

The European Commission's evaluation report on the operation of Regulation No. 1400/2002

Observations of Van Bael & Bellis

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Table of Contents

1.	INTRODUCTION.....	3
2.	THE EVALUATION REPORT	3
3.	THE MVBER HAS CONTRIBUTED TO A MISALLOCATION OF RESOURCES.....	4
4.	THE MVBER HAS BROUGHT ABOUT DIVERGENCE	7
5.	CONCLUSION	9

1. INTRODUCTION

1. Van Bael & Bellis welcomes the opportunity to submit its observations on the European Commission's Evaluation Report on the operation of Regulation (EC) No 1400/2002 concerning motor vehicle distribution and servicing (the "Evaluation Report").

2. As a law firm with considerable experience in applying the competition rules generally and the Motor Vehicle Block Exemption Regulation (EC) No 1400/2002 (the "MVBBER") specifically, Van Bael & Bellis believes it is better suited to addressing the findings in the Evaluation Report from a legal perspective than from a commercial perspective. Nevertheless, Van Bael & Bellis would note that the Commission's findings relating to the existence of strong competition in the relevant markets concerned appear to be well-reasoned.

3. As explained in greater detail below, Van Bael & Bellis believes that the application of sector-specific rules for the motor vehicle industry has created two somewhat overlapping concerns from a legal perspective:

- *First*, many of the sector-specific rules have given rise to issues over which there is significant legal uncertainty, requiring companies to expend considerable resources. Since many of these issues are unrelated to concerns normally associated with competition law, these costs seem largely disproportionate.
- *Second*, the use of sector-specific rules has also introduced legal uncertainty insofar as such rules have suggested a possible divergence of approach in areas where it appears the Commission did not intend to treat the motor vehicle industry separately. Moreover, the uncertainty generated by the sector-specific rules may risk spilling over into other industries subject to the general rules on vertical agreements, which rules have thus far operated without significant legal concerns.

4. In light of the Commission's findings that the market is characterised by strong competition, it is the view of Van Bael & Bellis that any benefits that might have once existed for the adoption of sector-specific rules for the motor vehicle industry are now outweighed by the disadvantages. In our view, exceptions (if any) to the generally applicable rules should be limited to provisions in respect of which, applying a conventional competition analysis grounded in economics, compelling reasons are found to exist to adopt a stricter approach.

2. THE EVALUATION REPORT

5. On 28 May 2008, the Commission issued its Evaluation Report on the operation of Regulation 1400/2002 concerning motor vehicle distribution and servicing. Given that the MVBBER is set to expire in May 2010, the Evaluation Report analyses the effectiveness of the MVBBER as a first step towards identifying an appropriate solution for a future regime.

6. Viewed in the current competitive environment, which the Commission considers to be much improved from the environment existing at the time of the adoption of the MVBBER, the Commission considers that the sector-specific provisions of the MVBBER are "overly strict, too complex and/or redundant".¹ Some provisions are seen as potentially running counter to the Commission's original competition policy objectives (by, for example, encouraging the use of quantitative selective distribution by virtually all vehicle manufacturers and exempting long term contracts). Others are seen as potentially constraining the conduct of parties to a greater extent than is necessary to protect effective competition (for example, the restrictions on single branding and the use of location clauses). Several specific provisions are also viewed as potentially unnecessary since the same

¹ Evaluation Report, p. 12.

effect is achieved by the application of the general competition rules or because they are now specifically covered by other regulatory measures (for example, the rules on access to technical repair information). The Commission also notes that the approach of the MVBBER may have had the unintended adverse effect of increasing dealer costs (by encouraging vehicle manufacturers to impose higher standards to prevent brand dilution).

7. With this background in mind, the Commission suggests that it has not been able to efficiently allocate its own internal resources since 2002 as a result of the contents of the MVBBER (and suggests the same is true for the National Competition Authorities). Although it has received many formal and informal complaints, the Commission has adopted no prohibition decisions and these complaints only resulted in 3 informal settlements. Informal complaints were often found to concern commercial disputes as opposed to competition issues. Despite the extent of its published guidance, the Commission has faced frequent requests for assistance which have generally related to formalistic questions of contractual interpretation rather than the impact of practices on competition. The Commission also points to the disproportionate number of requests for preliminary rulings made by the national courts to the European Court of Justice concerning the rules on contractual termination in the motor vehicle sector.

