

SPEECH

ERIC VAN GINDERACHTER

Head of Unit (Motor vehicles and other means of transport)
(Directorate-General for Competition)
The European Commission

**« HOW DOES EUROPEAN COMPETITION POLICY
CONTRIBUTES TO THE CREATION OF A SINGLE
MARKET FOR CAR DISTRIBUTION WHICH WILL
BENEFIT CONSUMERS »**

Delivered at the occasion of the

**EUROPEAN COMPETITION DAY DURING THE PANEL
“CAR DISTRIBUTION”**

LISBON, 9 JUNE 2000

INTRODUCTION

Ladies and Gentlemen,

I would like to thank you for the opportunity to address the European Competition Day conference on automobile distribution.

As we all know, before the consumer can get behind the wheel of his new car, the car has to be transferred physically and legally from its birthplace, the factory, via an importer and/or a dealer to the buyer. It is this distribution process at the beginning of the “life” of a new motor vehicle involving the manufacturer, the distributors and the consumer, on which I will focus.

The current “highway code” for this process is the EC block exemption on motor vehicle distribution and servicing agreements, Regulation 1475/95. This Regulation dating from 1995 will expire at the end of September 2002. Everybody would like to know, of course, what is going to happen to our code after this date.

The future of the motor vehicle distribution is thus right now a hot topic since the highway code that I have just mentioned is now under review by the European Commission.

As you know, the Commission is preparing an Evaluation Report on the Block Exemption Regulation for motor vehicle distribution and servicing agreements¹, which is due to be adopted and published by the end of this year. This report, as Commissioner Monti has already declared on several occasions, will not include proposals regarding the future regulatory framework. To discuss the future framework without first establishing whether the existing regulation has worked would be “to put the cart before the horses”. The discussions regarding this future legal framework

¹ See Article 11 of Regulation 1475/95.

will start only in 2001. It is clear, however, that the evaluation report will constitute a major element for the determination of the future regulatory framework.

In a recent speech delivered in Brussels on 11 May 2000 to a conference on Car Distribution, Commissioner Monti explained the preliminary findings of the DG Competition in the current evaluation exercise. In a word, they are rather negative since it would seem that most of the objectives pursued by the regulation have not been achieved and that the assumptions on which this regulation is based are now at least questionable.

It so happens that in parallel to the Commission's evaluation exercise, one of the national Competition authorities i.e. the UK one, is also active in this field.

On 10 April, the UK Competition Commission's report on motor vehicle distribution in the United Kingdom was published by the Secretary of Trade and Industry, Mr. Stephen Byers. The Competition Commission found that there is an urgent need for a radical change in view of the negative effects the "highway code" generates on car prices in the United Kingdom: the UK Competition Commission's radical suggestion is to prohibit selective as well as exclusive distribution agreements in the car sector.

As regards consumers, their interest in the current review is comprehensible since the car is an expensive purchase (the second expenditure in a household) and consumers pay consequently attention to prices. One objective of the current rules is to give the consumers a right to purchase a new vehicle from any dealer in the Internal Market. In view of the price differentials across Europe, new information technologies and the increased mobility of consumers, there are now real possibilities for consumers to shop around and to try to find the best deal.

In order to get a good deal, consumers sometimes wish to buy a car abroad, either directly or via a so-called intermediary. Consumers strongly and rightfully criticise the functioning of the

Internal Market if they are unable to find a dealer who is willing to supply them or if they are discriminated against in relation to national consumers. In our experience, this still happens in too many cases. In this respect, I would mention the campaign by the British Consumers' Association, who told Commissioner Monti that British car buyers feel that they are being "ripped off" and sent him some 20,000 protest notes signed by British consumers. Such consumer actions cannot be ignored when the Commission will discuss the future rules for motor vehicle distribution.

It seems quite revealing that such radical consumer action appears to be limited to the car sector.

