McDermott Will & Emery

International News

ISSUE 3 2011

Focus On **Employment** and **Employee Benefits**

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In This Issue

Welcome to the third and last issue of *International News* for 2011. The focus for this issue is employment and employee benefits.

We start in China with a look at developments that suggest that collective salary negotiations may play a major role in the pending Draft Salary Regulation.

Moving on to the United Kingdom, we explore a number of ways in which companies can cope with the expansion of social media and how to deal with its misuse by staff. We also examine the options that a company has when faced with having to cut employment-related costs. Redundancy is not the only route to take.

Despite these being challenging times, there is some support available for companies, certainly in the European Union where the European Commission has made exemptions to its State aid rules to support employment schemes. We review the opportunities for companies and how measures can stay in line with State aid rules.

The global expansion of companies often necessitates the movement of personnel between jurisdictions. With countries having different rules for employee benefits, however, it is vital that businesses with an international workforce understand the differences. We take a look at just a couple of common examples.

We explain that Germany has no laws in place to deal with whistle-blowing. A recent European Court of Human Rights judgment and existing Federal case law do, however, provide some guidance to employers. In addition, a recent European Court of Justice ruling has again addressed the question of when a fixed-term employment contract is acceptable under German employment law. Bearing in mind the high level of protection enjoyed by employees in an unlimited employment relationship under German law, any violation could prove to be very expensive.

Moving on to France, this year has seen some key developments in employment law. Most notably, there has been a landmark ruling on the validity of change of control clauses. In addition, the necessity of providing bonus targets and rules in French has been reinforced.

Finally, in the United States, there is no uniform law regarding restrictive covenants, such as non-disclosure, non-competition and non-solicitation agreements. Instead, each state has to balance the freedom to contract and compete, with the right to protect property rights from theft and unfair competition. We look at the situation in three key states.

In our Features section, we start with an examination of the European Union's approach to State-owned enterprises (SOEs) investing in Europe. The European Commission must approve any transactions that could have a significant impact on the European market, regardless of the country where an SOE is based, and there are special considerations applicable to SOEs.

The Paris-based International Chamber of Commerce (the ICC) has released its new Arbitration Rules. We outline some key differences between these and the old Rules that show how the new Rules have improved efficiency and neutrality.

In the United States, we look at major changes to the disclosure requirements under the Hart-Scott-Rodino Act. There are three key changes: the required revenue data has become less burdensome, the concept of "associates" has been introduced and there are additional document disclosure requirements.

Finally, we look at how cross-border tax schemes can be legitimate under French tax law.

If you have any comments on this issue or would like to contribute to *International News*, please contact me at hnineham@mwe.com.

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Recent Developments in Collective Salary Negotiation in China

By **May Lu**

As a result of discussions around China's pending Draft Salary Regulation, collective salary negotiation has once again become a hot topic.

There have been several well-known, recent cases relating to collective salary negotiation. In 2010 one Japanese-invested car company raised its Chinese employees' salaries by 35 per cent after experiencing a strike that lasted more than two weeks and interrupted almost all of its manufacturing in China. In 2011 it was reported that French supermarket Carrefour had not raised employees' salaries for 12 consecutive years. This drew considerable attention from the local government in Shanghai and Carrefour was forced to raise wages by 8 per cent after a Government-led collective negotiation with the employees.

In addition, trade unions at different levels have been very active in urging employers to sign collectively bargained contracts that include salary increase as the main content. Furthermore, additional rules relating to the collective negotiation process have been issued to provide guidelines regarding collective negation for enterprises that do not have trade unions. The future for collective salary negotiation looks bright, but is that really the case?

Has China Entered an Era of "Collective Negotiation"?

The Chinese collective negotiation system has actually been in place since 1994. However, due to weak trade unions and the lack of practical procedures, the system did not have much impact. More recently, however, there have been interesting developments as it became clear there needed to be a more effective collective negotiation system with salary negotiation at its core.

> "The future for collective salary negotiation looks bright."

First, the Labour Contract Law in China was updated in 2008, giving employees clearer protection of their legal rights. The Labour Contract Law once again emphasised collective contract issues and created several new categories of collective contract, *e.g.*, specific collective contract, industry association collective contract and regional collective contract. This

allowed more employees to utilise the new laws and regulations to bargain for an increase of salary and improvements to other legal rights.

Second, there were more and more collective labour disputes. In recent years, an increasing number of strikes have been reported in manufacturing (*e.g.*, the car industry), and the services industry (*e.g.*, the taxi drivers' strike in Hangzhou, Chongqing and other cities), amongst others. In all these disputes, salary increase was the key concern.

> "The current system is unlikely to prevent collective labour disputes."

There have been other, more tragic, examples of employee dissatisfaction. Many employees are required to work a lot of overtime, which creates intense physical and psychological pressure, and some employees have even chosen to commit suicide. In 2010 more than 10 young employees of Foxconn, the world's largest maker of electronic components, jumped from buildings in a string of suicides, with work pressure cited as one of the causes.

Third, Government trade unions have become more active since the enactment of the 2008 Labour Contract Law. In the past, the main purpose of local government has been to boost economic development. As such, local government did not intervene on whether an enterprise should establish its own trade union or not. However, to reduce labour disputes and promote a harmonious society, the Government is now more active in urging enterprises to establish trade unions and sign collective contracts regarding regular salary increases. In Carrefour's case, members of the Shanghai trade unions were sent as representatives to negotiate the collective contract with Carrefour.

Further, in order to deal with the difficulties of collecting trade union dues (2 per cent of total salary), a lot of trade unions at municipal levels are working with local tax bureaus to collect dues regardless of whether an enterprise has established a trade union or not. Once the union is in place, the money will be handed over.

What Else Needs to Be Addressed?

Like many policies in China, this wave of collective salary negotiation and establishment of trade unions is being driven by the Government. In many locations, the establishment of collective salary negotiation systems is utilised as one of the standards to evaluate the performance of local governments. However, one of the key parties, the employee, is not actively involved in the process, which means his or her actual needs may not be addressed properly. As a result, the current system is unlikely to prevent collective labour disputes.

In addition, the system lacks certain rules, which would ensure its smooth operation, such as rules on employee representatives. At present, there are no national rules regarding how to elect employee representatives, what percentage of employee representative is proper and what are their rights and obligations, *etc.* Some cities have, however, issued local rules in this regard. In Shanghai, Rules Regarding the Employee Representative Meeting in Shanghai became effective 1 May 2011. For those enterprises that do not have a trade union, meetings between the employer and employee representatives could serve an important role in collective salary negotiation.

Unfortunately, some local rules have been blocked by resistance from the employers. Last year, the city of ShenZhen planned to issue its own rules regarding collective negotiation. After hearing of this, 47 Hong Kong trade associations released a joint announcement that if these local rules were issued, they would cause the closure of a number of enterprises that had been invested in by Hong Kong investors, who would then withdraw their money from ShenZhen. As a result, no local rules were issued in Shenzhen until now.

What Does the Future Hold?

After more than 30 years of economic development, China is facing a great challenge in transforming its current employment model. Cheap labour was previously the major attraction for overseas investors. The current generation of workers, however, is more sensitive to their rights, and the protection and fair treatment of employees needs to be taken seriously. It is estimated that, although the pace is slow, collective salary negotiation is on its way to being the nationally established and adopted system in China.

