

## The new competition framework for vertical agreements in the motor vehicle sector

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On 31 May 2010, the Commission adopted a new legal framework for vertical agreements in the motor vehicle sector. This new structure, comprising Regulation 461/2010 <sup>(2)</sup> and its accompanying sector-specific Guidelines, replaces block exemption Regulation 1400/2002 <sup>(3)</sup> and has been designed to reflect the differing intensities of competition on the markets for the distribution of motor vehicles, for spare parts, and for the provision of repair and maintenance services. The sector-specific Regulation and Guidelines, which will be valid for 13 years until May 2023, supplement Regulation 330/2010 <sup>(4)</sup> and the Guidelines on Vertical Restraints <sup>(5)</sup>.

In 2002, when the Commission last reviewed the rules applicable to the sector <sup>(6)</sup>, one option would have been to apply the general rules, in the form of Regulation 2790/1999 <sup>(7)</sup>. At that time, it decided not to take this course, in particular because the car sales markets were seen as problematic following a series of prohibition decisions. The Commission instead opted for a regulation that was based on Regulation 2790, but had both higher thresholds for exemption of certain types of distribution <sup>(8)</sup> and a longer and stricter set of hardcore clauses and conditions.

### Application of the general rules to the market for distribution of new motor vehicles

The Commission's latest review of the rules applicable to the sector began in earnest in 2008, with the publication of an Evaluation Report <sup>(9)</sup>, which showed that competition on the vehicle sales markets was strong. Prices in real terms had been steadily falling, and product range expansion meant that there were increasing numbers of vehicles in each market segment. The strict 2002 regime for those markets therefore no longer appeared to fit the economic context, and the rules imposed an unnecessary strait-jacket that injected extra costs into the distribution chain and inhibited contractual and commercial freedom. Meanwhile, the general rules set out in Regulation 2790/1999 had been applied successfully to vertical agreements in other sectors for a decade.

In the light of the Commission Communication of summer 2009 <sup>(10)</sup>, it came as no surprise that the Commission decided that the general rules could be successfully applied to agreements for motor vehicle distribution. Article 2 of Regulation 461/2010 duly provides that Regulation 330/2010 is to apply to the primary market, but with a three-year transition period to allow parties to adapt. Detailed clarification has also been given in the form of Commission Guidelines which will allow the parties to dealer agreements to assess their compatibility with Regulation 330/2010 and with Article 101 of the Treaty on the Functioning of the European Union (TFEU).

The move to the general rules has several consequences for firms entering into vehicle distribution agreements.

Although the general regime will not mean that firms have to change the distribution model commonly used in the sector since, like Regulation 1400/2002, Regulation 330/2010 exempts quantitative selective distribution, it will, however, entail a lowering of the exemption threshold for such agreements from 40% to 30%, meaning that more manufacturers in more

<sup>(1)</sup> The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

<sup>(2)</sup> Commission Regulation (EU) No 461/2010 of 27 May 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices in the motor vehicle sector.

<sup>(3)</sup> Commission Regulation (EC) No 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector.

<sup>(4)</sup> Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.

<sup>(5)</sup> Guidelines on Vertical Restraints (2010/C 130/01).

<sup>(6)</sup> The block exemption at the time was set out in Commission Regulation (EC) No 1475/95 of 28 June 1995 on the application of Article 85(3) of the Treaty to certain categories of motor vehicle distribution and servicing agreements, OJ L 145, 29.6.1995, p. 25–34.

<sup>(7)</sup> Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, OJ L 336/21, 29. 12. 1999.

<sup>(8)</sup> 100% for qualitative selective distribution, and 40% for quantitative selective distribution agreements for the sale of new vehicles.

<sup>(9)</sup> Commission Evaluation Report on the Operation of Regulation (EC) No 1400/2002 Concerning Motor Vehicle Distribution and Servicing — [http://ec.europa.eu/competition/sectors/motor\\_vehicles/documents/evaluation\\_report\\_en.pdf](http://ec.europa.eu/competition/sectors/motor_vehicles/documents/evaluation_report_en.pdf).

