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Review

EU, Competition & Trade team

COMPETITION

The French iPhone case – Interim measures suspending Orange's exclusivity

About a year after the first version of the iPhone was launched on the French market, and only 6 months after the release of the 3G version, Apple's distribution model for its blockbuster handset[1] is being challenged by the French Competition Authority[2]. A week before Christmas 2008, the former Conseil de la Concurrence[3] decided to suspend Apple's 5 years exclusive deal with France Telecom's Orange pending an "in-depth" investigation into the merits of the case. Orange's appeal against the Authority's decision did not change much as the Paris Court of Appeal upheld the Authority's decision granting interim measures[4].

The suspension allows Orange's competitors to purchase iPhone devices from Apple and to sell them to their customers.

The French Competition regulator considered that the elements required in order to impose such interim measures were met: the exclusive deal was likely to further stifle competition in a sector that suffers from a competition deficit. The emergency was demonstrated by the fact that, due to the iPhone's growing success, the damage to the economy was irreversible. Hence, according to the Conseil and the Court, the suspension of Orange's exclusivity was necessary.

Nevertheless, the two decisions leave a mixed impression. The suspension of exclusivity seems to be justified, notably in view of its length and scope, but the Authority and the Court of Appeal put forward questionable arguments and sometimes seem to be contradicting themselves.

> The five year exclusivity was considered excessively long by comparison with usual practice in the sector. Moreover, the scope of the exclusivity was seen as being particularly wide.

ON THE EXISTENCE OF A RESTRICTION OF COMPETITION

Characteristics of Orange's exclusivity

The 5-year exclusivity was designed by means of various contracts between Orange and Apple, and through distribution contracts between Orange and "authorised distributors".

These agreements designated Orange as the exclusive network operator for iPhones in France. Orange was also designated as the exclusive wholesaler and, as such, entered into distribution contracts with authorised distributors, which were prevented by agreement to distribute the iPhone without Orange's services. Furthermore, the authorised distributors were required to offer the entire range of Orange's services dedicated to the iPhone and were forbidden to supply another member of the distribution network. Finally, other contractual provisions had the effect of preventing distributors from circumventing Orange's exclusivity through imports from other countries.

These characteristics led both the Conseil and the Court to the conclusion that the distribution contracts between Orange and the authorised distributors could not benefit from the presumption of legality laid down under the Vertical Block Exemption Regulation (Regulation 2790/1999), as the prohibition of direct sales between members of a selective distribution network constitutes a

1. Orange has sold more than 810 000 iPhone devices since November 2007 (Le Figaro 11/03/2009)
2. Décision n°08-MC-01 17 December 2008 on practices in the distribution of iPhones
3. Replaced by l'Autorité de la Concurrence (the Competition Authority) from 2009
4. CA Paris 4 February 2009

"hardcore restriction" under this regulation. The Conseil also noted Orange's market share on the mobile telephony market. However, at this stage, the Conseil refused to formulate a final view on this point.

The Conseil then proceeded with a detailed individual assessment of the effects of the exclusivity agreement, as Regulation 2790/99 was not applicable in the present case.

Effects of the exclusivity

In order to assess whether the exclusivity does create an artificial barrier to entry, the Court (as did the Conseil before it) reviewed the main elements that were identified in previous case-law[5]: the provider's and the purchaser's respective market position; the scope and length of the exclusivity; and the competitive conditions prevailing in the market.

According to the Conseil, Apple benefits from unquestionable advantages; although the company's entry in the mobile phone market is very recent (November 2007), its product is quite successful. Apple can rely on a strong brand power and its strong position on various (neighbouring) markets, including computers, MP3 players and online music.

The five year exclusivity was considered excessively long by comparison with usual practice in the sector (3 to 6 months). Moreover, the scope of the exclusivity was seen as being particularly wide; the contract provided that the handsets sold by Orange should be sim-locked on Orange's network in order to prevent the exclusivity from being circumvented. In addition, the only way to unlock the phone to use it on another network, before the end of a six month period, was for the client to pay the sum of €100.