The Government will continue its efforts to support the establishment of trade unions within industries. This may not be a bad thing for investors and employers. A well-established trade union could help build bridges between the local government, employers and employees. Investors and employers could even take a proactive stance and help set up a trade union and make it functional. To this end, investors and employers should open dialogues with local governments to explore their options relating to the trade union laws and regulations, set-up procedures and how best to train employees, *etc.*

A series of internal rules regarding collective salary negotiation should be established for the purpose of preventing collective labour disputes. These rules should at a minimum include employee representative election and meeting rules, collective labour contracts and a tripartite negotiation system for conflicts between Government, employer and employee.

A comprehensive collective salary negotiation system is likely to be a major issue in the forthcoming Draft Salary Regulation. Foreign investors and employers should therefore take proactive steps to implement such a system from the outset.

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Anti-Social Media? Managing Social Media Issues in the UK Workplace

By **Sharon Tan** and **Paul McGrath**

Use of social media is widespread amongst employees in both a personal and a professional context. It can, undoubtedly, have significant benefits for employers, but these must be weighed against the potential consequences that can flow from misuse.

Particular risks for UK employers include vicarious liability for discriminatory or defamatory acts, breach of data privacy, infringement of third-party intellectual property rights, loss of productivity, dissemination of confidential information and reputational damage. How can UK employers reduce exposure to these risks whilst harnessing the opportunities that social media presents?

The key is to ensure employees are given clear guidance about what is and is not acceptable use of social media in the workplace and, where appropriate, outside it. If an employee strays outside the set parameters, disciplinary action, and possibly dismissal, may ensue.

Setting restrictions on use of social media, particularly outside the workplace, is a sensitive subject that must be given careful consideration. Excessive intrusion or discipline due to misuse of social media can lead to allegations that the duty of trust and confidence, and the employee's rights to privacy and freedom of expression, have been breached. Nevertheless, the fact that actions may take place outside working hours *via* a personal account and/or device will not necessarily prevent an employer from lawfully disciplining an employee, provided the misconduct can properly be categorised and substantiated.

As with all conduct issues, it will assist an employer to be able to point to any rules, policies and training through which expected behavioural standards have been made clear to employees. In a recent case, a bar manager was found to have been fairly dismissed for starting a Facebook discussion, which contained offensive comments about customers. The staff handbook listed as misconduct acts committed outside work that brought the employer into disrepute. Moreover, the internet policy reserved to the employer the right to instigate disciplinary action if an employee contributed to a blog, including Facebook, that lowered the reputation of the company, its staff or customers. Here, the employee's comments made their way back to the customers concerned and the ensuing dismissal was considered to be fair.

> "The key is to ensure employees are given clear guidance about what is and is not acceptable."

To defend a dismissal for misconduct, an employer will need to establish that it had a genuine belief in the employee's guilt, had reasonable grounds for its belief in that guilt and carried out as much investigation as was reasonable in the circumstances.

An employer will also usually need to point to actual damage caused in order to justify dismissal, as a lack of damage may render the dismissal unfair. A recent example arose when an employee was deemed to have been unfairly dismissed for making a number of "relatively mild" Facebook comments in circumstances where there was no evidence of resulting reputational damage. Another dismissal was unfair because a video posted on YouTube had been viewed only eight times.

Key Points to Take Away

Employers should review their existing UK policies and employment contracts to ensure they deal expressly with social media issues. In addition to bolstering the ability to take disciplinary action for misuse that does take place, educating employees about proper use of social media and providing clear guidance will better enable employers to maximise the potential business opportunities provided by social media.

Potential misconduct issues that arise should be carefully categorised, and employers should be mindful of the need to balance employees' rights to privacy and freedom of expression against legitimate business interests.

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Trimming Employee-Related Costs in Tough Times Without Resorting to Redundancies

By **Sharon Tan** and **Niall Pelly**

In a turbulent economic climate, with the prospect of sluggish economic growth forecast, it is unsurprising that many employers are actively seeking to reduce employment costs. This typically brings to mind phrases such as "downsizing" or "rationalisation", with such savings often being achieved *via* morale-sapping compulsory redundancy exercises.

Redundancies are not a cheap option. At an absolute minimum an employer will be faced with the cost of notice pay and accrued holiday pay, plus any redundancy payments (statutory and/or contractual) and severance payments to which each redundant employee is entitled.

In addition, where 100 or more redundancies are proposed, consultation must commence at least 90 days before the first redundancy is intended to take effect and 30 days beforehand where 20 to 99 redundancies are proposed. Then there is individual redundancy consultation, which typically takes at least a couple of weeks to complete. Affected employees must be paid throughout. The good news is that other options are available.

Savings might be achieved by more efficient use of the existing workforce. Productivity could, for example, be increased by more focused performance management. Reducing provision of non-contractual benefits and implementing a hiring freeze as vacancies arise, or implementing a pay freeze, could also generate cost savings.

Contractual Amendments

Cost savings might also be achieved by amending employees' contracts. Reducing pay is the obvious option, but other changes can achieve substantial cost reductions, *e.g.*, reducing working hours or offering unpaid sabbaticals.

Contractual amendments should preferably be secured by agreement with individual employees following a period of consultation.

If agreement cannot be reached, a higher risk strategy is sometimes chosen, unilaterally imposing the proposed changes. This will constitute a breach of the employment contract, but an employee may be deemed to have accepted the breach if he/she does not swiftly express opposition to altered terms that have an immediate impact. The risk is that the employee may choose to resign and claim constructive dismissal or, alternatively, reserve the right to sue whilst continuing to work under protest. This approach might therefore backfire if the short-term cost saving gives rise to more expensive litigation further down the line.

An alternative is to dismiss the relevant employee and offer to re-engage him or her on revised terms. This might give rise to a claim of unfair dismissal, but this can be defended if the employer can demonstrate it had a "fair" reason to dismiss and acted reasonably in all the circumstances.

In *Garside and Laycock v Booth* [2011] IRLR 735 EAT, the dismissal of an employee who refused to agree to a pay cut was held to be fair for "some other substantial reason". There was a sound business reason for the pay cut and the employer was found to have acted reasonably in carrying out substantial consultation before its implementation. Similarly, in *Slade v TNT* [2011] 0113_11_1309 EAT, the removal of a contractual bonus scheme, achieved through the dismissal and re-engagement of a number of employees, was held to be fair against the background of substantial consultation. These cases highlight the importance of consultation with employees before taking action if this option is chosen.

More generally, given current economic conditions, employees may be more willing to agree to innovative measures that deliver cost reductions while saving jobs. Rather than immediately looking to make redundancies, employers should consider more creative solutions, which could achieve similar savings, whilst remembering that employee buy-in will be critical to success.

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State Aid Support for the European Labour Market

By **Martina Maier** and **Philipp Werner**

EU State aid rules in principle prohibit public support of companies without the approval of the European Commission. There are, however, a number of exceptions that apply to measures that support employment.

The European State aid regime has been set up to ensure competition and trade inside the European Union are not unfairly distorted through financial interventions by governments. The State aid rules are applicable to any selective aid, which is granted by a Member State or through State resources to companies in any form whatsoever, that threatens to distort competition and affects trade within the European Union.

Fostering a high-employment economy is one of the key policy aims at EU and Member State level. Under the Europe 2020 strategy, the European Union has put forward a target of at least 75 per cent employment for the age group 20 to 64. The public expenditure committed to labour market policy measures in the European Union—consisting of benefits for the employment and training of workers and amounting to around €57 billion in 2008, underlines this ambition to boost employment.

