implemented.

The Regulation also gives customs and police officials the power to supervise the means of payment if the required declaration is missing or if the declared data are untrue

## In general terms, the Regulation applies to:

- Credit institutions
- Insurance companies and life insurance brokers
- Investment firms and investment management firms
- Mutual guarantee societies
- Payment institutions and electronic money institutions
- People whose regular business activity is currency exchange
- Postal services with respect to money orders and transfers
- Property developers
- Loan or credit intermediaries
- Auditors, external accountants, or tax advisors
- Notaries Public and Land Registrars, Commercial Registrars, and Property Registrars
- Lawyers and court liaisons when they participate in purchases of property, management of funds or bank accounts, and set-up and management of companies, or professionals engaged in these activities
- Casinos
- Jewellery, stone, and precious metals merchants and art or antique merchants
- Lottery business operators and operators of other gambling businesses
- Traders of assets in transactions amounting to more than EUR15,000 when payment is made in cash or cheques or other pay-to-bearer instruments
- Foundations and associations
- Operators of payment and securities clearing and settlement systems, derivatives, and debit or credit cards

or give rise to reasonable doubts as to their truth. Supervision will also be warranted when there are indications or certainty that the means of payment relate to money-laundering or the funding of terrorism.

The process for authorising the international transfer of funds and the freezing or release of funds was also regulated, when authorisation is needed.

These measures are conceived as sanctions and international financial countermeasures.

Authorisation of international transfers will be denied when there are agreed measures to freeze the funds of the persons or entities taking part in the transfer or when the transfer violates the prohibitions established by the Council of Ministers or by an EU regulation.

The Regulation also introduced the regulation of the Financial Holders File.

Credit institutions must present a monthly statement to the Executive Service of the Commission regarding the opening, cancellation, or alteration of current accounts, savings accounts, securities accounts, or term deposits, as well as the identification of their title-holder, real title-holder, or persons with the power to dispose.

This file will begin to operate with an order from the Ministry of Economy and Competition.

The Regulation also established the institutional organisation for the prevention of money-laundering and the funding of terrorism, consisting of:

- the Commission on the Prevention of Money-Laundering and Currency Infractions, in charge of defining national policies against money-laundering;
- the Commission's Permanent Committee, in charge of organising the Executive Service of the Commission, drawing-up the requirements for obligors to comply with their obligations under Law 10/2010, and opening and shelving sanctioning procedures due to breaches of such obligations;
- the Financial Intelligence Committee, in charge of analysing national risks with respect to money-laundering and the funding of terrorism and of proposing measures to mitigate the risks identified;
- Secretariat of the Commission, in charge of the actions leading to sanctioning procedures and examining each case in such procedures;
- the Executive Service of the Commission, in charge of supervising the prevention of money-laundering and the funding of terrorism, as well as enforcing the sanctions and financial countermeasures imposed; and
- the State Tax Agency Unit, which may request and obtain information which obligors possess as a consequence of the due diligence measures.

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# Flawed negotiations prompt unwanted corporate consequence

No matter the economic hardships faced by corporate entities, they cannot afford to abandon important labour principles. Alba Lladó reports.

A recent judgment by the Supreme Court which has annulled the collective redundancy process implemented by Celsa Atlantic, S.L. has made clear that "the strategy during a collective redundancy process can be more important than the reasons on which it is based".

It bears further analysis.

Celsa Atlantic, S.L. is a Spanish Company with four work centres in the national territory and currently part of the business group Celsa España. On 20 April 2012, due to its appalling economic situation –essentially concentrated on the massive losses accumulated over the years – it decided to start a consultation period with the employees' representatives in order to reduce their salary by 30 percent, slightly increase their working day, terminate 91 employment contracts from their work centres in the Basque Country and withdraw the company collective agreement.

Despite a series of meetings the company was not able to reach an agreement with the employees' representatives who, on 8 May 2012, decided to call an indefinite strike which became the cornerstone of the situation.

That same day, the company terminated the period of consultations without agreement and the following day, on 9 May 2012, it notified the start of a new collective redundancy procedure, this time aimed at terminating all the employment contracts (358) of the work centres in the Basque Country.

Once again, this collective dismissal was based on the economic situation of the company and the group – the negative operating result, accumulated losses of EUR79 million and a decline in sales, orders and invoices. There were objective grounds for the dismissals.

Nevertheless, the outcome of these negotiations with the employees also failed to lead to an agreement, so after five fruitless meetings and after fulfilling the necessary legal procedures, the company unilaterally proceeded with the termination of the employment contracts of the 358 employees – with a first round of 178 dismissals and a second round of 180 dismissals.

After this, the employees brought proceedings to contest the legality of the redundancy procedure. Having examined the chronology of events, the Court considered that the call for an indefinite strike by the employee representation was what created a shift in the company's position as to how to approach the situation.

## Rights infringed

There was a radical change between the first decision of the company (salary cuts, increased working time, withdrawing the

> "…the company's decision to shut down the work centres constituted a breach of fundamental rights…"

> “...the company had strong objective causes that would have allowed it to terminate the contracts of part of its workforce, but it lost this opportunity by committing a serious error during the negotiation process...”

collective agreement and the dismissal of 91 employees) and the second decision (closure of the work centres in the Basque Country with the resulting layoff of 358 employees). But the gap between the two decisions was less than one month – during which the economic and productive circumstances of the company remained the same. This was taken into account by the Court to conclude that the company had infringed the employees' right to strike.

Besides the brief period between the call for the strike and the second collective redundancy procedure, another deciding factor for the Supreme Court to annul the collective redundancy procedure was that 97.75 percent of the dismissed employees in the first round would have supported the strike. Also no measures were foreseen for the remaining work centres of the company, even though the organisation's economic difficulties were global.

The Supreme Court deemed that the company's decision to shut down the work centres constituted a breach of fundamental rights, such as the right to strike and union freedom, and was a direct reprisal on the collective decision to support a strike following the failed prior negotiations. It ordered the reinstatement of the 358 employees in the work centres that had ceased to exist for the company.

Although the company had strong objective causes that would have allowed it to terminate the contracts of part of its workforce, it lost this opportunity by committing a serious error during the negotiation process. This judgment's legacy needs to be taken into account in future collective redundancies, as no company, no matter how bad its economic situation, should underestimate the importance of acting in good faith during negotiations.

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# Switzerland

## Green light given for distribution of additional paid-in capital surplus

Matthias Trautmann comments on selected aspects of a recent Supreme Court decision on intra-group loan arrangements.

> ...additional paid-in capital surplus is by law part of the general reserves – it is not part of the blocked equity capital...

With its decision of 16 October 2014 (4A_138/2014), the Swiss Federal Supreme Court confirmed a previous ruling rendered by the Commercial Court of the Canton of Zurich with respect to the applicable rules on capital protection in the context of zero balancing intra-group cash pooling arrangements while overruling the Commercial Court on whether additional paid-in capital surplus is distributable.

The equity capital of Swiss share corporations consists of the share capital (*Aktienkapital*) and retained earnings which have not been distributed. Furthermore, when shares are issued in exchange for a contribution that exceeds the nominal value, i.e., the shares have been issued above par, the amount exceeding the nominal value qualifies as an additional capital surplus (so-called *Agio*) which is also part of the company's equity capital.