Concerning the competitive conditions of the market, the Authority underlined that the French market suffers from several disadvantages: France is the only European market where only three operators are active; the entry of Mobile Virtual Network Operators (MVNOs) is quite recent; France has the lowest mobile phone penetration rate in Europe; and long-term consumer contracts are prevalent (12 to 24 months). Therefore, the considerable length and scope of the exclusivity, as well as the iPhone's attractiveness for consumers, were considered likely to strengthen Orange's already strong position on the mobile phone services market, which suffers from low competitive intensity.

Based on this, the competition regulator put forward the argument that should the iPhone's exclusivity model, which links a particular device to only one operator for a considerable length of time, be replicated, this could result in market foreclosure. Notably, the two decisions mention that the other two competing operators are indeed planning to distribute so called "iPhone-killers" with similar exclusivities.

It is inevitable that the replication of such agreements between operators and mobile phone producers will further segment the market, and increase switching costs. However one cannot help but wonder whether the Conseil and the Court have drawn the correct conclusions from their own observations. As mentioned above, the decisions noted that, apart from its excessive duration, the potential danger of the exclusivity came from the particular attractiveness of the iPhone as a product and the power of Apple's brand on other markets. Therefore, it seems that this theoretical foreclosure argument is only relevant if other operators can be granted exclusive distribution rights for handsets that are as attractive and as successful as the iPhone. This does not seem to be the case at present.

One can question, however, whether such an exclusivity model is likely to be replicated. Indeed, as underlined by the Court, Apple has decided to abandon this distribution system for its forthcoming products and is actually providing competing operators with iPhones in various countries. Thus, one can reasonably conclude that, in the future, handset producers may not envisage entering into this type of agreement, if it is not considered to be economically viable by one of their most active competitors.

Having established the likely effects of the exclusivity agreement on the market, the Conseil and the Court assessed whether Orange's and Apple's efficiency defence was sustainable.

5. Decision n°08-D-10 of 7 May 2008

ON THE REJECTION OF THE EFFICIENCY DEFENCE

The disproportion of the investments and the length of the exclusivity

Long exclusivity periods may be justified when distributors have to invest large amounts of money in order to promote a product or a brand, or when the product is particularly complex or new. In the present case, the two decisions state that the length of the exclusivity was disproportionate to the investments effectively realised by Orange for the launch of the iPhone.

Orange stated that it had invested more than €100 million. However the Conseil and the Court found that most of these expenses were not specific to the iPhone but were linked to the subsidisation of the handsets and to the income Orange shares with Apple. Over the alleged €100 million investment, only €16.5 million were considered to be specifically related to the iPhone. This amount has to be compared to the €222 million turnover Orange generated from the iPhone 3G in the three months following its launch in July 2008.

On this basis, the two decisions state that the 5-year exclusivity is disproportionate to the amount Orange had to invest for the iPhone's promotion. In light of the first element, the Conseil suggested that an acceptable duration of the exclusivity would likely be less than three months.

The lack of causality between the exclusivity and the level of subsidisation

Apple required that the level of subsidisation for the iPhone had to be 20% more than for other handsets commercialised by Orange. According to Apple and Orange this high level of subsidisation, from which consumers benefit, was made possible by the exclusivity and the level of income it secures. However, the Conseil and the Court took the view that it is also possible to reach this level of subsidisation in a system which allows retail price competition, and that the parties did not successfully demonstrate the contrary.

Thus, Orange and Apple could not justify the length and scope of the exclusivity by efficiency gains, notably in view of the important turnover realised by Apple and Orange through iPhone sales.

ON THE GRAVITY AND IMMEDIATENESS OF THE REPORTED PRACTICE

The gravity of the infringement

The two decisions considered that the length of the exclusivity along with the particular attractiveness of the product provided Orange with a competitive advantage, which, taking into account the low competitive intensity on the French mobile telephone market, would be likely to strengthen its position on the market and to further stifle competition. As mentioned above, there is a risk of market foreclosure and the Court even considered that it could possibly lead to the exclusion from the market of Bouygues Telecom. However, these conclusions on the foreclosure effect need to be put into context. It is true that, in markets suffering low competitive intensity, competition regulators ought to review very carefully every element that could cause irreversible damage. Some argue, however, that the Court may have taken its hypothetical analysis a little too far.

