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QUICK LINKS

Court of Justice issues judgment in Fiat State aid case

INTRODUCTION

On 8 November 2022, the European Court of Justice (CJ) handed down its judgment in the Luxembourg and Fiat case, finding that the European Commission and the European General Court (GC) had erred in their conclusion that Luxembourg had granted unlawful State aid to Fiat. The landmark judgment represents another significant blow to the Commission's strategy to challenge 'sweetheart' tax rulings by some EU Member States on State aid grounds.

BACKGROUND

In 2012, the Luxembourg tax authorities adopted a tax ruling in favour of a Fiat subsidiary (the Tax Ruling). The Tax Ruling cleared the use by Fiat of a transfer pricing methodology for determining the subsidiary's remuneration for treasury and other intra-group services.

In 2015, the Commission found that the Tax Ruling conferred a selective advantage on Fiat that resulted, in the Commission's view, in an artificial reduction of tax liability of up to €30 million, in breach of EU State aid rules. Luxembourg was ordered to recover from Fiat the unlawful and incompatible aid. Margrethe Vestager, Executive Vice President of the Commission, stated at the time: "*Tax rulings that artificially reduce a company's tax burden are not in line with EU State aid rules. They are illegal*".

Luxembourg and Fiat lodged an appeal before the GC seeking annulment of the Commission's decision. By its judgment dated 24 September 2019, the GC upheld the Commission's findings and conclusion. Fiat further appealed that judgment to the CJ, supported by Luxembourg and Ireland.

KEY ISSUES ON APPEAL

A number of requirements must be satisfied in order for a measure to be considered State aid. The most important in this case was that the measure must confer a 'selective advantage' on the beneficiary, having regard to other persons in comparable factual and legal situations.

In the context of tax measures such as the Tax Ruling, this requires the Commission to assess whether the measure creates a tax advantage for the beneficiary in comparison with their position under the 'reference system', usually the 'normal' tax system applicable in the Member State concerned.

In the Fiat case, a key question was whether the Commission had applied the correct reference system when assessing whether the Tax Ruling had granted Fiat a selective advantage.

For further information on any EU or UK Competition related matter, please contact the Competition Group or your usual Slaughter and May contact.

Square de Meeûs 40
1000 Brussels
Belgium
T: +32 (0)2 737 94 00

One Bunhill Row
London EC1Y 8YY
United Kingdom
T: +44 (0)20 7600 1200

THE CJ'S JUDGMENT

The CJ reaffirmed that, in establishing the existence of a selective advantage for State aid purposes, the correct reference system should be used as the basis for this comparison. In this context, the CJ emphasised that "*only the national law applicable in the Member State concerned must be taken into account in order to identify the reference system for direct taxation, that identification being itself an essential prerequisite for assessing not only the existence of an advantage, but also whether it is selective in nature*". This meant that the relevant reference system to be identified and used as a benchmark in the Fiat case was the domestic tax system applicable in Luxembourg, as opposed to broader international tax rules and principles.

The CJ held that the Commission and the GC, when attempting to establish whether a selective advantage had been granted to Fiat, were incorrect in their application of a hypothetical tax system that applied a different arm's length principle to the one applicable under the law of Luxembourg. Since Luxembourg had set down specific rules interpreting the arm's length principles in that Member State (as it was entitled to), the Commission should have included those rules in its analytical framework when assessing whether the Tax Ruling gave rise to a selective advantage for Fiat.

The GC was therefore wrong to endorse the Commission's approach of applying an arm's length principle different from that defined by Luxembourg law, without an objective examination of the content, interaction and concrete effects of the rules applicable under Luxembourg law. The CJ concluded that the GC judgment must be set aside and, giving final judgment on the matter, annulled the Commission's 2015 decision.

CONCLUSION AND IMPLICATIONS

The judgment represents a major blow to the Commission owing to the significant resources it has invested in challenging 'sweetheart' tax rulings on grounds of illegal State aid – at a time when the Commission's appeal against the GC's annulment of its Apple State aid decision is still pending.

The Fiat judgment makes it clear that action by Member States in areas that are not subject to harmonization by EU law, including taxation, is not excluded from the scope of the EU State aid rules.

The Commission has stated that it will carefully study the judgment and its implications, and that it is committed to continue "*using all the tools at its disposal to ensure that fair competition is not distorted in the Single Market through the grant by Member States of illegal tax breaks to multinational companies*".

For further discussion and analysis of the tax implications of the judgment, please refer to the Slaughter and May's tax team recent blog post on this topic.

