

Client Alert

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EC Motor Vehicle Block Exemption Reform: Are You Ready For the New Regime? Stakeholders are Asked to Comment on Planned Changes by 25 September 2009

The motor vehicle sector, in particular the distribution of passenger cars, commercial vehicles, spare parts and repair services, is subject to a specific block exemption, Regulation (EC) No 1400/2002, which is due to expire on 31 May 2010.¹ Following a review launched in mid-2007, the European Commission adopted a Communication on 22 July 2009 to set out the basic policy orientations for the future legal framework that should apply to motor vehicle distribution and after-sales services agreements after the expiry of the motor vehicle block exemption.

Overall, the Commission proposes to scale back specific competition rules in the motor vehicle sector and intends to subject most of the motor vehicle sector to the general competition regime. The Commission proposes in particular that the general competition rules should apply to the distribution of new motor vehicles after 31 May 2013. It is further proposed to retain some specific rules for the aftermarket and spare parts markets. The revised aftermarket rules are supposed to take effect earlier, namely at the expiry of the current motor vehicle block exemption, *i.e.*, after 31 May 2010. In addition, the Commission proposes to publish guidelines to address sector-specific competition issues and to aid companies in the competition analysis of intended arrangements in the sector.

This *Client Alert* summarizes (i) the current status of the review of the motor vehicle block exemption, (ii), discusses relaxed single-branding rules, a new approach to "location," "sales only" and other contractual clauses in dealer agreements as well as restrictions on parallel trade in motor vehicle distribution agreements, and (iii) addresses the proposed rules governing open access to technical information, repair services networks and spare parts in the aftermarkets.

Stakeholders should carefully consider the impact of the planned revisions on their business practices. All interested parties are invited to submit comments on this Communication before 25 September 2009.

The Motor Vehicle Block Exemption Reform At A Glance

The motor vehicle block exemption (Regulation (EC) No 1400/2002) creates a safe harbor for categories of agreements in the motor vehicle sector that are caught by the prohibition in Article 81(1) of the EC Treaty, relieving companies concerned of the need to analyze whether those agreements meet the conditions of Article 81(3). Agreements not covered by a block exemption are not presumed to be illegal and are

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generally assessed on an individual basis unless the practices are identified as hard-core restrictions, in which case they are illegal.

On 22 July 2009, the European Commission (the "Commission") adopted a Communication to set out policy orientations for the future legal framework for motor vehicle distribution and after-sale services agreements after the expiry of the current block exemption in May 2010.² The Communication is based on an extensive fact-finding mission undertaken by the Commission that began in mid-2007.

Overall, the Commission proposes to scale back specific competition rules in the motor vehicle sector and intends to subject most of the motor vehicle sector to the general competition regime, in particular the general vertical block exemption.³ The Communication draws a basic distinction between the primary market for the distribution of new vehicles, where it has found no indications of significant competition shortcomings in the EU, and the so-called after-markets (markets for repair and maintenance services and/or for spare parts distribution), where the Commission considers that competition is less intense.

As regards the distribution of new motor vehicles, the Commission proposes the application of the general vertical block exemption on vertical agreements along with sector-specific guidelines. As regards the after-markets, the Commission is still considering whether to complement the general vertical block exemption with sector-specific provisions designed to address a number of problematic issues, retain a specific limited motor vehicle block exemption, and/or publish its views in guidelines.⁴

New Vehicle Distribution

The Commission has found that the markets for the distribution of new motor vehicles are highly competitive and customers benefit from falling prices. The Commission has also found that concentration levels are declining, and that Asian brands (*e.g.*, Chinese and Indian manufacturers) are increasingly present on the EU markets. Therefore, the Commission considers that special rules are no longer warranted and

proposes to apply the general vertical block exemption to sales of new motor vehicles. To address some remaining sector-specific issues, the Commission envisages to discuss issues such as single branding, quantitative selective distribution and contractual terms between car manufacturers and dealers, as well as some guidance on parallel trade issues in sector-specific guidelines. In order to allow all operators time to adapt to the general regime, the Commission proposes that the provisions of the motor vehicle block exemption remain in force in this area until 31 May 2013.

In the Communication, the Commission considers in particular the following policy choices in relation to the markets for the distribution of new motor vehicles:

Relaxed Single-Branding Rules

Single-branding obligations prevent or otherwise restrict dealers from selling competing brands. The current motor vehicle block exemption is stricter than the general vertical block exemption in respect to single-branding obligations. It prohibits obligations on dealers that go beyond 30 percent of their requirements. Thus dealers are theoretically free to sell at least three different brands, while such obligations are generally allowed to cover up to 80 percent of the requirements of the dealer under the general vertical block exemption.

The Commission observes that in practice the block exemption has had no significant impact in this area, as dealers using this option account for less than 1 percent of all sales. In addition, the Commission found that same-showroom multi-branding can dilute brand image, and can cause manufacturers to take steps to preserve it by adjusting dealership standards. They may also refrain from investing in their dealerships, for instance through training, in order to avoid free-riding risks. In practice, these factors have led to a general increase in the distribution costs borne by dealers, and ultimately by consumers.