The immediateness of the infringement

The Conseil justified the infringement's immediateness by the fact that the sales of handsets are usually very important before Christmas and because consumers usually commit to one operator for long periods. According to the Conseil, these factors justified the immediate suspension of the exclusivity because it was considered that otherwise it would be likely to cause irreparable damage to the competitive situation of the market. This argument may be convincing from a technical viewpoint, as it is important to ensure that competition is not harmed during the most active period of the year, but unfortunately the decision was taken too late to really have an effect on Christmas sales. In fact, the Decision was only published on 17 December 2008, only 8 days before Christmas. It was therefore nearly impossible for Orange's competitors to be ready to sell iPhones on time. In fact, SFR and Bouygues Telecom only started to offer iPhones from April 2009, more than 4 months after the Conseil's decision.

Interestingly enough, the Court's judgment was published on 1 February 2009, thus it was not able to reproduce the Conseil's argument on Christmas period sales. It stated instead that the important success of the iPhone is unlikely to significantly decrease in the coming months, and that it is happening to the detriment of its competitors, as consumers are tied to long term deals and by the music they purchase from the iTunes store. Although the presence of long term deals should have sufficed to characterise the exclusivity's foreclosure effect, both the Conseil and the

Court felt that they had to justify their decision with an element that is specific to the iPhone. The actual foreclosure effect of the music bought on iTunes, however, is not clear. The decisions put forward that the iPhone's clients are tied in because the music sold on iTunes contains Digitial Right Management (DRM) provisions and draw the conclusion that consumers cannot switch to another device without losing all the digital music they have purchased.

One can question the validity of such an argument. Indeed, the music purchased on iTunes is primarily linked to the computer that is used to manage the iPhone music library. Hence when consumers switch from the iPhone to another device they do not lose their music library. Secondly, as mentioned in the Court decision, Apple no longer sells digital music with DRMs on its digital platform, therefore it appears that this argument is no longer valid going forward. However the Court justifies its decision by mentioning the fact that consumers who have already bought music on iTunes are tied in because switching from DRM to DRM-free tracks has an elevated cost.

CONCLUSION

It would appear from these decisions that the French Competition Authority already has most of the elements necessary to sanction the exclusivity agreement between Apple and Orange. The "in-depth" investigation will certainly be used to further examine the market data that is to be taken into account for the assessment of efficiencies, but the final conclusion should be similar. The imposition of interim measures also seems to be justified in view of the length and scope of the exclusivity. However, the demonstration of the infringement's immediateness is not as straightforward as the demonstration of the restriction's existence. Although the fact that consumers have to sign long term deals with Orange, linked to the growing success of Apple's device, may have been sufficient to justify the suspension of the said exclusivity, the two decisions leave a mixed impression as they put forward questionable arguments to justify the interim measures.

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PUBLIC PROCUREMENT

Defence Procurement – new directive, new opportunities?

Published on 20 August 2009, the new Directive on Defence Procurement (Directive 2009/81/EC) has now entered into force, with the objective of establishing a single market for European defence and security equipment and services.

Following the adoption of Directive 2009/43/EC on intra-Community Transfers of Defence Products last December, the European Union has taken an additional step in creating a unique regime for defence and security markets.

The new Defence Directive aims to enhance transparency and openness in the European defence and security procurement market, a market with an estimated value of over €90 billion. It will apply to contracts for the supply of military and sensitive equipment (i.e. arms, munitions and war material, including sensitive security equipment), and to works, supplies and services directly related to them. The Directive requires implementation by Member States into national law by 21 August 2011.

WHY IS THE DEFENCE DIRECTIVE NEEDED?

Defence and security contracts currently fall within the scope of the general procurement regime, which applies to all public sector contracts (Directive 2004/18/EC). This situation was unsatisfactory because Directive 2004/18/EC is ill-suited for the special features of many of the defence contracts, which tend to be particularly sensitive and complex. As a result, Member States tended to rely on the exemption provided under Article 296 EC Treaty (which is intended to be applied in strictly defined circumstances), resulting in the procurement regime rarely being applied in a defence procurement context. The European Commission has been concerned that the exemptions were being applied in circumstances that did not justify the disapplication of the procurement regime, which in turn, resulted in infringement proceedings being brought against Member States on related grounds.

Against this backdrop, the Defence Directive aims to address these concerns and provide a bespoke procurement regime for contracts in the defence and security sector which should, it is hoped, limit the circumstances in which contracts are awarded without a competitive tender. This should, accordingly, increase the transparency of the market and provide greater insight for companies to understand the opportunities that are available to them on the defence and security market.