> A measure that qualifies as State aid is generally prohibited under EU law.

The majority of the measures favouring employment are not subject to State aid rules as they do not give an advantage to one company ahead of another. They tend instead to benefit employees, either individuals or collectively, through measures such as general tax reductions, provisions of guidance and counselling, and general assistance and training programmes for the unemployed. As a result, these types of measures are not prohibited under State aid rules.

In contrast, measures that favour certain companies, such as initiatives that lead to a reduction in wage costs or other expenses a company would otherwise have to bear, give those companies a competitive advantage, and therefore generally constitute State aid in the sense of the European rules. This kind of support most commonly takes the form of grants or exemptions from social security contributions or taxes.

A measure that qualifies as State aid is generally prohibited under EU law and will need to be approved by the European Commission before it is implemented.

The infringement of State aid rules has far-reaching consequences for the companies that received the advantage. If the Commission finds that State aid rules have been breached, it will prohibit the measure and, if it has already been implemented, will order the Member State that granted it to immediately recover the aid. The companies in receipt of the aid will have to repay all advantages received, plus interest.

However, the Commission has the discretion to declare certain interventions that are considered beneficial for the economy to be compatible with the State aid rules. The Commission has set out criteria for the approval of certain measures that facilitate the strengthening of the labour market.

Supporting Disadvantaged and Disabled Workers

Aid with the primary aim of favouring employment by focusing on the maintenance of jobs is generally not viewed favourably by the Commission, which is unlikely to approve such aid, as it essentially helps companies pay their running costs.

Aid may, however, be exempted from the prohibition under certain limited conditions if it is aimed at future job creation and the recruitment of disadvantaged and disabled workers. To incentivise the employment of disabled people, aid may be given in the form of wage subsidies and public support for covering the extra costs that can be incurred when disabled people are employed (such as costs for creating a wheelchair-friendly workplace, *etc.*).

Training

Public support for training measures that favour one or several companies, certain sectors or industries, and that limit the costs normally incurred for measures to raise the skill level of their workforce, is covered by EU State aid rules. It therefore must be approved by the Commission to avoid being found to be in breach of European law.

It is irrelevant whether companies provide the training themselves or rely on public or private training centres, but the Commission distinguishes between general and specific training aid. The first covers measures that create transferable qualifications and leads to the improvement of the general employability of workers. Specific training aid is mainly beneficial to the individual company and is only exempted at low levels of funding. The Commission is more likely to permit funding through aid of general rather than specific training.

Other State Aid Employment Support

Apart from these exemptions, employment aspects of aid are regularly taken into account if other grounds for authorisation exist. This is the case in particular for regional investments, the support of small- and medium-sized enterprises, and research and development.

Under the special circumstances of the economic and financial crisis, the European Union instituted a temporary framework that gave Member States a broader set of instruments to install measures to counter the flagging economy. In 2009 and 2010, local governments were allowed to set up schemes for giving aid totalling up to €500,000 per company, without giving reference to any particular objective. This was widely used by Member States as a flexible instrument to counter the negative effects of the crisis on employment.

> Companies should make sure the measure has been approved prior to its implementation.

In summary, the creation and maintenance of employment is a general policy aim, but concrete public support measures must be in line with EU State aid rules. Boosting employment as such is not a justification for financial interventions by public authorities in favour of individual companies, if such measures can have a negative effect on competition.

Companies that want to benefit from the support of State aid for their employment or training costs should be aware of the legal situation. It is important for companies to make sure that if they receive any advantage, be it as a result of a tax break or assistance with training, it does not constitute State aid under the meaning of EU law. If the measure does constitute State aid, companies should make sure the measure has been approved prior to its implementation.

It should be noted that competitors are increasingly resorting to State aid law as a means to prevent other businesses from taking advantage of assistance, so businesses need to be sure that any investigation prompted by a competitor's complaint will not uncover any wrongdoing.

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International Transfers: Implications for Employee Benefits

By **Paul Melot de Beauregard** and **Todd Solomon**

As large companies increase their global presence, their workers are becoming increasingly mobile between jurisdictions. Such companies need to be aware of a number of international benefits issues that can have an impact on companies and their mobile employees. The following scenarios are typical of those an international company may face.

Scenario 1: From the United States to Germany

A US-based employee transfers to the headquarters of a German company for three years. What happens to his medical and retirement benefits?

With respect to the transferred employee's medical benefits, the employee's US benefits will likely expire once the employee transfers to Germany. However, because Germany runs a deviating system of mandatory public medical benefits, the employee is obliged to contribute to that system and may simply utilise these benefits as necessary. Some companies with large global workforces also sponsor expatriate plans to ensure expatriates have continuing access to coverage similar to that offered in their home countries. As the German system is mandatory and sponsored by employer and employee 50:50, expatriate plans involving Germany may easily lead to doubled costs.

With respect to the transferred employee's retirement benefits, the analysis is even more complicated. Because a transfer can have a significant impact on the employee's retirement benefits, the company must first analyse the benefit rules applicable in the United States and Germany. Following the completion of this analysis, the company must decide whether and how it will remedy any retirement benefit inequities resulting from the transfer.

First, the company must review both the US plan provisions and the German pension rules. With respect to the US plan, tax-qualified retirement plans (*e.g.*, pension and 401(k) plans) typically preclude participation by employees with no US-source income.

> Expatriate plans involving Germany may easily lead to doubled costs.

Assuming the employee transfers to the German payroll upon relocation, he will have no US-source income, and will therefore be excluded from participating in his company's US retirement plans. This ineligibility will leave him with US$0 in retirement benefit accruals under the US plans for his three years abroad. However, because German law requires all employees working in Germany to contribute to a statutory pension scheme, the employee will accrue some retirement benefits and will have access to these funds upon his retirement.

Next, the company may wish to compare the retirement benefits the employee would have earned had he stayed in the United States with those he is earning under the German statutory pension. Because the German statutory benefits are likely not comparable to the transferred employee's US retirement benefits in both type and amount, the company may wish to offer the transferred employee a "mirror" of his US retirement benefits while he is working abroad. Under this type of arrangement, the company promises to pay the transferred employee the additional retirement benefits the employee would have accrued under the US plan, had he continued working in the United States. It is worth noting that any such benefits must be paid from the general assets of the company and cannot be paid from a qualified retirement plan because the plan does not specifically provide for these mirror benefits. Depending on the arrangement, these benefits may also be subject to Code Section 409A of the US Internal Revenue Code, which imposes a 20 per cent excise tax on nonqualified plan payments unless the company follows specific rules relating to time and form of payment.

Scenario 2: From the United States to Italy

A US-based employee transfers to her company's Italian office for one year, but remains on the US payroll. What happens to the employee's medical and retirement benefits?

Because the employee remains on the US payroll, she is typically eligible to continue participating in the US medical and retirement plans. The company should verify the employee's continuing eligibility with its legal counsel. More important, the company should also confirm with Italian counsel whether the company is required to make any statutory pension contributions on behalf of this transferred employee.

Despite the fact that the employee remains on the US payroll, some jurisdictions will require statutory pension contributions by virtue of the fact that the transferred employee is performing services in that jurisdiction. Finally, the company should also verify the transferred employee's eligibility for any private pension schemes sponsored by the Italian office.