OTHER DEVELOPMENTS

MERGER CONTROL

CMA CONDITIONALLY APPROVES CARPENTER'S ACQUISITION OF RECTICEL'S ENGINEERED FOAMS BUSINESS

In its Final Report published on 16 November 2022, the UK's Competition and Markets Authority (CMA) announced that it has accepted divestment remedies in relation to Carpenter's proposed acquisition of Recticel's engineered foams business. In July 2022, the CMA had initiated an in-depth investigation after the phase 1 investigation raised concerns that the proposed transaction - which would reduce the number of foam producers with plants in the UK from three to two - would give rise to a realistic prospect of a substantial lessening of competition (SLC) as a result of horizontal unilateral effects in the supply of unconverted polyether comfort foam, unconverted technical foam, and converted comfort foam in the UK. At the start of the phase 2 investigation, both parties 'conceded' that the transaction created an SLC and asked the CMA to 'fast track' the case to the assessment of remedies, making use of the CMA2 revised mechanism introduced in January 2021.

The proposed remedy package comprised two parts. Firstly, the partial divestiture of the UK assets and operations of Recticel's engineered foams business, including the UK subsidiary Recticel Limited, to a pre-approved third party. Secondly, Carpenter and Recticel offered to enter into a transitional service and supply agreement (TSA) relating to various support services covering areas including R&D services, chemicals supply and consulting arrangements, as well as information technology, finance and HR support services.

In its Final Report the CMA confirmed that the merger may be expected to result in an SLC, as identified in its phase 1 investigation. The CMA, however, accepted that the parties' proposed partial divestiture would resolve its competition concerns, but noted that the proposed TSA relating to R&D and to the purchasing of chemicals risked diminishing competition between the parties. The CMA therefore excluded those aspects of the proposed TSA from the scope of the remedy.

This case represents the first time that merging businesses conceded an SLC during a phase 2 investigation. The parties made use of the 'fast track' mechanism, resulting in the phase 2 investigation being resolved two months before the 24-week statutory deadline.

ANTITRUST

CHINA'S SUPREME PEOPLE'S COURT RULES ARBITRATION CLAUSES DO NOT PREVENT COURTS FROM HEARING ANTITRUST CLAIMS

On 12 November 2022, a ruling (in Chinese) of the Supreme People's Court of China (SPC) was published, finding that courts can hear antitrust cases even where agreements contain a provision for disputes between parties to be resolved through arbitration.

The case was brought by Beijing Longsheng Xingye Technology Development, a distributor of Honeywell Automation and Control Solutions (China). In late 2020, Longsheng filed a lawsuit against Honeywell alleging it had forced Longsheng to pay higher prices, stock excess products and had restricted Longsheng's resale pricing and sales channels. Longsheng also claimed that Honeywell and Resideo Smart Homes Technology (Tianjin) forced it to resell products to them at lower prices. Longsheng sought compensation and an order that this conduct amounted to a vertical monopoly agreement but the trial court (the Beijing IP Court), dismissed the case on the basis that the dispute arose from agreements between the parties which contained clauses saying that all disputes relating to the agreements should be resolved by arbitration.

Longsheng appealed to the SPC, arguing that the dispute arose from vertical monopoly agreements so should be considered according to China's Anti-Monopoly Law and that arbitration clauses could not be used to exclude the jurisdiction of the courts on monopoly agreements. The SPC agreed with Longsheng and overturned the Beijing IP Court's decision. The SPC found that monopolistic behaviour falls outside the parties' rights and obligations in the agreements, so is not covered by the agreed arbitration clauses and should be heard by the Beijing IP Court. The ruling could lead to more private litigation involving antitrust issues in China, with arbitration or other dispute resolution mechanisms no longer providing a legitimate excuse to avoid such court proceedings.

GENERAL COMPETITION

COMMISSION LAUCHES CONSULTATION ON DRAFT REVISED MARKET DEFINITION NOTICE

On 8 November 2022, the European Commission launched a public consultation on the draft revised Notice on the definition of relevant market (draft Notice), representing the first time that the Notice has been revised since its adoption in 1997. The 1997 Notice was first published to explain how the Commission applies the concept of relevant product and geographic markets when it enforces competition law. The Commission has now proposed several updates to the 1997 Notice to bring it in line with developments in the Commission's practice, the EU courts' case law, and to take account of new market realities, including increased digitalisation and global trade.

The draft Notice aims to provide more guidance, transparency and legal certainty for businesses in the Commission's use of market definitions in merger control and antitrust cases. Among other things, the proposed changes explain the principles of market definition; place a greater emphasis on non-price elements such as innovation and product quality; provide clarifications regarding the forward-looking application of market definition, especially in markets that are expected to undergo structural transitions such as technological or regulatory changes; provide new guidance on the definition of digital markets (e.g. multi-sided markets and digital eco-systems) and innovation-intensive markets; offer more guidance on geographic market definition (including in relation to global markets, imports and local markets defined by catchment areas); and clarify quantitative techniques that the Commission may use when defining a market.

In terms of next steps, interested parties are invited to submit their comments on the draft Notice by 13 January 2023. The Commission will then revise and finalise the draft Notice, with the aim of adopting a new Notice in Q3 2023.

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650