<sup>(10)</sup> Communication from the Commission — The Future Competition Law Framework applicable to the motor vehicle sector — COM(2009) 388 final.

Member States will have to individually assess their dealer contracts. In a few more cases, they may well come to the conclusion that quantitative selection may not benefit from Article 101(3) TFEU and that they will have to open their distribution networks to all prospective dealers that meet quality criteria. However, this should be balanced against the fact that market shares tend to have evened out across car manufacturing countries in recent years, with carmakers losing market share on their home markets, and gaining it in other Member States, thereby gradually reducing the number of instances where a given manufacturer may face antitrust scrutiny.

Another change is that the new rules will not contain any requirements as regards contractual protection of dealers. As a condition for exemption, the previous block exemption required contracts to contain certain clauses relating to the transfer of dealerships between distributors of the same network, notice periods for contract termination, contract duration and arbitration<sup>(11)</sup>. Evaluation showed that these provisions had not achieved their aim of making markets work better and may even have made access to distribution networks more difficult for newcomers. Moreover, they encroached on areas that normally fall within the ambit of national contract laws, and led to confusion and wasted enforcement resources. In view of the ineffectiveness of these contractual clauses, their abolition is unlikely to lead to any change in the relationship of dependence between dealers and their suppliers, which is in any event due to the widespread use of quantitative selective distribution systems rather than to the effect of block exemption provisions.

This is not to say that the Commission is entirely neutral as regards the contractual framework between dealers and suppliers; clearly, if contract terms are applied in a less-than-transparent manner, there is more room for unwritten forms of pressure to be put on dealers to refrain from pro-competitive activity, such as granting discounts, or selling to foreign consumers. The Guidelines therefore explain that when a competition authority assesses an individual case, it will be easier for a car manufacturer to prove that it has not placed undue pressure on dealers if its contractual relations with them have been transparent. One means of achieving this is by applying a Code of Good Practice such as that put forward by the European and Japanese car manufacturers' associations ACEA and JAMA<sup>(12)</sup>.

A further consequence affects dealers who sell the brands of more than one manufacturer. It should firstly be borne in mind that by setting a low thresh-

old of 30%<sup>(13)</sup> for the definition of single-branding obligations, compared to 80% under the general regime, Regulation 1400/2002 made it possible for dealers with contracts conforming to the block exemption to sell two additional brands. Secondly, the Regulation contained detailed rules aimed at favouring a particular form of multi-branding which at the time seemed promising – the sale of different brands within the same showroom. In the event, however, the rules proved unnecessary, as inter-brand competition remained strong. They were also ineffective, as there was little growth in the kind of in-store multi-branding that they were intended to promote. Worse, the specific rules were counter-productive, in that carmakers reacted to the threat that generalised multi-branding might pose for brand identity and corporate image by increasing the level of investment required from their dealers, while at the same time reducing their own contribution to investment in distribution. The result was an overall increase in distribution costs, estimated at up to 20%.

Overall, and in retrospect, the old rules placed emphasis on the benefits of multi-branding, but without giving due credit to the advantages that single-branding may bring in the form of loyalty and an alignment of the investment incentives for dealers and manufacturers. The general rules, on the other hand, represent a more balanced approach, which will allow manufacturers greater freedom to organise their networks as they see fit and, in particular, to strike the right balance between single- and multi-brand dealerships.

Under the new regime, single branding<sup>(14)</sup> may be used, subject to three main limits. Firstly, aligning the legal framework with that applicable to other sectors will allow only manufacturers with a market share of less than 30% to impose single-branding obligations within the scope of the block exemption. Above this threshold, they must have regard to detailed considerations set out in the Guidelines, including the percentage of dealers on the market in question that are subject to non-compete obligations. Secondly, under the general rules set out in Regulation 330/2010, suppliers with a market share of below 30% may impose single-branding obligations for a maximum of five years, following which dealers must be free to terminate the tie. Thirdly, single-branding obligations specifically designed to exclude newcomers

<sup>(13)</sup> See Article 1(1)(b) of the Regulation.

