European Distribution Lawyers

Statement pursuant to the revision of the Vertical Group Exemption Regulation (EC) no. 2790/99 and its Guidelines

A. Organisation and contacts

The EDL (Association of European Distribution Lawyers) is a European amalgamation of lawyers specialised in distribution and anti-trust law from 19 European countries with 22 members.

The members address distribution and anti-trust issues associated with this area on a continuous basis, in particular in the automotive sector, but also in other sectors such as agricultural implements, construction machinery, medical-technical equipment, optical devices, electronic devices, etc.

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B. Statement of position

1. Introduction

In view of the Impact Assessment on the future competition law framework for the motor vehicle sector issued by the Commission on 22nd July 2009, the Vertical Regulation is assuming an even greater importance. It is moreover noteworthy that distribution systems in Europe are changing constantly, which makes the provisions set out in the Vertical Regulation of even greater relevance:

According to a study carried out by the Rheinische Fachhochschule in Cologne, the closed distribution systems of all sectors in 2004 look as follows:

commercial agents:	17 %
authorised distributors:	68 %
franchise:	9 %
commission agents and similar	6 %

According to an analysis by the Rheinische Fachhochschule which has not yet been completed, the percentages accounted for by the different components of the closed distribution systems have probably changed considerably once again in the meantime, with the share of commercial agents continuing to decline, and the percentage of authorised distributors systems and (in particular) franchising growing. A conservative estimate indicates that commercial agents systems will probably only account for 10% to 11% of all distribution systems in 2010.

The DGTV Department of the European Commission is no doubt aware that there is an identical statutory foundation f– but by no means for the area of authorised distributors and franchise systems – throughout Europe

as a result of the Harmonisation Directive issued in 1986. The statutory foundation for authorised distributors only exists in Belgium and since October 2 2007 in Greece (application of commercial agents law). In addition, Germany and Austria have systems which have developed through civil case law, under which law governing commercial agents may be applicable to authorised distributor agreements under some circumstances.

This legal situation, which is not regulated by any law, has led to suppliers – at least powerful ones – having a wide-ranging freedom in structuring and setting out contractual obligations and rights which they generally also make use of at the expense of their authorised distributors.

It is at the same time striking that **a vast majority of** suppliers by the same token do not abide by, or even abuse, the scanty legal foundations which exist in the first place. These few legal foundations include the Vertical Regulation. Failure to abide by this regulation or even abuse of it is particularly evident in sectors in which authorised distributors in addition to distributing products are obligated to provide services such as maintaining stocks of spare parts (e.g. in the following sectors: motorcycles, construction machinery, agricultural implements, medical-technical equipment, photocopiers and printers and electronic devices):

* The suppliers generally agree upon a prohibition against competition with their distribution partners. Frequently this prohibition against competition is not limited to five years, instead applying for the term of the (unlimited) agreement.

* If the supplier restricts the prohibition against competition to five years, the respective authorised distributors agreement generally has a term of the same duration. Shortly before the expiry of this term, the authorised distributors is usually offered a new agreement with the same content by their supplier, once again containing a prohibition clause against competition for five years.

* Agreements which stipulate that up to a maximum of 20% of the total volume other brands can be distributed after the expiry of the term are more or less no longer in existence (the exception here being BMW Motorcycle). The reason for this is that disputes have usually developed because the individual authorised distributors have for the most part no influence over their respecting exactly this 20% amount for the distribution of competing products, the reason being that distribution depends on many features and cannot be limited to a maximum percentage.

* The prohibition against competition **in the overwhelming number of cases** relates not only to the distribution of the main contractual good, but also to the distribution of its spare parts for service activities. In this connection it is plainly evident that in many of the aforementioned sectors the supply of manufacturer's spare parts and the execution of maintenance and repair of machinery by the respectively authorised contractual partners is absolutely necessary for technical reasons (on a much greater scale than the automotive sector). This means that the market share with regard to the distribution spare parts and with regard to service is generally far greater than 30%. Even though a restriction on competition with a market share of more than 30 % is not possible, this is ignored by suppliers in designing agreements: a restriction on competition is imposed on contractual partners anyway (through a competition clause).

