EUROSPICE GROUP SA AND ERASMUS SA V THE REPUBLIC OF ARRAKIS

The Republic of Arrakis is a country in Eastern Central Europe, a Member State of the EuropeanUnion since 1 May 2004 (a so-called 'new' Member State). The Arrakian people are a very proudpeople with a history going back to the first millennium. After the Second World War Arrakis wasone of the first nations to resist Soviet influence, but the struggle was put down by military force.Forty years later the Arrakian nation rose successfully against the Communist dictatorship. Theirmovement became an inspiration to and catalyst for other like nations to throw off suppressionand, ultimately, to tear down the Iron Curtain.(2)

Following the fall of the Iron Curtain and the opening up of markets, droves of experts andconsultants from the United States and Western Europe descended upon Arrakis in order to explainhow a formerly planned economy could best be transformed into a free market economy.Privatisation and liberalisation were their two main counsels. As a result all of the formerly state-owned enterprises which had enjoyed monopolies in their respective markets were sold off, boughtmostly by Western European corporate groups and mostly at a price significantly lower than theirreal value. Inexorably the march of Western European companies led to acquisition, in theirrespective markets, of dominance over local companies.(3)

The Eurospice Group SA was one of the winners in the opening up of Arrakian markets. Eurospice isa company group, having its seat in the old EU Member State Luxoria, which controls more than400 non-specialist large-scale retail outlets in Arrakis. The Arrakian retail market, as defined by theArrakian authorities, covers the sale of daily consumer goods (both food and non-food) byhypermarkets, supermarkets and discount chains. This market is basically split amongst three bigWestern European companies: Eurospice holding a market share of 30 per cent, Tosca with 25 percent and Carefive with 20 per cent. The largest Arrakian retailer, Kwik-A-Mart, has a market shareof 12 per cent. The remaining 13 per cent is shared amongst several Arrakian-owned retail outlets.In 2010 the total turnover on the above mentioned Arrakian retail market was about 90,000 millionArrakian Gulden (ARG) (= € 3,000 million).(4)

In 2008 Arrakis was rocked by the economic and financial crisis. Banks were on the verge of collapse, loans for companies in Arrakis dried up and orders for businesses and industries werefalling away. Many companies were forced to make redundancies, social turmoil rose. The thenArrakian government ultimately had no choice but to step in to save the banks with capitalinjections and government guarantees, to grant subsidies and loans to businesses and industries inserious trouble, and to reduce taxes in certain sectors such as motorcar production, energy supply,telecommunications and retail. As a consequence public debt rose dramatically, up to 120 per centof Arrakian GDP. The yields on Arrakian sovereign bonds increased in parallel. To make mattersworse, in early 2010 a rating agency gave Arrakis' debt a BBB- rating, and accordingly it becamemore and more difficult for the government to refinance public debt on the financial markets.

In Spring 2010, in the midst of the national political crisis, elections were held in Arrakis. Theelection campaign was rancorous and bitterly fought. Mr Wiktor Harkonnen, the charismatic leader

of the Citizens' Union for Arrakis (CUA), a right-wing party, delivered a decisive election speech inwhich he pilloried the government rescue measures for "privatising the profits of huge foreignholding companies in Arrakis and socialising their losses." The Arrakian people should not have topay for "the failures of incompetent foreign managers." If the CUA was elected "we will make thesecompany groups pay for their part in our crisis. Those who can pay should pay!" Swept up in thispopulist rhetoric the Arrakian people voted out the existing centre-left government and elected MrHarkonnen as prime minister.(6)

In November 2010 Mr Harkonnen presented his ‘crisis tax scheme’: the crisis tax is levied in twosectors, energy supply and retail. The tax is based on the annual net turnover from taxable activitiesin the sectors in question. The applicable tax rate increases with the size of such sectoral turnover.As for company groups taxable turnover is aggregated and the tax liability calculated on the basis of that amount. Companies with a very low annual turnover are exempt from the crisis tax. The taxrates for both energy companies and retailers were fixed as follows:

- Up to 60 million ARG (= € 2 million): 0 % (tax exemption)

- From 60 million ARG (= € 2 million) to 3,000 million ARG (= € 100 million): 0.1 %

- From 3,000 million ARG (= € 100 million) to 12,000 million ARG (= € 400 million): 0.5 %

- Above 12,000 million ARG (= € 400 million): 2.5 %The crisis tax is to expire on 1 January 2013.(7)