KEY FEATURES OF THE DEFENCE DIRECTIVE

There are a number of new features in the Defence Directive that are tailored to address specific issues and, in so doing, aim to provide a more appropriate framework for the procurement of defence and security contracts than that provided under the general procurement regime.

Security of Information

Under the new Defence Directive, a contracting authority can impose certain requirements on a tenderer that are aimed at protecting the confidentiality of information communicated during the tender procedure. Further, the contract documentation can specify requirements and measures that are needed to safeguard the confidentiality of the information. These may include, for example, commitments from the tenderer and requirements on the tenderer to provide certain assurances regarding sub-contractors.

Security of Supply

In a similar way, a contracting authority can specify in the contract documentation its requirements relating to security of supply. Again, this recognises the unique nature of defence and security contracts and, specifically, the degree of reliance that Member States are likely to place on the fulfilment and delivery of such contracts in protecting national security interests. The Defence Directive sets out certain measures that may be required by a contracting authority to demonstrate security of supply. These include: certification regarding the ability of the tenderer to export, transfer and transit the goods; information regarding the tenderer's supply chain and/or strategy; and commitments from the tenderer relating to carrying out maintenance, modernisation or adaption of supplies under the contract.

Flexible procedures

The procurement procedures under the Defence Directive are largely comparable with those under the general procurement regime, with the exception that the negotiated procedure (with prior publication of a contract notice) is freely available under the Defence Directive (i.e. without the need for special justification). There is also provision for the use of framework agreements, although the duration is more flexible than under the general procurement rules. In addition, the Defence Directive specifies certain circumstances that would justify the use of the negotiated procedure without the publication of a contract notice; for example, in relation to air or maritime services for the forces of a Member State deployed abroad.

Research and Development

Provisions on R&D have been included (in addition to those existing under the public sector rules) and allow, to a certain extent, for the award of R&D contracts on the basis of the negotiated procedure without prior advertisement of a contract notice. This exemption could be used, for example, when contacts are awarded as part of a cooperative programme between two or more Member States.

OUTLOOK

The Defence Directive does not introduce a new and radical regime that departs dramatically from the general procurement regime. It does, however, provide a specialised and bespoke set of provisions, based on the general procurement framework. This should provide an opportunity for greater transparency and an inducement for contracting authorities to use competitive tendering more readily. This may, in turn, create significant opportunities for companies (including, for example, American based defence and security companies that already have a significant penetration in the EU market) to engage in competitive tendering processes for defence and security contracts that might previously have been awarded without a call for competition. Whilst the practical implications of the Defence Directive remain to be seen, the opportunities for companies to engage in this market should increase as a result.

To read the full text of the Defence Directive please click here.

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TRADE

Recent developments in the area of EU Export Control – the EU introduces new export controls on brokering and transit for dual-use items

On 27 August 2009 the long awaited, recast, EU, dual-use Regulation became effective. The main changes to the previous system are the introduction of brokering and transit controls. Member States are now also required to place a stronger emphasis on a company's internal compliance with export control rules when reviewing an application for global export authorisations. The rules on export and intra-Community transfer of dual-use goods remain, however, virtually unchanged.

After over two years of consultations the EU adopted Regulation 428/2009[6] setting up the new Community regime for the control of exports, transfer, brokering and transit of dual-use items on 5 May 2009. It was published in the Official Journal of the European Union on 29 May 2009 and entered into force on 27 August 2009. Regulation 428/2009 is a recast of Regulation 1334/2000[7].

Regulation 428/2009 leaves the rules on the export and intra-Community transfer of dual-use items virtually unchanged. Under the new regulation items listed in Annex I and IV will continue to require an authorisation for export and intra-Community transfer respectively. Note that Annex I has been updated in line with the EU's international obligations. The catch-all clause of Article 4 also remains unchanged so that an export of unlisted dual-use items is subject to an

6. Council Regulation (EC) No 428/2009 of 5 May 2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items, OJ 2009 L134/1.

