

# **RMI National Franchised Dealers Association (NFDA)**

## **Comments on the Draft Commission Regulation and Draft Supplementary Guidelines applicable to the motor vehicle sector (published 21 December 2009)**

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## **The NFDA**

The NFDA is a trade association representing the interests of approximately 85% of all authorised dealers and repairers in the UK.

## **Executive Summary**

The NFDA considers that the Commission's proposals (the Proposals) have certain benefits for the sector:

- prolonging the application of Regulation 1400/2002 until 31 May 2013 in relation to the sale of new vehicles, should help preserve the current levels of competition in this sector for the time being;<sup>1</sup> and
- retaining sector-specific regulation for after-sales should continue to allow competition to develop in that field.

In other respects, however, the NFDA considers that the complex patchwork of general and sector-specific regulation and guidelines represented by the Proposals (in place of the simple refinement and renewal of Regulation 1400/2002) will result in:

- less legal certainty;
- higher compliance and assessment costs;
- a weakening of the deterrent effect of Article 101(1) as a result of the Commission downgrading the perceived level of competition risk applicable to vehicle sales (through more permissive regulation);
- little prospect of the private enforcement of competition law developing in the automotive arena;<sup>2</sup>
- a significant relapse towards lower levels of competition across the EU, resulting in:
  - less choice and higher prices for consumers generally; and
  - because of the renewed ability of manufacturers to link sales and service, consumer detriment feeding through to the aftermarket;<sup>3</sup> and
- a greater need for (and responsibility on) national and EC competition authorities to intervene (post-infringement).

The scenarios in **Appendix 1** indicate some of the potential negative impacts of the Proposals at the retail (and aftermarket) level.

The NFDA considers that the above concerns, which it has previously raised with the Commission, are still valid. It does not endorse the Proposals to remove sector-specific regulation for vehicle sales post-May 2013; however, the NFDA has, in the absence of more meaningful changes to the Proposals, suggested certain improvements to the draft supplementary guidelines and draft (aftermarket) regulation.

Details of the suggested amendments are set out in amended versions of the draft regulation and supplementary guidelines in **Appendix 2**.

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<sup>1</sup> However, the Commission's decision to signal the end of Regulation 1400/2002 may, in the absence of clear emphasis on the part of the Commission that it should continue to be observed, undermine its effectiveness in the interim.

<sup>2</sup> The disparate, complicated but looser system of regulation will discourage smaller businesses from seeking to challenge anti-competitive behaviour which, in turn, will encourage a trend towards progressively more restrictive arrangements on the part of the largest market players. The Proposals would, therefore, appear to be at odds with the Commission's own key policy objective of facilitating greater private enforcement of competition law.

<sup>3</sup> Given that the Commission has declared that it still has concerns in relation to the level of competition in the aftermarket, this would not seem to be an appropriate risk to take.

## **Key concerns arising from the Commission's proposals**

**The Commission considers that, in relation to the sale of new vehicles, sector-specific regulation is no longer necessary. The Commission assumes that general regulation will deliver greater innovation and argues that sector-specific rules prevent manufacturers from adapting their networks to the market.**

- In reality, manufacturers will be granted even greater powers to restrict the pro-competitive activities of their distributors and distributors' ability to adapt to evolving consumer needs. Manufacturers have rarely chosen to adopt less restrictive systems of distribution, despite having the discretion to do so.
- The Commission refuses to acknowledge that Regulation 1400/2002 delivers consumer benefits, which risk being lost under a general system of regulation. Under the Commission's Proposals:
  1. Dealers may be restricted from selling competing brands, whether from a single showroom or at dealer group level, which will result in less consumer choice and higher barriers to new market entry and expansion.

**The NFDA considers that right to multi-brand should be preserved in any new regulation.**

2. Dealers will lose the right of intra-network transfer, which will – aside from being used as a tool to restrict dealer behaviour - undermine dealers' ability to adapt their businesses or realise the value of the goodwill that they have developed, as well as limiting any scope for improved economies of scale.