After this general introduction, I intend to divide my intervention into three parts:

1. First, to briefly examine, with an almost historical analysis approach, the Community regulatory framework which has governed motor distribution to date, namely regulation 123/85, for the past, and regulation 1475/95, for the present. This will allow me also to explain to you how is motor vehicle distribution organised in Europe right now.
2. Secondly, to make some general observations on the sector and the motor vehicle distribution, which show that the situation in 2000 is rather different from that which prevailed in 1994/95, when the Commission decided to renew the then existing block exemption for motor vehicle distribution by adopting regulation 1475/95, which is to expire in September 2002.
3. Finally, after having examined the past and the present with a critical eye, to talk about certain parameters which seem to have to be taken into consideration when determining the future regulatory framework.

Allow me to come now to the first point: the historical analysis.

I. PAST AND PRESENT LEGAL FRAMEWORK FOR MOTOR VEHICLE DISTRIBUTION

It is a popular saying that one can really build the future only if one knows the past and the present well. It appears to me that the car, despite all its recognised or alleged specific characters, has to comply with this popular wisdom rule.

1.1. The Past - regulation 123/85

This regulation granted, in 1985 and for a ten-year period, a block exemption to the agreements concerning distribution and sales and after-sales service for motor vehicles.

The characteristic of this exemption is that it allowed the combination of selective (with the imposition not only of qualitative but also quantitative criteria) and exclusive distribution.

Apart from some vehicles, which are directly sold on by the manufacturers to final consumers (the so-called “direct sales”), most new motor vehicles are distributed via selective and exclusive dealers.

At the time, the exemption was based on the specific characters of the motor vehicle product advanced by the manufacturers in order to permit this system of distribution which is, it is to be underlined, the most restrictive than one can imagine from the competition point of view.

I will recall here very briefly the restrictions that are imposed within the framework of such a system.

What does selectivity and exclusivity practically mean?

Selectivity means that manufacturers can set qualitative criteria. They can request that their dealers meet performance related criteria, such to meet standards for the sales outlet and advertising and to comply with quantitative stock requirements.

Manufacturers can also prohibit dealers belonging to their network from selling goods on to resellers not belonging to the distribution network, the so-called “grey dealers”.

Manufacturers and importers are by the Regulation allowed to carry out a further, quantitative selection amongst those distributors who meet the qualitative criteria. Such quantitative criteria are for instance the number of dealers belonging to the network, the imposition of quantitative sales targets, the size of the dealer or the consideration that the number of dealers belonging to the network is sufficient to pursue the manufacturers' marketing strategy. Such quantitative selection is advantageous for manufacturers, since they can tailor their distribution system as they like.

As to exclusivity, manufacturers appoint in principle one dealer for a geographically limited territory - the contract territory - on which this undertaking has to concentrate its marketing efforts. Therefore, dealers are not allowed to open sales outlets or to appoint sub-dealers or sales agents outside their contract territory nor to sell actively, with the means of personalised advertising, within the territory of any other dealer. Based on this, dealers get a certain protection from competition from other dealers belonging to the same network.

Moreover, the current regime gives manufacturers the possibility to tie the sale of new cars to the provision of after sales services: In order to be admitted to a network as an official distributor, under the current regime, dealers have also to provide after-sales services.

To summarise regulation 123/85: «in a nutshell», one can say that it enabled the motor vehicle industry to dictate to its dealer networks not only the type of customer to whom they can sell (only to private individuals and in principle to the dealers of the same network) but also their location (in principle the dealer's exclusive territory). As a consequence, the consumer has no other source of supplies than the manufacturers' or its official network, as the manufacturer can impose on the dealers of its network a ban on selling to independent retailers.

The current Block exemption Regulation gives thus manufacturers a large leeway to shape their distribution network according to their own needs and marketing philosophy. These opportunities given to manufacturers have also been used extensively and other retail channels or methods have not developed in the car sector so far.

The Block exemption had thus a certain straight jacket effect in that other ways of distribution could not have developed.

At that time, the balance between the interests of the various parties concerned leaned clearly to the manufacturers' side. Dealers suffered from an extreme economic dependence on the latter. The experience also revealed that the consumers' rights to buy their vehicles and to have them maintained across the European Union where they could find the best offer as regards price and quality, have to a large extent remained a dead letter. Therefore, at the time of the discussions on the renewal of regulation 123/85, it was considered that some of the regulation's main objectives, like the opening of home markets and the correlative completion of the Internal market for motor vehicles, had only been partially achieved.