Scenario 3: From Germany to the United Kingdom

A Germany-based employee transfers to the United Kingdom. What happens to his medical and retirement benefits?

A transfer within the European Union is quite different to the scenarios described above. In particular, claims gained against one Member State system regarding social security may count against claims that have been accrued in another State. Moreover, it is significantly easier to remain in the home country's social security system while working abroad in the host country. In addition to the State plans that exist more or less in every European country, company-funded plans may play a major role in the United Kingdom. In this scenario, an employee would therefore either take advantage of UK company-funded plans, or use an additional German private health insurance to cover his time in the United Kingdom.

Scenario 4: Non-US Citizens Participating in US Plans

A French citizen works in her company's New York office for five years, and is eligible to participate in the company's non-qualified deferred compensation plan, which is subject to Section 409A of the Internal Revenue Code. Does this mean the French citizen is also subject to the provisions of Code Section 409A?

Because the employee is accruing benefits under a plan subject to Section 409A of the Internal Revenue Code (Code Section 409A), she is also subject to Code Section 409A. Therefore, the time and form of payment of the French citizen's plan benefit must comply with Code Section 409A. If, for some reason, payment of her award violates Code Section 409A, she will still be subject to a 20 per cent excise tax on the amount paid. Code Section 409A does not include any exceptions for non-US citizens participating in a US-based plan.

Scenario 5: Equity Grants Across Multiple Jurisdictions

A US company wants to provide equity grants to employees working in multiple jurisdictions. Is this feasible?

Such an offering is feasible, but the company should contact legal counsel in each of the targeted jurisdictions to determine the relevant caveats of such an award in that particular jurisdiction. Potential issues include the need for works council approval (a potential issue in many jurisdictions, including Belgium, France and Germany), the applicability of forfeiture provisions (a potential issue in France, amongst other jurisdictions), and the need for adherence to a detailed offering procedure (for example, China has detailed offering procedures that all overseas companies must follow).

> A transfer within the European Union is quite different.

As each situation is always unique, specific advice should be sought to determine the most cost-effective and compliant outcome for each individual company.

Lisa Loesel also contributed to this article.

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Whistle-Blowing in Germany: The Reliability of the Disclosure

By **Volker Teigelkötter** and **Bettina Holzberger**

On 21 July 2011, the European Court of Human Rights (ECHR) passed judgment on *Heinisch v Germany* (28274/08) and ordered Germany to pay damages of €15,000 to Ms Heinisch for infringing her right to freedom of expression, after the German courts upheld her dismissal without notice on the grounds that she lodged a criminal complaint against her employer.

German law does not contain any general provision governing the disclosure of deficiencies in enterprises or institutions, such as illegal conduct on the part of the employer, by an employee (so called whistle-blowing).

However, there is Federal Constitutional Court case law on this issue. The Court established the principle that the exercise of a citizen's right, here the report and/or supply of evidence of illegal conduct or wrongdoing, could, as a rule, not justify a dismissal without notice, unless the employee had knowingly and frivolously reported incorrect information. An employee who exercised that right in good faith could therefore not be disadvantaged in the event the underlying allegations were proved to be unequivocally wrong, or the ensuing investigation could find no, or insufficient, evidence of wrongdoing. Indications of an employee's bad faith include his/her motivation to file the complaint or failure to point out the deficiencies to an internal manager.

In its 21 July decision, the ECHR established a balancing test between the employer's interest to protect its reputation and the employee's right to freedom of expression under Article 10 of the European Convention on Human Rights. The ECHR decided the dismissal of Ms Heinisch constituted an interference with her right to freedom of expression. At the same time, the ECHR was mindful that employees owe a duty of loyalty and discretion to the employer. To determine the ultimate legitimacy of Ms Heinisch's dismissal, the ECHR assessed the proportionality of her employer interfering with her right to expression in relation to the legitimate aim pursued.

> The ECHR demands a much less strict standard.

The criteria considered in the ECHR's judgment are almost identical to the ones the German courts considered in its decisions. According to the ECHR, the following have to be taken into account:

- Whether the disclosed information is in the public interest
- Whether the employee had alternative channels for making the disclosure, *i.e.*, he/she could or did seek an internal investigation of his/her allegations
- The reliability of the disclosed information (the person who discloses the information must be able to verify that it is accurate and reliable; allegations must be backed up with facts)
- Whether the employee acted in good faith (the allegations must not amount to a gratuitous attack on the employer)
- Detriment to the employer
- Severity of the sanction imposed on the employee

In reviewing these general principles and the specifics of *Heinisch v Germany*, it is arguable that the response to the third point is "no". The different decisions by the German courts and by the ECHR originate in the different interpretation as to what is meant by "reliability of the information". The ECHR demands a much less strict standard concerning the employee's understanding of whether an investigation will lead to an indictment or will be halted and, therefore, whether or not his/her allegations are, in fact, true. According to the ECHR, it is more than sufficient that the employee had reasonable grounds to believe that the information disclosed was true, even if it later turned out that was not the case.

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Fixed-Term Contracts in Germany

By **Paul Melot de Beauregard**

The recent decision of the European Court of Justice (ECJ) in *Prigge & Ors v Deutsche Lufthansa AG* 13 September 2011 C-447/09 again addressed the question of when a fixed-term employment contract is acceptable under German employment law.

The ECJ reviewed a clause in a German collective bargaining agreement that fixed at 60 the age when pilots are considered as no longer possessing the physical capability to carry out their professional activity and therefore have to retire. The ECJ held that this clause is not in line with European law, as such clauses essentially fix a termination date for the employment relationship, making it a fixed-term contract.

> Acceptable justifications for fixed-term contracts are listed in the Act.

The legitimacy of fixed-term contracts is regulated strictly by the TzBfG, the German Act on Part-Time Work and Fixed-Term Employment Contracts (the Act). The Act determines whether or not the fixing of a deadline is justified on factual grounds.

Accepted Justifications for Fixed-Term Contracts

Acceptable justifications for fixed-term contracts are listed in the Act. The most common reasons for fixing a term of employment are when:

- The demand for workers is temporary (*e.g.*, for seasonal work such as at Christmas or during harvests).
- The period of employment is to provide a young person with work experience and the role may transition to a permanent one.
- The employee is employed to cover an absent permanent employee (*e.g.*, maternity leave coverage).
- The fixed term serves as probationary period.
- The employee's personal situation creates an inherent deadline (*e.g.*, he or she is on a short-term work visa).

The list outlined in the Act is not exhaustive. However, any reason put forward as justification by a company has to be considered by employers and trade unions to be as credible as those that are listed.

Unjustified Fixed-Term Contracts

If there is no acceptable justification for a fixed-term contract, the maximum it can be fixed for is two years. If the contract is for less than two years, it can be extended three times, but only up to a maximum of two years in total.

One exception to this rule relates to start-up companies. Up until four years after their establishment, start-up companies may agree to fixed-term contracts of up to four years. Within this period, multiple extensions are acceptable beyond the three occasions permitted in other circumstances. This exception does not apply to companies that have been created as a result of restructuring.

Another exception applies to employees older than 53. If they have been unemployed for at least four months before the commencement of the fixed-term employment, their contract may be limited for a period up to five years. This exception doesn't infringe EU anti-age discrimination regulations as it encourages the hiring of older employees.

If the employee was employed by the employer previously, it is not acceptable to employ them on a fixed-term basis, regardless of whether the earlier contract was fixed-term or unlimited. There are, however, two exceptions to this rule.