In the Arrakian Parliament Mr Harkonnen defended his crisis tax scheme as sharing the financialburden of the crisis: “Today is payback day. The time has come when those who profited most fromthe government rescue measures, those who have a large market share and accumulated hugeprofits from Arrakian consumers and taxpayers have to meet their responsibilities to the nationbehind the market. Everyone must bear a share of the burden to overcome the crisis. The larger acompany the greater the role it must play in stabilising the Arrakian public budget. However, smalland micro enterprises, already struggling to survive the competition with large foreign holdingcompanies and not earning substantial profits, should not suffer the additional burden of the crisistax and are consequently exempted from it.”(8)

The crisis tax was adopted by the Arrakian Parliament the same day. It forms henceforth a part of the Arrakian tax system which is traditionally recognised to be very progressive. Arrakian incometax jumps from 5 per cent for most of the population to 30 per cent for annual income above 1.2million ARG and 70 per cent for annual income above 7.5 million ARG (so-called “rich tax”). The taximposed on vehicles differentiates according to engine displacement: The tax rate for vehiclesbelow a displacement of 2.5 litres is 3,000 ARG, it is 12,000 ARG for a displacement up to 5 litresand 36,000 ARG for above 5 litres.(9)

In January 2011, the Eurospice Group received its crisis tax assessment for 2010. It refused to pay.Under Arrakian tax law, unpaid tax is considered to be a civil debt. Therefore the Arrakian taxauthorities raise an action against Eurospice for recovery of the amount owing before the DistrictCourt of Arrakeen, the capital city of Arrakis. Eurospice consulted the international law firm Crayon,Paul & Schmitz in order to plead its case in the District Court. (10)

Eurospice considers the crisis tax to be invalid for breach of European Union law, specifically that itcontravenes the principles of a non-discriminatory European internal market. The tax discriminatesagainst foreign companies and so violates EU fundamental freedoms. Moreover, Eurospicecharacterises the crisis tax as one simply “milking the cash cow”. It affects exclusively only thosesectors whose businesses can react to only a limited extent owing to fixed infrastructure.Companies in sectors other than energy supply and retail are not taxed at all, even though they tooreceived public subsidies during the crisis. Compared to the motor manufacturers which couldeasily outsource their plants to other Member States, energy suppliers and retailers have not theoption of leaving. Taxing those who cannot escape the territory of the taxing state is not in line withEU law and its principle of equal treatment.(11)

In the same action Eurospice raises a counterclaim that the Arrakian tax authorities be ordered,first, to apply the same tax rate to every company within the taxed economic sectors and, second,to levy the crisis tax upon every company that received support from the government during theeconomic crisis, regardless of the economic sector in which it is active. Eurospice argues that thetax free category and the different tax bases on the one hand and the non-taxation of certainsectors that have received government support on the other constitute an illegal State aid. Sincethe objective pursued by the crisis tax is the sharing of the financial burden of the supportmeasures during the economic crisis, every company that enjoyed support should be liable for it.Moreover, the definition of “retailers” applied by the Arrakian government means that e.g.convenience stores (including corner shops, petrol stations etc.) are not subject to the crisis tax,although they sell many products which compete with those sold by Eurospice.(12)

Counsel for the Arrakian tax authorities respond with the argument that the Arrakian legislationremains within the fiscal autonomy Member States continue to enjoy. EU law does not precludedifferential tax treatment: tax free categories and different tax bases are devices commonlydeployed to differentiate between economic actors. A differentiation according to the degree of mobility of economic actors must be a legitimate possibility since otherwise tax competition wouldlead to a race to the bottom.

Alongside its excellent wines, a hospitable and well-educated people and beautiful countryside, theRepublic of Arrakis is widely known for its unique social model of codetermination. Some say it isthe very reason behind Arrakian economic power until the crisis unfolded. As workers participate inevery important decision made by management, they are party to, and voluntarily accept,management decisions even when unfavourable to them, so long as it is for the good of the wholecompany. Whilst during previous economic crises other national economies were hit by massstrikes, Arrakian companies could count on their workers and the trade unions unifying them.However, with the outbreak of the economic crisis in 2008 the Arrakian consensus model becamefragile, managers induced to begin to consider ways of preventing workers from interfering inmanagement decisions. Yet it was clear to them that workers would never approve a drop in wagesor in payrolls in order to save money and make the company more efficient.(14)