1.2. The Present - Regulation 1475/95

In order to put a remedy to the failures that I have just mentioned

and to encourage competition on both sales and after-sales markets, the Commission considered necessary in 1995 to provide a series of modifications. However, the principle of a both exclusive and selective distribution was not questioned.

The chosen approach consisted of adopting amendments aiming at establishing a better balance between the interest of all parties involved, i.e. between the car manufacturers and their network dealers, between the car manufacturers and the manufacturers or distributors of spare parts as well as the independent repairers, and the improvement of the consumers' rights to purchase a new vehicle from any dealer in the Internal market.

I will not dwell myself on the first evaluation made of regulation 1475/95. I have already touched upon it in my introduction when I referred to the recent speech made by Commissioner Monti on this topic.

II. GENERAL OBSERVATIONS

The current background concerning motor vehicle industry and distribution is very different from the one which existed at the time when the European Commission concentrated on the renewal of regulation 123/85, the first block exemption regulation for motor vehicle distribution.

The following observations illustrate it:

- The Community/Japan agreement, which established a quota system (voluntarily accepted by the Japanese manufacturers) limiting the number of Japanese cars that could be imported and sold in the Community, expired at the end of 1999. It was not considered necessary to renew it.

This agreement had undoubtedly played a significant role in the back thoughts of certain decision-makers of the time. They feared that substantial modifications of the existing legal

framework for motor vehicle distribution could challenge the sound management of the agreement, which was then regarded as an essential measure for the competitiveness of the European motor vehicle industry.

This element has disappeared from the debate. The expiry of the agreement by the end of 1999 illustrates by itself alone the revival of competitiveness that the motor vehicle industry, including European industry, is experiencing at this moment.

- The European motor vehicle industry is in a better financial condition and more competitive. The various take-overs by the European manufacturers in other manufacturers in recent years prove it (Daimler/Chrysler, Renault/Nissan, etc.)
- In parallel, a new market structure from a competition point of view emerges because of this very strong and still current consolidation of the car manufacturers. Nowadays, 6 car manufacturers have +/- 75% of the European market. An increasingly oligopolistic structure of the European market now exists and it is probable that this tendency to concentration will still continue in the years to come.
- Having regard to the intensive use of the «outsourcing» by the manufacturers, an increasing importance in the manufacturing of cars of parts coming from the equipment suppliers (between 65 and 75%)¹. The result is that the car manufacturer becomes more and more a part assembler than a part producer to whom parts are delivered on a lean production basis by equipment suppliers. The latter have increasingly run the risk of part development and correlatively to have a better access to dealers guaranteed. In addition, the purchase of various fast-fit chains by certain manufacturers is an example of the increasing importance that manufacturers seem to attach to the after-sales market.
- The marketing of increasingly reliable cars requiring less and less maintenance. These cars include, however, an increasing

number of high technology instruments, which need specialised diagnosis and repair equipment in case of serious breakdown of the car.

- Very strong criticism of the consumers as regards the current system as well as the United Kingdom authorities as confirmed in the U.K. Competition Commission report published on 10 April 2000, which pleads for the dismantling of the exclusive and selective distribution system.

In addition to these observations of a general nature, the current context in which the future legal framework will have to be determined is also characterised by various recent developments, which occur in motor vehicle distribution itself.

They involve:

- The progressive passage by manufacturers from a traditional distribution system known as « Stock-Push supply system » to a « lean distribution » system also known as « pull system » which allows production more centred on the customer's precise requests. The setting up of the «lean distribution» coupled with the «lean production» constitutes a major development. It should in theory have a major effect on the management and the level of stocks (leading towards a reduction of the costs) and make the reduction of delivery periods possible. Renault, for instance, has announced that thanks to the next entry into force of lean distribution it intends to provide in the future a delivery time of two weeks for its cars in the future. At the same time, one can think that the implementation of the «lean distribution» could increase the manufacturers' control on their dealers, due in particular to the reduction of the stocks and the possible impact that it can have for the margins and therefore the dealers' economic health.
- Another important development is the integration of information technology like the Internet but I will return to it later.

