

At the Crossroads: Europe's Motor Vehicle Block Exemption

by

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From Detroit to Deutschland, major car manufacturers and their dealer networks are becoming increasingly reliant on government support, whether in terms of bridging loans or subsidized retail incentives designed to stimulate consumer demand. In the United States, the “Big Three” face enormous challenges. Elsewhere, sharp falls in production and demand exacerbated by the squeeze on credit has led to claims that the car industry is “battling for survival.”¹

In the United Kingdom, one of Europe's largest car markets, production in April 2009 was down over 55% year-on-year, with many plants suspending shifts. In Germany, manufacturers, such as Porsche and Mercedes-Benz, have reported a one-third drop in sales and over half of the sector's employees are working reduced hours.²

According to Martin Winterkorn, Chairman of VW:

*“We have never before seen this kind of crisis...
I don't know what else is going to happen...”*³

Against the background of this crisis and uncertainty, the European Commission is expected to decide the future of the single most important piece of EC legislation affecting the distribution of new motor vehicles and automotive servicing and repair – the Motor Vehicle Block Exemption (the “MVBE”).⁴

I. MVBE: Background

The MVBE is an antitrust regulation focused on the automotive sector, although its remit is broader than antitrust as, arguably, its provisions extend to principles of contractual and commercial fairness. It largely came into effect on 1 October 2003 (replacing an earlier regulation) and, unless renewed, will expire on 31 May 2010.

Like other EC block exemptions, the MVBE provides a “safe-harbor” from the general prohibition on anti-competitive agreements. Article 81(1) of the EC Treaty prohibits agreements that are likely to affect trade between EU countries significantly and thus to restrict or distort competition appreciably. However, Article 81(3) provides that this general prohibition does not apply when the economic advantages attached to particular agreements outweigh their anti-competitive effects.

The European Commission recognizes the difficulty in individually assessing every potentially restrictive agreement to see whether it meets the criteria for exemption set out in Article 81(3). Therefore, the Commission has published a series of block exemptions, which describe standard conditions for exempting certain types of agreement. There are a number of block exemptions, including those which provide a safe-harbor

¹ Jean Eaglesham, *Carmakers press for urgent aid*, FINANCIAL TIMES, 24 January 2009.

² *German car industry rattled by crisis*, AAP, 16 May 2009 (livenews.com.au).

³ Dietmar Hawranek, *German Auto Industry Facing the Abyss*, SPIEGEL, 25 November 2008.

⁴ Commission Regulation (EC) No. 1400/2002.

for certain categories of vertical agreements⁵ (i.e. most distribution agreements) and those which exempt certain categories of technology transfer agreements⁶ (for example, patent and know-how licensing and production agreements).

However, the MVBE is unusual because it is virtually the only remaining industry-specific block exemption⁷ – focusing on the types of agreement and restrictions that are permissible in the context of the distribution, servicing and repair of motor vehicles in Europe. Indeed, the MVBE has been, if not the blueprint, a highly influential factor in how car makers have structured their European sales and after-sales networks.

II. MVBE: Features

The MVBE came about as a result of the European Commission wanting to encourage greater cross-border trade (and more innovative forms of distribution) in the automotive sector, as well as opening up after-sales networks to more competition. The Commission also felt that the position of dealers, repairers and independent aftermarket operators should be strengthened, such as to limit the risk of past market abuses.⁸ As Mario Monti (the then Competition Commissioner) noted in 2003:

“The [MVBE] represents a fundamental move away from a distribution environment whose lines were

rigidly laid down by regulation and by car manufacturers, towards a more balanced flexible system in which all operators have more scope to act pro-competitively. It offers an unprecedented opportunity for those who are willing to be imaginative in the way that they carry out their business and who are prepared to respond to consumer demand rather than conform to a single model. At the same time it reduces the opportunities for car manufacturers to abuse their powers, as we know has occurred in the past.”⁹

In light of these objectives, the MVBE makes the benefit of the safe-harbor (i.e. the block exemption) contingent on:

- vehicle manufacturers not imposing any blacklisted hardcore restrictions on their distribution networks, which range from relatively standard abuses such as price-fixing (including resale price maintenance) and market partitioning to industry-specific competition concerns such as restrictions on the sale of spare parts to independent repairers;
- vehicle manufacturers not combining features of exclusive and selective distribution in the same markets for their vehicles (for example, if dealers are allocated an exclusive territory, the manufacturer is not entitled to prevent such dealers from selling to unauthorized resellers) as well as the introduction of

⁵ Commission Regulation (EC) No. 2790/1999.