**The right of transfer should also be preserved in any new regulation.**

3. Other measures that promote dealer independence (minimum notice periods, greater scrutiny over terminations etc.) will also be lost from any formal regulation and guidelines.<sup>4</sup>

**The guidelines should identify in more detail - and with examples - the types of indirect measures or pressure that can be applied to restrict distributor behaviour (both in sales and after-sales) and give distributors greater scope to challenge such restrictions. In any event, manufacturers should be required to give detailed, transparent and objective reasons for termination.**

4. Aside from the practical challenges of cross-border expansion to date, dealers will, in the majority of cases, be restricted or discouraged from setting up new sales and delivery outlets elsewhere in the EU, thereby undermining their ability to meet consumer demand properly.

**The Commission should provide more explicit guidance on this issue in order to help preserve this option for distributors in the automotive sector.**

5. Manufacturers may still have scope to limit the supply of spare parts from OEMs by means of restrictions or targets imposed on the manufacturer's distribution/repair network (whether through volume purchase incentives or parts bonuses designed to make it unviable for the dealer/repairer to source elsewhere).<sup>5</sup> and

**Please see comments under item 3 above.**

6. The right to fair and proportionate access to technical information is not set out clearly and does not balance the rights of access by the independent sector against the standards and levels of investment that authorised operators are expected to meet.

**This should be dealt with explicitly in any new regulation or in more detail in any guidelines.**

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<sup>4</sup> Although this may be alleviated by provisions contained in any code of conduct that manufacturers choose to observe.

<sup>5</sup> It is worth noting that under the Commission's proposed rules, there is no clear provision safeguarding against restrictions imposed on distribution networks from buying matching-quality parts. This needs to be resolved.

- Furthermore, the NFDA considers that the staggered and then concurrent application of different exemptions and guidelines to retail and after-sales markets envisaged by the Proposals is likely to create complexity and uncertainty, at a time when the sector is least able to cope.
- The Commission has under-estimated the risk that, in reality, this more disparate and complex regulatory framework - against the background of a perceived relaxation of competition rules - will undermine the ability of distribution networks, often comprised of undertakings with limited resources, to challenge perceived anti-competitive restrictions, whether informally or through private enforcement.
- The Commission appears to believe that competition operates in isolation; in other words, there is no place in competition law for provisions dealing with contractual fairness; however, this ignores the significant overlap between commercial arrangements and competition law (for example, the use of variable margins linked to the achievement of standards that are designed to induce dealers not to multi-brand).
- By signalling the 2013 move to a more permissive system of regulation for sales, the Commission is inviting manufacturers to disregard the continued application of Regulation 1400/2002 now. **The Commission should re-emphasise the full application of Regulation 1400/2002 - including the Article 3 provisions - until 31 May 2013**

**Owing to current healthy levels of inter-brand competition (fostered under Regulation 1400/2002), the Commission appears to believe that it can safely reduce the prevailing level of *ex ante* regulation without any danger of adverse consequences arising.**

- This approach is high risk, particularly given the compliance record of certain manufacturers. It removes a number of mechanisms through which distributors (whether SMEs or larger retail groups) can challenge perceived anti-competitive behaviour before the adverse effects of such behaviour manifest themselves.
- The Commission also appears to have based its analysis on a disconnect between sales and after-sales activities. Indeed, the Proposal to apply different regulations to sales and after-sales activities (and, in particular, to afford wider discretion to manufacturers in the sales sector) increases the possibility that pressure will be exerted in the primary market to achieve anti-competitive objectives in the aftermarket.<sup>6</sup> **Even if this point is not specifically addressed in any new regulation, it should be amplified in any accompanying guidelines.**
- Ultimately, the Commission's proposal may necessitate greater *ex post* intervention by competition authorities. Any confidence that distributors might previously have had in a reasonably clear, fair and predictable system of competition regulation will collapse. In any event, few distributors (even larger groups) will have the resources to challenge manufacturers under the looser system of regulation proposed by the Commission.