<sup>(14)</sup> Single-branding obligations are defined in Article 1(1)(d) of Regulation 330/2010 as 'any direct or indirect obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or any direct or indirect obligation on the buyer to purchase from the supplier or from another undertaking designated by the supplier more than 80% of the buyer's total purchases of the contract goods or services and their substitutes on the relevant market'.

<sup>(11)</sup> See Article 3 of Regulation 1400/2002.

<sup>(12)</sup> [http://www.acea.be/images/uploads/files/20100906\\_BER\\_code\\_of\\_conduct.pdf](http://www.acea.be/images/uploads/files/20100906_BER_code_of_conduct.pdf).

or smaller brands that are currently sold in existing multi-brand outlets will not be exempted.

The Guidelines also explain two safety valves in the general regime that can be used to act against single-branding obligations that have a negative impact on competition. On the one hand, if the widespread use of single-branding obligations leads to competing brands being shut out from the market, competition authorities may withdraw the benefit of the block exemption for individual car manufacturers. On the other hand, if single-branding obligations cover more than 50% of a given market, the Commission may adopt a regulation declaring the block exemption inapplicable to agreements containing such obligations.

The practical impact of the new rules on multi-branding is likely to be limited, given in particular the low take-up of the same-showroom model that Regulation 1400/2002 sought to promote. On the one hand, dealers and manufacturers will continue to agree on multi-branding where it makes economic sense – at remote locations, or in areas with low population density. On the other hand, multi-brand groups will also continue to operate because they enjoy significant bargaining power in their relations with vehicle manufacturers. This is obvious if one considers that many of them sell several manufacturers' brands, and that in theory Regulation 1400/2002 would have allowed manufacturers whose brands made up less than 30% of such a dealer's total purchases to obstruct further multi-branding. In reality, however, there are few instances where manufacturers have sought to block such expansion, partly because multi-brand groups protect brand identity, and also because they are often obligatory contractual partners. The only real effect of the change is likely to be to reduce upward pressure on dealership standards, as manufacturers feel less threatened by the potential for dealers to display vehicles of their brands in a higgledy-piggledy manner.

The motor vehicle sector has left an indelible print on one area of competition law in particular – the issue of parallel trade and territorial protection. In the 1990s, several vehicle manufacturers saw market partitioning as a logical way to attempt to gain market share on other manufacturers' turf, while protecting their home market, leading the Commission to intervene in three major cases<sup>(15)</sup>. One problem

is that vehicles of different specification are often supplied in various Member States, and the resale value of a 'foreign-spec' car may be lower, deterring consumers from buying abroad – the availability of right-hand-drive vehicles on the Continent is a case in point. Previous block exemptions contained a specific measure known as the 'availability clause' to ensure that dealers could obtain foreign-spec vehicles for sale to consumers from other Member States. The new legal framework does not contain a specific reference to such a clause, but the Guidelines explain that, in line with the case law of the European Courts<sup>(16)</sup>, failure to make such vehicles available will be seen as a limit on sales, and a hard-core restriction under Article 4(1)(b) of Regulation 330/2010.

A final issue concerns the exemption of location clauses in selective distribution systems, the end of which had provoked so much polemic when Regulation 1400/2002 was adopted. By aligning the rules with the general regime, location clauses will be exempted if a supplier has a market share below 30%. However, the Guidelines explain that above this level, it is possible that location clauses will not be able to benefit from an exception under Article 101(3) TFEU.