The first is when a significant period of time (usually a couple of years) has passed between the previous employment and the new contract.

The second is when the employee was employed previously by another company in the same group or by a company that has since been taken over or merged with. Similarly, pre-employment training or on-the-job training does not constitute employment as defined by the Act.

Consequences of a Violation

If an employment contract violates the Act or EU regulations, the fixed-term contract is deemed as an unlimited employment contract. This also applies if the agreement of a fixed deadline does not comply with the legal requirement stipulation that it must be in writing. Bearing in mind the high level of protection enjoyed by employees in an unlimited employment relationship under German law, any violation could prove to be very expensive.

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Key Developments in French Employment Law 2011

By **Jilali Maazouz**

There have been two key developments in French employment law this year. The first relates to a landmark ruling on the validity of change of control clauses. The second relates to the necessity of providing bonus targets and rules in French.

Change of Control Clauses

In July 2005 several officers of the telecommunications group Havas were terminated. Subsequently, one of the senior managers decided to leave the company by claiming constructive dismissal under her change of control clause. The reasons given were as follows:

- The identities of the top managers and officers were key reasons as to why the employee entered into her employment contract.
- Should one or several of these top managers be terminated by the company, the employee would be entitled to claim constructive dismissal.
- The claim for constructive dismissal would trigger the payment of a golden parachute.

Typically, change of control clauses refer to a change in the personnel controlling a company and are designed to protect executives from termination. However, such clauses had never actually been tested, so there was no guarantee they were effective. The French Supreme Court ruled in January that this change of control clause was indeed valid. As a result of this landmark ruling, the court has created the possibility that companies with senior management in France can apply the change of control clause as a deterrent to hostile takeovers. With this Supreme Court ruling, it is now likely that such clauses will become more common in France.

Bonus Targets and Rules in International Companies Must Be in French

Under Article L.1321-6 of the French labour code, "any document relating to employee obligations, or the provision of what is necessary to the execution of the employment contract, must be in French. These provisions do not apply to documents received from abroad … ."

Bonus targets and rules are considered as "necessary to the execution of the employment contract" within the meaning of Article L.1321-6. However, because in international companies these documents are literally "received from abroad", it has been common practice to communicate these documents only in English to French employees.

On 29 June 2011, the French Supreme Court challenged this practice and applied Article L.1321-6 to bonus targets that were communicated in English to a French employee of the French subsidiary of a US company.

As the information on the company's bonus plan and the rules on targets were communicated in English only, the Court found that the targets were not enforceable against the French employee. Although the Supreme Court did not rule on this issue, the likely consequence of unenforceable targets is that the employee would be entitled to 100 per cent of his bonus.

The employee's senior position, the fact that he understood English perfectly, and the fact that the targets and bonus were set, in practice, by a US company, did not matter to the Supreme Court.

It seems that the Supreme Court took a purely legal approach, as opposed to a pragmatic one, in considering that the document setting the targets was not "received from abroad", as the targets were communicated to the employee by his direct employer, the French subsidiary.

As a result of this landmark Supreme Court decision, international companies in France must now communicate to employees any information on bonus targets and bonus rules in both English and French. It is worth considering that other documents "necessary to the execution of the employment contract" could also include performance appraisal documents and company policies, and should therefore be translated into French.

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State-Specific Approaches to Restrictive Covenants

By **Stephen Erf**

The US government has not established a uniform law regarding restrictive covenants, such as non-disclosure, non-competition and non-solicitation agreements. The occasional statute, and the more common case law interpretations that don't have the benefit of a statute to guide the outcome, result from the different balance each state reaches in accommodating the values placed on freedom to contract and compete, versus protecting property rights from theft and unfair competition.

At the least, an enforceable restrictive covenant in the context of an employment relationship (as opposed to a sale of business) would require a legally recognised protectable interest, and clauses that are reasonable in terms of geography covered, temporal duration and scope of activity restricted to be included with the specific terms of the offer of employment. To get an injunction enforcing the restrictive covenant, an employer would be required to show irreparable injury, the balance of harm favouring the employer, the lack of adverse impact on the public (and sometimes lack of hardship to the employee) and that a damage recovery would be inadequate.

> California is perhaps the state most hostile to restrictive covenants.

California

California is perhaps the state most hostile to restrictive covenants. Its statute has been interpreted since 2008 by the California Supreme Court as prohibiting all restrictive covenants in the employment context, except to protect against the use of the employer's trade secrets to solicit its clients. In fact, in a later case, an appellate court held that an employer could be liable for agreeing to honour the (unenforceable) restrictive covenant of another employer by refusing to hire an individual it otherwise would have hired.

Georgia

Other states have become increasingly receptive to the enforcement of restrictive covenants. For example, Georgia historically imposed highly technical requirements and invalidated all aspects of restrictive covenants, even if only a discrete area transgressed. For example, if a non-competition clause was otherwise lawful but contained a clause improperly requiring confidentiality for an indefinite period, the court invalidated the non-competition clause, as well as the confidentiality clause. However, in 2011 Georgia amended its constitution to permit the adoption of a statute that increased significantly the ability to enforce restrictive covenants. Now, a confidentiality obligation may exist as long as the underlying information remains confidential. The nature of the employer's recognised protectable interests has been broadened, the persons from whom a restrictive covenant may be secured is more clearly and reasonably identified, and the specific nature of the permitted restrictions are also clarified and broadened. Both employers and employees benefit from the greater degree of predictability the statute provides.

Texas

Similarly, Texas has relaxed its interpretation of the statute regarding restrictive covenants that imposes a requirement of ancillarity. Historically, Texas required the employer to commit (other than in an "at will" employment arrangement) to providing confidential information in exchange for which it could secure a restrictive covenant carefully tailored to protect that information. However, based on cases from 2006 and 2009, the Texas Supreme Court has permitted enforcement of a non-competition agreement in an at-will employment agreement, even though the employer only implied a promise to provide the confidential information the employee promised to keep confidential. Further, in 2011 the Texas Supreme Court permitted enforcement of a restrictive covenant contained in a stock option purchase plan made available to certain key, higher level employees to align their interests with the entity.

> Texas has relaxed its interpretation of the statute regarding restrictive covenants.

In order to enhance the ability to protect confidential information, trade secrets, customer goodwill and other corporate assets, employers should tailor the employment agreement and restrictive covenants from the start, avoid use of stock or overreaching restrictive covenants, and exercise care in locating operations and employees in particular states.

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State-Owned Enterprises Investing in Europe

By **Frank Schoneveld**

As emerging markets become more economically powerful, State-Owned Enterprises (SOEs) are beginning to make investments in companies with substantial operations in Europe.

The European Commission must approve any transactions that could have a significant impact on the European market, including those involving SOEs and regardless of the country where those SOEs are based. SOEs and their advisers need to take into account the special considerations applicable to SOEs before embarking on corporate activity with a company that has operations in Europe.

As with any private undertaking, SOEs must notify and obtain prior European Commission approval of large mergers, acquisitions or joint ventures if the transaction involves companies that have turnover in excess of thresholds set down in the European Union's Merger Control Regulation (the Regulation). Failure to obtain clearance before implementing a transaction can result in divestment orders and significant fines. Even if the turnover thresholds are not reached at an EU level, many individual EU Member States require national authority approval, and failure to obtain it can also result in fines of up to 10 per cent of the SOE's worldwide revenues. An example of this risk is the Commission's €20 million fine of Electrabel for failure to notify its 2004 acquisition of Compagnie National du Rhône, even though it later obtained unconditional approval for the acquisition in 2009.