Pursuant to mandatory Swiss corporate law, dividends may only be distributed from the disposable profit and from reserves formed for this purpose. The Swiss Code of Obligations (CO) further sets out the rules on the accumulation of reserves. Pursuant to these rules, five percent of the annual profit must be allocated to the general legal reserves until this equals 20 percent of the paid-up share capital. Even after the general legal reserves have reached the statutory level, the law explicitly requires allocation of any share issue proceeds in excess of the nominal value remaining after the issue costs have been met. Legal reserves may be distributed as dividends only if they exceed half of the amount of the share capital. This general rule does not apply for companies whose primary purpose is to hold equity participations in other companies; these holding companies may distribute any reserves exceeding 20 percent of the paid-up share capital.

In its earlier decision, the Commercial Court stated that the additional paid-in capital surplus may not be distributed by way of a dividend because the rules on the prohibition of capital reimbursements according to mandatory Swiss corporate law would also apply to paid-in capital surplus. Since particularly in the context of group reorganisations, large amounts consisting of additional paid-in capital surplus had been distributed, the Commercial Court's decision caused severe uncertainties regarding dividend distributions.

While the Swiss Federal Supreme Court held the Commercial Court's arguments concerning the impact of intra-group loans on distributable equity of a company to be convincing, for the first time the Swiss Federal Supreme Court has now decided, contrary to the Commercial Court's position, that additional paid-in capital surplus is by law part of the general reserves. It is therefore not part of the blocked equity capital according to the rules on prohibition of capital reimbursements.

In its latest judgment the Supreme Court discusses the arguments of eminent legal scholars on the distribution of capital surplus. The CO explicitly specifies allocating additional paid-in capital to the general reserves which has also been corroborated by the majority of Swiss legal scholars. This view has now been confirmed by the Supreme Court. Since the general reserves are freely distributable insofar as they exceed half of the share capital, the Court, as a consequence, concludes that an additional capital surplus may be distributed in compliance with these general principles on distribution of dividends. Consequently, additional paid-in capital is not subject to the rules on the prohibition of capital reimbursements and may be distributed according to the ordinary rules on distribution of dividends. The Supreme Court's arguments are also in line with the rules on additional paid-in capital surplus from a Swiss tax law point of view.

The question whether capital surplus is distributable has been subject to an ongoing dispute among eminent Swiss legal scholars. According to the understanding of a minority who hold additional capital surplus to be non-distributable, the general legal reserve may only be distributed to the extent that it exceeds half of the share capital and that it does not consist of additional paid-in capital. The distribution of capital surplus would, according to this minority opinion, violate the capital protection rules since the paid-in capital is deemed to serve the financing of business activities and may therefore only be paid back by means of a capital decrease. Additional paid-in capital surplus would not qualify as a profit in the sense of the CO and would therefore not be distributable to shareholders. The Commercial Court affirmed these arguments without discussing the position of the majority of legal scholars but has now been overruled.

On a different note, the Commercial Court held, in the context of a group cash pool arrangement, that in the event that a company grants loans to its indirect parent company (upstream loans) or to subsidiaries of its parent company (cross-stream loans) such loans would block the distributable equity of the respective company if they have not been granted at arm's length. The court states that loans granted to parent or sister companies are deemed to qualify as distributions according to the capital protection rules if the respective loan has not been granted at market conditions.

> "...upstream and cross-stream intra-group loans which are not granted at arm's length may be deemed to block the distributable equity of a company..."

Consequently, a company which has granted upstream or cross-stream loans that are not at market conditions may only distribute assets in the form of a dividend to the extent that its freely distributable equity has not been blocked by such upstream or cross-stream loan amounts. Without answering the question, the Supreme Court stated that it may be questionable whether participation in a cash pooling arrangement, pursuant to which the participant allocates its liquidity, would ever pass the arm's length test.

The widely discussed Commercial Court decision has now been confirmed by the Supreme Court regarding this question. With its considerations regarding the impact of intra-group loans of an upstream and cross-stream nature on distributable equity, the Supreme Court, like the Commercial Court, applies a strict interpretation of the arm's length principle. As regards the case at hand, the Supreme Court doubted that an unsecured loan in the double digit million range would be granted at market conditions. The Supreme Court further stated that for the assessment of whether sufficient freely distributable equity is available, only the balance sheet date is decisive.

The Supreme Court has now clarified that upstream and cross-stream intra-group loans which are not granted at arm's length will be deemed to block the distributable equity of a company while it is not entirely clear which benchmark in terms of passing the arm's length test will apply in a general sense. This topic will be subject to ongoing discussions among Swiss legal scholars, given its huge impact on intra-group financings.

The recent judgment of the Supreme Court on the one hand now ensures legal certainty in terms of possible distributions of additional paid-in capital surplus (*Agio*). On the other hand, however, the court decision creates severe uncertainties in view of possibly blocked distributable reserves due to upstream and/or cross-stream intra-group loans. It remains to be seen how deeply the decision will impact common financing practices.

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# Major rule changes loom for financial markets in 2015

Selina Many and Ivan Dunjic report on substantial changes planned for Swiss financial market legislation and assess the implications.

On 27 June 2014, the Swiss Federal Council initiated the consultation procedure for the Federal Financial Services Act (FinSA) and the Financial Institutions Act (FinIA). The provisions of the FinSA and the FinIA – combined with the already more progressed bill on a new Market Infrastructure Act (FMIA) as well as the Federal Act on the Swiss Financial Market Supervisory Authority (FINMASA) – remodel the Swiss financial market architecture.

The Swiss financial market legislation currently in force has grown over the past 130 years. Since legislation was usually implemented whenever a need for regulation in a specific sector of the financial market emerged, it is generally very sector- and product-oriented. The Swiss financial market architecture can best be described as a pillar-system, the four main pillars being bank legislation, legislation on stock exchanges and securities dealing, legislation regarding collective investment vehicles and legislation regulating the insurance sector. Exceptions to this pillar system can be found with regard to the regulations regarding financial market supervision, which is carried out by the Swiss Financial Market Supervisory Authority (FINMA) as well as to anti-money laundering regulations, which overlap all the sector-specific pillars.

> "...the FMIA shall adjust the regulation of financial market infrastructures and derivatives trading in line with international standards..."

The most recent financial crisis and the respective changes in international financial market regulations led to the Federal Council proposing a comprehensive redesign of the legislative architecture. Through the introduction or revision of four general financial market acts, the Federal Council proposes the general abolishment of the sector- and product-oriented regulation approach and the introduction of a regulatory legislative network equally applicable to all financial services and products. These financial market acts are:

- FINMASA, regulating the supervisory body of the Swiss financial market (to be amended);
- FMIA, regulating the organisation and the functioning of financial market infrastructures including rules of conduct on the market (new);
- FinIA, concerning the supervision of the various financial services providers (new); and
- FinSA, regulating the provision of financial services (new).

## Federal Market Infrastructure Act

The FMIA shall adjust the regulation of financial market infrastructures and derivatives trading in line with international standards, including EU regulations such as MiFID II, MiFIR, EMIR and CSDR, with the aim of preserving the competitiveness of the Swiss financial market. However, to a wide extent and different from the EU and also the US, the FMIA stands by a concept of self-regulation.

The FMIA shall govern the organisation and operation of financial market infrastructures. Therefore, various provisions of other Federal acts (e.g., the Federal Stock Exchange Act) shall be summarised in one single act and amended in line with changed market conditions and international standards. It will especially introduce a general licensing requirement for central counterparties, central depositaries, trade repositories and, in certain cases, payment systems. Under the current regime, FINMA may only subject central counterparties, central depositaries and payment systems to the Federal Banking Act or the Stock Exchange Act (both to be revoked) under certain circumstances, while no regulation for trade repositories exists at all.