* In many authorised distributors agreements there is moreover an obligation for the authorised distributors to only be supplied with the contractual good by the supplier.

On the whole, then, it would appear that the provisions of Vertical Regulation 2790/99 are frequently ignored or even deliberately abused. At the same time, it is true that there have nevertheless not been many

complaints by the Commission. The reason for this is that the distributors do not dare resist these invalid provisions as a result of their economic dependency. This is also frequently due to the ignorance of distributors as regards their legal situation, however, whereby experience of the members of the EDL indicates that at the same time only a handful of lawyers and attorneys are even aware of the Vertical Regulation and its provisions at all.

2. The legal situation

We agree with the Commission: it is the task of a BER – and hence the objective of the Commission – to establish legal security for stakeholders.

Given all this, we must first of all note that the desired legal security has not been established. Much to the contrary: the few regulations which exist are disregarded by suppliers or are even deliberately abused. This state of affairs must in our opinion give cause for the Commission to rethink these arrangements, in particular the arrangements governing restrictions on competition. This does not appear to have happened to date, possibly because the Commission has not been aware of the scope of the failure to abide by regulations or even abuse of them.
When it is stated in no. 17 that the competition authorities could review potentially anti-competitive practices more, this does not in our view appear to suffice in few of the virtually pervasive disregard/abuse of the Vertical Regulation. Constant disregard of the borderlines in admissible restrictions on competition or even their abuse by suppliers can only mean that suppliers‘ option to restrict this competition must be eliminated. If a BER is to give legal security it must establish legal security. A mainly equivalent renewal of the Vertical Regulation therefore cements defects and does not give any legal security.

3. Separation between distribution and customer service

In 2002, the Commission very rightly recognised – with respect to the automotive sector – that a separation is warranted between distribution and customer service. This applies not only to the automotive sector, however, but to all branches which involve technically complex machinery or equipment, for the repair of which only special spare parts can be used (which can generally only be supplied by nobody else but the manufacturer) and whose repair requires a high level of special know-how and training, which for this reason can only be performed by an authorised contractual partner.

As the statements of the Commission demonstrate, the Commission is fully aware that there is generally a major difference in market shares or in the assessment of market shares when it comes to the distribution of main products (machinery/equipment) or when it comes to the spare parts or service required for these. This only indicates, however, that this separation between the distribution of machinery/equipment, the distribution of spare parts and the distribution of maintenance and repair services require **separate statutory arrangements** in order to bring about the required clarity – and hence legal security – for the stakeholders.

Moreover, this is not only important for the stakeholders, but also for national government agencies and courts, which are frequently not familiar with such complex topics as anti-trust regulations.

4. Market share

This is particularly evident with respect to the calculation/assessment of market share, which is the starting point in the question of whether and to what extent restrictions on competition are to be allowed or not for reasons of cartel law. Instructions on how a respective market share is to be calculated in the Vertical Regulation or the commentary on the Impact Assessment must be considered insufficient. One example in this regard is the MAN procedure at the German Federal Anti-Trust Agency: This procedure in particular involves the question of how market share is to be calculated in the service area and in particular whether and to what extent the performance of guarantee and warranty work is to be taken into account. The official investigatory procedure initiated by the German Federal Anti-Trust Agency in 2004 has yet to produce a conclusive position to date! In addition to the separate consideration of distribution, spare parts and customer service, what is needed is a more specific definition, such as how market share is to be respectively calculated or at least a respective explanation in the Guidelines on how the market share of distribution, of maintenance and of repair services is to be calculated, and in particular whether guarantee or warranty work is to be included or not.

