

## **Response to the Commission's public consultation on the review of competition rules for the Motor Vehicle sector**

Bilia AB (hereinafter "Bilia") is the largest dealership and authorised workshop chain in the Nordic countries. In response to the *Commission's Consultation of the 21<sup>st</sup> of December 2009*, regarding *the Commission's published draft Regulation on the application of Article 101(3) of the Treaty to categories of vertical agreements and concerted practices and draft Supplementary guidelines on vertical restraints in the motor vehicle sector* (hereinafter 'the Proposal'), Bilia wish to make the following comments related to the primary market; sale of new cars.

Bilia has not altered from its position as already articulated in its earlier submissions. It considers that the pre-existing arguments have not been addressed in the Proposal. Accordingly, the company will re-iterate the substantive points made earlier. The fact that the Commission has ignored them hitherto does not divest them of validity in our view. Furthermore, it is accepted in competition law analysis in the EU and in the US antitrust regime as well, that a change at the helm of enforcement can have direct impact on the mode of enforcement. In the EU, a change in Commissioner therefore can alter the emphasis on policy pursued by the Commission within the framework of the Treaty. In addition, the new Commissioner encounters a market radically altered from that which existed at the time the studies into the Block Exemption began. Not only have the economic circumstances shifted, but the shape of economic analysis itself may be changing. The dominance of the 'Chicago School' of economic thinking may be qualified by a more varied approach, as a degree of market scepticism is reflected in the policy of regulators supported by Governments who have intervened to deal with market failures in the financial domain. It is worth noting how academic commentators in the US have pointed out that the approach of the US Supreme Court and federal enforcement agencies in relation to vertical restraints were one of the domains most influenced by economic theory. While the pendulum will not shift back to where it is used to be, it is not unlikely that a more critical approach to vertical restraints may occur. It is accordingly possible that some of the economic 'truths' underlying the Commission's approach may be undermined. Facilitation of vertical restrictions in economic theory is consistent with a supply-side orientation and might therefore not adequately consider consequences from a consumer perspective. Economic analysis (as required in competition law) does not merely refer to a static, snapshot description of market share and should not proceed ideologically with a bias towards suppliers. Therefore, on the basis that the Commission may be mistaken in its specific analysis of the market (particularly in its assessment of experience since 2002- as articulated in the preamble to the Regulation in the Proposal) and on the basis of our belief in the persistence of the validity of our argument and bearing in mind that there is a new Commissioner in post, and the likely change in emphasis in economic analysis, we would respectfully re-articulate our stated position. If it cannot affect the overall policy choices adopted, we would at least hope that the concerns expressed are integrated into the enforcement thereof.

In short, we are convinced that the Commission has a flawed reading of the market that is biased towards the manufacturer's perspective and detrimental to the dealer and ultimately consumer interest. This flawed approach does not facilitate market integration, favour the EU citizen nor further the spirit of Treaty goals and will hamper innovation at a time when it is most needed. A more sensitive, pragmatic, economic analysis not based on ideology should be considered. In that spirit, it is submitted that the arguments that have been ignored should be re-examined. They are thus re-iterated below with minor modifications.

## 1 Inter-brand competition

The Commission keeps referring to inter-brand competition in the sector as strong. The world market is dominated by a few big players, in Europe (EU 27 + EFTA), 10 manufacturers hold close to 90% of the market for passenger cars.<sup>1</sup> When stating that intra-brand competition is less important as long as inter-brand competition remain strong, the Commission is failing to take into account the oligopolistic nature of the car industry, in its economic analysis and market assessment. If the supply of goods in a market is oligopolistic then the facilitation of vertical integration can only perpetuate and extend the concentration of market power, ultimately to the detriment of the consumer.