**The Commission believes that general regulation will not lead to market foreclosure and has rejected the right to multi-brand. The Commission is concerned that multi-branding may increase distribution costs and tends to lead to free-riding by rival suppliers.**

- However, this approach:
  1. ignores the dangers of single-branding (affecting all types of multi-branding, not just same showroom) which might now be applied to retail networks and could undermine or delay market entry and expansion and, hence, prejudice consumer welfare through less choice and higher costs/prices;
  2. fails to produce any corroborating evidence to show that free-riding by rival suppliers is actually occurring to a material degree (and fails to recognise that most retail investment is borne by the dealer);

(Admittedly, not all investment by manufacturers is visible at the retail level; however, the Commission has not described in any detail the type of manufacturer investment that it feels could be put at risk by multi-branding. In this regard, the Commission appears willing to accept manufacturers' representations at face value which, given

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<sup>6</sup> For example, without the benefit of any Article 3 safeguards, a manufacturer could imply that any future transfer of a dealership would be blocked if the dealer/authorised repairer persists in sourcing certain spare parts direct from the OEM.

the potential ramifications on prices, consumer choice and convenience, is a significant concern.)

3. fails to acknowledge the Commission's obligation to scrutinise and challenge artificial standards intended to limit competition (i.e. the need for more vigorous enforcement); and
4. places undue faith on manufacturers to behave in an entirely rational way when it comes to weighing the potential for a more efficient sales network against their market share aspirations.

**The Commission appears to consider that sector-specific guidelines should plug any gaps in the application of general competition rules to the automotive sector.**

- However, the non-binding status of the guidelines generally may prove problematic in terms of:
  1. providing adequate legal certainty; and
  2. delivering any real deterrent effect.
- **Moreover, any guidelines should be at least as detailed as the 'Explanatory Brochure' which they replace – and should clearly identify where they apply to the retail market as well as after-sales. It would also be helpful if such guidelines outlined in greater detail the types of indirect restrictions that might infringe Article 101(1) and which might be difficult to justify under Article 101(3) with examples.**
- **To illustrate this point, the guidelines (and regulation) should make it clear that restrictions - single branding or otherwise - which purport to limit free riding, are only defensible where the relevant VM has made clearly identifiable, substantial and tangible investments in a dealer (to be defined)<sup>7</sup>, which would not have been made (in all reasonableness) if there were any real prospect that such investments would have been unfairly exploited for the benefit of others.**
- **The guidelines could also highlight that if, say, more than 30% of authorised dealer networks are subjected to single branding (non-compete) obligations in any Member State, the Commission could presume such obligations to have a market foreclosure effect, in which case the Commission would seek to withdraw or dis-apply the benefit of block exemption from all such restrictions. At the very least, the guidelines should be more specific about how the Commission would investigate potential foreclosure effects in the case of a certain percentage of the market being subject to certain types of restriction.**
- **The guidelines should also indicate that any post-term non-compete obligation is likely to infringe Article 101(1). To date, these types of restriction have not been prevalent in the automotive sector (partly as a result of the very substantial level of investment that dealers are asked to make); however, if such restrictions are introduced now, they will be used as yet another powerful tool to control dealers.**

**The Commission has noted previously that "...market forces have led the [automotive] sector to develop positively in a way initially not foreseen by the Commission..."<sup>8</sup>**

- In view of the uncertainties posed by the recent economic crisis, it would seem dangerous to predict the most appropriate regulatory solution for four years time. **While it is essential to prolong the MVBE until 2013 for the retail market, a longer extension, together with the promise of a further review towards the end of that period (i.e. by mid-2015) to see how the sector has oriented itself and help decide on the best regulatory outcome, would be more meaningful and far safer.**
- **Moreover, even if the Commission does not take the opportunity to revisit the Proposals as a whole at this stage, it should indicate that it is ready to re-introduce sector-specific regulation in full to new vehicle sales if it identifies any decline in competition as part of its 2015 review.**

<sup>7</sup> For example, see Article 3(4) of the previous motor vehicle block exemption (Regulation 1475/95)

<sup>8</sup> Evaluation Report (May 2008), page 11.

