DISTRIBUTION (MOTOR VEHICLES): COMMISSION REGULATION

Subject: Distribution
Block exemption

Industry: Motor vehicles

Source: Commission Statements IP/02/1073 and MEMO/02/174, both dated 17 July 2002

(Note. This new block exemption regulation replaces the existing regulation and is based on a greater degree of independence for motor vehicle distributors. While the Commission may be pinning too great hopes on the practical effects of the new regulation on, for example, pricing policy, there are reasonable grounds for expecting that the effects of the principal reforms, described in this report, will in general be salutary. For the text of the regulation, see the website referred to on the previous page of this issue. The second part of this report is based on a Commission Memorandum serving as a background paper to the main Statement.)

Part I Summary of the new Regulation

The Commission has adopted what it describes as "a bold but balanced reform of the competition rules for the motor vehicle sector". The new block exemption regulation aims to put right 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. At the same time, the quality of vehicle servicing and repairs will be fully maintained. The new regulation comes into force on 1 October 2002, with a one-year transition period allowing for the adaptation of existing contracts. A special, longer transition period until 30 September 2005 applies to the phasing-out of location clauses.

Emphasis on both sales and servicing

According to the Commission, the aim of the new regulation is to inject competition at all levels of car distribution and repair. The cost of repair and maintenance of a car is as high as the purchase price. It is therefore appropriate to provide equally effective measures for both sales and servicing. As from October 2002, dealers - directly or indirectly - will be able to reach consumers wherever they are in the EU without constraints; and consumers will benefit from greater diversity and choice. They will also benefit from improved after-sales servicing.

The Commission welcomed the importance of the input and opinions received during the public consultation on the new regulation, and especially of the views expressed by the European Parliament. In fact, the Commission accepted, either wholly or partly, 18 out of the Parliament's 29 requests for modifications. On an issue which commanded particular interest, the ban of the so-called location clause in contracts between car manufacturers and their dealers, a longer transition period than initially foreseen has now been granted. In addition, the Commission intends to meet the Parliament's wish to keep under review the developments in the market and undertakes to monitor the effects of the regulation on competition in retailing and after-sales servicing in the common market or relevant parts of it, including its effects on the structure and level of concentration.

The new regulation will replace the regime introduced in 1985 and slightly revised in 1995, which is due to expire on 30 September 2002 (current Regulation 1475/95). All Member States, the European Parliament and the Economic and Social Committee agreed on the urgent need for a substantial reform. 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.

Restrictive nature of motor vehicle distribution

The evaluation report confirmed the restrictive nature of the distribution methods established by the motor vehicle manufacturers: a restrictive nature widely spread across the whole motor vehicle sector, as all manufacturers implement similar distribution agreements. In particular, the evaluation report identified the combination of full control over dealer selection by the manufacturer with the allocation of exclusive sales territories to dealers as the main reason for substantial lack of intra-brand competition.

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 new sector-specific Regulation spells out the stricter exemption conditions that will apply for the distribution and after-sales agreements of new motor vehicles; and it will be applicable to the sale and after-sales services of all motor vehicles (passenger cars, light commercial vehicles, trucks and buses).

The new regulation 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 in Europe but rather leaves a wide number of choices open to carmakers, distributors and dealers. Car manufacturers may choose *exclusive distribution*, where each dealer approved by the manufacturer is allocated a sales territory but is free to sell to operators that are not members of the official network set up by the manufacturer. They may also choose *selective distribution*, where dealers are also selected according to a set of criteria but are not allocated a sales territory and are not allowed to sell to operators that are not members of the official network set up by the manufacturer. 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 in offering a broad range of possibilities.

Multi-brand dealerships

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 regulation therefore gives retailers a genuine choice as to whether they sell more than one brand. Carmaker may impose a requirement to display their cars only in brand-specific areas within the showroom. The current regime imposed conditions such as separate premises, separate legal entities and separate management: consequently multi-branding did not constitute an economically sustainable option for most dealers.

Making the Single Market a reality for the European consumer

The existing clause commonly referred to as the "availability clause", which allows dealers to supply cars to consumers from other Member States identical with those supplied to dealers in the consumer's home country, is retained in the new regulation. This allows consumers to make cross-border purchases, and has enabled, for example, 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 last year concluded that these differences could not totally be explained by differences in tax levels. The new regulation contains other measures making 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.

The new 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 in any sense for selling in this manner. Dealers in an *exclusive distribution* system may actively sell to independent resellers within their exclusive territory and may also, if approached, sell to final consumers or resellers based outside their territory. These active sales inside the territory, and unsolicited sales outside the territory, will create the conditions for better price competition across the EU than under the current regime where all active sales outside the territory, as well as sales to independent operators, were forbidden.

