DISTRIBUTION (MOTOR VEHICLES): DRAFT REGULATION

Subject: Distribution arrangements
Selective distribution
Exclusive distribution
Pricing policy

Industry: Motor vehicles

Source: Commission Statements IP/02/196, and MEMO/02/18, dated 5 February 2002

(Note. At this stage, the Commission's draft is still subject to further consultation: the final version of the Regulation is expected to be adopted in time for it to come into force on 1 October 2002, when the current Regulation expires. The full text will then be published in this newsletter. In the meantime, the Commission has issued an explanatory Statement, together with a list of Questions and Answers about its draft. These are set out below.)

The Commission has proposed new competition rules for the motor vehicle sector, which aim at a better deal for car buyers throughout the European Union. The new draft regulation aims to remedy the competition problems identified in the Commission's 2000 evaluation report on the current competition regime. It is designed to increase competition and bring tangible benefits to European consumers for both vehicle sales and servicing. The regulation will open the way to greater use of new distribution techniques such as Internet sales. It will lead to more competition between dealers, make cross-border purchases of new vehicles significantly easier, and lead to greater price competition. Consumers will be better informed and it will be easier to compare cars and associated services offered by dealers. Car owners will have easier access to after-sales servicing, potentially at lower prices. The quality of vehicle servicing and repairs will be fully maintained. With regard to all these aspects, the driving theme that has inspired the draft regulation is that the consumer's interests must be put first.

"This bold initiative encourages diversity and choice in motor vehicle retailing and puts the European consumer firmly in the driver's seat", Competition Commissioner Mario Monti explained. "It should help to remedy the competition problems that we have observed in the sector over the past few years and allow the car buyer to purchase a vehicle wherever it is cheapest. The new regulation will improve competition in both vehicle sales and servicing. This is important because, over the lifetime of a car, a consumer spends as much on maintenance and repairs as he does to purchase the car in the first place."

The draft is intended to replace the regime established in 1995, which is due to expire on 30 September 2002 (Regulation 1475/95). If the Commission simply let this Regulation lapse, the car sector would automatically fall under the general competition rules for distribution agreements (Commission Block Exemption

Regulation 2790/99). While this general regime is suitable for most economic sectors, the Commission has concluded that it does not contain sufficient safeguards to remedy the problems identified in the evaluation report, and that a stricter regime for the car sector is therefore necessary.

The draft was prepared following an extensive process of fact-finding and consultation, and takes into account the views of interested parties and the findings of a series of studies commissioned from independent consultants. The Commission's own evaluation report showed that several of the aims underlying Regulation 1475/95 had clearly not been achieved. European consumers do not derive their fair share of benefits from the system, competition between dealers is not strong enough and dealers remain too dependent on car manufacturers. Consumers have also in practice found it difficult to exercise their Single Market right to take advantage of price differentials between Member States and buy their vehicle wherever the price is lowest.

The new Regulation will be applicable to the sale and after-sales services of all motor vehicles (passenger cars, light commercial vehicles, trucks and buses). It is based on the same philosophy as Regulation 2790/99 in that, unlike the current sector-specific block exemption (Regulation 1475/95), it does not prescribe a single rigid model for car distribution but rather leaves a set of choices open to carmakers, distributors and dealers. Car manufacturers may choose between exclusive distribution, where each dealer approved by the manufacturer is allocated a sales territory, and selective distribution, where dealers are selected according to a set of criteria. The Commission does not seek to define what criteria are permitted or how a carmaker should organise his network; instead, providing an agreement corresponds to the basic conditions for the application of the regulation, everything is permitted with the exception of a defined blacklist of "hard core" (that is, severely anti-competitive) restrictions. Although the Regulation is much stricter than the current block exemption when it comes to ensuring effective competition, it is also more flexible.

Studies have shown that many consumers would value the in-store choice and comparability available in multi-brand outlets. This "multi-branding" reinforces dealers' commercial independence vis-à-vis their suppliers and also enables dealers in sparsely populated areas to keep their businesses profitable. The new draft regulation therefore gives retailers a genuine choice as to whether they sell more than one brand.