The automotive sector has been sheltered over the years, which has contributed to the industry's suffering in the current recession. Had competition been allowed to flourish, current overcapacity would not be so vast, distribution costs would be significantly lower and manufacturers would be quicker to adapt output to match the current demand. The existing oligopoly has contributed to the build-up of overcapacity, which now manifests itself in price reductions, which contributes to the misconception of a sector in fierce competition. However, the underlying market structure is still very much the same as in 2002 when the Commission voiced its concerns over the shortage of both inter- and intra-brand competition.

### 1.1 Multi-branding

Multi-branding is good for competition and the consumers. The Commission choose to disregard the benefits of multi-branding from a cost cutting perspective – multi-branding allows the dealer to reduce overheads through a more efficient use of facilities, personnel, IT-systems etc, which will inevitably benefit the consumer and have a direct impact on competition in the market. These are all recognised economic and competition arguments which the Commission do not address.

Manufacturers in general have tended to raise the quality-standards required of dealers. In some cases the quality-standard requirements have increased overall to avoid brand-dilution and in other cases the costs have been shifted from the manufacturer to the dealer in order to avoid the free-riding effects that might occur with dealers engaging in multi-brand sales. Increased quality-standards have resulted in higher costs for the dealer to comply with, in order to maintain its distribution contract. Increased costs to avoid brand-dilution or free-riding are a frequent argument used by the car manufacturers and accepted by the Commission, against multi-branding. The choice of manufacturers to increase dealer quality-standards and require higher investment in the brand is not harmful from a competition perspective as long as the dealer makes the investment insofar as no free-riding can be said to occur. What is harmful is the Commission's response to the phenomenon namely by suggesting the limitation of multi-branding by letting the motor vehicle sector be regulated by the coming version of *Regulation (EC) No 2790/1999 of 22 December 1999 on Vertical Agreements and Concerted Practices* (hereinafter referred to as "VBER").

The Commission also refers to the 'de minimis Notice' to argue that single-branding is not always harmful. This is correct on its own but far from a sufficient reason to reduce

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<sup>1</sup> ACEA:s statistics for the year 2008 of new vehicle registrations for passenger cars divided by manufacturer, available on the 16<sup>th</sup> of September 2009 at:  
[http://www.acea.be/images/uploads/files/20090728\\_08\\_2008\\_vo\\_By\\_Manufacturer\\_Enlarged\\_Europe.xls](http://www.acea.be/images/uploads/files/20090728_08_2008_vo_By_Manufacturer_Enlarged_Europe.xls)

competition by severely limiting multi-branding across the board. By allowing for non-compete obligations in accordance with VBER for manufacturers holding a market share of up to 30% (25% more than allowed for under the ‘*de minimis* Notice’) a harmful effect is inevitable.

## **1.2 Foreclosure to new entrants**

The absence of multi-branding inhibits new entrants to the market at a time when innovation is highly desirable. New car manufacturers, predominantly from Asia, but also locally (mostly in the form of electric alternatives with less solid financial backing) are about to make their presence known to European consumers. The idea of a competition law regime wholly separated from EU policy in other domains demonstrates an unhelpful fragmentation of approach.

Moreover, relying as the Commission suggests, on the ability to withdraw the benefit of VBER if foreclosure should occur,<sup>2</sup> shows a lack of regard for the serious impact of foreclosure. Surely a prophylactic approach is more desirable from a competition perspective. Market players need consistency. The dealers that have now invested heavily in multi-branding stand to lose out and the costs will ultimately be borne by the consumer or society at large. Dealers who put good faith in the system and have invested in multi-branding will know better than to trust the regulator again, and other informed actors on the market will also be reluctant to do so. The foreclosure effects might then prevail, regardless of withdrawal of the benefit of VBER. Swift u-turns by the regulator are not a viable option from a competition perspective and risk harming the trust in the legal system and undermine citizens’ trust in the EU at large.

At a time of environmental crisis, barriers to entry and innovation are a serious adverse consequence of the promotion of established vehicle manufacturers’ interests. The perceived failure at Copenhagen illustrates the need for a genuine multilateral strategy.