5. Lack of practicability leads to legal insecurity

Even though the old Regulation 2790/99 and the future Vertical Regulation in Art. 5, section 1 postulate a five-year prohibition against prohibition; after the expiry of this term, however, it is possible for the supplier to stipulate that its distribution partner may still only sell 20% of its products from competitors. Aside from the fact that this circumvents the prohibition against competition – as described in the foregoing – this arrangement has proven to be completely impracticable. One example which can be cited for this is a BMW motorcycle distributor (the BMW motorcycle agreement contains such an arrangement):

Assuming that current BMW motorcycle models became suddenly less competitive because they were too prone to breakdown, too expensive, or used too much fuel, a distributor upon whom such a prohibition against competition is imposed would nevertheless not be allowed to sell more than 20% of a competing brand. The distributor would therefore even possibly have to discontinue distribution in part or in whole if the vehicles of its "main brand" turn out to be unsellable. Such a distributors can – to a very limited extent - offer consumers a better, more inexpensive motorcycle if the sale of the main brand declines, as the 20 % are calculated from his total sales target: if the sale of the main brand declines by 50 %, he has to reduce the sales of a second brand by 50 % too. In the view of the members of the EDL, this does not have anything to do with free competition, but rather is a restriction that cannot be justified in any way. By the same token, we are keenly aware that such clauses restricting competition can only be used by parties which already possess considerable market power, anyway. This means, however, that this arrangement is ultimately based on a clause which has the effect of restricting and closing off markets. This is most certainly not in the interest of consumers, who the Competition Commission is supposed to protect.

6. Legal security through a uniform legal situation in Europe

Decision-makers in the Commission have frequently stated that the details in distribution agreements (for example including with respect to periods of notice of termination, etc.) must be orientated towards national law. As we have related in the foregoing: **there is no national law** – and there is thus a high level of legal insecurity.

National institutions such as anti-trust agencies and courts are moreover not in the least suited to take the steps necessary to create the required security or legal security, the reason being that anti-trust agencies and courts issue decisions

which differ from one another due to the **lack of statutory arrangements –** both at the national and supra-national levels. Statutory arrangements with respect to reasonable periods of notice for termination are by the same token of fundamental importance in terms of competition and anti-trust law. This is so because the shorter the period of notice, the greater the dependence of the distribution partner and the greater the possibility for a supplier to impose (additional) obligations restricting competition on them. General statutory arrangements involving competition are therefore needed not only in the automotive sector, but generally speaking in all sectors.

7. Definition of end consumers

The new draft Vertical Regulation refers to "end consumers" without, however, specifically defining this term. This holds out the danger of allowing direct restrictions on competition which would harm consumers: leasing agreements are in widespread use nowadays – not only in the motor vehicle area, but also in many other sectors. If in contrast to Vehicle Regulation 1400/02 – the definition of end consumer is not interpreted to also include leasing companies, suppliers will attempt (as they did before 2002) to classify a leasing company which does not belong to the supplier, which is to say an independent leasing company, as a "non-authorised reseller", which would mean that the distribution partner is prohibited from distribution of products to independent leasing companies. If the supplier does not have to fear any competition with its leasing companies. The competitive disadvantage associated with this is obvious: consumers will have to foot the bill.

8. Internet distribution

It is no doubt right and proper that the Competition Commission is also focusing its attention on distribution via the Internet. Nevertheless, a gap in regulations remains which urgently needs to be eliminated. These involves primarily Internet auctions, for which no attempt at delimitation has been made to date. This is necessary, however, because it has not been determined, for example, whether this involves "active selling" or not. Here as well, an appropriate commentary and clarification is needed.

9. Implementation of the automotive distribution

According to the Impact Assessment of 2nd July 2009, the Commission intends to make the distribution of automobiles subject to the Vertical Regulation. We urgently recommend that the Commission reconsider this. Legal disputes between suppliers and distribution partners have declined considerably throughout Europe since the introduction of Regulation 1400/02 because Regulation 1400/02 sets out a sufficiently rigid framework for contractual relationships, which was warranted not least due to the absence of other statutory arrangements. This is all the more the case because the members of the EDL realised that the intended changes in the Vehicle Regulation would ultimately benefit the five big automotive manufacturers, but otherwise limit and restrict competition even for smaller manufacturers and suppliers – to the detriment of consumers, but also at the expense of distribution partners. In this regard, please refer to our statement of position on the Impact Assessment.

Should you have any questions or desire a personal discussion, we shall be at your disposal.

Faithfully yours,
on behalf of the EDL

Prof. Dr. F. Christian Genzow, Spokesman