Furthermore, the FMIA shall regulate securities and OTC derivatives trading for all market participants. It therefore includes provisions on the disclosure of shareholdings, insider trading and market manipulation, public offers as well as new regulations – partially with extraterritorial effect – for derivatives trading which comply with the international standards, primarily with EU legislation. As in the EU, the following key obligations for derivatives trading shall be applicable in Switzerland: clearing via a central counterparty, reporting to a trade repository and risk mitigation. However, for the sake of proportionality, smaller contracting parties may profit from certain exceptions.

The current regime divides Swiss trading venues into "stock exchanges" and "institutions similar to a stock exchange", the latter only being subject to authorisation if FINMA so requires. The FMIA shall bring another noteworthy novelty in this regard: the institutions currently being qualified as "institutions similar to a stock exchange" will – in alignment to the EU regulations – be divided into "multilateral trading facilities" and "organised trading facilities". While the first will be subject to licensing, the latter shall only be required to implement certain organisational measures. Institutions similar to a stock exchange should therefore closely monitor possible licensing requirements. Finally, the FMIA shall also introduce a uniform set of regulations concerning administrative assistance.

"...it governs the licensing and organisational requirements for financial institutions with the purpose of protecting investors and clients of financial institutions, the proper functioning of the financial market and the stability of the financial system..."

## Federal Act on Financial Institutions

The draft FinIA is designed as a framework regulation which leaves room for a more detailed and flexible implementation on a secondary legislative level. It governs the licensing and organisational requirements for financial institutions with the purpose of protecting investors and clients of financial institutions, the proper functioning of the financial market and the stability of the financial system. The draft FinIA shall govern the prudential supervision of the various financial institutions. This includes asset managers, qualified asset managers (being defined as asset managers of collective investment vehicles or such of Swiss pension funds), fund management companies, securities houses and banks. The provisions of the draft FinIA do, among other things, not apply to persons who manage solely the assets of persons with whom they have business or family ties or who manage assets solely within the context of employee incentive programs and to social security schemes.

In general, all financial institutions require an authorisation from the supervisory authority. Different from the current regime, also "common" asset managers will have to be licensed for practicing. The FinIA will also incorporate special bankruptcy provisions currently included in the Federal Bank Act. However, said provisions shall not only apply to banks (and securities houses) but also to fund management companies.

In view of recent developments in the field of combating tax evasion, the draft FinIA also provides for higher due diligence obligations of financial institutions, with their primary obligation being the risk-based examination whether the assets to be managed are undeclared or will not be declared to the competent tax authorities, in case the respective customer is domiciled in a jurisdiction with whom Switzerland has not entered into an agreement on automatic exchange of information (AEOI) in tax matters. The respective provision is designed to be complementary to the upcoming obligations of Swiss reporting financial institutions under the OECD Common Reporting Standard for the AEOI. If the financial institution must presume that the respective assets have not been declared according to applicable tax legislation, it must refuse to accept the assets and to enter into a new business relationship, or – in the case of existing clients – terminate the business relationship in case the client fails to prove that the respective assets have been duly taxed, provided, however, that a regularisation of the client's tax situation would not pose a unreasonable detriment to him or her.

> ...it includes the strengthening of the ombudsmen as well as provisions reducing the financial risks of a client when suing his or her financial service provider...

### Federal Financial Services Act

FinSA seeks to protect the clients of financial service providers (including individuals who provide such services in their own name or in the name of an entity) and to establish a level playing field for financial service providers. It shall apply to any person who provides financial services on a professional basis in Switzerland or for clients in Switzerland, whereby the term "financial services" is defined very broadly.

> ...the financial service provider bears the burden of proof for meeting its legal information and disclosure duties...

The draft FinSA also introduces a registration obligation for foreign financial service providers performing an activity subject to authorisation in Switzerland, unless they are already in the possession of a licence to provide their services. Pursuant to the draft FinSA, foreign financial service providers are eligible for registration if:

- they have an authorisation for the activity subject to an authorisation in Switzerland and they are subject to supervision that is deemed equivalent to that of Swiss financial providers in their registered state or the state in which their head office is located;
- they have professional indemnity insurance or have provided similar financial guarantees;

> "...the FinSA aims at improving the documentation of financial products by imposing a general duty to publish a prospectus for all financial instruments, containing a minimum set of information on the respective product..."

- they have agreed in writing to inform FINMA comprehensively about their business activities in Switzerland and their business relationships in Switzerland; or
- a memorandum of understanding has been concluded between FINMA and the relevant foreign supervisory authorities concerning mutual cooperation and information exchange.

Another novelty of the FinSA is the systematic segmentation of clients as retail clients, professional clients and institutional clients, whereby the respective clients have opt-in and opt-out choices. It depends on the classification of a client with which information and disclosure duties a financial service provider has to comply. In this regard, the draft FinSA also contains various new provisions regulating the enforcement of any potential client claims. It includes the strengthening of the ombudsmen as well as provisions reducing the financial risks of a client when suing his or her financial service provider. Additionally, the bill provides for collective redress mechanisms. Another significant provision states that the financial service provider bears the burden of proof for meeting its legal information and disclosure duties.

Finally, the FinSA aims at improving the documentation of financial products by imposing a general duty to publish a prospectus for all financial instruments, containing a minimum set of information on the respective product. Such a prospectus must generally be pre-examined by licensed bodies. With regards to financial instruments to be offered to retail clients, an additional "basic information sheet" will need to be published.

While the tendency of the FMIA is clear, the expected consultation report regarding FinSA and FinIA should provide more clarity about the exact content of the FinSA and FinIA. Its publication is expected in the first quarter of 2015. Subsequently, it is expected that the Swiss parliament will debate on and adopt the FinIA and the FinSA in the third or fourth quarter of 2015. Therefore, the FinIA and the FinSA are likely to enter into force in 2017 or 2018. In contrast, the FMIA shall become effective prior to the other two bills given that the parliamentary procedure on its adoption shall be initiated soon.

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# Parallel imports of pharmaceutical products with respect to Swiss Law

Carol Rothenfluh reports on progress regarding the prevention of parallel imports under Swiss Intellectual Property Law.

There have been recent discussions with regard to the prohibition of parallel imports under Swiss intellectual property law, in particular with regard to pharmaceuticals. Since pharmaceuticals are often trademark and patent-protected goods, the Swiss trademark law and the Swiss patent law present the legal basis to prevent parallel import of pharmaceuticals. However, in practice, the intellectual property right provides limited protection.

## Definition of parallel imports / selective distribution system

Parallel imports are generally understood to be imports of genuine goods from foreign countries, where they have been placed on the market by the manufacturer or with consent, onto a third country without the consent of the manufacturer. Often, the parallel import will be performed against the manufacturer's consent or intention. For instance, the parallel imports of goods are often a result of a breach of the distribution contract or distribution system established by the manufacturer.

Manufacturers often choose to distribute their goods under a selective distribution system. Under this selective distribution system, manufacturers or distributors may appoint a limited circle of distributors to sell their products and restrict sales outside this distribution system. Provided that the distributors have been selected based on objective, non-discriminatory criteria in consideration of the specific nature of the respective products, the selective distribution system is generally permitted under Swiss law. Besides this, the distribution of goods and products outside the rights holders' selective distribution system could theoretically be considered as misleading if the distributors make incorrect or misleading statements with regard to their business relationship in a way that consumers wrongfully assume that they belong to the selective distribution system. However, in practice, the Swiss authorities are very reluctant in this respect.