### The aftermarkets – completing the reform of 2002

Competition in the maintenance and repair markets occurs between authorised repairers that belong to the manufacturers' official networks and between them and independent workshops. For several reasons, competition on these markets is not particularly strong. For one thing, the carmakers' authorised networks have high market shares – often in excess of 50%. For another, carmakers have a stranglehold over two of the inputs necessary to compete effectively – technical repair information and certain spare parts, known as captive parts, which can only be obtained from the vehicle manufacturers. This is an important market for consumers, since car ownership is a major part of overall expenditure, and repair and maintenance costs currently account for around 40% of the total cost of owning a car.

It might therefore seem odd that in 2002, the Commission plumped for a regime that exempted the qualitative selective agreements commonly used on those markets up to a market share of 100%. However, it has to be borne in mind that the prior block exemption, Regulation 1475/95, went so far as to exempt *quantitative* selection of authorised repairers

<sup>(15)</sup> Commission Decision of 28 January 1998 relating to a proceeding under Article 85 of the EC Treaty (Case IV/35.733—VW) (1) Official Journal L 124, 25.04.1998, pp. 60–108; Commission Decision of 20 September 2000 relating to a proceeding under Article 81 of the EC Treaty (Case COMP/36.653—Opel) (notified under document number C(2000)2707) Official Journal L 59, 28.02.2001, pp. 1–42; Commission decision of 10 October 2001 relating to a proceeding under Article 81 of the EC Treaty and Case COMP/36.264—Mercedes-Benz) SEP et autres / Automobiles Peugeot SA (case COMP/36623) Summary version of the decision in all languages. Official Journal L173, 27.06.2006, p. 20.

<sup>(16)</sup> Judgment of 28 February 1984, joined cases 228 and 229/82 Ford of Europe Inc. and Ford-Werke Aktiengesellschaft v Commission ECR (1984) Q2 1129.



without market share limit, and even excluded agreements with stand-alone repairers<sup>(17)</sup> from the block exemption. It is therefore clear that although the reform was not total, the 2002 regulation went a long way towards ‘normalising’ the Commission’s approach to the automotive aftermarkets, by aligning the market share threshold for the exemption of quantitative selection with that in Regulation 2790/1999 – 30% – and by making it plain that at higher market share levels, vehicle manufacturers should bring robust evidence of real efficiencies if they wished their service and spare parts distribution agreements to benefit on an individual basis from Article 81(3), as it then was. The number of authorised repairers increased greatly, with resulting benefits for the owners of younger cars, who tend to use authorised garages in order to maintain a ‘full dealer service record’ and thereby maintain the residual value of their vehicles.

In order to counterbalance the 100% exemption of authorised repair agreements, the Commission included a series of hardcore clauses in Article 4 of Regulation 1400/2002 relating to the distribution of spare parts and to the dissemination of technical repair information to independent operators. The latter<sup>(18)</sup> proved problematic – the notion of technical information was set in stone instead of following technological progress, and there was an exception allowing suppliers to withhold information relating to safety and security (Recital 26). In practice, the presence of a hardcore provision had little deterrent effect and the Commission was compelled to bring cases against four car manufacturers that withheld technical information<sup>(19)</sup>. In the meantime, regulatory provisions were being put in place to oblige manufacturers to release technical information on new models; EURO 5/6 Regulation 715/2007 obliges manufacturers to provide such information on cars launched after September 2009 and Regulation 595/2009 will do the same as regards heavy vehicles from 2013. The approach of coupling a broad exemption with a hardcore list had other disadvantages, in that it made it more difficult for the Commission to act in respect of novel forms of restriction. One such problem, which has become more prevalent since 2002, involves the misuse of warranty terms to exclude independent repairers from doing any work on vehicles during the warranty period and to mandate the exclusive use of carmaker-branded ‘original’ spare parts.

<sup>(17)</sup> In other words, within the framework of the block exemption, only car dealers could operate authorised repair workshops — in the language of the time, there was a forced sales-service link. See Recital 4 of Regulation 1475/95.

<sup>(18)</sup> Article 4(2) of Regulation 1400/2002.

<sup>(19)</sup> Daimler/Chrysler, Fiat, Toyota and General Motors (see IP/07/1332).