8. The Commission, therefore, indicates that a more flexible and less formalistic approach than is provided under the MVBBER, which would draw closer inspiration from the general principles applicable to vertical restraints, may be appropriate. We share this conclusion.

3. THE MVBBER HAS CONTRIBUTED TO A MISALLOCATION OF RESOURCES

9. Our experience in advising clients on the sector-specific rules applicable to the motor vehicle industry confirms the Commission's preliminary view that these rules are overly strict and too complex.² Similarly, our experience confirms the Commission's preliminary view that significant resources have been spent on addressing issues that do not relate to genuine competition issues but rather to *inter partes* commercial disputes³ or simply to ensuring compliance with the safe harbour. This is true regarding the industry's attempts to comply with provisions contained in Articles 3, 4 and 5 of the MVBBER, as well as the Commission's Explanatory Brochure and FAQs.

10. Although we cannot disclose all of the issues that have arisen, it is useful to identify several examples:

Example 1: Article 3(6) of the MVBBER provides that the exemption shall apply on the condition that the vertical agreement provides for each of the parties the right to refer disputes concerning the fulfilment of their contractual obligations to an independent expert or an arbitrator. Although this provision initially seems relatively straight-forward, confusion is added by the statement that this right "is without prejudice to each party's right to make an application to a national court". The relationship between these two potentially conflicting provisions is not clear, particularly as they apparently limit to some unspecified extent the ability of parties to bind themselves to resolve all disputes through arbitration.⁴

² We take no position in these observations on the Commission's preliminary view that the sector-specific provisions are also redundant, particularly insofar as they rely on legislation such as the Vertical Agreements Block Exemption Regulation which is also under review.

³ Evaluation Report, p. 13.

⁴ Limitations on the ability of parties to agree that all disputes will be resolved through arbitration would run contrary to the Commission's intention to promote the use of arbitration in the motor vehicle sector and, more generally, to the fact that such exclusive arbitration clauses are possible in all other sectors subject to national rules on arbitration.

Example 2: Article 4(1)(j) classifies as a hard-core restriction an agreement whereby a motor vehicle manufacturer restricts a supplier's ability to sell original spare parts or parts of matching quality to, *inter alia*, authorised distributors or repairers. It is unclear whether this is intended to apply also to agreements otherwise covered by the Commission's subcontracting notice,⁵ which concludes that such obligations do not even restrict competition under Article 81(1) EC in certain circumstances.⁶

Example 3: In an attempt to clarify the meaning of a "non-compete" obligation under Article 5(1) of the MVBBER, the Explanatory Brochure and FAQs provide specific guidance on a number of issues. However, these attempts to clarify the rules bring about further confusion, as they create the impression that different standards will be used to assess different types of obligations. Thus, for example, some obligations (e.g., brand-specific sales personnel⁷) are apparently permissible if the dealer agrees and the supplier pays the costs. Other obligations (e.g., brand-specific seating areas or even coffee machines⁸) apparently are never allowed (presumably even if the dealer agreed and the supplier paid the costs). Still other obligations (e.g., brand-specific reception desks and the minimum number of vehicles to be displayed⁹) are assessed with regard to their effect on the dealer's ability to sell other brands. Determining whether any particular obligation is permissible under the MVBBER can be very difficult to establish in practice, particularly in light of the lack of certainty over the test to be applied.

Example 4: In an attempt to clarify when a sale to an "intermediary" constitutes a sale to an end user (and thus to explain when such sales may not be restricted under Article 4(1)(b) of the MVBBER), the Explanatory Brochure and FAQs prescribe a number of rules that must be followed. For example, Article 5.2 of the Explanatory Brochure emphasised that the "only" limitation on an intermediary is that the supplier may require a valid mandate. This rule was somewhat relaxed in the FAQs, which noted that a supplier could require a dealer to impose additional obligations, but this was limited to "individual exceptional cases".¹⁰ A similarly lenient approach is taken with respect to determining whether a sale to an apparent leasing company constitutes a sale to an end user.¹¹ These rules, however, create tension with other fundamental requirements in the MVBBER (and more generally of Article 81 EC), such as the requirement under Article 4(1)(b)(iii) of the MVBBER to ensure that authorised distributors do not sell motor vehicles to unauthorised resellers in the context of a selective distribution system, giving rise to uncertainty over what, specifically, is permitted or required.