The last element that I would like to mention in order to allow you to have a complete view of the current context is the adoption, at the end of December, of a new legal framework for the vertical agreements. It will apply in principle as from June 2000 to all the economic sectors except to the motor vehicle distribution. It is the Commission's block exemption regulation 2790/1999 of 22 December 1999.²

This regulation represents, in principle, the «benchmark» to refer to when evaluating the situation of competition restrictions contained in vertical agreements as regards Community competition law.

The new general approach followed by the Commission under this legal framework is to focus its analysis on the real effects, from the competition point of view, of these vertical agreements on the market. To synthesise, this new policy can be described by saying that it exempts all the vertical agreements concluded by suppliers who have a market-share of less than 30%, in as far as they do not contain certain restrictions having serious anti-competitive effects (such as the imposition of a fixed or minimum selling price or certain restrictions aiming at absolute territorial protection leading to market division). It is therefore an assumption below this threshold that the vertical agreements generate advantages («economic efficiencies») likely to compensate for the disadvantages that these agreements produce on competition.

Cumulative effect of the parallel networks of vertical agreements

The new block exemption for vertical agreements constitutes one of the possible alternatives to the regulatory framework of regulation 1475/95. It stipulates,³ however, that when parallel networks of vertical agreements which have similar restrictive effects cover more than 50% of a given market, the Commission

² OJ L 336 of 29.12.1999, p21.

³ Article 8 of Regulation 2790/99 of the Commission.

is entitled to declare inapplicable this regulation to the vertical agreements concerned and to restore full application of Article 81(3) to these agreements.

Such a provision could, at first sight, be applicable to motor vehicle distribution in the European Union since almost all cars are distributed through vertical agreements that have similar restrictive effects and that in addition the five major manufacturers applying these distribution systems have also together market-shares higher than 50%. It seems that the possible application of this provision will be a major element to consider by the Commission for the determination of the future regulatory framework.

III. PARAMETERS TO BE TAKEN INTO CONSIDERATION AND TRACKS TO BE EXPLORED

Even if the factual evaluation of regulation 1475/95 is not yet finished as I have said, I would like to stress that certain parameters appear to have to be taken more seriously into consideration for a future regulatory framework, whatever it will be.

Interest of the consumer and better achievement of the Internal market for the motor vehicle

It should be verified that the new regulatory framework can better take into account the consumers' interest, in order to assure, in a more concrete way, that they can benefit from the possibilities offered by the single Market to buy a car wherever is cheaper without this affecting the level of guarantee and maintenance. It is also a legitimate objective of the consumers in the Member States where prices are high, to see prices fall to be aligned with lower prices practiced in other Member States.

Since 1993, the Commission has every six months published a

report on car prices within the EU. Prices for about 75 most frequently sold car models are submitted by manufacturers expressed in euro and in national currencies, excluding and including taxes. These prices are analysed as regards the development of pre-tax price differentials within the European Union. The result of this analysis is published in press releases which accompany the publication of the report. These reports, of which currently more than 4000 copies are sent out, attract a large degree of interest from consumers and their associations.

The publication of this report has created greater price transparency and induced consumers to acquire cars in another Member State where pre-tax prices are lower. Such parallel trade, if substantial enough, should be an important market-related factor for reducing price differentials.

It is essential to attain this objective of the Single Market for the consumers. One of the competition policy first aims is to ensure that consumers obtain a fair share of the benefit, and this also constitutes one of the advantages sought by the introduction of the Single Market.

Quite a long way still remains when looking at the small percentage of parallel imports taking place at present, in spite of the important price differentials between certain Community Member States, in particular between the United Kingdom and the mainland countries. But also in Germany, which is the country with the higher prices in the « eurozone ».