## Can the parallel import of genuine goods be deemed to be trademark infringing?

As a general principle, Swiss trademark law is designed to protect a sign which is used to distinguish the products and services of one business from another. In this regard, if the owner has registered its trademark, he or she has the exclusive right to use a certain sign for specific goods and services or to grant someone else the right to use it (e.g., licensing). Furthermore, he or she has the right to prevent others from using an identical or similar sign for the same or similar goods and services. Against this background, the trademark law also allows the owner of the trademark to place the product on the market with the exclusive right to use the trademark.

> "...the principle of international exhaustion determines the general rule that once an exhaustion of IP rights with respect to a specific product has occurred, the rights holder only exceptionally rely on intellectual property rights preventing the further distribution of such product..."

According to the Swiss Federal Supreme Court, the unwritten principle of exhaustion is of general application in intellectual property (IP) and is in line with the essential functions of the IP. The principle of exhaustion determines the general rule that once an exhaustion of IP rights with respect to a specific product has occurred, the rights holder cannot rely on intellectual property rights preventing the further distribution of such product. With regard to trademark law, this means that after trademarked goods have been placed for the first time on the market by the rights holder or with his or her consent, by a third party, the trademark rights with respect to such goods are exhausted. The Swiss Federal Supreme Court has consistently stated that the principle of exhaustion applies irrespective of which market the trademark good has been placed on; the principle of exhaustion has an international character with regard to the trademark law.

In the Federal Supreme Court Decision no. 122 III 85 (also known as the "Chanel Case"), the Swiss Federal Supreme Court reminded that the essential function of the trademark law was to individualize goods and services and to exclusively identify the origin of these goods and services. Besides this, trademark law shall not be deemed to protect other functions of the product, such as the guarantee of the good's quality or its advertising effect and, additionally, trademark law shall not be used for the trademark owner to control the distribution chain of its product.

> "...the parallel import of genuine products has a pro-competitive effect, which is why the Swiss competition authority is not interested in generally preventing parallel imports and grey market products..."

Against this background, the Swiss trademark law is generally not deemed to be used to prevent parallel import of genuine goods. Furthermore, the parallel import of genuine products has a pro-competitive effect, which is why the Swiss competition authority is not interested in generally preventing parallel imports and grey market products. In fact, the Swiss competition authority has taken measures to protect undertakings against the ban of parallel imports. Efforts to ban parallel imports by contracting out the principle of international exhaustion have been assessed under article 5 (that prohibits unlawful agreements affecting competition) and 7 (that prohibits unlawful practices by dominant undertakings) of the Swiss Cartel Act. In this regard, the Swiss competition authority has opened several investigations and issued fines against undertakings that allegedly tried to prevent parallel imports of genuine goods.

## Can the parallel import of genuine goods be deemed to be patent infringing?

As noted, the principle of exhaustion in relation with the Swiss trademark law is considered to have an international character and, as a consequence, trademark law is not the efficient instrument to prevent parallel import of trademarked goods. In contrast, the principle of exhaustion has a more prominent role with respect to Swiss patent law.

The principle of exhaustion has been subject of legal development: In 1999, the Swiss Federal Supreme Court set up the principle of national exhaustion for patent law (BGE 126 III 129). As a consequence, the patent owner was legally entitled to prevent his or her patent-protected products to be imported into Switzerland against his or her will, if these products were not launched before into the Swiss market but only on the foreign market.

After controversial discussions, in 2009, art. 9a of the Swiss patent law entered into force, stating the principle of unilateral regional exhaustion in relation with the European Economic Area (EEA). In application of this provision, the owner of the patent who has placed the patent-protected goods on the market in Switzerland or somewhere within the EEA, or has consented to its placement by a third party, the principle of exhaustion applies. As a consequence, such goods may be imported, used and resold commercially in Switzerland.

By contrast, if the patent-protected goods have been launched on the market outside of the EEA, they may only be imported, used and resold commercially in Switzerland without the consent of the rights holder if they have been placed by the owner of the patent himself or he has consented to their placement. Plus, as a further restriction, the goods may only be distributed if the patent protection for the functional characteristics of the goods is only of subordinate importance, which is presumed unless the patent owner provides *prima facie* evidence to the contrary. However, in the event that the price of the patent-protected goods is mandatory fixed by a competent Swiss or foreign authority, these goods may only be placed on the market and/or imported with the patent owner's explicit consent. This provision in fact implies that parallel imports of patent-protected pharmaceuticals that are reimbursed by public health insurance are prohibited and only parallel imports of over-the-counter products and pharmaceuticals of which the patent protection has been expired are allowed. In this regard, the Swiss patent law provides certain prevention against parallel imports of pharmaceuticals.

As regarding the burden of proof, as a general rule, the burden of proving the existence of an alleged fact shall rest on the person who derives rights from that fact.

"...the owner of the patent who has placed the patent-protected goods on the market in Switzerland or somewhere within the EEA, or has consented to its placement by a third party, the principle of exhaustion applies..."

With regard to the principle of exhaustion, the Commercial Court of the Canton of Bern has in its decision dated 28 February 2014 stated that the burden of proof lies with the importer or reseller who claims that the parallel import or the distribution of goods outside the rights holder's selective distribution system is in line with the principle of exhaustion. Thus, the importer has to prove that a product has been placed on the marked by the rights holder or by a third party but with the rights holder's consent and that, therefore, the rights holder's rights have been exhausted.

However, whereas it is often difficult or impossible for the importer or reseller to prove the exhaustion, it is often much easier for the rights holder to prove the contrary. According to the Commercial Court of Bern, in such cases, the reversal of the burden of proof is generally justified and the rights holder has to prove that the product has not been placed on the marked by him or her, or by a third party with consent. Thus, from a practical perspective, the possibilities for the rights holders to prevent and to take action against parallel imports are limited under current Swiss law.

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# Have you had your day in Court? Swiss Federal Supreme Court decision clarifies conditions for conclusive dispute resolution in international arbitration proceedings

Anne-Catherine Hahn explains the application of the res judicata principle by Swiss arbitral tribunals.

One of the central objectives of civil procedural law is to provide a mechanism for the final and conclusive resolution of disputes. In accordance with the *res judicata* principle, matters which have been judged on the merits are, therefore, deemed binding on the parties, and may no longer be re-litigated nor decided differently in subsequent proceedings.

Although this principle is very widely recognised, the effects of judgments, and the criteria for determining the identity of prior and fresh proceedings, vary between jurisdictions. For example, while the binding effect judgments emanating from civil law jurisdictions is generally limited to the actual holding, common law jurisdictions also know a broader concept (issue estoppel) which prevents parties under certain circumstances from questioning the reasoning of a prior judgment in subsequent proceedings. These divergences between national approaches can create particular challenges when identical or related matters are first litigated before the courts of one country and then again raised before an arbitral tribunal in another country.

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...divergences between national approaches can create particular challenges when identical or related matters are first litigated before the courts of one country and then again raised before an arbitral tribunal in another...

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## Binding effect of foreign court decisions on arbitral tribunals

As far as Swiss law is concerned, it has long been recognised that arbitral tribunals seated in Switzerland must respect the *res judicata* principle, and that awards made in violation of this principle may be set aside on public policy grounds. It is equally established that this only applies to the extent that the foreign court judgment concerns a matter identical to the one pending in arbitration, and that it is susceptible of recognition in Switzerland in accordance with the requirements set forth in the Private International Law Act. By contrast, case law on the criteria relevant for determining the identity of prior and fresh proceedings, and on the law applicable to these questions, has so far been scarce. In a recent decision concerning a setting aside application (4A_508/2013, rendered on 27 May 2014), the Federal Supreme Court has now provided some important clarifications on these issues.