⁵ Notice on subcontracting, OJ 1979 C1/2.

⁶ This is namely the case where the contractor (the vehicle manufacturer) provides technology or equipment to the subcontractor (the parts manufacturer) for the purpose of manufacturing parts. The Commission has only recently indicated its view that the provisions of the subcontracting notice would govern its assessment of this issue. See Evaluation Report, p. 7.

⁷ See MVBBER, Article 1(1)(b).

⁸ See FAQs, Question 5.

⁹ See FAQs, Question 5.

¹⁰ In our experience, the Commission's attempt to facilitate the use of intermediaries by relaxing the documentation requirements has in fact led to abuse by so-called "intermediaries" who can easily build stock on the basis of false mandates.

¹¹ The Explanatory Brochure suggests that no limits may be imposed on the quantities of vehicles that a "leasing company" may obtain to build stock (Question 49), making it difficult to ensure that the leasing company is not acting as a reseller. While the Explanatory Brochure indicates that a dealer may require a leasing company to sign a declaration that it will not resell the vehicles while "new" (Question 47), it is unclear whether *vehicle manufacturers* can require dealers to impose this requirement. It is also unclear what constitutes a "new" vehicle for these purposes. In our experience, the provisions concerning sales to leasing companies, coupled with the substantial degree of uncertainty as to how to determine whether a vehicle is no longer "new", creates a situation which facilitates the activities of sham leasing companies.

Example 5: Article 3(4) of the MVBBER provides that the exemption shall apply on the condition that the vertical agreement requires the supplier, when giving even 2 years' notice, to provide in writing detailed, objective and transparent reasons for termination in order to prevent the supplier from terminating a member of its network for engaging in activities that cannot be restricted by the MVBBER. The requirement that the reason for termination should be objective creates considerable uncertainty as it is used by terminated parties to argue (incorrectly in our view) that any decision to terminate must be reasonable.

11. While of course there can never be complete legal certainty, the issues raised in these examples (as well as many others) pose particular problems for two reasons. First, they give rise to considerable doubt as to the applicability of the MVBBER.¹² This defeats the purpose of block exemption regulations, which is to increase legal certainty and provide a safe harbour.

12. Second, and arguably even more significantly, the legal uncertainties demonstrated in these examples (as well as many others) pose particular problems because they raise concerns about the applicable underlying framework to be applied. Thus, even though companies are free to disregard the safe harbour of the block exemption, the effect of these legal uncertainties remains because they also appear to affect any individual analysis to be applied.

13. In general, the fact that there is no concrete guidance on all issues relating to vertical agreements is relatively unproblematic under Article 81 EC because of the existence of an overall analytical framework grounded in economics that considers the effects (both positive and negative) of an agreement.¹³ By virtue of the sector-specific rules applicable to motor vehicles, however, it appears that this traditional analytical framework is, in important respects, not applicable. As the Commission itself has recognised,¹⁴ many of the general conditions in Article 3 appear to be more related to contractual law than genuine competition issues. Yet the fact that these are made conditions for the application of the MVBBER strongly indicates that they are important to the overall analysis to be applied even outside the safe harbour. In the same vein, the unconventionally prescriptive approach applied to various issues under Article 4 and, to a potentially even greater degree, Article 5, of the MVBBER, combined with the Commission's public stance on the importance of compliance, further suggests that there is an analytical framework to be applied that differs significantly from that explained in the Vertical Restraints Guidelines.¹⁵

14. In our experience, motor vehicle manufacturers seek to ensure strict compliance with all the requirements imposed by the MVBBER and corresponding documents to ensure legal certainty. This is not surprising because, although the Commission has maintained from the outset that the MVBBER is only a safe harbour, the considerable efforts it expended to ensure compliance with the MVBBER created the clear impression that it would be very difficult to justify distribution arrangements that failed to comply with not only Article 4 of the MVBBER (concerning hardcore restrictions) but also the conditions in Article 3¹⁶ and, above all, Article 5.¹⁷ Furthermore, there have been understandable

¹² This first issue of course does not apply to Example 3, as the existence of a non-compete obligation does not prevent the application of the block exemption to the remainder of the agreement.