> "The Commission indicates relevant criteria to determine whether an SOE has an independent power of decision."

The approach of the Regulation to public sector organisations is initially to determine whether the organisation is an "undertaking" involved in an economic activity. If a State-controlled organisation is simply exercising public powers or official authority, it will not be regarded as an undertaking, so the merger control rules would not apply. However, an SOE acquiring a business or taking part as a joint venture partner in a business that has operations in or with Europe, will almost certainly be regarded as an undertaking, potentially requiring Commission approval.

Revenue Thresholds for Mandatory Notification

If the SOE's annual revenue reaches certain thresholds, there is a requirement to notify and obtain the Commission's approval for the transaction. The lower turnover thresholds are as follows:

- Combined aggregate worldwide revenue of the SOE(s) and the target or joint venture business is more than €2,500 million.
- In each of at least three EU countries, the combined aggregate revenue of all the undertakings concerned is more than €100 million. In each of these three EU countries, the aggregate revenue of each of at least two undertakings concerned is more than €25 million.

- The aggregate EU-wide revenue for each of at least two undertakings concerned is more than €100 million.

Large SOEs often have sales of more than €25 million in a number of EU countries. Tremendous expansion in developing countries and overseas means that many SOEs will easily reach the threshold of €2,500 million in worldwide revenues when these are combined with the revenues of the business being acquired or with the revenues of a joint venture partner. As an SOE's business expands, and sales increase in Europe, a link-up with a business having significant sales in Europe will more likely require notification and approval from either the European Commission or a national competition authority in Europe.

Single Economic Unit

The Regulation provides that for public undertakings such as an SOE, the calculation of revenue is based on the revenue of an undertaking making up a "single economic unit" with an independent power of decision.

> An SOE should know the answers to three important questions.

First, the Commission establishes whether the SOE has an independent power of decision. Second, if that is not the case, it determines the ultimate state entity that controls the SOE, and what other undertakings are owned or controlled by this state entity and therefore need to be considered as part of the same economic entity. If regarded as not independent, the revenues of all the SOEs controlled by that State entity will be accumulated.

Market Power

If an SOE satisfies the EU merger control thresholds requiring notification, the Commission then assesses whether the transaction would significantly impede effective competition. A key factor in making such an assessment is market power, often reflected in the market shares of the parties concerned in the transaction. If the SOE is not independent, but is controlled by another entity that in turn controls other SOEs active in the same market, the Commission will accumulate the market shares of all those SOEs. This accumulation could raise competition concerns to such a level that the Commission determines the transaction would impede effective competition in Europe and therefore rejects it.

If it cannot be excluded that the SOE is not an economic unit with independent power of decision from the relevant State, the European Commission will also assess, amongst other things, whether:

- The SOEs might have incentives to coordinate their behaviour on the market, and whether such coordination was likely.
- The opportunities for SOEs to act independently of the State are more limited than for private enterprises in the sector.
- There are privately held companies from that country that could compete in the market.
- The State could influence the behaviour of private suppliers from that country active in the EU market.
- There were signs of other forms of State coordination of the market behaviour of firms from that country active in the industry.
- The combined market shares of all the country's SOEs active in the sector could give rise to competition concerns.

Key Questions

Before proceeding with any transaction in Europe, an SOE should know the answers to three important questions.

Question One: Does the parent/holding company or government agency that the SOE reports to, or that owns or controls the SOE, also own or control other SOEs or companies? If yes, the revenue of these other entities may need to be accumulated with the revenue of the SOE becoming active or expanding in the European Union.

Question Two: Do the market shares in the relevant market (typically the European Union as a whole) of these SOEs cumulatively lead to a dominant position or a combined market share big enough to conclude that significant market power would result? If yes, the SOE needs to be prepared to provide evidence and arguments that the transaction would not significantly impede effective competition on relevant markets in Europe.

Question Three: If competition concerns might arise, does the SOE have a fall-back position that would satisfy the European regulator so that approval would be granted if, for example, the transaction had a different structure? The SOE might contemplate purchasing only part of the target, selling some of the target's or the SOE's current business, or limiting a joint venture to a smaller range of products/services. In such a case, experienced EU competition law advice is crucial to minimising divestitures or other changes to the original transaction, so that the European Commission (or a national competition authority) approves the transaction.

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The New 2012 ICC Arbitration Rules

By **B. Ted Howes** and **Stefano Mechelli**

In September 2011, the International Chamber of Commerce (the ICC) held two events—one in Paris and one in New York—for the purpose of releasing the long-anticipated new version of its Arbitration Rules (the new Rules). As the ICC is the most widely used international arbitration institution in the world, the changes heralded by these new Rules are important for any company involved in international commerce. The new Rules become effective, and supersede the current ICC Rules, on 1 January 2012.

While the new Rules present some major revisions to the current version of the ICC arbitration Rules, including the addition of several new Articles (*e.g.*, "Joinder of Additional Parties", "Multiple Contracts" and "Consolidation of Arbitrations") and the addition of two new Appendices (IV and V), the drafters limited their changes to those provisions of the current Rules that, in the experience of the ICC staff, had proved problematic in application. Overall, the changes provide for increased efficiency and improved neutrality to the ICC arbitration rules, and demonstrate a progressive evolution of the ICC arbitration regime.

More Efficient

Perhaps the most important improvement to the efficiency of the ICC arbitration rules is the new, mandatory case management conference provision. Under the current ICC Rules the arbitral tribunal is merely required to "consult" the parties in establishing "a provisional timetable" for the arbitration (Article 18 (4) of the current Rules). Under the new Rules, the arbitrators are required to convene an autonomous "case management conference," with the parties present, to establish the procedural timetable for the arbitration and to adopt efficient case management techniques (new Article 24 (1)).

> "The new Rules demonstrate a progressive evolution of the ICC arbitration regime."

Far from simply imposing another formality on the arbitral process, this change mandates an entirely new approach in which the arbitrators and the parties must, at the outset of the arbitration, discuss and determine the most efficient way of proceeding with the case.

The increased efficiency of the new Rules is also encompassed in the following specific changes:

- Arbitrators must now, before they are appointed by the ICC, sign a statement attesting that they are "available" to handle the case (new Article 11 (2)). This "statement of availability" was added to the Rules in response to complaints about overworked arbitrators who are too busy to keep the case moving expeditiously.
- Both the arbitrators and the parties are now affirmatively required to "make every effort to conduct the arbitration in an expeditious and cost-effective manner, having regard to the complexity and value of the dispute" (new Article 22 (1)). In addition, the arbitrators are now required to "ensure continued effective case management" (new Article 24 (3)) by adopting efficient procedural measures "not contrary to any agreement of the parties" (new Article 22 (2)).
- Appendix IV to the new Rules provides arbitrators with examples of model case management techniques designed to increase the efficiency, and decrease

the cost, of the arbitration. These model case management techniques include, significantly:

- Discovery and document production limitations (new Appendix IV (d)), which prohibit the type of discovery fishing expeditions often sought by US litigators.
- The option of "bifurcating the proceedings or rendering one or more partial award on key issues" (new Appendix IV (a)) and identifying issues that can be decided solely on the basis of documents (new Appendix IV (c)), which together make possible the early disposition of arbitration claims , similar to the US-style motion practice.