⁶ Commission Regulation (EC) No. 772/2004.

⁷ The other sector-specific regulation being the Insurance Block Exemption - Commission Regulation (EC) No. 358/2003 - which itself is due to expire on 31 March 2010.

⁸ The Commission was particularly concerned that consumers were suffering harm as a result of the sustained anti-competitive practices of a number of major car manufacturers including Volkswagen (two separate infringements), Opel and DaimlerChrysler. These practices, which prevented consumers from exploiting the single EU market, resulted in the Commission imposing a series of fines totalling well over €200 million.

⁹ SPEECH/03/59, 6 February 2003.

qualifying market share thresholds;¹⁰

- vehicle manufacturers not preventing dealers to sell/service motor vehicles of several competing brands;
- the ability of dealers (and repairers), within a selective distribution system, to open up secondary sales (and service) outlets anywhere in the EU;
- the ability of dealers to separate retail and after-sales activities (i.e. for a dealer to subcontract repair and servicing activities to a third party);
- the ability of dealers and repairers to transfer their franchises to other dealers and repairers within their franchised network (without having to obtain the manufacturer's approval);
- an obligation on manufacturers to provide a minimum of two years' notice of termination for open term agreements (save in certain circumstances and provided the dealer is not at fault) or, for fixed term agreements, a minimum of a five year fixed term;
- an obligation on manufacturers to give detailed and objective reasons for dealer or repairer terminations;
- the ability of a manufacturer and its authorized dealers or repairers to refer disputes to an independent expert or arbitrator;
- the ability of authorized repairers to source quality spare parts from independent wholesalers;

- the ability of suppliers of original equipment to sell their products as spare parts to any aftermarket operator;
- the ability of suppliers of original equipment to place their trade mark or logo on components supplied to a vehicle manufacturer; and
- the ability of independent aftermarket operators (such as providers of roadside assistance, multi-brand repairers, manufacturers of diagnostic equipment or parts wholesalers) to access technical information, tools and training required for the repair and maintenance of motor vehicles.

At the time it was implemented, the Commission believed that the MVBE would encourage new distribution techniques, increased price competition and improved access to spare parts as well as repair and maintenance services for customers across the EU.

III. MVBE: The Commission's Initial Evaluation Report

As with any block exemption, the Commission is obliged to evaluate the effectiveness of the MVBE within several years of its implementation – to decide whether or not to amend or renew it when it expires. For the Commission, this comprises a four stage process: i) an information gathering exercise; ii) the publication of an initial Evaluation Report; iii) a consultation process; and iv) the publication of a final Impact Assessment.

¹⁰ Regarding vehicle sales, to benefit from block exemption, the manufacturer's market share (based on all marques within its group) should not exceed: i) 30% for exclusive distribution systems; or ii) 40% for selective distribution systems which restrict dealer numbers by applying both quantitative (i.e. absolute limits on numbers) as well as qualitative (i.e. quality standards) criteria to their appointment. For after-sales, the threshold is set at 30% for both exclusive and quantitative selective distribution. Qualitative selection is exempted up to 100% market share. Clearly, completely open systems of distribution or those in which dealers or repairers are selected purely on the basis of meeting qualitative criteria do not tend to need the benefit of block exemption. The upshot of this feature of the MVBE is that most manufacturers in Europe have: i) pursued a system of selective distribution (based on quantitative and qualitative criteria) for their dealers; but ii) because of their strength in after-sales for their own vehicles, have pursued a system of 'qualitative-only' selective distribution for their repairers – thereby, in theory, admitting any repairer to their network which meets the manufacturer's standards.

The Commission published its preliminary conclusions on the effectiveness of the MVBE by way of a May 2008 Evaluation Report.¹¹

The Evaluation Report indicated that

- since 2002, competition within the automotive sector has improved generally; and
- the MVBE has helped to protect competition in markets for new vehicle sales, and to a more limited extent in markets for after-sales services, to the benefit of consumers.