7. Council Regulation (EC) No 1334/2000 of 22 June 2000 setting up a Community regime for the control of exports of dual-use items and technology, OJ 2000 L 159/1.

authorisation requirement if the exporter knows[8] or is informed by the authorities that the dual-use goods are subject to certain end-uses. Most importantly an authorisation is required if:

- the items in question are or may be intended, in their entirety or in part, for use in connection with weapons of mass destruction (WMD) or missiles capable of delivering such weapons[9]; or
- the purchasing country or country of destination is subject to an arms embargo[10] and the items in question are, or may be intended in their entirety or in part, for a military end-use[11].

Regulation 428/2009 introduces, among others, two important changes for exporters. It introduces rules on brokering and transit, so as to bring the EU system into conformity with UN Council Resolution 1540 of 28 April 2004. Furthermore, Regulation 428/2009 requires Member States to take company internal compliance programs into account when deciding upon applications for global export authorisations. This could generally lead to a stronger focus on and controls of companies' compliance with export control laws.

BROKERING

Brokering services comprise the "negotiation or arrangement of transactions for the purchase, sale or supply of dual-use items from a third (i.e. non-EU) country to any other third country" or "the selling or buying of dual-use items that are located in third countries for their transfer to another third country". Brokering does not, however, comprise mere ancillary services such as transportation, financial services, (re-)insurance, or general advertising or promotion (Article 2(5) of Regulation 428/2009).

A broker is any natural or legal person or partnership resident or established in a Member State engaging in the described services from the Community into the territory of a third country (Article 2(6) of Regulation 428/2009).

Article 5 of Regulation 428/2009 introduces an authorisation requirement for brokering services when they concern goods listed in Annex I and are subject to an end-use in relation to WMD or missiles capable of delivering such weapons. The authorisation requirement attaches if the broker is either aware or informed by the authorities of such use.

Member States may extend brokering controls to non-listed dual-use goods if they are subject to an end-use in connection with WMD or missiles capable of delivering such weapons, or to a military end-use in a country subject to a military embargo[12]. With regard to WMD controls, Member States may also require a broker to contact the relevant authorities not only if he is aware of such end-use, but also if he has mere suspicion thereof.

In addition, Regulation 428/2009 imposes certain information and documentation requirements on brokers. A new Annex IIIb provides a model for brokering services authorisation forms.

TRANSIT

Transit refers to "a transport of non-Community dual-use items entering and passing through the customs territory of the Community with a destination outside the Community" (Article 2(7) of Regulation 428/2009).

Under Article 6, Member States may prohibit the transit of non-Community dual-use items listed in Annex I of the Regulation 428/2009 if the items are or may be intended for use in relation to WMD or missiles capable of delivering such weapons.

Note that the provision on transit does not establish an authorisation requirement, but rather a right for the authorities to intervene in suspicious transactions.

8. While Article 4(4) requires awareness, exporters should de facto apply the more conservative standard "could have known". It will otherwise be very difficult for exporter s to convince the authorities that they were not aware of a controlled end-use if the exporters failed to conduct prudent checks of clients or disregard obvious indications that an exported dual-use good shall be subject to a controlled use. Also note that some Member States such as the UK increased the standard for national controls by requiring merely "suspicion" rather than "awareness" as to trigger a licence requirement.

9. See Article 4(1) of Regulation 428/2009.

10. Based on a Common Position or Joint Action by the Council, a decision of the OSCE or an UN Security resolution.

11. See Article 4(2) of Regulation 428/2009.

12. This provision corresponds to the catch-all clause of Articles 4(1), (2) and (4) (see above).

As with brokering, Member States may apply stricter controls. Member States can impose authorisation requirements and extend the application of transit controls to unlisted dual-use goods, subject to end-uses in relation to WMD or missiles capable of delivering such weapons, or to a military end-use in a country subject to a military embargo.

RELEVANCE OF INTERNAL COMPLIANCE PROGRAMMES FOR GLOBAL AUTHORISATION APPLICATIONS

When deciding on applications for global export authorisation[13] Member States must, in the future, take into account whether a company has measures in place to ensure compliance with export control laws.

This will likely bring companies' internal compliance programs and their effectiveness under stronger scrutiny.

WEB-UP/DOWNLOADS CONSTITUTE AN EXPORT

Regulation 428/2009 also clarifies various definitions as to remove uncertainties regarding their interpretation. Most importantly, Regulation 428/2009 clarifies the definition of export with regard to the transmission of software and technology.