Regulation 1475/95 contains a clause commonly referred to as the availability clause, intended to allow dealers to supply cars to consumers from other Member States that are identical to those supplied to dealers in the consumer's home country. This clause is retained in the new draft regulation, as it allows consumers to make cross-border purchases, and has enabled UK and Irish consumers to obtain right-hand-drive vehicles from Continental dealers at lower prices. The Commission's twice-yearly car price report has consistently revealed major differences in new car prices between EU Member States. A study published for the Commission a year ago concluded that these differences were not entirely due to differences in tax levels[2]. The draft for a new regulation contains other

measures intended to make it easier for the consumer to take advantage of lower prices in other EU countries. In particular, existing restrictions on operators who act on behalf of a consumer with regard to the purchase of a vehicle will be lifted. In future, these representatives, commonly referred to as intermediaries, will only have to produce a mandate showing that they are acting on behalf of a consumer. Under Regulation 1475/95, when a consumer wants to buy a car cheaply in another Member State, it is mainly up to the individual concerned or his intermediary to try to locate dealers willing to sell to this person. The new draft Regulation not only makes shopping abroad easier, but also contains measures to allow those dealers who wish to sell to consumers in other areas of the European Union to be more pro-active. It provides that dealers in a selective distribution system may engage in active sales in other words, they may place advertisements in other areas, and address mail shots and personalised e-mails to consumers located anywhere in the European Union. Dealers may not be penalised financially for selling in this manner, and may not have a quota imposed on them.

In addition, dealers in a selective distribution system may set up a secondary sales outlet or a delivery point in another part of their own country or in another Member State of the European Union. One might imagine, for example, that a Ford dealer in Belgium who commonly sells many vehicles to UK consumers might find that it made business sense to open a sales outlet or a delivery point in London. The new draft regulation would make it possible for him to do so. These measures should help to ensure that the Single market operates to put pressure on the often extraordinarily high price differentials that exist between Member States of the European Union.

Whereas, under the current system, every car dealer is forced to invest in facilities to carry out repairs and maintenance on the vehicles they sell, under the new draft, dealers may choose whether they wish to carry out repairs themselves, or sub-contract them to another authorised member of the manufacturer's network, be it another dealer/repairer or a repairer only. The new draft regulation also provides that, providing they meet the quality standards set by a manufacturer, both independent repairers and today's car dealers may become authorised repairers within that manufacturer's network, without being obliged to sell new cars. The carmaker may not place a limit on the number of authorised repairers, and may not seek to limit an authorised repairer's right to repair vehicles of other makes. Studies have shown that consumers favour a dense network of repairers, and this proposed change should help to maintain network density while reinforcing the current level of technical expertise within the network.

The draft regulation also provides that carmakers must allow those repairers who choose to remain independent from specific brands, access to all necessary technical information, tools, equipment, including diagnostic equipment, and training. Furthermore, the draft forbids clauses which seek to prevent authorised repairers from supplying original spare parts or parts of matching quality to independent repairers. These provisions aim to ensure that independent repairers can continue to compete effectively with the manufacturer's network of

authorised repairers. The consumer will therefore have a choice as to where his vehicle is repaired.

The draft also aims to give consumers a choice as to which spare parts are used to repair their vehicle; clauses by which a carmaker seeks to prevent repairers from obtaining spare parts from other sources or which restrict the right of authorised repairers to use spare parts which match the quality of original spare parts would not be allowed by the new block exemption. These measures should lead to more spare parts being sold directly to repairers by the spare part producers, thereby lowering prices for the European consumer. However, in view of the vehicle manufacturers' direct contractual involvement in free servicing, recall operations, and repairs under warranty, authorised repairers may be obliged to use original spare parts supplied by the carmakers for these types of repair.

Taken as a whole, the changes as regards both independent and authorised repairers set the scene for improvements in competition and for safe and high-quality repair and maintenance services, to the benefit of the European consumer. Strengthening dealers' commercial independence to allow them to better serve the car buyer. Although the current rules contain provisions to reinforce dealers' commercial independence through contractual protection, notably by providing for minimum notice periods for contract termination, the Commission's evaluation report makes it plain that these have not been sufficient to achieve all of the desired effects.