¹³ See, e.g., Section VI.1 of the Vertical Restraints Guidelines, 2000 OJ C291/1.

¹⁴ Evaluation Report, p. 13.

¹⁵ An example is provided by the outcome of the Commission's investigation into the indirect restrictions allegedly imposed by General Motors and BMW on the sale of competing brands of vehicles in the same showroom (see Press Release IP/06/302 of 13 March 2006). Rather than citing the risk of the foreclosure of competing brands as justification for its intervention, the Commission instead focussed on the need to prevent restrictions which would require dealers to make inefficient duplicate investments in order to sell other brands. This latter concern is not discussed in the analysis of single branding contained in the Vertical Restraints Guidelines, which focuses instead on the risk of foreclosure through competing brands being unable to obtain access to dealerships through the widespread use of non-competes.

¹⁶ In the Explanatory Brochure (Question 8), the Commission suggests that the omission of any of the contractual protection clauses in agreements not covered by the *de minimis* notice will be sufficient to

concerns as to whether national courts would uphold agreements that were not in conformity with the MVBBER given the approach of the Commission. As a result, significant resources have been spent on addressing a wide variety of issues to ensure compliance with the MVBBER. By reducing the number of potential issues to those more directly linked to competition concerns, and by introducing a clear and consistent analytical framework, we believe the Commission can ensure a more optimal allocation of resources.¹⁸

4. THE MVBBER HAS BROUGHT ABOUT DIVERGENCE

15. A second area of concern with respect to the use of sector-specific rules is that they have suggested a possible divergence of approach in areas where it appears the Commission did not intend to treat the motor vehicle industry separately. Moreover, the uncertainty generated by the sector-specific rules may risk spilling over into other industries subject to the general rules on vertical agreements, which have thus far operated without significant legal concerns.

16. Again, although we cannot disclose all of the issues that have arisen, we believe it would be helpful to identify several examples:

Example 6: The Commission's strict approach to non-compete obligations under the MVBBER has generated a number of areas of apparent divergence compared to other sectors. As discussed in Example 3 above, the Commission's attempt to clarify the rules applicable to non-compete obligations indicates that different analyses will be used to assess different types of obligations. Thus, for example, while an effects-based test may apply in some circumstances (e.g., determining the minimum number of display vehicles), at other times a more *per se* rule will apparently apply (e.g., seating areas or coffee machines).

Also notable is the Commission's contention that it may be necessary to relax certain standards on a dealer-by-dealer basis to the extent that, given the circumstances of a particular dealer, specific standards in practice impede the ability of the dealer to sell competing brands in the same showroom.¹⁹ This diverges from, and indeed risks conflicting with, the general rule that a supplier within a selective distribution system must commit not to appoint any dealers that do not meet its standards.²⁰ A further potentially significant issue is the suggestion that restrictions on a dealer's right to sell competing products in a single showroom may not be consistent with the requirements of a valid quantitative selective distribution system.²¹ This is not a requirement of the Vertical Agreements Block Exemption.

Although it is clear that the Commission intended to be less permissive regarding the exemption of single-branding obligations under the MVBBER,²² these developments appear inconsistent

demonstrate that the agreement infringes Article 81(1), requiring the vehicle manufacturer to justify its agreements under Article 81(3).

¹⁷ See, e.g., the investigations concerning compliance with Article 5.1(a) by General Motors and BMW (cited above).

¹⁸ The same would appear to be true as regards the allocation of the Commission's resources. See Evaluation Report, p. 13.

¹⁹ See FAQs, Question 5.

²⁰ See Article 1(d) of the Vertical Agreements Block Exemption and Article 1(f) of the MVBBER.

²¹ See *Multi-brand distribution and access to repairer networks under Motor Vehicle Block Exemption Regulation 1400/2002: the experience of the BMW and General Motors cases*, Competition Policy Newsletter Number 2 – summer 2006, at p.34.