Accordingly, the transmission of software and technology by all electronic means to a destination outside the European Union constitutes an export. In this respect the regulation clarifies that emails, websites, web up- and downloads etc are also covered by the definition.

Regarding the oral transmission of technology over the telephone, Regulation 428/2009 omits the previous requirement that such technology must be laid down in a document to constitute an export.

As was previously the case, the supply of services or the transmission of technology will not fall under Regulation 428/2009 if they involve a cross-border movement of persons. If, for instance, a EU technician travels to a country outside of the EU where he performs maintenance services on a dual-use good, he would not require a licence under Regulation 428/2009 (but potentially under national laws). While Regulation 428/2009 does not extend to cross-border movement of persons, any tools, spare parts, or laptops which contain sensitive software that they wish to take with them might, however, attach a licence requirement.

OUTLOOK

Regulation 458/2009 falls short of many of the initial proposals by the European Commission that were aimed at providing a friendlier regulatory environment for businesses. Despite a requirement for enhanced cooperation between Member States, it is doubtful whether the new regulation will provide a more consistent and homogenous application of export controls to dual-use items within the EU.

Member States have ample flexibility to impose stricter and additional export controls to those of Regulation 428/2009. Companies with seats in more than one Member State are therefore likely to face increasing differences in national rules and procedures in the future.

Regulation 428/2009 confronts authorities and exporters with significant challenges. Brokers and authorities in certain Member States such as, Germany[14] and the UK[15] have applied brokering controls for several years already. In other Member States, the authorities will only now have to establish respective controls and administrative systems. Likewise, the stronger focus on companies' internal compliance in the review of global licence applications must not be underestimated. Businesses will be well advised to carefully review and potentially update their internal systems and ensure that the relevant staff have the knowledge and experience in handling exports of dual-use items.

13. A global export authorisation is granted to one specific exporter in respect of a type or category of dual-use items which may be valid for exports to one or more specified end users and/or in one or more specified third countries.

14. See Sections 40 to 42 of the Foreign Trade and Payment Regulation.

15. See Part 4 of Export Control Order 2008.

OTHER IMPORTANT DEVELOPMENTS

Two other important recent developments in the area of EU export controls concern a European Commission proposal for the adoption of additional Community General Export Authorisations (CGEA)[16] and the publication of Directive 2009/43/EC[17], simplifying the terms and conditions of transfers of defence-related products within the Community (Transfer Directive).

On 16 December 2008[18] the European Commission proposed to the Council the introduction of additional CGEA which shall facilitate exports of low value shipments, export after repair, export for exhibition, computers, telecom and information security and chemicals. The proposal is currently under review. Concerning the draft CGEA for computers, the European Commission has recently approached interested parties to obtain a better understanding of the possible benefits for European businesses.

The Transfer Directive was published in the EU OJ on 10 June 2009 and encourages more harmonised procedures in the area of intra-Community trade of certain defence-related products among Member States. They are required to introduce a system of general and global, rather than individual, licences for certain types of intra-Community transfers of products listed in the EU Common Military List. General licences are established by national law or an administrative act, rather than in response to an application. Global licences authorise a supplier to transfer (categories of) defence-related products to certain (categories of) recipient during three years.

Use of such licenses can significantly facilitate and speed up a company’s daily business administration, as not each single shipment would need prior approval from the authorities. The most attractive general licence is probably that for certified recipients. For suppliers to benefit from this general licence, a recipient must undergo a detailed certification process that probes its reliability and compliance with export controls. In addition, Member States may also entirely exempt certain intra-Community transfers from the licence requirement. Member States have to implement the Transfer Directive into national laws by June 2011.

For more information on the Transfer Directive please click here to view a Hammonds LLP Review of the developments relating to the Transfer Directive

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16. CGEA is an export authorisation for exporters to certain countries of destination available to all exporters who respect its conditions of use as listed in Annex II of Regulation 428/2009.
17. Directive 2009/43/EC of the European Parliament and of the Council of 6 May 2009 simplifying terms and conditions of transfers of defence-related products within the Community, OJ 2009 L146/1.
18. Proposal for a Council Regulation amending Regulation (EC) No 1334/2000 setting up a Community regime for the control of exports of dual-use and technology, COM(2008)854 final, available at: http://trade.ec.europa.eu/doclib/docs/2009/january/tradoc_142038.pdf