In the absence of more effective measures, there is the risk that certain carmakers might use termination or the threat of termination as a way of preventing dealers from engaging in the types of pro-competitive behaviour which the new draft regulation seeks to encourage, such as selling more than one brand within the same showroom, or selling to consumers from other Member States or their representatives. To prevent manufacturers or their importers from undermining the new regime in this way, to the detriment of both consumer interests and dealers' commercial independence, the draft regulation now provides that any carmaker wishing to terminate a dealer agreement must give clear written reasons for doing so. This measure should enable a judge or an arbitrator to check the validity of the contract termination.

The draft regulation will now be submitted to the Advisory Committee on Restrictive Practices and Dominant Positions, consisting of representatives from the Member States. The Committee is due to be convened at the beginning of March 2002. In the meantime, it will also be sent for consultation to the European Parliament and the Economic and Social Committee. After its discussion in the Advisory Committee, the draft will then be published in the Official Journal to give interested parties the opportunity to comment. After further consideration by the Commission of all the views expressed during the consultation period, the draft will be submitted to the Advisory Committee once more and should formally be adopted by the Commission before the summer break. The new regulation is due to come into force on 1 October 2002. There will be a transition period (probably one year) during which all distribution agreements existing as of that date will have to be brought in line with the new

rules. The block exemption provided for in the draft regulation will expire on 31 May 2010. This date was chosen to coincide with the expiry of Regulation 2790/99, the general block exemption regulation applicable to vertical restraints.

Commission Memorandum: Questions and Answers

What is a Block Exemption?

The EC Treaty lays down a basic rule (Article 81(1)) banning agreements which could have anti-competitive effects. Of course, many common agreements which are pro-competitive and benefit the consumer contain clauses which limit one or other of the parties' ability to compete, and the Treaty (in Article 81(3)) therefore gives the Commission the power to exempt such agreements from the ban. Rather than read through every individual agreement notified to it, the Commission often exempts a whole class of agreements, on condition that they respect certain requirements and so long as they do not contain "hard-core" restrictions. The new draft regulation is an example of such a "block exemption". The new draft regulation applies Article 81(3) of the EC Treaty to certain types of motor vehicle distribution and servicing agreements, and is intended to replace block exemption Regulation 1475/95, which came into force in 1995 and is due to expire on 30 September 2002.

How did the Commission elaborate its proposal?

The proposal was drawn up following an extensive process of fact-finding and consultation. This began with the publication, in November 2000, of an "evaluation report" which identified a series of problems with the current regulatory regime. European consumers do not derive a fair share of benefits from the system, competition between dealers is not strong enough and dealers remain too dependent on car manufacturers. Consumers have also in practice found it difficult to make use of their Single Market right to take advantage of price differentials between Member States and buy their vehicle wherever the price is lowest. Studies were commissioned from independent consultants on key elements of the review, such as the obligation to link sales and service, the nature of price differentials, the views of consumers on different features of current and possible future regimes, and the potential impact of various regulatory changes on all of those concerned.

A hearing was held in February 2000 to debate the findings of the evaluation report and the first two of the studies. It was attended by consumers' associations, car dealers' associations, and representatives of the major carmakers among others. In addition, the Commission considered individual submissions from interested parties, and took into account large numbers of individual letters received from European consumers.

Why not just let the current Block Exemption Regulation 1475/95 expire?

During the review, the Commission considered a number of alternatives for legislative change. It was clear from an early stage that simply letting Regulation

1475/95 expire was not a realistic option. If the Commission allowed Regulation 1475/95 to lapse, the car sector would automatically fall under the general competition rules for distribution agreements (Commission Block Exemption Regulation for vertical restraints, Regulation 2790/99). While this general regulation is suitable for most economic sectors, the Commission concluded that it does not contain sufficient safeguards to remedy the problems which the evaluation report identified in the automobile sector. Additional safeguards were especially necessary because the Commission also identified what is referred to in the legal jargon as a "cumulative effect" in the motor vehicle sector. This may occur when a high percentage of goods are distributed using distribution networks which have near-identical features which are restrictive of competition.

What is the nature of the proposed regime?

While the new draft regulation is stricter than its predecessor, it is less prescriptive. Carmakers may choose an exclusive distribution system, where dealers are allocated a territory, or a selective distribution system. If a selective distribution system is chosen, the carmaker may apply a combination of qualitative and quantitative criteria, or he may alternatively select his dealers according to purely qualitative criteria. If he chooses the latter option, he will not be able to place a ceiling on the number of dealers and any dealer who meets the criteria may join the network.