## **2 Intra-brand competition – freedom of location**

The most important consequence of freedom of location is the price convergence that has taken place within the internal market. As the Commission’s Report on car prices shows, there is a clear correlation between the adoption of MVBER and price convergence within the internal market. As soon as the wording of MVBER was established, the coming abolition of location clauses resulted in rapid price convergence. It is a fair assumption that prices will start diverging again between countries as the freedom of location disappears. A slight divergence has already been noted, which is likely to be attributed to three inter-related factors: decreased frequency in publication of data by the Commission, exacerbated by the increase in currency fluctuations and the increased likelihood of the regulator re-introducing location clauses.

The re-introduction of location clauses will inevitably lead to lower network density and thereby higher prices for the consumer. Without the risk of new entrants in an area, prices will also rise as soon as the market is in balance after recuperating from the current crisis. There is no alternative conclusion to come to, in this matter.

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<sup>2</sup> COM (2009) 388 final, paragraph 21

As the right to transfer contracts, existing under Article 3 (3) in MVBER, is not found in VBER, protection against location clauses will be needed more than ever at a time when they are also being abolished.

### **3 Contractual protection – preserving the deterrent effect of Article 101**

The contractual protection clauses might be an oddity from a competition law perspective but its ultimate goal has always been to protect competition, nothing else. It is therefore surprising to see how dismissive the Commission has been of these obligations by suggesting they predominantly have other functions.<sup>3</sup> The protection of dealer investment is a pragmatic approach to serious competition shortcomings in the industry. It can not possibly be the case that these rules have hampered the industries adjustment to the current crisis as the Commission suggests may be the case.<sup>4</sup> The right to terminate agreements within a year should be sufficient to reorganise dealer networks and the Commission has not presented any evidence to the contrary. The second argument by the Commission, to diminish the importance of contractual protection, is a technical one and highly questionable. By stating that the dealer has no remedy against the contracting party for failure to incorporate contractual protection clauses in a contract the Commission argues that they hold little value.<sup>5</sup> In practice this is not the case and vehicle manufacturers try to bring their agreements within the safe harbour of MVBER. Should the Commissions argument in this regard hold any credibility, all block exemptions would diminish in legitimacy and we would have to rely directly on the articles in the Treaty on the Functioning of the European Union.

By allowing the manufacturer to increase dealers' dependency on the manufacturer, the dealer's investment-risk increase significantly; and by taking away the right to multi-brand at the same time, there will be little ability for the dealer to balance risk. As the dealer will have a severely reduced ability to manage its risks and stand to lose large investments, it is not likely that dealers will attempt to act in a pro-competitive way in relation to intra-brand competition due to the imminent risk of contract termination.

### **4 Objectives and possible prolongation of MVBER**

The Commission states that all the underlying objectives of MVBER remain valid. It is therefore difficult to follow the subsequent deduction that none of the objectives relating to the primary market, such as: prevention of foreclosure to new entrants, ensuring intra-brand competition and preserving the deterrent effect of Article 101, no longer need regulation to be upheld.

### **5 The Proposal**

*“The history of competition enforcement in this sector shows that certain restraints can be arrived at either as a result of explicit direct contractual obligations or through indirect obligations or indirect means which nonetheless achieve the same anti-competitive result. A supplier wishing to influence a distributor's competitive behaviour may, for instance, resort to threats or intimidation, warnings, penalties, delay or suspension of deliveries or contract*

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<sup>3</sup> COM (2009) 388 final, paragraph 45

<sup>4</sup> COM (2009) 388 final, paragraph 43

<sup>5</sup> COM (2009) 388 final, paragraph 44

*terminations in relation to sales to foreign consumers or the observance of a given price level.”*<sup>6</sup> In view of the Commission’s acknowledgement, as quoted above, the abandonment of the articles in MVBER aimed at reinforcing the deterrent effect of article 101, gives cause for concern. The suggestion that the feeble code of conduct<sup>7</sup> proposed by ACEA could compensate for comprehensive competition promotion measures found in MVBER is unsatisfactory.