However, the Commission also noted that:

- improvements in competition can also be attributed to external forces, for example, new manufacturers entering the market;
- problems continue to characterize the markets for spare parts, servicing and repair;
- the MVBE has resulted in some unexpected side effects, such as:
 - uniform (meaning ‘less innovative’) distribution networks; and
 - a disproportionate increase in standards, implemented as a reaction on the part of certain manufacturers to address concerns over greater independence being afforded to sales and after-sales networks.

Moreover, the Evaluation Report went on to suggest that other parts of the MVBE might be redundant; demonstrated by the apparently limited number of dealers taking up opportunities to set up sales and delivery outlets in other EU countries or pursuing a

retail-only business model (regardless of the wider economic rationale).

IV. MVBE: Reading Between the Lines

The Commission’s initial conclusion, in light of the above, appears to have been that competition might best be served by allowing the MVBE to lapse. This would mean that the automotive sector would then be regulated – from a competition perspective – under the general ‘vertical agreements’ block exemption which, as indicated above, currently covers distribution in most industries except motor vehicles.¹²

The Evaluation Report indicates that the application of this general block exemption, which exempts a greater range of behaviors than the sector-specific MVBE, could provide more flexibility and encourage greater innovation in distribution channels.

While this approach is perfectly in line with the general policy of using a less prescriptive and more economic approach in European antitrust policy, one should bear in mind that

- 1) the general vertical restraints block exemption would be considerably less advantageous for authorized dealers and repairers. For example, under the current vertical agreements block exemption, dealers could be restricted from selling competing makes of motor vehicle. Likewise, they would not be entitled to benefit from some of the provisions that support their competitive independence, for example, the right to two years’ notice of termination.
- 2) other than the current MVBE, the vertical agreements block exemption does not address a number of critical aftermarket issues. Among others,

¹¹ http://ec.europa.eu/competition/sectors/motor_vehicles/documents/evaluation_report_en.pdf

¹² Commission Regulation (EC) No. 2790/1999, also referred to as the ‘umbrella regulation’ or the ‘VRBE’. This instrument is set to expire on 31 May 2010, but is expected to be renewed without fundamental changes. A public consultation on the future VRBE is expected for the summer 2009.

it does not specify that independent aftermarket operators should have access to technical information required for repair or maintenance jobs.¹³ Similarly, it does not delineate whether a parts manufacturer (such as Bosch, Federal Mogul, Johnson Controls or Valeo) may place its logo on products supplied to the vehicle manufacturer.

- 3) under the general regime, the benefit of the block exemption is only available where the manufacturer's market share does not exceed 30%. In this regard, it is less generous than the MVBE. If the general regime became applicable to the motor vehicle sector, vehicle manufacturers might no longer benefit from a safe-harbor (block exemption) in their aftermarket activities.¹⁴ Rather, they would need to assess the compatibility of restrictive covenants with antitrust law on a case-by-case basis.

V. MVBE: Consultation and Feedback

Remembering that the Commission had, as part of its Evaluation Report, provisionally hinted at removing the sector-specific regulation, it is interesting to reflect on industry responses to the Evaluation Report which showed marked support for the retention of sector-specific regulation. On 21 November 2008, the Commission published the non-confidential versions of the responses to its post-Evaluation Report consultation, which had been received from interested parties that summer. Almost 110 responses were submitted to the Commission, of which over 70% appear to endorse sector-specific competition rules for the automotive sector.

Most interestingly, such endorsements came from a variety of different stakeholder groups (consumer organizations, dealer representatives, independent parts bodies, EU countries and even certain car makers). Some such views are reproduced below:

- *"...the NFDA continues to favor meaningful sector-specific regulation post-2010 to best ensure the development of competition and safeguard the improvements seen over the last six years."* RMI National Franchised Dealer Association, United Kingdom
- *"...the distribution of automotive spare parts and after-sales services should be governed by specific rules which ensure effective competition on all levels of the automotive after-sales market..."* FIGIEFA, International Federation of Automotive Aftermarket Distributors
- *"...we believe that only a sector-specific regulation can protect motorists from practices which might abuse their dependence on manufacturers..."* 40 million d'automobilistes (motoring/consumer body), France
- *"...the future regulatory framework should not weaken the degree of independence between dealers and manufacturers that has been achieved to date. New, innovative forms of distribution may possibly need more time to be created and established on the market, especially taking into account the predominantly small- and medium-sized structure of enterprises. This matter should not be decided solely by manufacturers."* Federal Ministry of Economics and Technology, Germany

¹³ For vehicle types approved under the Euro 5 emissions standard, i.e. as of 2009, an obligation to provide technical information to independent operators results from Regulation (EC) No. 715/2007. For the existing vehicle park, the situation is more complex. Arguably, vehicle manufacturers are obliged to provide such technical information under Art. 82 of the EC Treaty, which deals with abuses of dominant market positions. In four parallel decisions dated 13 September 2007, the Commission stated that each vehicle manufacturer had a monopoly on repair and maintenance information. The decisions are based on Art. 81 EC, as they relate to the combined effect of anti-competitive agreements. For a summary, see press release IP/07/1332 at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1332>.