A figure proving this is the percentage of parallel imports taking place at the United Kingdom: less than 1% of the cars registered in the United Kingdom in 1998 (and less than 2% of the cars registered by private individuals)⁴, while important price differentials exist⁵, reaching in certain cases up to +/-35%, which should create in all logic a strong parallel import trend.

⁴ « the U.K. Competition » Commission Report, p21.

⁵ Press release of the Commission of 7 February 2000 published on the occasion of the last report on the motor vehicle price.

The UK Commission Competition, in its report published on 10 April 2000, attributes this “de facto” situation to the current selective and exclusive distribution system, which would create a barrier to trade between the various Member States while making it possible for the manufacturers to continue to determine their commercial policy on a purely national basis and by giving them the instruments to limit or restrict parallel imports. It would also allow maintaining high prices in the United Kingdom.

The Volkswagen decision adopted in 1998, by which the Commission sanctioned by a record fine of Euro 102 million the restrictive practices of this manufacturer aiming to prevent parallel imports between Italy and Germany or Austria, constitutes another clear indication that a problem exists in this respect within the regulatory framework. Other possible cases of similar infringements made by other manufacturers, which are still being examined, reveal that, as soon as parallel imports reach a figure of about 3% of sales in a Member State, a percentage which represents all in all a low figure, restrictive measures aiming to block them are taken. In one of these cases, the restrictions observed concern the parallel trade between Spain and Portugal. The prices were higher in Portugal than in Spain for certain models of that manufacturer and parallel trade was taking place. The car manufacturer apparently decided then to reduce the vehicle allocation in respect of those Spanish dealers who had been selling cars to Portugal and cars awaiting distribution to dealers were not delivered. Other measures to halt exports of cars to Portugal were also taken. The result was a steep decline of sales to Portugal compared with the previous years.

This all indicates that the current regulation seems to have not been applied properly by the car industry even if this current regime is very generous towards them.

In these circumstances, it can be understood that parallel imports have not had for effect, to date, to achieve a decrease of the price differentials (as it is assumed by regulation 1475/95). This is an

important element, more than the volume of parallel imports itself.

Parallel to an active policy of pursuing of such possible infringements, which was already announced by Commissioner Monti at the time of the publication of the last Car price report in February 2000, it will be appropriate to examine which are the current elements of the system which can create obstacles to the development of such exports, or act in a way that dealers cannot due to a car shortage or have no economic interest in selling cars to consumers from other Member States. The future framework will have to offer more possibilities for consumers' arbitration to better materialise. The role and the effects of the sales targets and the current system of rebates and bonuses appear to have to be analysed in this context.

Measures aiming at introducing more competition both at the sales and after-sales levels, (possible reinforcement of the role of intermediaries or of the independent retailers are to be examined) will probably have to be imagined. The new vertical regulation allows in particular active sales by dealers outside their territory while this is not permitted within the current regulatory framework.

One thing is clear: any new regulatory framework will have to rise, and under no circumstances will be able to lower, the ceiling of satisfaction of the consumers' benefits. For example, the British consumers' right to buy a right-hand-drive car on the continent (the famous availability clause of regulation 1475/95; Articles 5 (2) d) and 6 (1) 7) will have to be preserved and probably strengthened. The same applies for the right of consumers to buy a left-hand-drive car in another Member State. Some wonder, for example, whether it would not be necessary to guarantee such a consumer's right by, for instance, giving a right of supply to the dealer from the manufacturer for the selling of such a car.

Competition to maintain and increase on the after-sales market

Manufacturers, as already explained above, show an increasing interest in this market.

Regulation 1475/95 lays down certain principles (contained for the most part in the black clauses prohibited by Article 6 of the Regulation), aiming to ensure effective competition on this market. They aim at facilitating the access of spare parts' manufacturers (equipment suppliers) and independent distributors to the various markets and in particular to the outlets of the car manufacturers' official networks. Such principles give clear advantage to the consumer by offering a possibility of choices, which creates competitive pressure on the invoiced prices for maintenance and repair of a car.