Therefore, the Commission proposes the application of the general vertical block exemption to single-branding obligations with its higher 80 percent threshold. However, the mechanism that

allows the Commission to withdraw the benefit of the block exemption will be maintained as a safeguard. Moreover, the Commission plans to include its analysis of single-branding in the motor vehicle sector in the proposed sector-specific guidelines.

“Location” and “Sales-Only” Clauses

The current motor vehicle block exemption exempts quantitative selective distribution systems for new motor vehicles up to a 40 percent market share threshold and combines such a wide safe harbor with stricter hardcore provisions and specific conditions concerning, in particular, restrictions preventing dealers from subcontracting repair and maintenance activities (“sales-only” dealers) and the opening by dealers of additional sales outlets (the so-called “location clause”).

These stricter conditions were intended to stimulate diversity in car distribution models. However, the Commission observes that this has led to higher investment costs and lower margins for dealers.

The Commission proposes the application of the general vertical block exemption. This implies that selective distribution will become subject to the general market share threshold of 30 percent. “Location clauses” as well as restrictions of “sales-only” dealers will be exempted up to this reduced threshold, and will be open to an individual assessment above this threshold. Moreover, the Commission proposes to include guidance on assessing those cases where the relevant market share exceeds the applicable threshold of 30 percent in its proposed sector-specific guidelines.

Contractual Clauses

The current motor vehicle block exemption contains a number of conditions to protect the dealers’ independence (e.g., contract duration, periods of notice, motivation of contract terminations and transfer of dealerships contracts between the members of the same networks, as provided by Article 3 of the current motor vehicle block exemption). These provisions were intended to safeguard the dealers’ sunk costs.

The Commission observes that the regulation of particular contractual clauses in the context of a block exemption is no longer an effective means to protect dealers’ independence as the violation of the supposedly protective provisions cannot be sanctioned. Moreover, the ability to reorganize the dealers’ network is vital for the car manufacturers’ industry.

The Commission envisages abandoning such safeguards to apply the general rules. The Commission plans to include guidance on possibly anticompetitive practices by manufacturers in its new sector-specific guidelines.

Parallel Trade Issues

Almost in passing, the Commission notes that its new guidelines on the motor vehicle sector are going to include guidance on the circumstances in which agreements restricting dealers’ ability to obtain and resell vehicles with foreign specifications (“availability clauses”) would amount to an indirect restriction on active and/or passive sale and therefore infringe Article 81 EC.

Repair, Maintenance and Spare Parts

As regards the after-market(s), the Commission finds that competition there is by its nature limited because the Commission considers that there is a specific market for each brand of vehicle. This means that manufacturers’ authorized networks are generally considered to enjoy high market shares. Car repair is important to consumers, for safety reasons, but also because repair services account for around 40 percent of the lifetime cost of owning and running a car. The Commission finds that repair prices have risen and spare parts’ prices remain very high. Therefore, the Commission considers that it may be necessary to complement the general vertical block exemption with more focused provisions covering these issues. The Commission proposes that the new regime will apply to vertical agreements for the provisions of repair and maintenance services as well as for the supply and distribution of spare parts as from 31 May 2010 (i.e., the date of expiration of the current motor vehicle block exemption). The

new guidelines will contain additional guidance.

In the Communication, the Commission considers in particular the following policy choices in relation to the repair, maintenance and spare parts markets:

Technical Information

The current rules are intended to make sure that independent repairers operate on a level playing field with the authorized networks, and in particular that they can access the technical information they need to repair today's complex vehicles. Technical information must be made available in a way that is proportionate to independent repairers' needs. This implies both unbundling of information and pricing that takes into account the extent to which independent repairers use the information.⁵

In addition, if repairs were carried out without the correct technical information, this could lead to vehicles being driven in an unsafe condition, and add to air pollution and wasted fuel. In this regard, the vehicle emissions regulation, Council Regulation (EC) 715/2007, provides for a detailed set of rules ensuring full and non-discriminatory access to such information for all independent operators. This regulation will become mandatory for the new type approvals from September 2009 onwards (however, for several years, a large numbers of vehicles will not be covered by it).

The Commission also considers it important that warranty terms are not misused to prevent the owners of newer vehicles from using independent workshops for repairs and maintenance that are not covered by warranty.

The Commission proposes that sector-specific provisions deal with the circumstances in which a refusal to grant full and non-discriminatory access to technical information to independent operators, or a misuse of warranties, would infringe Article 81.

Open Access to the Authorized Repair Networks

Repair and maintenance services are considered to be brand-specific markets. As the network of the authorized

repairers and parts distributors of a given brand normally holds market shares well in excess of 30 percent, the safe harbor of a block exemption (whether motor vehicle or general) is typically not available. Thus, vehicle manufacturers are typically limited to choosing qualitative selective distribution systems, which fall outside the scope of Article 81 or can be justified under Article 81(3). Such systems must meet stringent requirements. In particular, access to the network of authorized repairers must be based on selection criteria which are objectively justified by bringing benefits to the final consumers.

