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The Commission's draft for a new motor vehicle Block Exemption Regulation - 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[1] 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.

[1] A recent series of decisions imposing fines on Volkswagen, Opel and DaimlerChrysler underlines that the car manufacturers have not always respected the current regulation, and have tried to prevent consumers from benefiting from the Single Market. These decisions are all available on the Commission's Internet site (see next page).

- A series of studies[2] 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.
- You may find all relevant material concerning the review on the Commission's Internet site at http://europa.eu.int/comm/competition/car_sector/distribution/

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.

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[2] The Sales-Service link, by Autopolis, Price Differentials in the EU: an Economic Analysis by Prof. Verboven and Degryse, Study of the impact of legislative scenarios about motor vehicle distribution, Andersen, and Customer Preferences for existing and potential Sales and Servicing Alternatives in Automobile Distribution, Dr Lademann. These studies are available at DG Competition Internet site (see next page).

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[3]. 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 that 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 as to whether the Commission ought to somehow 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 that allow manufacturers to choose whether they sell cars also to supermarkets[4].

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[3] Although 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 <u>same</u> manufacturer.

[4] The Commission also took into account the findings of the Andersen and Lademann studies, according to which there was not currently much consumer demand for supermarket of Internet sales.

During the lengthy and in-depth 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 BER gives no business opportunities to supermarkets. A supermarket could become a dealer (mono or multi-brand) if it satisfies the same criteria laid down by the manufacturer as any other potential dealer and if the car manufacturer accepts it as such. Similarly, it may act as an intermediary for consumers, since we have relaxed 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 also 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 carried out for DG Competition (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.

It should be noted however that the new draft rules clarify 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.

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 (e.g. 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 European Commission is not a price-fixing authority. 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.

Moreover, it is important to remember that competition takes place on other grounds as well. For instance, product quality and diversity are major elements of competition in the car industry today. Last but not least, such elements also have a high priority for consumers.