The case arose out of a dispute between a Ukrainian state-owned company and a Turkish contractor in relation to a large construction project in Ukraine. While the project was already underway, a prosecutor in Ukraine opened civil proceedings before a state court against both parties, and successfully challenged the validity of an addendum to the initial contract, on the basis that the representative of the Ukrainian party had lacked the necessary power to enter into the addendum. The High Commercial Court in Ukraine ultimately upheld the prosecutor's arguments, declaring the addendum to be invalid.

About two years after the start of the Ukrainian proceedings, the Turkish contractor commenced an ICC arbitration in Switzerland, seeking compensation for outstanding payments and lost profits, and eventually obtaining an award in which the validity of the controversial addendum was upheld. In reaching this decision, the tribunal considered that it was not bound by the prior Ukrainian court decision because the parties and the relevant facts were not identical. The tribunal in particular noted that no identity of parties existed due to the participation of a public prosecutor in the first proceedings, and further found that the Ukrainian state entity had repeatedly treated the amendment as valid and binding, including after the completion of the Ukrainian court proceedings.

## Standards applied by the Federal Supreme Court

The Ukrainian party then sought to have this award set aside in Switzerland, arguing that the arbitral tribunal had erred in disregarding the *res judicata* effects of the Ukrainian court decision. The Federal Supreme Court rejected this application, holding that the foreign court proceedings did not involve the same parties. The Supreme Court also considered that there had in any event been no breach of the *res judicata* principle, as the Ukrainian party's alleged acquiescence to the addendum had partly only arisen after the completion of the Ukrainian court proceedings, such that the dispute resolved through arbitration was not identical to the one previously decided in Ukrainian state courts.

To reach this outcome, the Federal Supreme Court not only restated the basic framework for the application of *res judicata* by Swiss arbitral tribunals, but also addressed the underlying civil procedure and conflict of law principles. Thus, it restated that a foreign court decision only prevents an arbitral tribunal from re-deciding specific claims and issues if such decision may be recognised in Switzerland, which in particular means that the foreign court must not have failed to refer the matter to arbitration pursuant to Article II (3) of the New York Convention, i.e., in spite of the existence of a valid arbitration agreement. In the present case, the potential recognition of the Ukrainian court decision did, however, not have to be analysed, as the arbitral tribunal could, according to the Supreme Court, indeed consider that the dispute was different form the one previously dealt with in Ukraine pending before it.

In this context, the Federal Supreme Court acknowledged that the conditions under which a foreign judgment becomes binding on the parties, and the specific scope of such binding effect, depend on the legal system from which the judgment emanates. However, a foreign judgment can never, according to the approach taken by the Supreme Court, deploy effects in Switzerland that would not equally be available to a Swiss domestic judgment. This in particular means that the *res judicata* principle only applies if the parties to the prior and subsequent proceedings, as well as the claims raised on the basis of a particular set of facts, are identical, according to the relevant standards which have been developed in Swiss domestic cases. Whether or not the required identity exists in other words needs to be decided in accordance with Swiss law, and this although Swiss arbitration law, as embodied in Articles 176 *et seqq.* of the Private International Law Act, does not expressly address *res judicata* issues.

At the same time, the Supreme Court signalled that it may under certain circumstance be

> "...Swiss arbitral tribunals must decline their jurisdiction if the same dispute involving the same parties has already been resolved by a foreign court judgment susceptible of recognition in Switzerland."

appropriate for a Swiss arbitral tribunal to deviate somewhat from the rather formal criteria of Swiss procedural law when considering the relevance of a foreign court decision. This may in particular be appropriate when there is a suspicion that the foreign proceedings were only commenced to ambush a parallel arbitration in the same case. Without deciding whether this was relevant in the present dispute, the Supreme Court noted that the identity between the parties to the Ukrainian court proceedings and the subsequent arbitration did not, contrary to the arguments developed by the Ukrainian party, exist solely because both parties were involved as defendants in the proceedings initiated by the Ukrainian prosecutor. This suggests that the inquiry into the formal identity of the parties may, at least in certain cases, have to be completed by an analysis of the roles and interests of the parties concerned. Ultimately, the Federal Supreme Court did not have to resolve this issue because it found that the subject matter of the dispute submitted to arbitration was in any event also different from the one adjudicated in the Ukrainian proceedings.

> "...the inquiry into the formal identity of the parties may, at least in certain cases, have to be completed by an analysis of the roles and interests of the parties concerned."

In conclusion, the Federal Supreme Court has in this decision restated its position according to which Swiss arbitral tribunals must decline their jurisdiction if the same dispute involving the same parties has already been resolved by a foreign court judgment susceptible of recognition in Switzerland. Awards rendered in violation of this rule may be set aside on public policy grounds. Additionally, it has now been clarified that the potential identity of the dispute is to be determined in accordance with Swiss procedural law principles, as developed in domestic cases, although certain adjustments to these principles may on a case-by-case basis be acceptable, or even necessary, to duly take into account the international character of the proceedings, but also to protect arbitrations seated in Switzerland from unjustified disruptions.

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# Turkey

## Hosting providers face liability for online sales of counterfeit products

In a landmark trademark infringement decision, the Turkish Supreme Court has ruled that hosting providers are liable for trademark violations in connection with the online sale of counterfeit products. Daniel Matthews and Mine Guner report.

> "...hosting providers...can be held liable for trademark infringement if they allow third parties to publish infringing material on their websites..."

In response to the online sale of allegedly counterfeit products, a cosmetics company sued a Turkish auction website for trademark infringement from the sale of counterfeit products through the site. The hosting provider asserted that it was not liable as it cannot test the products, and the site is merely an intermediary platform providing a safe payment environment for users. The trial court agreed, ruling that the hosting provider was not liable for selling counterfeit products given the absence of a specific regulation imposing liability. On appeal, the Supreme Court reversed the trial court's decision, holding that the hosting provider (auction site) was liable for trademark infringement associated with the sale of counterfeit products, and referred the case back to the trial court for further proceedings.

On remand, relying on EU regulations similar to Turkish law on the issue as well as European Court of Justice precedents, the trial court ruled the hosting provider was not liable because the claimant failed to serve notice under the notice and takedown rules before filing suit. The notice was required as the hosting provider was not in a position to know whether a product is genuine, and has no legal obligation to monitor content or products.

In January 2014, the Supreme Court disagreed, holding that a hosting provider is liable once it becomes aware of the counterfeit products. In overruling the trial court a second time, the Supreme Court found that the trademark owner's filing of the lawsuit against the hosting provider satisfied the notice requirement. As a consequence, it was unnecessary for the trial court to rely by analogy on a

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...trademark owners may simply notify the hosting provider to stop trademark infringement...

"

similar European regulation. If the hosting provider was on notice of the lawsuit and yet continued to provide a platform for sales of the counterfeit product, it was, in essence, participating in the infringement. The court also found that the plaintiff's lawsuit was sufficient to serve as a cease-and-desist letter under Article 50 of the Code of Obligations.

As the first decision on hosting providers' liability for trademark infringement in Turkey, it is a milestone with significance for both trademark owners and hosting providers. Future decisions will hopefully provide more guidance as to the prerequisites for liability. Until future clarification, hosting providers should be aware that they can be held liable for trademark infringement if they allow third parties to publish infringing material on their websites after being notified by the trademark owner. Once providers become aware of the trademark infringement, they are obligated to prevent it, otherwise becoming jointly liable for damages arising out of the sale and publication of the infringing material.

For trademark owners, a major problem has always been finding a party against whom to file a claim as counterfeiters are often not easy to find. Now, trademark owners may simply notify the hosting provider to stop trademark infringement.