- In setting arbitrator fees, the ICC Court is now required to consider "the timeliness of the submission of the draft award" (new Appendix III, Article 2 (2)). This change should increase pressure on arbitrators to issue their awards in a more timely fashion.

> "The new Rules directly impact in-house lawyers of the parties."

- The arbitrators are now required to consider "the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner" in their decision on the allotment of legal fees and costs between the parties (new Article 37 (5)). This change should encourage parties to avoid time-wasting motions and other tactics designed to obstruct a speedy arbitral process.
- Finally, the new Rules directly impact in-house lawyers of the parties, as arbitrators are now entitled to "request the attendance at any case management conference of the parties in person or through an internal representative" (new Article 24 (4)). By requiring party representatives to attend case management conferences, ICC arbitrators now have the power to bring the parties together early in the process, which should increase pressure on the parties and their counsel to agree to an efficient arbitral process/timetable.

The new Rules also give the ICC institution a more significant role in administering the preliminary phases of the arbitral proceeding. Among other things, in the case any party objects to the adjudication of multiple claims in a single arbitral proceeding, the ICC Secretary General is now entitled, *before* the appointment of the arbitral tribunal, to refer such objections to the ICC Court for determination (new Article 6 (3)). The ICC Court, once involved, has the authority to make *prima facie* decisions about the often thorny issues arising from multiparty and multi-contract arbitrations (new Article 6 (4)).

Improved Neutrality

The changes in the new Rules also provide for improved neutrality. In particular, the new Rules now provide that arbitrators must be not only "independent", but also "impartial" (new Articles 11 (1) and (2)). To avoid abusive challenges to arbitrators on the ground of impartiality, however, the new Rules have set a standard for determining whether an arbitrator is not impartial that is lower than the subjective standard applied to arbitrator independence. Specifically, whereas an independence challenge can be based on facts or circumstances that call into question the arbitrator's independence "in the eyes of the parties", an impartiality challenge can only be brought if there are "*reasonable* doubts as to the arbitrator's impartiality" (authors' emphasis) (new Article 11(2)).

The Evolution of the ICC System

The new Rules also provide for some major development in the evolution of the ICC system, including the following:

- The integration of emergency arbitrator provisions, which permit parties to seek expedited injunctive relief from an "emergency arbitrator" before the permanent arbitral tribunal is constituted (new Article 29). As it can often take up to three months to constitute the permanent arbitration tribunal, this gives parties the ability to arbitrate (rather than litigate) emergency issues that often arise at the very beginning of a commercial dispute.
- The new powers of the ICC Court to make *prima facie* rulings on, among other things
  - Whether an arbitration can proceed when the claims are among multiple parties or the claims arise out of multiple contracts (new Articles 6, 8 and 9).
  - Whether a party can join a third party to the arbitration (new Articles 6 and 7).
  - Whether separate arbitration proceedings can be consolidated into one proceeding (new Article 10).
- The opening of ICC proceedings to investment treaty arbitrations, by, for example, contemplating the possibility of States as parties to ICC arbitrations (new Article 13 (4) (a)).

In sum, the new Rules of the ICC go a long way to addressing some of the larger inefficiencies and jurisdictional problems under the current Rules. How successfully these new Rules will work in practice remains to be seen, but there is little doubt that the ICC has taken a step in the right direction.

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Major Changes to Disclosure Requirements Under Hart-Scott-Rodino Act

By **Joseph Winterscheid** and **Carla Hine**

Final changes to the rules and notification form that parties to certain transactions must submit under the Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976, as amended, became effective on 18 August 2011.

The HSR Act requires parties to notify the US Federal Trade Commission (FTC) and the US Department of Justice (DOJ) of proposed transactions that meet the act's jurisdictional thresholds and to observe a statutory waiting period while the agencies review the competitive impact of the transaction. These changes eliminate disclosure requirements for information the FTC and DOJ no longer find helpful in their initial antitrust review, and introduce new provisions to capture additional information to make known competitive relationships and implications not revealed by current HSR filings. The changes also correct minor oversights from the FTC's 2005 rulemaking related to unincorporated entities.

The most significant of the changes include:

- Revisions to the revenue data that parties are required to report.
- Introduction of the concept of "associates", which requires disclosure of "managed" entities (whether or not these are "controlled").
- Additional document disclosure requirements.

Changes to Required Revenue Data

Previously, the HSR notification and report form required revenue data by North American Industry Classification System (NAICS) codes for a base year (2002) and the most recently completed year. The FTC recognised that providing data for a base year can be burdensome for some parties and that it did not advance the agencies' analysis of the transaction.

> The FTC recognised that providing data for a base year can be burdensome for some parties.

The new rules eliminate the requirement for base-year revenue data, but also refine the data required for the most recently completed year. Parties are now required to provide manufacturing revenues for the most recently completed year by the more detailed 10-digit NAICS codes, instead of the more general seven-digit NAICS code. Further, the revised rules now require revenue data for products manufactured outside the United States, but sold into the country. This will enable the agencies to

better evaluate the parties' operations that affect the US economy, but companies with global operations may find them difficult to compile.

Introduction of "Associates"

Perhaps the most significant change to the HSR rules is the introduction of the concept of "associates". Previously the HSR form only required information from the ultimate parent entities of the parties to the transaction, including data on any entities they "control". The HSR control rules are specific, and in many cases an ultimate parent entity does not control portfolio companies or other entities that are managed, but not majority owned. For example, two investment funds managed by the same organisation may not be under common control for HSR purposes. If one fund made an acquisition, its form would not reveal any information regarding the operations of the second fund. The agencies are interested in assessing the potential competitive impact of acquisitions by entities that have or manage, or are managed by entities that have or manage, overlapping interests in the same industry as the target.

The introduction of "associates" is intended to address these concerns and facilitate the gathering of relevant information. The definition of associate effectively captures entities under common management, as well as those entities controlled or managed by an associate.

"Managing" refers to "the right, directly or indirectly, to manage the operations or investment decisions" of an entity involved in the proposed transaction (whether the ultimate parent entity or the acquisition subsidiary). Acquiring parties are required to report, based on their knowledge and belief: i) associates' significant minority holdings (*i.e.*, more than 5 per cent but less than 50 per cent) of entities that have revenues in NAICS codes that overlap with the acquired business; and ii) the names of those entities that associates control that the acquiring person believes derive revenues in those NAICS codes that overlap with the acquired business, as well as the geographic areas in which the associates derive those revenues.

Additional Document Disclosure Requirements: 4(d) Documents

Item 4(c) of the HSR notification requires submission of documents prepared by or for an officer or director "for the purpose of evaluating or analysing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets."

The HSR rules now include an Item 4(d), which expands the scope of documents parties are required to submit. These include Confidential Information Memoranda that specifically relate to the entity or assets to be sold, documents prepared by third-party advisors during an engagement or for purposes of seeking an engagement that specifically relate to the entity or assets to be sold, and certain documents evaluating synergies or efficiencies for the purpose of evaluating or analysing the proposed acquisition. In all instances, parties will not be required to search for documents beyond those prepared by or for an officer or director of the acquiring or acquired persons, or of the acquiring or acquired entities.

> "The introduction of "associates" is intended to address these concerns."