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. Manufacturers would therefore not be allowed to restrict the freedom of existing dealers to expand by developing secondary outlets (this is the so-called ban on location clauses). For example, a dealer in Spain who commonly sells many vehicles to French consumers may find that it makes business sense to open a sales outlet or a delivery point in Marseilles; the new regulation will make it possible for him to do so. The prohibition of such location clauses is indispensable as otherwise car manufacturers could continue to apply both selectivity and territorial protection, effectively carrying over the main features of the current regime, which has not delivered the expected benefits to the European consumer. The evaluation report identified this combination as the main obstacle to competition between dealers and to the proper functioning of the Single Market. Moreover, location clauses hinder the development of multi-brand dealerships. These measures should help to ensure that consumers are allowed to take advantage of the often high price differentials among the Member States of the European Union.

Promoting competition, quality and choice in the repair sector

Under the current regime, anyone who sells new cars is obliged to carry out repairs. Under the new regulation, dealers may choose whether they wish to carry out repairs themselves, or sub-contract them to another authorised member of the manufacturer's network, whether it is another "integrated dealer/repairer" or a repair-only outlet. The new regulation also provides that, if 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 limit the number of authorised repairers, and may not limit an authorised repairer's right to repair vehicles of other makes. Studies have shown that consumers prefer a dense network of repairers, and the changes should help to maintain network density while reinforcing the current level of technical expertise within the network.

The regulation also provides that carmakers must allow those repairers who choose to remain independent from specific brands to have access to all necessary technical information, tools, equipment, including diagnostic equipment, and training. Furthermore, the regulation 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 regulation also aims to give consumers a choice as to which spare parts are used to repair their vehicle; clauses under which a carmaker seeks to prevent repairers from obtaining spare parts from other sources or to restrict the right of authorised repairers to use spare parts matching the quality of original spare parts will not be allowed. These measures should lead to more spare parts being sold directly to repairers by the spare part producers, giving the consumer more choice and increasing competition for the supply of parts. 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.

Strengthening dealers' commercial independence

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 the desired effects. In the absence of more effective measures, there is the risk that certain carmakers may 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 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 regulation provides that any carmaker wishing to terminate a dealer agreement must give clear and objective written reasons for doing so. Moreover, the regulation sets a five year minimum term for fixed-term contracts to prevent carmakers from using short-term contracts to put pressure on dealers not to engage in pro-competitive behaviour; it also provides that distributors of a given brand should remain free to acquire and sell any other distributorship of this brand wherever in the EU. This provision will promote the creation of distributors with greater bargaining power vis-à-vis the car manufacturer, and will also favour the creation of cross-border dealerships.

Duration of Regulation

The new regulation is to come into force on 1 October 2002 and 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.

Part II Background information: questions and answers

Why not let the current 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 did 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.

The general competition rules for distribution agreements would also allow for a near-identical reproduction of the current system as far as sales of motor vehicles are concerned. For example, the block exemption regulation on vertical restraints actually allows the "location clauses", which are undesirable in the context of the motor vehicle sector. *[See the question on location clauses below.]* Moreover, the general competition rules for distribution agreements would not promote competition in the repair sector, in particular as regards the supply of parts and the conditions under which independent repairers can run their business.

What is the nature of the proposed regime?

While the new regulation is stricter than its predecessor, it is less prescriptive. Carmakers may choose between an exclusive distribution system, where dealers are allocated a given 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. In all selective systems, whether qualitative or quantitative, the manufacturer may require that sales are made only to final consumers and other members of the authorised 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. (In sparsely-populated areas such as Scandinavia the practice is common. It should also be noted that many dealers in Europe sell more than one brand from the same manufacturer.) At present, manufacturers may 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 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, as in motor-shows. Imposed brand-specific sales personnel would not be allowed as it could represent a substantial additional cost and therefore put a brake to multi-branding development, unless it were so decided by the dealer and the manufacturer paid all the additional costs. Finally, carmakers will be able to require a multi-brand dealer to source a minimum number of cars of their make, but this minimum may not exceed 30%.

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 a dealer's total sales volume. 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 as to whether the Commission ought somehow to compel 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. 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 undertaken by the Commission, no supermarket or association speaking on their behalf ever directly expressed a desire to sell cars on a regular basis; and consumers do not appear to be much attracted by the idea of buying a car from a supermarket, according to the Lademann study.