¹⁴ In Europe, a vehicle manufacturer and its authorized network normally hold 40-60% of the relevant aftermarket.

“...the current block exemption regulation concerning motor vehicle distribution and servicing has clarified the application of competition rules on the automotive field and improved predictability.” Ministry of Employment and the Economy, Finland

“...we would welcome an essentially unchanged continuation of the current Block Exemption provisions as the future legal framework governing the automotive industry. The present Regulation 1400/2002...achieves a good overall balance in that it ensures the benefits compliment each other and deliver an overall benefit to the consumer.” Ford UK/ Ford UK dealers (joint submission)

VI. MVBE: A Change of Heart?

Following the consultation process, senior Commission officials stressed that the Commission is, notwithstanding its initial views on the MVBE, still keeping an open mind with regard to the retention of a sector-specific block exemption.

In a speech on 10 September 2008, Commission Vice-President and Commissioner for Enterprise and Industry, Günter Verheugen, stated:

“The [MVBE] has two key objectives: it provides legal certainty for all stakeholders, and it carefully balances their interests. Legal certainty is particularly indispensable where investment decisions have a long-term nature and require a significant amount of capital...Creating a legal framework that balances all stakeholders’ interests is a prerequisite for pro-competitive market behaviour and results, which of course need to be passed on to consumers.”

In her speech of 9 February 2009, the European Commissioner for Competition Policy, Ms. Neelie Kroes, assured stakeholders that the current macro-economic circumstances would be taken into account when deciding on the future competition law framework applicable to the automotive sector:¹⁵

“I am not tied to any particular outcome, and I am well aware that the situation today is different from when we began this process.”

VII. Rocky Road Ahead

Since the publication of the Evaluation Report, the Commission has been seeking to refine its initial conclusions, in the light of:

- a wide ranging endorsement of sector-specific rules from stakeholders;
- the present economic difficulties facing the global economy (and the motor industry in particular) which could be exacerbated by legal uncertainty; and
- the risk that a looser, more permissive regime might encourage players with significant market power to pursue restrictive strategies to the detriment of consumers.

Members of the European Parliament have voiced that right now, market players should be allowed to focus on adjusting to the economic crisis, rather than having to spend resources on adjusting to regulatory changes.¹⁶ Besides, the MVBE may not have been in force long enough to allow a proper economic analysis of its effects.

Against this background, the Commission and the national competition authorities of the 27 EU member states have discussed different scenarios on the future

¹⁵ Neelie Kroes, European Commissioner for Competition Policy, Closing remarks at roundtable to discuss future of the Car Block Exemption, Brussels, 9th February 2009, SPEECH/09/45.

¹⁶ Dr. Christoph Konrad, Member of the European Parliament, “Die Zukunft des Automobilsektors in Europa“, <http://www.cducusu.eu/content/view/5615/32/>.

legal framework. The options discussed include¹⁷

- 1) extending the existing rules;
- 2) applying the general 'vertical agreements' exemption to the automotive sector;
- 3) applying the general 'vertical agreements' exemption together with a set of guidelines illustrating how the general norms should be applied to the automotive sector;
- 4) drafting a new, more concise sector-specific regulation (possibly complemented by a set of guidelines).

In any of the four scenarios, the block exemption would not apply to agreements containing certain hardcore restrictions (i.e. resale price maintenance, restrictions on passive sales into territories or to customer groups allocated to other distributors, restrictions on active and/or passive sales to end users in markets where selective distribution is used, restrictions on the ability of original equipment suppliers to sell spare parts to independent repairers). Similarly, all four possibilities would contain specific conditions excluding the benefit of the block exemption from non-compete obligations lasting more than five years, from obligations preventing authorised distributors from selling products of particular suppliers, as well as certain post-term non-compete obligations.