²² The general Vertical Agreements Block Exemption exempts for an indefinite duration obligations in which a buyer is required to purchase from the supplier up to 80% of its requirements for the supplier's products and competing products. The MVBBER purposefully imposes a stricter requirement, and only exempts such an obligation up to 30% of the buyer's requirements.

with the Commission's attempt to apply the same underlying framework of assessment under Article 81 EC as in other sectors at least outside the safe-harbour of the MVEBR.²³

Example 7: The Commission's decision to exempt "quantitative selective distribution" for the sale of new motor vehicles up to a market share of 40% (as opposed to the general 30% threshold) led to the introduction of a definition of this term. Under the definition contained in Article 1(1)(g) of the MVEBR, a quantitative selective distribution system is one in which the supplier uses criteria which directly limit the number of authorised distributors or repairers. This has caused some courts to require the supplier to specify in its contracts the criteria which it uses to directly limit the number of members of the authorised network.²⁴ It may further have contributed to the French Cour de cassation erroneously suggesting that criteria used in a quantitative selective distribution system must be objective and that their manner of implementation be reviewable by the courts, an approach which (as the Commission has recognised) undermines the entire basis of the distinction between quantitative and qualitative selective distribution.²⁵

In its intervention in the *Gremeau* case, the Commission acknowledged that, in the context of a quantitative selective distribution system exempted by the MVEBR, a supplier can use criteria that are not objective, and the validity of these criteria cannot be reviewed by the courts (or, presumably, the competition authorities) for the period when the relevant agreements are covered by the MVEBR. As, therefore, the use of subjective quantitative criteria is exempted, it cannot serve any substantive purpose to make the validity of the block exemption depend on those quantitative criteria being specified by the supplier in its contractual relations with its network. It is submitted that, in essence, a "quantitative selective distribution" system is any selective distribution system that does not meet the strict requirements to qualify as a qualitative system. The definition of "quantitative selective distribution system" is therefore superfluous. Indeed, under the general Vertical Agreements Block Exemption, no definition of this term is provided because it is not necessary, since all forms of selective distribution are exempted uniformly.

Example 8: A further apparent point of divergence relates to the Commission's decision to bring agreements between a vehicle manufacturer and authorised repairers related to the repair services provided by the latter within the scope of the MVEBR, and to further treat them as selective distribution agreements even though they do not relate to the supply of products or services to the repairer. Indeed, although agreements related to the supply of spare parts to authorised repairers may typically qualify as selective distribution agreements, the same cannot be said of contractual provisions under which a manufacturer authorises a repairer to use its trade mark to carry out repair services. There would seem to be no reason to distinguish between authorised repairers and independent repairers insofar as their activities are directed at the repair of motor vehicles. Yet the former are treated as members of a selective distribution system, whereas the latter are treated as end users,²⁶ with the important practical consequence that, in the Commission's view, a vehicle manufacturer must appoint as authorised repairers all those candidates that meet the applicable repairer standards (assuming the 30% market share threshold is exceeded).²⁷ This, in effect, results in a requirement on manufacturers to license their trade mark rights for the carrying out of repair services. This obligation apparently applies

²³ See Explanatory Brochure, Question 17.

²⁴ The Commission seems to have followed this approach in its intervention in the *Gremeau* litigation before the Cour d'appel de Paris (*Garage Gremeau/Daimler Chrysler France* RG no. 05/17909).

²⁵ *Garage Gremeau/Daimler Chrysler France* (cited above). The requirement that quantitative criteria should be objective was reiterated by the Tribunal de Commerce de Bordeaux in a judgment of 8 February 2008 (*Auto 24/Land Rover France* no. 2007F01420).

²⁶ See Evaluation Report, p. 7.

²⁷ See FAQs, Question 13.

even if the manufacturer appoints all qualified candidates (including repairers) to sell its spare parts. This divergence risks causing further confusion as to the true nature of a selective distribution system.

17. Although such risks of divergence can be avoided by the adoption of clear guidance limiting the possible spill-over of the sector-specific rules to other areas, there would be advantages in simply abandoning the sector-specific rules in light of the Commission's findings in the Evaluation Report that the relevant markets are competitive, as this would create a simpler legal framework.

5. CONCLUSION

18. For the reasons discussed above, the application of specific rules to the motor vehicle sector has given rise to a number of concerns. While such concerns may not necessarily in themselves call for the elimination of the sector-specific rules, it is our view that any exceptions to the generally applicable rules should be limited to provisions in respect of which compelling reasons are found to exist to adopt a stricter approach. In light of the Commission's findings that the market is characterised by strong competition, it is accordingly the view of Van Bael & Bellis that any benefits that might have once existed for the adoption of extensive sector-specific rules for the motor vehicle industry are now outweighed by the disadvantages.