Will the Regulation lead to multi-brand sales outlets?

Although, under the current Regulation, dealers are in theory allowed to sell vehicles of more than one brand, in practice they rarely do so. The Regulation allows manufacturers to require dealers to sell other brands in separate premises, through a separate company, with separate management and a separate sales force, and in practice this makes multi-brand sales uneconomic. Studies have shown, however, that there is consumer demand for dealers to sell more than one brand, and the new draft regulation accordingly lifts most of the restrictions that are allowed under the current regulation, giving retailers (and ultimately consumers) a genuine choice. Car manufacturers may, however, protect their brand image by requiring their vehicles to be displayed in a "brand-specific" area of the showroom.

What are the changes for the so-called "intermediaries"?

Experience has shown that it is difficult for the individual consumer to buy a vehicle abroad. He or she may experience language problems, or may be unfamiliar or uneasy with the commercial environment in another Member State. Past regulations in this sector therefore made room for the consumer to use a representative, known in the jargon as an intermediary. Many of the operators who advertise on the Internet, such as Virgin Cars or OneSwoop, operate as intermediaries. So far, measures adopted by the Commission allow manufacturers to impose restrictions on the activities of these intermediaries, such as a rule that no intermediary is allowed to buy more than ten per cent of his vehicles from the same dealer. These rules obviously hamper what is a perfectly legitimate trade,

and they will in future be prohibited. The only rule that car manufacturers will be able to impose will be a requirement that the intermediary must produce a mandate from the consumer.

What about sales through supermarkets?

There has been speculation whether the Commission ought somehow to force car manufacturers to sell to supermarkets. In a free market economy, it is the general rule that manufacturers of goods may choose to whom they sell, and it is only in extreme circumstances that a competition authority could intervene to force a supplier of goods or services to sell to a certain individual or class of operator. One might imagine, for example, an island with only one port facility and no airport. If the port operator only allowed vessels from one shipping company to dock, the island's competition authority might consider forcing the port to let in other shipping companies. The Commission acknowledges that such an extreme situation does not currently exist in the motor vehicle sector in Europe. It has accordingly opted for a set of flexible rules allowing manufacturers to choose whether they sell cars also to supermarkets. During the consultation process undertaken by the Commission, no supermarket or association speaking on their behalf ever directly expressed a desire to sell cars on a regular basis. This is all the more striking when one considers that all other operators on this market have commented extensively on many topics.

The available evidence shows moreover that, if manufacturers were now forced to accept supermarkets into their distribution systems, this could have a certain negative impact on manufacturers and distributors. Studies (the Andersen study) show that this could lead to a concentration of players, cause product ranges to shrink, decrease product innovation and could, after a short period of lower car prices, lead to less effective intra-brand competition and ultimately to higher prices. Moreover, other studies (the Lademann study) show that consumers are not much attracted by the idea of buying a car from a supermarket.

On the other hand, it would not be true to say that the draft Block Exemption Regulation gives no business opportunities to supermarkets. A supermarket could become a dealer (mono- or multi-brand) if it satisfied the same criteria laid down by the manufacturer as any other potential dealer and if the car manufacturer accepted it as such. Similarly, it may act as an intermediary for consumers, given the relaxation of the rules on intermediaries, and may also establish privileged relationships with dealers all over the Common Market. For instance, 'El Corte Inglés' has introduced this model in Spain and may develop it further.

Why is the Commission stopping short of requiring car makers to sell to pure Internet operators?

The Commission's analysis tends to show that in the longer term alleged benefits for consumers would be outweighed by drawbacks: Internet distributors who sell vehicles exclusively over the Internet could be seen as free-riding on other distributors who have an obligation to invest in a showroom, demonstration vehicles and trained sales staff who give advice to consumers. Consumers, it

might be argued, would take advantage of all of these facilities but would then turn to an Internet dealer for the actual purchase of their new vehicle. In view of these risks and the fact that a study (the Lademann study) shows that consumers are not much attracted by the idea of buying a car from a pure Internet distributor, it seems for the time being inappropriate to force manufacturers to give them full and unconditional access to distribution networks. However, under the new draft rules, no dealer who meets the manufacturer's criteria may be restricted as to his ability to sell via the Internet, or in his use of an Internet referral site. The Internet is a low-cost medium and should in the medium term reduce both distribution costs and consumer prices.