The extension of the current rules (scenario no. 1) would mean that certain aftermarket activities of a vehicle manufacturer continue to benefit from the block exemption, as the sector-specific regime exempts

qualitative selection regardless of market share. Given the considerable market shares of 40-60% that vehicle manufacturers reportedly enjoy in the aftermarket, it is not obvious why they should require the benefit of an exemption in their aftermarket activities. At the same time, extending the current rules would imply the continuation of clauses aimed at protecting dealerships (i.e. minimum notice periods). Given that the market for new vehicles is highly competitive, the Commission repeatedly expressed doubts that these provisions were essential for achieving consumer benefits.

Applying the 'vertical agreements' exemption to the automotive sector (scenario no. 2) would lead to vehicle manufacturers' gaining more control over their authorized dealers. Among other things, the termination of dealer contracts or prohibiting the opening of secondary sales outlets would become easier for them. On the other hand, a vehicle manufacturer would lose the benefit of a block exemption for its aftermarket activities - and, thus, some of its ability to control the aftermarket - because its share in the relevant aftermarket is normally above the 30% market share threshold provided for in the 'vertical agreements' exemption.

Where a block exemption is not available, or where generic rules do not allow specific conclusions for the automotive sector, the stakeholders would be looking to the Commission for guidance. Therefore, scenario no. 3 provides for the issuance of sector-specific guidelines by the Commission, which would explain the application of the general regime to the automotive sector, and thus complement the 'vertical agreements' regulation.¹⁸

¹⁷ <http://www.kfz-betrieb.vogel.de/verbaeundpolitik/eupolitik/articles/189592/?nl=1&cmp=nl-125-1-280509>.

¹⁸ In their reactions to the Evaluation Report, numerous industry players had requested that such guidelines be issued. Apparently, many European companies and associations prefer legal certainty over a more economics-based approach, which might provide for more flexibility but which also makes it more difficult to predict how an enforcement agency may view a particular type of conduct. In this context, one should bear in mind that even a violation of a hard-core restriction merely implies that the benefit of the block exemption is no longer available. It does normally, but not automatically, follow that such conduct is incompatible with antitrust law, as an individual exemption might still be available under Art. 81(3) of the EC Treaty.

As a final alternative (scenario no. 4), the Commission considers a reduced sector-specific block exemption. Such an instrument would focus on the impediments to competition which the Commission has observed to exist, particularly in the aftermarket. It would contain specific rules, i.e. on the access of independents to technical information or on the ability of parts suppliers to apply their own logo even to products sold to vehicle manufacturers as original equipment. A regulation would continue to address the specific points of concern, and provide a certain degree of clarity for market players.

The Commission's final conclusions were published on 22 July 2009 in the form of an Impact Assessment.¹⁹

In essence, the Commission favours the application of the 'vertical agreements' block exemption to the distribution of new vehicles. But taking account of the current economic crisis and the need for stakeholders to adapt to a new regime, the Commission is prepared to offer a transitional period of three years, during which the current rules should continue to apply. Therefore, authorized dealers will not immediately lose the current level of protection regarding notice periods or secondary sales outlets. Moreover, the Commission plans to provide

guidelines on how competition law should be applied to the sector after the end of the transitional period. In other terms, the Commission plans to use 'scenario 1' for a period of three years before moving to 'scenario 3'.

As to the aftermarket, the Commission leaves open whether the aftermarket should be subject to the 'vertical agreements' regulation, or more tailored rules for the industry. There will be specific guidelines, and possibly a specific regulation. In either event, the Commission considers it a priority to align the relevant market share threshold at 30%. Where this threshold is exceeded, the benefit of the exemption is not available. In other terms, the Commission favors 'scenario 3' and 'scenario 4' when it comes to the aftermarket.

Stakeholders are invited to submit their comments on the Commission's conclusions by 25 September 2009.²⁰ Once having considered these comments, the Commission will vote on the new regulation and guidelines. Depending on their exact design, the future legal framework applicable to Europe's automotive sector could mean a bumpy ride for stakeholders – or an opportunity for antitrust enforcers to shift into high gear.

¹⁹ Full text available at http://ec.europa.eu/competition/sectors/motor_vehicles/block_exemption.html. The publication took place immediately before this article went to press, which is why only a summary report is included.

²⁰ Comments may be sent by electronic mail to comp-car-sector@ec.europa.eu by 25 September 2009.