Supermarkets or other stores may always act as intermediaries for consumers, since the rules on intermediaries have been relaxed, 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 not require 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. *[Editorial Note. This is a spurious argument. The essence of "shopping around" is to go to a variety of retailers, some well equipped, some scarcely equipped at all. This is not free riding: it is a matter of choice by the retailer and choice by the consumer.]* 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 the Lademann study carried out for DG Competition shows that consumers are not yet much attracted by the idea of buying a car from a pure Internet distributor, it seems - for the time being - inappropriate to compel manufacturers to give them full and unconditional access to distribution networks.

It should be noted however that the new rules make it clear that 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. Internet operators, similarly to supermarkets, could also act as an intermediary for consumers and could establish privileged relationships with dealers all over the Common Market.

Will links between sales and after-sales servicing 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 the 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, and the distance between the sales outlet and the repair shop.

Furthermore, under the new regime, the necessary infrastructure consisting of official repairers, who meet the quality standards of a manufacturer needed for the honouring of warranties and the carrying out of recall operations and free servicing, will exist throughout Europe, just as it does today.

The difference between the new and existing regimes is that some official repairers would in future not sell new vehicles. Already, for example Audi, VW and Ford have a network of official repairers (such as 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 Commission's attention. Moreover, under the new regime, independent repairers may qualify to become 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 the risk of loss of technical expertise from the market and will help to maintain a dense coverage of service points.

What will be the impact of the new rules in the repair sector?

In addition to all advantages related to the reorganisation of the link between sales and after-sales activity, as explained above, the impact will be significant for independent repairers, and also regarding supply of original spare parts. First of all, every repairer satisfying the manufacturer's criteria may become an official repairer, thereby increasing the number of competing undertakings. Independent repairers, as under the current regime, will still have access to spare parts, but access to technical information, software and reprogramming, tools, diagnostic equipment, garage equipment and training is further broadened. Access to technical information is made more convenient for a specific need, such as the assistance offered by motor clubs and other roadside breakdown services. The principle is that such access must be given on non-discriminatory terms to both the authorised and all other repairers.

Independent repairers, even those qualified that wish not to become authorised repairers, will thus be able to compete on the same level with authorised repairers, thereby allowing them to keep pace with technological evolution. There are currently more than 100,000 independent repairers in the EU: they constitute a considerable competitive pressure towards authorised networks holding 50% market share of all repairs (and even 80% for cars under 4 years). These are impressive market shares justifying stricter conditions on the repair market. Similarly, parts producers will have better access both to the authorised and independent repairer. These producers manufacture 80% of all components and parts of a new car, while the car manufacturer produces only 20%.

Under the new regulation, parts producers will be allowed to place their logo, along with the car manufacturer's logo, on the original spare part sold to the vehicle manufacturer. The part producer could also sell the same part with his own logo without losing the description of "original spare part", either to the authorised repairers or to the independent repairers. Usually those parts are cheaper than the same parts supplied by the vehicle manufacturer. To conclude, the new regulation injects more competition between authorised repairers, between authorised and independent repairers, and between the vehicle manufacturer and the part manufacturer for the supply of original spare parts.

What will be the impact of the new rules on employment?

The 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 regulation offers former dealers the opportunity to become official repairers within the manufacturers' network.

What is the location clause and how does it function?

The location clause is a provision whereby car manufacturers may control where distributors will establish their sales or delivery outlet(s). Subject to the manufacturer's policy regarding territorial coverage, it also guarantees existing distributors that no other competing distributor will establish close to his own premises any competing sales or delivery outlet. Location clauses restrict competition between dealers of the same brand. They allow for a near-identical reproduction of the current distribution system of motor vehicles under which territorial protection and selectivity are combined. The Commission's evaluation report on the current regime applicable to motor vehicle distribution identified this combination as the main negative restriction hindering substantially competition between dealers. Therefore the new regulation prohibits the use of such location clauses by the manufacturers whenever selective distribution is implemented (where sales are permitted only to final consumers and other authorised members of the network set up by the manufacturer, and therefore prohibited to independent operators).

This applies to both passenger cars and light commercial vehicles. The new regulation provides therefore that existing distributors in a selective system may not be prohibited from opening secondary sales or delivery outlets anywhere in the EU. Such additional premises will, however, have to comply with the manufacturer's criteria for the area concerned so that there is competition on a level playing field between established dealers and potential newcomers.

Under exclusive distribution, the manufacturer keeps de facto a control on the place of establishment of his distributors, as he allocates exclusive sales territories. But under this type of distribution, the authorised distributors are free to sell to independent car resellers (including supermarkets and internet operators) and these independent operators are able to trigger arbitrage between the exclusively allocated territories and across the EU.

Do the new rules apply equally to all motor vehicles?

Although the new rules apply equally for all motor vehicles both for sales and after-sales provisions, manufacturers will be allowed to implement location clauses for trucks, buses and coaches. ■