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# Turkey introduces comprehensive regulation of bank and credit card fees

Daniel Matthews and Muhsin Keskin outline the key changes which financial institutions need to navigate when issuing a range of consumer products and services.

In October 2014, the Turkish Banking Regulatory and Supervisory Authority (BRSA) published a new regulation on the fees and commissions which banks, card issuers and other financial institutions may charge consumers in connection with loans, financial products, and other services. The regulation applies to agreements entered into after 3 October 2014, as well as transactions completed after that date under existing agreements.

The regulation does not apply to insurance and securities-related services and products offered to consumers or to non-consumer products and services.

The fees and commissions Turkish banks and other financial institutions charge for consumer transactions have been the centre of vigorous debate for some time now. Many consumers have litigated the fees they have paid for their transactions, creating uncertainty in the Turkish banking market. The BRSA has now delivered the last word, bringing clarity to the market.

The regulation contains an exhaustive list of products and services (see box) for which a fee or commission may be charged to consumers, as well as the types of permissible fees and commissions. BRSA approval is required for any new fee or commission for new or existing products and services. The BRSA has the right to amend the list at any time.

Customer approval must be obtained before providing any product or service for which a fee or commission is charged.

Any fee increase more than 1.2 times an increase in the consumer price index in any given calendar year for products or services provided on an ongoing basis requires advance consumer consent. For other increases, the consumer must be notified at least 30 days in advance. Consumers are entitled to cancel the delivery of products and services within 15 days of receiving notification of an increased fee.

Paper agreements with consumers must include a handwritten statement by the consumer that he or she has received a copy of the duly signed agreement.

Institutions offering consumer loans and mortgage loans can only request an arrangement fee, which cannot be higher than 0.5 percent of the loan's principal.

Credit card issuers must offer a membership fee-free credit card to their customers and consumers cannot be charged an annual card membership fee for bank cards and virtual cards.

These changes are generally a positive development for both banks and consumers – banks now know what they can demand from consumers, and consumers know the costs associated with financial products and services, including bank and credit card fees.

## Products, services and applicable fees

Consumer Loans

- Arrangement fee
- Expert fee
- Security registration fee

Deposits

- Account maintenance fee
- Withdrawal fee

Fund Transfers

- Electronic fund transfer fee
- Remittance fee
- SWIFT fee

Credit Cards

- Annual membership fee
- Supplementary cards annual membership fee
- Card renewal fee
- Cash withdrawal fee

Other

- Safe deposit box fee
- Sale campaign commission
- Invoice payment fee
- Archive fee
- On-approval notification fee
- ATM fee for using third party bank ATMs
- Payment service fee

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# Delay forecast until commercial court reforms conclude

Koray Sogut, Sadi Oz and Nildan Dilaver outline the restructure of Turkey's commercial courts and the impact on pending cases.

> ...pending legal actions may be renumbered and reassigned...

Turkey has recently restructured its commercial courts. Certain cases will now be handled by three-judge panels, rather than a single judge. While the new law is intended to speed up proceedings, in the short term pending cases are experiencing significant delays while case files are being reassigned to new courts.

Previously, all commercial disputes cases were handled by a single judge. Now, certain types of cases will be reassigned to three-judge panels:

- claims of more than TRY300,000 (approx. USD140,000);
- bankruptcy, postponement, rescission and closing of bankruptcy, and company restructuring actions;
- actions to cancel general assembly resolutions, and against corporate boards of directors and supervisory boards; and
- actions to enforce foreign arbitral awards.

Panels will also consider requests for interim injunctions in these types of cases.

The creation of three-judge panels has resulted in an overall decrease in the number of commercial courts, with many courts closed as of 15 September 2014. Cases pending before the now-closed courts are being transferred to the remaining courts and, upon transfer, new case file numbers will be assigned. During this transition period, litigants should expect postponed hearings and further delays.

Company in-house counsel should be aware of the new structure, follow up on changes to case file numbers and new court hearing schedules, and ensure that external counsel closely follow these changes.

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# Rules tighten around online commerce activities

Hakki Can Yildiz and Can Sozer explain how strict new rules will be applied to online sales, commercial messages and data protection.

Imposing strict new rules on online sales, commercial messages, and the protection of personal data, on 23 October 2014, the Turkish parliament adopted Law No. 6563 on the Regulation of Electronic Commerce. The e-commerce law will enter into force on 1 May 2015.

Under the new e-commerce law, prior to concluding an online sales agreement, an e-commerce service provider must state: its name and contact details; the process for concluding the agreement; whether the service provider will retain the agreement after its conclusion, and whether the buyer will be able to later access it and for how long; the procedure for correcting data entry errors; the privacy terms and alternative dispute resolution mechanisms, if any; and the service providers' professional chamber memberships, if any, and governing codes of conduct.

The e-commerce law also imposes requirements for online orders. A service provider must: clearly state the terms of the agreement, including the total amount of payment due, at the agreement approval stage and before the counterparty enters payment details; immediately confirm to the counterparty the receipt of the order; and provide the buyer with appropriate, effective and accessible method to correct data entry errors.

These requirements will not apply to agreements concluded by email or similar personal communication, and to B2B transactions.

The e-commerce law bans commercial messages by email, text messaging (SMS), fax and autodial machines (robocalls) to consumers without their prior approval. Previously, unsolicited messages were permitted if consumers were provided an easy and free-of-charge opportunity to opt-out. The opt-in system will not apply to B2B relationships, and commercial messages can still be sent to businesses without their prior approval.

The content of commercial messages must be in line with the approval given. The message also must include: the sender's identity; the sender's telephone number/fax number/SMS number/email, depending on the electronic method of communication used; the subject and purpose of the message; and information on the actual sender, if the message is sent on behalf of another entity.

If a commercial message relates to a promotional activity (e.g., offers a discount or gift, or is related to a contest), the sender must provide an easy way to access the terms of the activity.

As consumers always have the right to opt-out of receiving commercial messages, the sender must provide the

> "...much greater transparency required for online B2C commerce..."

> "...consumer data must be securely stored and not shared – failure to comply risks stiff fines..."

consumer an easy and free-of-charge opportunity to revoke prior approval; details of this opportunity must be contained in the message.

The service provider is responsible for storing and securing the personal data obtained from the online agreement. The service provider cannot transfer the personal data to third parties without the buyer's consent, or use the data for other purposes.

Service providers can be fined between TRY1,000 and TRY15,000 (approx. USD450 and USD6,650, respectively) for each violation of the e-commerce law. The fines can be raised in certain circumstances, e.g., if a commercial message is sent to more than one person at a single time without the buyer's prior consent.

Real persons or legal entities providing an online platform to facilitate e-commerce for other real persons or legal entities are defined as "intermediary service providers". Intermediary service providers are not obligated to supervise the content of other providers, or the products and services offered, on their platform. A separate regulation, however, is expected to provide a framework for intermediary service provider obligations.

Companies should consider how these significant changes may affect their operations in Turkey, and take steps to ensure compliance with the e-commerce law.

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# Employers take on greater role monitoring subcontractor actions

After the Soma mine disaster, new rules have been introduced to protect subcontractors' employees. Daniel Matthews, Nuri Bodur and Ozan Kesim report.

> ...revised work, salary and leave provisions have been granted to employees of mining subcontractors...

In the wake of the Soma mine disaster in May 2014, the Turkish Parliament recently adopted a law amending numerous employment and social security laws and regulations and imposing new responsibilities and liability in connection with the use of subcontractors. Many of these changes apply to all employees of subcontractors, while others are limited to the mining industry.