Article 1 of the Arrakian Codetermination Act (ACA) provides that

“Any limited liability company with more than 2,000 employees shall implement a system of codetermination in accordance with the following provisions”. Under the Act companies are required to create a ‘Supervisory Board’ in which employees and shareholders are represented in equal measure. In case of deadlock the vote of the chairman decides. The representatives of the shareholders are elected by the annual general meeting of shareholders. Only workers employed in a branch or a subsidiary established in Arrakian territory have the right to elect employee representatives to the Supervisory Board and to stand for election to the Board. The Board monitors the company’s management as to legality, economic efficiency and expediency. The ACA obliges a company to provide in its Articles of Association that certain management decisions are subject to agreement with the Supervisory Board. It also elects the‘Management Board’, in which, according to the ACA, a representative of the workers must holdthe post of the director of Human Resources.(15)

Erasmus SA is a limited liability company formed under Arrakian law. It produces electric devices mainly by order of the Eurospice Group. Currently it employs around 3,000 people in its Arrakian factories and 5,000 in branches or subsidiaries established in other EU Member States. As the ACAis applicable to Erasmus, it has both a Supervisory Board and a Management Board.(16)

In late 2010 the Erasmus management was minded to outsource a plant with 500 employees from Arrakis to the Republic of Caladan, a member state of the European Union, as the Caladanian government offered Erasmus subsidies for the construction of a new plant. Article 23(2) of theErasmus Articles of Association requires agreement with the Supervisory Board in the event of “important infrastructure decisions such as the construction of new plants”. After presentation of the management plans at a meeting of the Supervisory Board on 8 November, an employee representative made it clear that they, the employees, would oppose the measure: were it approved by the Supervisory Board the trade unions would resist “with vigour and by all possible means”.(17)

Frustrated by the employees thwarting their decisions, management consulted the international law firm Crayon, Paul & Schmitz upon recommendation of the Eurospice Group in order to find away to circumvent the ACA and so to neuter the power of the workers within the company. Dr.Crayon explained that a change of the applicable law might be a solution. He proposed thatErasmus SA convert into a form of company governed by the law of a Member State which has no codetermination law. Under Arrakian private international law the national law applicable to a company governs every legal aspect of a company’s activities including its legal relations to their workers. By changing the applicable law Erasmus could outflank Arrakian codetermination law:following conversion into a company governed by the law of another Member State, the new company will be one formed under a national law which knows nothing of codetermination. Dr.Crayon suggested Caladanian law, as it is the most inimical in the Union to employee participation. The Erasmus management happily agreed to the proposal and instructed Dr. Crayon to proceed accordingly.(18)

On 1 February 2011 Erasmus SA held the annual general meeting of shareholders in Arrakeen. The management presented a draft new Articles of Association drawn up in accordance with Caladanian law together with a draft resolution to transfer its registered office to Cala City in Caladan by conversion into a Caladanian limited liability company. The presentation resulted in heated debate over the management’s transfer plans. One group of shareholders, being members of Arrakian trade unions, accused management of “hidden social dumping”. After the debate the annual general meeting adopted the new Articles of Association and affirmed the resolution on the conversion by a majority of 90 per cent. The next day, 2 February 2011, Erasmus requested its incorporation in Caladan and entry in the Commercial Register of Cala City. Under Caladanian private international law, Caladanian company law applies immediately the registered office appears in the commercial register. Caladanian law on company transformation contains no impediment to an inbound conversion of foreign companies. The Commercial Court of Cala Cityindicated to the company’s management that it would be willing to register the new company so long as Erasmus submits a certificate issued by the competent authority in Arrakis attesting to the completion of all acts and formalities to be accomplished under Arrakian law before transfer of the registered office.(19)

Angered by what they see to be social incompetence and irresponsibility on the part of the shareholders, the minority group of shareholders being members of trade unions decided on 5February 2011 to raise an action for annulment of the decision of the annual general meeting to adopt the new Articles of Association and the resolution on the conversion before the Court of First Instance of Arrakeen. In Arrakian commercial law any shareholder, irrespective of the number of shares he holds, has the right to challenge any decision made by the annual general meeting. The grounds of review are restricted to formal errors. The legal consequence of raising an action is a barinterdicting ad interim the competent authority from registering the changes agreed by the annual general meeting. The Commercial Code provides no mechanism for circumventing the bar – for example in cases where the action has obviously no real prospect of success. The parties have aright of appeal against a judgment of the Court of First