Although manufacturers are not forced to accept pure Internet operators into their networks, the draft BER nevertheless does allow such operators some business opportunities. For instance, a pure Internet operator could complement his virtual sales operation with one bricks and mortar multi-brand dealership, wherever he wants, if he satisfies the same criteria laid down by a manufacturer as any other potential dealer, and is accepted as such by the car manufacturer. He could then sell cars over the Internet to all consumers in the Common Market. Such an operator could also act as an intermediary for consumers and could establish privileged relationships with dealers all over the Common Market.

Will the reorganisation of the link between sales and after-sales servicing really be in the consumer's interest?

Under the current regime, any dealer member of the network has an obligation to provide for sales and servicing of cars if the carmaker so requires. He cannot currently choose one or other of the two activities, which restricts his business freedom considerably. Under the new regime, a distributor who wants to specialise in selling cars will have the choice between carrying out after-sales servicing himself or subcontracting it to one or more official repairers which are easily accessible for his consumers. This approach will ensure that the customers of each distributor will be able to turn to at least one official repairer and will be informed by the dealer of the location of this repairer before acquiring the car. Furthermore, under the new regime, the necessary infrastructure consisting of official repairers, which meet the quality standards of a manufacturer needed for the honouring of warranties and carrying out of recall operations and free servicing, will exist throughout Europe, just as it does today.

The only difference between the new regime and today's system is that some of the official repairers would in the future not sell new vehicles. This is however already the case today: for example Audi, VW and Ford have a network of official repairers (for example, the Audi service centres in Germany and Belgium or the Ford service outlets) which also carry out this type of repairs. No problems regarding this arrangement have been brought to the attention of the Commission's services. Moreover, under the new regime, independent repairers may qualify to be official repairers if they fulfil carmakers' criteria, which will improve service to consumers and territorial coverage. Also, dealers who have their dealership terminated will be able to stay as official repairers of the make.

This will avoid that loss of technical expertise from the market and will help to maintain a dense coverage of service points.

What is the expected impact of the new rules on employment in the sector?

The draft regulation is not expected to have any direct discernible net effect on employment in this sector, which is ultimately driven by the profitability of the retail and after-sales markets. Most manufacturers are already implementing programmes to cut costs and rationalise distribution networks in the EC. The trend which began under the current Regulation 1475/95 is expected to continue into the future, with industry analysts predicting that the number of official network dealers will diminish by between 20-25% by 2010, regardless of the competition rules applicable to the sector.

The draft regulation offers former dealers the opportunity to become official repairers within the manufacturers' network. No quantitative ceiling can be imposed on repairers which fulfil the qualitative criteria for joining the network, which allows former dealers to continue to operate within the network as authorised repairers. In this way, the draft regulation should at least partly compensate the expected decrease in dealer numbers. Those who currently operate as independent repairers may also find this opportunity attractive, even though qualifying as a member of a manufacturer's network may necessitate a certain level of investment in tooling, personnel and training. Moreover, by enabling independent repairers to keep pace with these developments, the draft regulation may indirectly preserve or even increase employment, by encouraging such repairers to consolidate their position on the market.

Does the Commission expect retail prices to decrease as a consequence of the new rules?

The only task of the Commission in terms of prices is to ensure that conditions exist on the market to allow satisfactory and undistorted competition. This implies also that consumers must have the right to buy wherever within the Single Market they find it most advantageous. Proper competition on the market, however, is generally an important factor to prevent price levels and price differentials that cannot be justified. In this respect, bi-annual car price reports issued by the Commission identify price differentials which may indicate a lack of competition or market-partitioning. The new regulation aims to create the market conditions which will lead to a reduction of the existing high price differentials in the European Union and to more competitive prices on the sales and after-sales markets. Competition takes place on other grounds as well. For instance, product quality and diversity are major elements of competition in the car industry today; and these elements also have a high priority for consumers. ■

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