## **Conclusions**

- The idea of general, effects-based regulation is attractive from a theoretical perspective as, by definition, it will only ever target those practices that can be shown to harm competition; in other words, it works on the assumption that almost anything can be justified, provided the benefits (or efficiencies) outweigh the drawbacks.
- However, the danger with this approach is twofold:
  1. in an industry characterised by significant disparities in the bargaining power of different stakeholder groups, it creates significant 'grey areas', which can be exploited by those in the strongest position to obscure a range of restrictive agreements, measures and practices, with little danger of any challenge; and
  2. with very limited exceptions, it relies on post-mortem investigation, or cure rather than prevention, by which time the harm has already occurred and, indeed, the competitive landscape may have deteriorated irreversibly (whether through structural changes, such as market exits, or simply as a result of an ingrained lack of confidence in effective regulation on the part of weaker operators).
- The NFDA considers that Regulation 1400/2002 already strikes a sensible balance between effects based regulation on the one hand, and being sufficiently detailed on the other to ensure that parties are reasonably aware of their respective obligations and have the practical means to challenge excessively restrictive behaviour.
- It is not enough to enunciate general principles or outline a limited number of core rules; on the contrary, effective competition regulation in the automotive sector must:
  1. recognise the dangers of potential market foreclosure and reduce the risk of it arising (i.e. before the event);
  2. comprehensively address a wide range of measures (both direct and indirect), which could be applied by manufacturers to undermine competition and consumer welfare; and
  3. provide clear, predictable and enforceable guidance.
- This will enable affected parties to better identify, challenge, and correct anti-competitive behaviour, whether as a self-help remedy or by means of a complaint to the appropriate authority.

## Appendix 1

### (Scenarios)

#### Scenario 1

- Manufacturer D operates a selective distribution network. It is unhappy that one of its dealers, Dealer F, is selling outside of its target area to consumers in another Member State - at a discount to local recommended retail prices. Manufacturer D knows that it is unable to prevent cross-border sales activity, at least, overtly.
- Although Dealer F is, in most other respects, a model dealer, Manufacturer D decides to terminate Dealer F's appointment on six months' notice,<sup>9</sup> which it is entitled to do under the terms of its (post-regulation 1400/2002) dealer agreement.
- Dealer F knows why Manufacturer D has terminated its agreement in reality, but because Manufacturer D is not obliged to provide detailed, objective and transparent reasons for termination (as would have been the case previously) and is simply entitled to terminate on notice, decides not to pursue any legal challenge.
- Dealer F is aware that several other manufacturers that it represents at different sites (but under similar agreements) are also unhappy with Dealer F's cross-border sales. Dealer F decides to discontinue such sales before it receives similar termination notices.
- Dealer F's consumers suffer as a result of less choice and higher local prices.
- Admittedly, there may be safeguards against this type of indirect restriction or pressure in the general regulation and its guidelines; however, as is the case elsewhere in these scenarios, without any practical means of challenge on the part of the weaker party, there is a real risk that the good intent of the regulations will be frustrated or circumvented by subtle measures designed to achieve anti-competitive ends.