Instance. On average the whole process takes around 8 months. Mostly these actions are settled after a couple of weeks by the expedient of the companies paying a large amount of money in order to ‘persuade’ the plaintiffs of the wisdom of withdrawing the action.(20)

On 8 February 2011 Erasmus SA notified the Arrakian authorities of their intention to convert into a company governed by Caladanian law whilst its economic activities remain effectively in Arrakis, and requested a certificate of completion.(21)

On 10 February 2011 the Commercial Court of Arrakeen, acting as competent register authority, refused to issue the certificate sought. The Court stated in its decision that, first, a company conversion is possible under Arrakian law only if a company moves its registered office and its main economic activities to another state; and that, second, the true purpose of the conversion in this case is the avoidance of the application of Arrakian codetermination law since the principal economic activity of Erasmus is to remain in Arrakis. However, the Arrakian consensus model is “of such importance to the political, economic and social fabric of Arrakis” that the Commercial Court is obliged to protect it by declining to issue the certificate of completion. In addition, this refusal is justified as the only means of achieving that end, for the Caladanian authorities had already indicated a willingness to assist in circumvention of Arrakian codetermination law by registering the new company upon issue of the certificate, so instituting the change of applicable law which can be seen as a violation of the duty to cooperate in good faith between Member States. Finally, the interim bar to registration owing to the review proceedings pending before the Court of First Instance prevents the Commercial Court from issuing a certificate of completion.(22)

On 1 March 2011 Erasmus lodged an appeal against the decision of the Commercial Court beforethe District Court of Arrakeen. It argued that the Commercial Court has prevented a cross-bordercompany conversion in violation of Articles 49 and 54 TFEU. Moreover, a scheme such as theArrakian action for annulment which confers upon a single minority shareholder the power to blocka cross-border conversion simply by raising the action is inconsistent with the freedom of establishment.* * *(23)

On 2 May 2011 the Arrakeen District Court decided to join the cases raised by the Eurospice Group SA against the Arrakian tax authority and Erasmus SA against the Commercial Court of Arrakeen(the Arrakian State being an indivisible person in Arrakian constitutional law) upon request of Crayon, Paul & Schmitz acting as counsel for both Eurospice Group SA and Erasmus SA. According to Article 1979 of the Code of Civil Procedure an Arrakian court may join cases for purposes of a reference for a preliminary ruling upon request of the parties if the questions involving European law raised during the national proceedings concern similar legal issues and the parties involved ar erepresented by the same counsel. As the District Court takes the view that the authorities regarding European Union law are unclear, it decided on 28 July 2011 to stay proceedings in both cases and refer the following questions to the European Court of Justice under Article 267 TFEU.

1. **Are Articles 49, 54 and 56 TFEU and the principle of equal treatment to be interpreted asprecluding legislation of a Member State such as that at issue in the main proceedings,which provides for a tax that is levied only upon certain operators and, furthermore,consists of a tax free category and a differentiation as regards the tax base according to annual turnover?**
2. **Must legislation of a Member State such as that at issue in the main proceedings, whichprovides for a tax that is levied only upon certain operators and, furthermore, consists of atax free category and a differentiation as regards the tax base according to annualturnover, be regarded as State aid within the meaning of Article 107 TFEU?**

3. **Must a Member State of origin pay due regard to Articles 49 and 54 TFEU in circumstancesin which a company legally incorporated in that Member State intends to convert into acompany form of another Member State yet continue to operate under the law of thatlatter Member State whilst its essential economic activity remains within the Member State of origin?**
4. **If the answer to the third question is in the affirmative, are Articles 49 and 54 TFEU to beinterpreted in such a way that the competent authority of the Member State of origin isentitled to refuse to issue a certificate of completion constituting the crucial preconditionfor the conversion in the event that**

   a) **an action for annulment raised by minority shareholders is pending before a court of the Member State of origin given that this action, which can be raised by a singleminority shareholder, results in an automatic interim bar to registration and provides no mechanism by which the company may overturn the bar in cases where the actionhas no real prospect of success?**

   b) **the Member State of origin seeks to safeguard its system of codetermination?**

The order for reference was received by the Registrar of the Court, who has assigned it casenumber M-238/11. In accordance with Article 23 of the Statute of the Court of Justice, the Registrarhas notified the Eurospice Group SA and Erasmus SA (as applicants) and the government of theRepublic of Arrakis (as defendant) and has invited them to submit written observations to theCo