Preparing Filings Under the New Rules

While many of the recent changes are ministerial in nature and will decrease parties' burdens in preparing HSR notifications, some of the changes will substantially increase the compliance burden for certain types of clients. Multinational businesses with overseas manufacturing operations that sell into the United States will need to gather and report revenue data from those overseas operations. This was not required previously. Private equity funds will need to report information on associates' operations, which they have not previously had to gather and report. Also, the addition of Item 4(d), while not significantly adding to parties' burden, will require some additional time to collect responsive documents.

Firms that are likely to have HSR filings should consider the changes to their processes that may be required so they can respond quickly and efficiently as the need for a filing arises. For example, companies could begin to collect revenue data by NAICS code, subsidiaries, shareholders, minority holdings and, in particular, associate information (and the industries in which they operate), without the pressure of preparing an HSR filing in short order. Firms could implement processes to update that information annually or immediately after any new acquisition, disposition or investment.

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Testing Cross-Border Tax Schemes Under French Law

By **Lila Bidaud**

The French tax authorities (FTA) may use the tool of "abuse of law" under Section 64 of the French procedure tax code (FPTC) to challenge the structure of a cross-border scheme. On the basis of recent case law, it is possible to identify some issues companies should screen for when establishing tax-efficient schemes, in order to avoid an accusation of abuse of law.

Fundamentally, the scheme will need to withstand the criteria that test if the cross-border scheme is fictitious, or if it has been created solely for tax purposes.

Is the Scheme Fictitious?

Recent case law has evaluated schemes on the basis of their "substance".

Example: A subsidiary was created in Belgium, benefiting from the privileged tax regime for coordination centres. Dividends were distributed to its French parent company, which benefited from the French participation exemption regime. The Conseil d'Etat considered this scheme to be genuine as the coordination center is the centre for the financial operations of the company, has employees, and has a significant turnover (Conseil d'Etat, 15 April 2011).

> A debt push-down scheme can be considered abusive if it is not a real debt.

Example: A US company transferred its shareholdings, including those of its French subsidiary, to a Danish holding company. The FTA claimed the Danish company was created solely for the purpose of avoiding the withholding tax on the distribution of dividends. The committee on abuse of tax law disagreed with the FTA, pointing out that the Danish holding company had real substance, as it held 140 subsidiaries in 20 countries and was functioning in accordance with its object (Decision 2010–12).

Although this scheme was found to be acceptable, the substance test was considered not satisfied in several other cross-border schemes. This example highlights a common pitfall: interposition of a foreign company without real substance may constitute a risk of abuse of law.

Example: A French parent company created a subsidiary in a country with a privileged tax regime; its income tax was subject to lower taxation in this foreign country. Dividends would benefit from the French participation in an exemption regime unless they fall under the scope of Article 209B of the FPTC.

The Conseil d'Etat issued decisions in favour of the FTA in three cases similar to this example (*Guyomach* 18 May 2005, decision 267087; *Conforama* 27 July 2009, decision 295805, and *Andros* 10 December 2008, decision 295977).

The lack of substance was characterised in these cases mainly by the fact that the French companies were not represented on the boards of these subsidiaries, and because there was no economic justification for their establishment.

Is the Cross-Border Scheme Driven Solely by Tax Considerations?

Example: A French company made a temporary sale of the usufruct of its shares to a UK company. The sole aim of the scheme was to benefit from the provisions of the UK/France tax treaty related to tax credit and withholding tax. The scheme was found to be artificial because the UK company was not the real beneficiary, the actual beneficiary was a US company (Conseil d'Etat, 29 December 2006, decision 283314).

> A tax ruling can be requested to prove the legitimacy of the scheme.

The committee of abuse of law has considered that a debt push-down scheme can be considered abusive if it is not a real debt. In this case the debt push-down did not generate any financial cash flow but merely resulted in bookkeeping entries between related parties without improving the overall cash position (decision 2010-12).

As a general rule, a cross-border scheme should be able to withstand scrutiny if it can be shown to be justifiable for a reason other than for tax purposes. If there is ever any doubt, a tax ruling can be requested to prove the legitimacy of the scheme.

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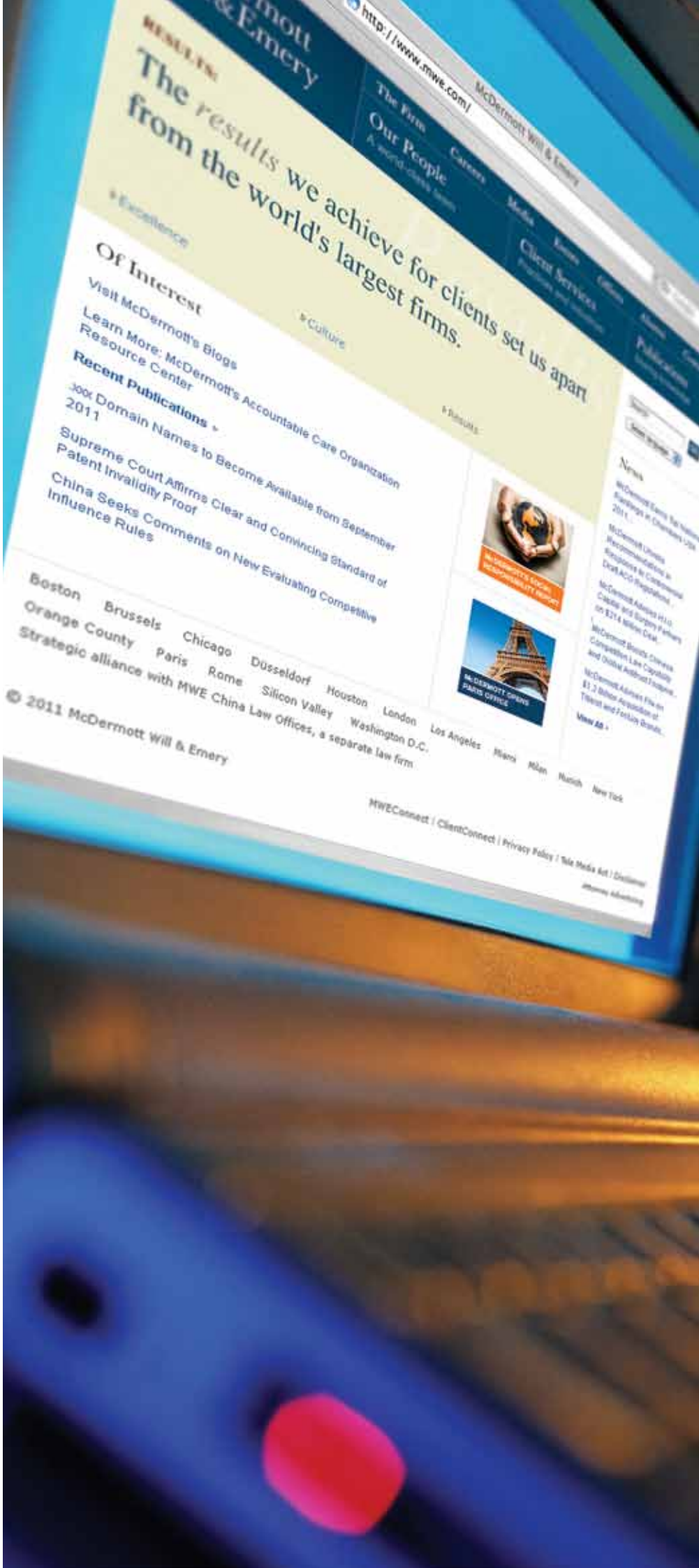

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