#### Scenarios 2A and 2B

- Dealer N represents Manufacturer G at four sites where it also provides authorised repair and parts distribution services in respect of Manufacturer G's vehicles. Dealer N has started to obtain a certain quantity of its spare parts from OEMs, which can supply Dealer N at a cheaper price, rather than sourcing them through Manufacturer G.
- **(2A)** Dealer N believes that even greater savings can be achieved if it acquires three more dealerships/authorised repair facilities in its region (also part of the Manufacturer G franchise). Manufacturer G is concerned that this will result in a further loss of parts sales and refuses to approve the transfers.
- **(2B)** Alternatively, in the absence of any proposed purchase or otherwise, Manufacturer G might simply decide to increase Dealer N's sales targets for new vehicles artificially, so that Dealer N cannot achieve its essential sales bonus margin – the inference being that the vehicle sales targets may be adjusted to more reasonable levels if Dealer N concentrates all of its parts purchases back with Manufacturer G.
- Dealer N is denied the opportunity to grow its business and/or is strongly discouraged from exploiting alternative parts supply channels in future. Its ability to deliver aftermarket cost-savings to its customers is compromised as a result of pressure applied to its primary market activities.

#### Scenario 3

- Dealer J is an authorised dealer and repairer of Manufacturer M and operates from several locations. It has identified an opportunity to open an independent repair facility in a neighbouring region as it:

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<sup>9</sup> Or even on two years' notice, if Manufacturer D has committed to abide by any code of conduct.

- considers there is local demand for such a facility;
  - has the relevant expertise; and
  - believes that the target consumers want a no-frills but high quality service which, in light of its experience, it can deliver efficiently without the burden of non-essential authorised repairer standards. Dealer J attempts to establish its independent repair operation.
- Dealer J immediately encounters resistance from Manufacturer M on the basis that there is an authorised dealer/repairer already servicing that area (or, indeed, that the area is an open-point that Manufacturer M wants to fill). Manufacturer M begins increasing Dealer J's car sales/purchase targets dramatically and implements an aggressive standards auditing process (with the implication being that minor failures could give rise to contract terminations in respect of all Dealer J's dealerships). With no means to challenge this behaviour, Dealer J abandons its plans.

#### Scenario 4

- Dealer Group A operates from 15 dealership/authorised repairer sites across a number of regions in one Member State. Manufacturer X, a large well-established manufacturer, accounts for the majority of Dealer Group A's franchises (and is represented at 12 of its sites).
- However, under Regulation 1400/2002 (and its predecessor), Dealer Group A has established a number of multi-franchised sites and converted a number of solus sites to multi-franchised status. Indeed, at eight of its sites, Dealer Group A sells the brands of Manufacturers Y and Z alongside X's brand (five of which are same-showroom arrangements).
- Manufacturer X tolerates this set-up under its agreements because it wants the certainty of block exemption, but (in reality) is unhappy with the multi-branding arrangements (except at two marginal locations) because it considers that they detract from its brand and erode its local market share. Manufacturer Y is a new market entrant trying to establish a wider distribution footprint and Manufacturer Z is a market 'maverick' with a history of aggressive discounting.
- In anticipation of the expiry of Regulation 1400/2002, Manufacturer X tells Dealer Group A that if it wants to remain within its network (which it knows will be essential to the overall viability of Dealer Group A) it will sign up to new open-ended agreements that permit Manufacturer X to insist that, either as a whole dealer group or at any dealership site, Dealer Group A must purchase not less than 80% of its new vehicle requirements from Manufacturer X.
- Manufacturer X decides to apply this discretion at all of the sites at which it is present (except the two marginal sites), the long-term effect of which is that Dealer Group A is unable to renew/is obliged to terminate its relationship with Manufacturers Y and Z at six key sites. This has a knock-on impact in terms of their aftermarket activities at those sites.
- Manufacturers Y and Z are potentially foreclosed from those areas; customers have to travel further to test/source their cars and get them serviced and repaired at an authorised outlet. Manufacturer X is insulated from competitive rivalry at those sites, and consumers lose out as a result of less choice and less intense price competition.

**Appendix 2**

**(Draft regulation and guidelines)**

(See attached)