Large investments are required to run a dealership and pay-back time is often up to 5-10 years. Extending MVBER for three years with regard to brand-specific investment<sup>8</sup> is not sufficient to protect dealers’ investment and will result in sunk-costs that are not recoverable.

We contend the Commissions statement that “*On the basis of an in- depth market analysis, it appears that, as regards the new motor vehicle distribution sector, there are no significant competition shortcomings which would distinguish it from other economic sectors and which could require the application of rules different from and stricter than those in the General Vertical Block Exemption*”<sup>9</sup> As we have pointed out in a previous submission; the market assessment is obviously flawed in relation to the maturity of economic conclusions. When the analysis was carried out, MVBER had only been in force for a short time, and it only took full effect, by removal of the location clause in October 2005. In addition, many dealer contracts were not readily negotiated until well into Spring 2004. No reliable figures can be available after such a short evaluation term and there is a vast degree of uncertainty as to whether the observations of the market can be attributable to MVBER or other factors. Therefore, the conclusions reached by the Commission in its Report lack sufficient economic analysis, contrary to what is required of the Commission as determined by the Court of Justice in the Wood Pulp II case.<sup>10</sup> The consequences of failure to assess the market adequately may be serious. Significant numbers of dealers have made substantial investments in multi-branding and new outlets. To them, removing the ability to multi-brand and decide on location, will result in sunk-costs and serious financial harm which will ultimately affect consumers.

## **6 Conclusion.**

The Commission could allow direct application of Article 101. But it will not because of the need for certainty for the estimated 120,000 vertical contracts affected. Instead it wants to use the VBER. This is a mistake since the certainty that VBER would bring to the market for distribution of cars is predominantly confined to reassure the manufacturer of the legality of competition reducing measures such as; limiting multi-branding and intra-brand competition. The option of letting VBER regulate the market in relation to the distribution of cars is therefore a certain way of reducing competition in the market.

In view of the restraints VBER would put on competition in the market for distribution of cars, we maintain that MVBER should be prolonged for a minimum of five years.

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<sup>6</sup> Draft Commission Notice: Supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles, recital 7

<sup>7</sup> [http://ec.europa.eu/competition/consultations/2008\\_motor\\_vehicle/acea\\_annex\\_en.pdf](http://ec.europa.eu/competition/consultations/2008_motor_vehicle/acea_annex_en.pdf).

<sup>8</sup> Draft Commission Notice: Supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles, recital 14

<sup>9</sup> Draft Commission Notice: Supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles, recital 12

<sup>10</sup> Cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 to C-129/85, Re Wood Pulp Cartel: *Ahlström oy v. Commission (Wood Pulp II)* [1993] ECR I-1307, [1993] 4 CMLR 407.

Alternatively, for VBER to be an acceptable alternative to regulate the primary market the following exemptions for the motor vehicle sector must be inserted in the proposal for a new VBER:

1. A special non-compete definition needs to be inserted, allowing for multi-branding by reducing the purchase requirements to a maximum of 30%, regardless of the contract term; in order to hinder foreclosure, let the dealer distribute its risk and offer consumers a wider and more cost-effective choice.
2. Prohibition of location clauses in order to promote intra-brand competition and price convergence within the single market.
3. Incorporate the most vital contractual protection clauses to maintain the deterrent effect of Article 101; such as right to transfer contracts to a dealer within the network.

By keeping the existing MVBBER or adjusting the future VBER in accordance with the above suggestions, competition can remain at the current level and the goals of competition law can be achieved. If an adjustment of the new VBER cannot be made, it should be declared not applicable to the distribution of cars through an appropriate exemption. Failure to amend the proposal will represent a failure by the Commission to fulfil its commitment to the EU citizen in favour of narrow interests of established producers. The economy has changed, emphasis in economic theory is moving, the Commission is different and the Competition Commissioner is another. It is time for a new direction here.

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