Since 11 September 2104, in addition to statutory annual paid leave, miners working underground are now entitled to an additional four days' leave. The retirement age for underground employees has also been reduced from 55 to 50, and now includes entitlement to a seniority payment without the previous minimum requirement of one year of seniority. Also, the minimum salary for miners' work in lignite and anthracite coal mines cannot be less than two times the statutory minimum salary provided by law, i.e., TRY2,268 (approx. USD1,015).

Since 1 January 2015, underground work hours for a miner cannot exceed six hours per day and 36 hours per week. Moreover, miners cannot be forced to work overtime except in the urgent cases specified in the Labour Code. If miners do work overtime, their hourly wage is doubled per each overtime work hour.

Employers must monitor whether their subcontractors have fully paid employee salaries in a timely manner. If the employer finds that a subcontractor has failed to pay its salaries, the employer must deduct equivalent amounts due to the subcontractor and deposit the payments directly into the subcontractor employees' bank accounts.

> ...employers now have oversight of subcontractors' employee payments...

In addition, employers utilising subcontractors must now ensure that their subcontractors' employees take all annual paid leave provided by law. To facilitate this, subcontractors must provide employers the annual paid leave records which subcontractors are required to keep by law.

Employers using subcontractors should work with their subcontractors to implement mechanisms for ensuring compliance with the Labour Code, including timely payment of salaries. Furthermore, mining companies should monitor whether their subcontractors allow their employees to use all of their statutorily mandated annual paid leave.

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# United Kingdom

## Diverted profits tax is game-changer for multinational supply chains

New tax will have significant impact on the digital economy and multinational supply chains. Baker & McKenzie's London lawyers explain how it works and who it affects.

> "...tax can apply if there are either transactions in the global supply chain involving low-tax entities lacking economic substance, or arrangements which have a main purpose of avoiding a UK corporation tax charge..."

The diverted profits tax (DPT) is a new UK tax targeting profits considered to have been diverted from the UK, applicable from 1 April 2015. The new tax can apply if there are either transactions in the global supply chain involving low-tax entities lacking economic substance, or arrangements which have a main purpose of avoiding a UK corporation tax charge. The new tax has potentially significant implications for the global supply chains of affected multinational groups which transact with, from or through the UK, whether they are headquartered in the UK or overseas, including the very real prospect of double taxation.

The DPT was first announced by George Osborne, the Chancellor of the Exchequer, in his Autumn Statement on 3 December 2014, and the draft legislation was published a week later. The Chancellor said that the new measure would target; "multinationals that use artificial arrangements to divert profits overseas in order to avoid UK tax". The legislation is on a fast-track and will be included in the short Finance Bill 2015 which will be enacted before Parliament is dissolved in anticipation of the general election on 7 May 2015.

The tax enables HM Revenue & Customs (HMRC) to re-characterise the supply chain of affected multinational groups and re-compute the profits that, in its view, it is just and reasonable to assume would have been earned in the UK and subject to UK corporation tax, had the supply chain not been designed to secure group tax efficiencies. The DPT will be charged at the rate of 25 percent on those diverted profits, a rate 5 percent higher than the UK corporation tax rate. A company must pay the tax before it can make substantive representations to HMRC or appeal against an assessment on the merits to the Tax Tribunal.

> "...the very real prospect of double taxation..."

The tax has been commonly referred to in the press as the "Google tax", and it will have a significant impact on the digital economy. However, the DPT has much broader implications for multinationals in general, whether they are headquartered in the UK or overseas, and across a very broad range of sectors, including consumer goods, industrial and manufacturing, pharmaceuticals and life-sciences, insurance and reinsurance, traders in the energy and commodity markets, EPC contractors, drilling companies and oil and gas contractors, among many others.

## Greatest risk

The DPT is potentially applicable in a range of commercially driven arrangements which would be currently respected under current UK and international tax norms.

Multinationals will be potentially at risk in three circumstances:

- Overseas mismatches - A foreign company sells goods or services to UK customers (with a turnover in excess of GBP10 million), but the company does not have a taxable presence in the UK and it is therefore not subject to UK corporation tax. Other persons are carrying on activities in the UK in connection with those UK sales. The foreign company makes payments to another foreign company which both lacks economic substance and is subject to a low rate of tax.
- Tax avoidance - A foreign company sells goods or services to UK customers (with a turnover in excess of GBP10 million), but the company does not have a taxable presence in the UK and it is therefore not subject to UK corporation tax. However, persons are carrying on activities in the UK in connection with those UK sales and there is an arrangement in place which has a main purpose of avoiding a UK corporation tax charge.
- UK mismatches - A UK company enters into transactions with a foreign affiliate which either increases its tax deductible expenses or decreases its taxable income. The affiliate lacks economic substance and is subject to a low rate of effective tax (less than 16 percent) on the profits that would otherwise have been earned by the UK company.

In any of these circumstances, HMRC can seek to assess DPT on the profit which it considers has been diverted from the UK through the manner in which the supply chain has been structured, even though no UK corporation tax would otherwise be payable under current law.

Where there is an overseas mismatch or a UK mismatch, HMRC can seek to re-characterise the supply chain if it is reasonable to assume that the transactions would not have been made or imposed in the same way in the absence of the effective tax rate mismatch. Where there is tax avoidance, HMRC can assess DPT on the profits of the foreign company which would have been chargeable to UK corporation tax if it was deemed to have a taxable presence in the UK.

In the first two cases, the DPT will be charged on the foreign company, as it will be deemed to have a taxable presence in the UK. However, the tax can be assessed on the company's representatives in the UK and recovered from any affiliates with assets in the UK. In the third case, HMRC will assess the DPT on the UK company in the first instance, but can also seek to recover any unpaid tax from its affiliates.

## Vulnerable transactions

In addition to the internet companies selling goods and services to customers in the UK, potentially vulnerable commercial supply chain structures include:

- Sales and marketing support, where a UK-based marketing team originates and negotiates sales but contracts are concluded overseas;
- Commissionaires and limited risk distribution, where a UK company sells goods and/or

supplies services to customers on behalf of an affiliate, but does not contractually bear significant risk and earns a limited return;

- Management services, where a UK company employs executives who play a key role in negotiating or evaluating deals with third parties, but the contract is actually entered into by a low-taxed affiliate which sub-contracts various aspects of the work to others who actually have the capability to perform the contract;
- UK IP development, where a UK company has sold its IP to an affiliate in a low tax jurisdiction, or where a UK company may be performing contract R&D services for the affiliate, or where sales and marketing activities relating to the IP are being performed in the UK;
- Property sale and leaseback, and any situations where UK real estate is owned by a foreign affiliate and leased to a UK affiliate;
- Equipment or vessel leasing, where a UK company leases equipment from an affiliate in a low-tax jurisdiction;
- Captive insurance, where a low-taxed affiliate provides insurance or reinsurance coverage for UK or other affiliates, where a UK company is providing significant management functions supporting the business, but not actually underwriting risk in the UK; and
- Procurement, where an affiliate in a low-tax jurisdiction procures goods and services and re-sells them at a profit to a UK company.

> "...DPT will be charged at the rate of 25 percent on those diverted profits, a rate 5 percent higher than the UK corporation tax rate..."

The DPT is a game changer in international taxation and undermines many generally accepted norms, including the basis upon which jurisdictions have generally agreed to allocate taxing rights in cross-border transactions through double tax treaties. The DPT creates significant uncertainty and risk, and raises the prospect of unexpected double taxation and protracted controversy.