Two new elements have to be stressed in this respect:

- First, the current consolidation in the motor industry and the emergence of increasingly powerful manufacturers, endowed with financial resources and with an ever increasing negotiating power;
- Secondly, the increasing inclusion of high technology parts in cars and the performance of diagnosis for maintenance or repair, with a risk of exclusion from the market and therefore less choice for the consumer if access to technical information is not guaranteed to third parties like the independent repairers.

It seems necessary to reaffirm such principles and even strengthen them if we want to guarantee competitive after-sales market and the free choice of the consumer regarding the source of the repairs and of the repair parts.

The dealer's economic independence from the manufacturer

Despite the amendments brought in 1995, which aimed precisely

at allowing greater economic independence, the current regulatory framework appears rather to have failed on this point.

It could be assumed that, in an ideal system that really takes the dealers' economic independence into account, the dealer should be able to sell the largest possible number of cars and that it should also be the manufacturer's interest to sell the largest number of cars. The dealer should also be able, if he so wishes, to devote its activities to sales or to the after-sales only on the basis of his economic interest.

The UK Commission Competition makes the same assessment with regard to the situation of dealers in its above-mentioned report of 10 April.

Multi-dealerships

A vast majority of dealers have remained with just one dealership. The amendment to regulation 1475/95 aiming at making it possible for a dealer to distribute competing marks and therefore increasing its economic independence has remained a dead letter. Indeed, the terms imposed by the regulation, such as the need to have a separate entity and buildings in order to exercise the multi-dealerships, have made it unattractive from an economic point of view, due to the fact that it does not enable the dealer to carry out economies of scale.

Development of new information technology and of electronic commerce on the Internet

In 1995, at the time of the renewal of regulation 1475/95, the Internet and its consequences were not taken into consideration. This was due to the fact that, at that time, the Internet was still only babbling as regards its possible commercial applications.

The situation has changed radically since then. The world of the .com or of the e-commerce has invaded our daily. Numerous products are already sold successfully in this way: disks, books, computers, financial services, and the list is only lengthening. We should also wonder about the car, which seems at first sight a suitable object for e-commerce at least for certain consumers.

In any case, the Internet offers an alternative for car distribution. The question is not how but rather up to what point the development of the Internet will influence the traditional car distribution system existing in Europe.

The current regulatory framework is not adapted to this possible new sales or marketing method.

It appears even that some of its provisions could be used by certain manufacturers to try to block the development of the Internet operators apart from networks that want to give new services for cars.

At present, such operators generally act like dealers' agents or more often like consumers' intermediaries. They have the advantage of making it possible for the consumers to better compare the prices in the European Union and to profit from the existing price differentials. Consequently, they play a useful role for the completion of the internal market by facilitating parallel imports and by exerting a downward pressure on the existing price differentials between the Member States.

It will also be advisable to think about the idea that a reseller using the Internet network could have the right to be considered as a pan-European dealer if necessary.

Dealers should, it seems, also to have their right recognised to be free to use such agents' services for car selling without the manufacturer interfering in their choice.

For the above mentioned reasons, there exists already to date, a clear will to allow the development of Internet operators, in

particular acting as intermediaries for the consumer in accordance with regulation 1475/95.

The future regulatory framework will therefore have to incorporate the Internet and to encourage its expansion. It is an objective in the straight line policy clearly stated at Community level and reaffirmed at the Council which took place recently in Lisbon, to encourage the development of the information society and therefore of the Internet.

It is appropriate to stress that the use of the Internet removes essentially national geographical barriers and appears not to adjust to the territorial exclusivity concept such as we know it today.

CONCLUSION

It seems that the final solution will have to be a more satisfactory solution for the consumers, taking their interests better into account.

Currently, it seems that the main driver of the distribution process is still the manufacturer and that dealers do not have much freedom. Moreover, Regulation 1475/95 has not contributed to integrate the national markets and has not been properly implemented by many manufacturers as the various procedures against them for infringement of the Regulation show.

It seems that the future framework also should have as a principle that all the operators involved in motor vehicle distribution (dealers, intermediaries, independent repairers, etc.) can act on the market more freely and in the most effective way.

The future will tell.