When deciding on a replacement regime for Regulation 1400/2002, the Commission also had regard to how competition on the markets had developed, and to the current economic background. Unlike car prices, the cost of the average repair job has actually risen over the past few years. Consumers particularly feel the effect of rising repair costs during the present crisis, as they are more price-sensitive and also drive older vehicles that require more frequent maintenance. If anti-competitive practices bring about price rises, this is likely to lead to cars being driven in an unsafe and unreliable condition. It is therefore particularly important to ensure that independent repairers are not excluded from the market – these operators increase choice for consumers, particularly the owners of older cars, and keep the price of repairs competitive by putting pressure on car manufacturers’ authorised repair networks.

There were therefore many reasons for the Commission to move away from its previous approach, while at the same time keeping the beneficial elements of the 2002 reform. The main plank of the reform is the alignment of the thresholds for exemption with the single 30% threshold of the general regime. At a stroke, therefore, the Commission has effectively removed the exemption from the vast majority of authorised repair agreements, implying that these will have to be self-assessed. Lowering the market share threshold will make it easier for the Commission and National Competition Authorities to deal directly with issues such as refusal to release technical information, which have threatened to exclude independent repairers from the markets. By making a clear link in the Guidelines with the EURO 5/6 Regulations, the new framework ensures consistency and allows the notion of technical information to evolve in line with technical progress. Additional guidance is given on issues such as misuse of warranties. In contrast to the approach under Regulation 1400/2002, which relied on a limited list of defined hardcore restrictions, the new regime will also make it easier to deal with new types of restrictions as and when they arise.

The motor vehicle spare parts markets are notoriously difficult to define, and are also very important from the consumer’s point of view, for reasons of both safety and cost. There is also a lack of transparency as to the origin of parts and their quality. Many consumers, for instance, believe that a part marked with a carmaker’s logo will have been made by that firm, whereas in reality, the majority of such parts are manufactured by third-party producers that also supply the aftermarket under their own brands. There are also numerous examples<sup>(20)</sup>, some apocryphal,

<sup>(20)</sup> See, for instance, [http://www.motor.com/MAGAZINE/Articles/012004\\_04.html](http://www.motor.com/MAGAZINE/Articles/012004_04.html).

of parts manufactured in developing countries that are unsafe for use. Because of the difficulty of defining relevant markets and the consequent uncertainty as regards market shares, the Commission decided to retain three of Regulation 1400's sector-specific hardcore clauses. These concern restrictions placed by car manufacturers on a) the sale of original spare parts by authorised repairers to independent garages, b) the ability of independent manufacturers of spare parts to supply to authorised or independent repairers, and c) spare parts' manufacturers' ability to put their trade mark or logo on their products.

The new Guidelines also make reference to a point which is particularly thorny from the point of view of parts producers – the use of 'tooling arrangements' to prevent a producer from selling directly to the aftermarket. In such a system, the vehicle manufacturer contributes or invests in a tool or part of a tool, and then forbids the parts producer from using it to produce parts for aftermarket supply. The Guidelines clarify the extent to which a car-maker can rely upon the 1978 subcontracting notice to argue that tooling arrangements fall outside Article 101(1) TFEU.

Because of the obvious consumer benefits of the reform and the minimal risk that the change in the rules could entail disruption for stakeholders, the new legal framework will apply to the aftermarkets as from 1 June 2010 – i.e. three years before it applies to vehicle distribution agreements.

## Conclusion

The new framework represents a more proportionate approach to the competition problems that may arise on the different markets in the motor vehicle sector. While on the primary market it gives car manufacturers greater freedom to organise their networks and to determine the conditions for selling their products, it also makes it easier for competition authorities to deal with problems on the less competitive aftermarkets. Moreover, the new rules should result in less waste of resources, allowing enforcers to better channel their efforts towards practices that result in real consumer harm. Market players therefore need to be on their guard to ensure that their agreements are in line with this new structure, and the extensive clarifications given in the Guidelines should help in this respect.