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# We're all paying for a summer holiday

Expectations regarding holiday pay have changed following a series of legal cases, potentially exposing employers to significant claims. Stephen Ratcliffe and Mandy Li report.

> "...payments received for "non-guaranteed" overtime should be reflected in the calculation of holiday pay..."

Following the flurry of cases in 2013 grappling with the issue of statutory holiday and sickness absence, the focus has now turned to the calculation of holiday pay following the Court of Justice of the European Union's decisions in *Williams v British Airways [2011]* and *Lock v British Gas [2014]* and, most recently, the EAT's judgment in Bear Scotland v Fulton [2014]. This is an area that employers should approach with care. The direction of travel of the courts gives rise to significant potential liability for employers, both in terms of future holiday payments and possibly for past payments going back several years, although the EAT's judgement in *Bear Scotland* may limit the scope for employees to claim for substantial past payments.

Workers in the UK are entitled to a minimum of 5.6 weeks of paid holiday (including bank holidays) under the Working Time Regulations (WTR). That right implements the Working Time Directive (WTD), and also "gold-plates" it, since the WTD only requires that workers receive a minimum of four weeks of paid holiday, including bank holidays.

In 2002, the Court of Appeal confirmed in its decision in *Bamsey v Albion Engineering and Manufacturing plc* that, in most cases, holiday pay need not include a payment to reflect overtime pay that an employee has earned, unless that overtime is both guaranteed (i.e., the employer must offer it) and compulsory (i.e., the employee must work it, if it is offered). As a result, staff who regularly work overtime often receive less pay during their holidays than they typically receive while working.

In 2012, the Court of Justice of the European Union (CJEU) handed down its decision in *Williams & Others v British Airways Plc*. That decision suggested that holiday pay for the four weeks of holiday guaranteed under the WTD should correspond to the normal pay that an employee would receive while at work. Strictly speaking, that decision related only to staff in the civil aviation industry such as pilots and cabin crew to whom specific legislation applies.

However, in the case of *Lock v British Gas Trading Limited*, the CJEU concluded that the same principle applied to non-aviation sector employees under the WTD and required that holiday pay should include an element to reflect commission payments that the employees had missed out on under the commission schemes in issue as a result of going on holiday.

## Claim timeframe

Claims for underpayments of holiday pay may be made under the WTR, where the time limit for bringing such claims is three months from the date on which the relevant holiday pay should have been paid. Alternatively, claims may be brought as claims for unlawful deductions from wages, in which case the employee can claim for a series of deductions, provided that the claim is brought within three months of the last in the relevant series of deductions. It has until now been unclear how far back that series can go, with commentators typically suggesting that it is either limited to the last six years, or potentially extends to all underpayments in the same employment since the enactment of the WTR in 1998.

The claimants in these three conjoined appeals (*Bear Scotland Ltd v Fulton and others*) each regularly worked overtime, and were paid additional sums for working those hours. That overtime was "non-guaranteed", in that it was not guaranteed by the employer but it was compulsory on the part of the employees if it was offered. In addition, in two of the three cases, the employees received additional allowances if they were required to travel for work purposes. However, in all three cases, the employee's holiday pay consisted of basic pay only, and excluded the payments received in respect of overtime and travel allowances.

The claimants relied on *Williams and Lock* in asserting that their holiday pay should include an element reflecting overtime pay and travel allowances. The respondents asserted that the principles outlined in *Williams* did not extend to "non-guaranteed" over time. They further asserted that, if the WTD did extend to non-guaranteed overtime pay, the UK WTR which sets out how holiday should be calculated would be incompatible with European law, so if the employees had a claim at all, it was against the UK Government for failing to implement the WTD properly. The UK Government, intervening in the case, supported the respondents' argument that "non-guaranteed" overtime need not be included in the calculation of holiday pay but argued that, if that was wrong, the UK legislation could be interpreted consistently with European law, such that any underpayments for past holiday pay should be made good by the employers.

The EAT accepted the claimants' assertion that payments that the claimants received for "non-guaranteed" overtime should be reflected in the calculation of holiday pay for the four weeks of holiday guaranteed by the WTD (although not for the additional 1.6 weeks required by the WTR or other enhanced holiday offered by the employer). It also accepted that the travel allowances should be included to the extent that they did not cover travel expenses, but reflected time spent travelling. If the payments had been intended merely to cover travel costs such as train fares, the payments would not have to be included.

The EAT also concluded that the UK legislation could be interpreted consistently with European law, with the result that the respondent employers were liable to pay the underpaid holiday pay to the claimants. The EAT achieved this result by rewriting the relevant part of the legislation. Though somewhat unclear, the result of this rewriting appears to be that, in most cases involving "non-guaranteed" overtime or allowances, holiday pay for the four weeks of leave guaranteed by the WTD should be calculated by reference to the average of such payments received over the 12 weeks preceding the relevant leave.

> "...a gap of more than three months between underpayments will break the series of deductions, and for claims brought on or after 1 July 2015, there will also be a two-year long stop on back pay claims..."

Finally, the EAT examined the question of whether the underpaid holiday constituted a "series of deductions", such that the employees could claim underpaid holiday going back over a lengthy period. In a novel decision, the EAT determined that, a gap of three months or more between underpayments would effectively break the series. The EAT also indicated (without deciding the point) that the first four weeks of leave taken in any leave year should be deemed to be the leave required by the WTD, and any additional holiday taken can be calculated under the normal principles of the WTR. Employees who will be impacted by this decision are reasonably likely to have had a three month period in the last year where they did not receive holiday pay (because it was not taken) or the holiday pay they received did not constitute an underpayment because it was not part of the four weeks required by the WTD. Based on the EAT's decision, that three month break would have broken the series of deductions and the employee would be unable to claim for underpayments prior to that point.

The EAT granted leave to appeal to the Court of Appeal, recognising that the "series of deductions" point in particular was an important issue. Unite, the trade union which represented some of the claimants in this case, has announced that it will not be appealing the EAT's decision. No announcement has yet been made by the employers as to whether they will appeal.

## Employer implications

This issue is very significant to employers who pay "non-guaranteed" overtime and travel allowances of the nature in issue in this case, but which are not included in holiday pay. Furthermore, this issue extends beyond "non-guaranteed" overtime and the travel allowances which were at issue in this case. The Employment Tribunal in *Lock* was scheduled to consider in February 2015 how the CJEU decision in *Lock* (that commission payments should in certain circumstances be reflected in the holiday pay) should be implemented into UK law, and whether the UK WTR can be interpreted consistently with the CJEU's decision. The Government has also announced the establishment of a "task force" of employer organisations which will examine how the impact of *Bear Scotland* may be limited.

The Government has since introduced new regulations, the Deduction from Wages (Limitation) Regulations 2014, which imposes a two-year long stop on claims for back pay from the date of the ET1 and expressly provides that the right to paid holiday is not incorporated as a contractual term in employment contracts. The Regulations came into force on 8 January 2014 and will apply to claims submitted on or after 1 July 2015.

For the time being therefore, a gap of more than three months between underpayments will break the series of deductions, and for claims brought on or after 1 July 2015, there will also be a two-year long stop on back pay claims. Whilst both developments will be welcomed by employers, this may incentivise workers with existing claims for arrears of holiday pay to bring claims now, before the two-year limitation period takes effect. It would be open to them to challenge the *Bear Scotland* "series of deductions" point and try to argue for losses going back, potentially as far as 1998, although they would have to go to the EAT or Court of Appeal to do so. Therefore, although both of these developments will be welcome for employers, the possibility of substantial claims for back pay has not been entirely removed, and employers should seek advice on their potential exposure, and the options open to them in respect of it.

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