The Commission proposes to clarify through future sector-specific provisions the circumstances in which qualitative selective distribution would fall outside the scope of the prohibition in Article 81 (*e.g.*, agreements linking sales and after-sales services may be possible for newcomers trying to enter a market).

Open Access to Spare Parts

Parts made on the same production line as the original component of the vehicle (OES parts) as well as parts made by "matching quality" parts manufacturers are often cheaper than identical parts bearing the brand of the vehicle manufacturer (OEM parts). Alternative supply channels for the distribution of spare parts to both independent and authorized repairers must remain open. On the one hand, independent repairers must have access to the full range of parts, including those that are only available from the vehicle manufacturer. On the other hand, authorized workshops must be entitled to purchase and use alternative brands of parts.

Under the current motor vehicle block exemption, restrictions by car manufacturers that prevent suppliers from selling to the after-market(s) are treated as hardcore restrictions. Under the general vertical block exemption such restrictions would not be considered as hard-core restrictions. While it may still be somewhat unlikely that parties could benefit from the safe harbor market share threshold of 30 percent, such provisions would in the future be subject to individual assessment. The Commission considers that this individual assessment would allow it

to target those agreements that do not benefit consumers. The Commission notes that agreements preventing independent repairers from getting access to original spare parts may also violate Article 82, when the vehicle manufacturer enjoys a dominant position in respect of a certain category of parts (e.g., captive parts).

The Commission will clarify in sector-specific provisions the circumstances in which the restrictions at issue would bring the underlying agreements within the scope of Article 81.

Next Steps

The Commission adopted this Communication to set out the basic policy orientations for the future legal framework that should apply to motor vehicle distribution and after-sales services agreements after the expiry of the current motor vehicle block exemption.

All of the main stakeholder groups, including car and parts manufacturers, dealers, roadside assistance operators and independent repairers need to be aware of the proposed changes and the possibility that they have to be involved in the reform process. All interested parties are invited to submit comments on this Communication before 25 September 2009.

Some of the proposed choices represent priorities also in relation to other Commission policies and thus they will not leave much space for debate in relation to the substance of the issue. For instance, access to technical information and alternative brands of spare parts will continue to be necessary preconditions for independent repairers to repair older vehicles so that they are driven safely, and meet vehicle emissions standards. However, the interested parties may submit comments to suggest to which level the proposed sector-specific guidelines should regulate the matter (e.g., the level of completeness of the technical repair information to which access is provided).

At this stage, it is not entirely clear how much, if anything, will remain of the sector-specific block exemption and whether the relevant provisions will be

integrated into the general vertical block exemption or will find their way into a "scaled down" sector-specific block exemption. It will also be interesting to see the proposed new guidelines for the motor-vehicle sector as it appears that the Commission plans to elaborate on some of the competition concepts applicable to the motor vehicle sector perhaps more extensively than it had previously. Typically, such guidelines would be published in draft form for comments prior to adoption.

Stakeholders should carefully consider the impact of the planned revisions on their business practices.

Each car or parts manufacturer, dealer, independent repairer or other interested party may take part in the reform process by sending their comments to the Commission as of now but before the deadline of 25 September 2009.

Endnotes

¹ Commission Regulation 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector, Official Journal L 203, 01.08.2002, pp. 30-41.

² Communication of 22 July 2009 on "The Future Competition Law Framework applicable to the motor vehicle sector," COM(2009) 388 final.

Following an in-depth market survey, the Commission had evaluated the impact of the block exemption on industry practices and the effects of those practices on competition in the EU markets in its Evaluation Report of 31 May 2008.

On the basis of the Evaluation Report and the ensuing consultations and discussions, the Commission's services have produced an Impact Assessment Report appraising the potential benefits and costs of various policy options for the future regime applicable to the motor vehicle sector. The Communication is therefore to be read in conjunction with the Impact Assessment Report.

³ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, Official Journal L 336, 29.12.1999, pp. 21-25. The general vertical block exemption is under review and the Commission is currently working on a revision.

⁴ Following the modernization of the EU competition rules, companies do not need a specific approval from the Commission for agreements that fall under Article 81(1). Instead

companies must conduct a self-assessment to verify that the conditions of Article 81(3) are met. As a result, block exemptions have lost some of their importance. That said, block exemptions continue to play an important role as in particular their safe harbor provisions provide legal certainty for companies. At the same time, Commission guidelines assist companies in assessing arrangements that may fall outside those safe harbor provisions.

⁵ For instance, in 2007, the Commission obtained commitments to provide technical information about car repairs to all independent garages in the EU from DaimlerChrysler, Toyota, General Motors and Fiat. See Commission press release of 14 September 2007 No. IP/07/1332.

The decisions were adopted under Article 9(1) of Regulation 1/2003. The commitments were given after a Commission investigation considered that inadequate access to the full range of technical information could drive independent repairers from the market and that the agreements between the carmakers and their authorized repairers would therefore infringe EC competition rules.

In addition, if repairs were carried out without the right technical information, this could lead to vehicles being driven in an unsafe condition, and add to air pollution and wasted fuel. The commitments will be binding until the current motor vehicle block exemption expires in May 2010.

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