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Distribution of new cars – no longer an issue for EU competition law?

Václav Šmejkal¹

Abstract: Distribution cartels in the automotive sector used to be frequently dismantled and sanctioned by the European Commission and the EU Courts still some 15 years ago. In recent years, however, only a few cases have been reported at the national level of EU Member States. Is it because the distribution of new cars really ceased to be a competition problem as the European Commission declared when it removed this part of the automotive business from the specific Block Exemption Regulation for the automotive sector in 2010? The purpose of the present analysis is first to inspect the car distribution cases that emerged in the EU after the year 2000 and, second, to speculate somewhat whether new forms of distribution, brought by the digitalization of marketing and sales, cannot bring about also new risks to cartel agreements and other types of distortions of competition in car sales.

Keywords: EU competition law, distribution of new cars, vertical cartels, national competition authorities

JEL Classification: L420, K210, K420

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1. Introduction

Traditionally, the European Union (EU) competition law has paid increased attention to the vertical relationship between car manufacturers and their dealers. The reasons for that were summarized in 2010 by the European Commission: “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. Suppliers wishing to influence a distributor's competitive behaviour may, for instance, resort to threats or intimidation, warnings or penalties. They may also delay or suspend deliveries or threaten to terminate the contracts of distributors that sell to foreign consumers or fail to observe a given price level.” (European Commission, 2010a, para 7).

In this excerpt from the currently valid Notice – Guidelines, the European Commission (EC) referred to the “history” as then – in 2010 – the situation was already perceived quite differently. The Commission described the present in the preamble (recital 10) of the so-called Block Exemption Regulation No 461/2010 for the motor vehicle sector: “As regards the distribution of new motor vehicles, there do not appear to be any significant

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competition shortcomings which would distinguish this sector from other economic sectors and which could require the application of rules different from and stricter than those set out in Regulation (EU) No 330/2010” (European Commission, 2010b). From the point of view of legislation and its application, the distribution of new cars has ceased to differ from other sectors, and moreover, has ceased to require attention of the EC. The Commission, for instance, also stopped in 2011 its monitoring of national differences in the prices of new cars and the publication of the annual Car Price Reports. Their goal had been to push down the price differences between Member States caused by the relative closeness of their national markets. In the Commission’s words: “Situation has improved greatly, in part due to enforcement action by the Commission, and also thanks to the increased availability of price information on the internet” (European Commission, 2020a). Even in 2021, based on extensive research over the previous decade, the Commission concludes that there is healthy competition for new vehicle sales, particularly in the passenger car sector, which accounts for 86.6% of all motor vehicle production in the EU. After 2010, the Commission has not had to deal with complaints either that car suppliers had put barriers in the way of intra-brand competition or that they had attempted any substantial obstruction of parallel trading (European Commission, 2021a and 2021b). The question suggests itself: Does the calm situation that prevailed in the distribution of new passenger cars in the second decade of the 21st century still endure at the beginning of its third decade? Can this period of calm end soon, as the car distribution is also gradually experiencing its digital revolution, which could bring “the end of car dealerships as we know them” (Mayor, Lakshman and Dubner, 2018)? The following text will therefore first review which offences the EU competition law enforcement authorities still had to deal with in relations between car manufacturers and their dealers between 2000 and 2010, then in the second decade of this century, and finally what is to be expected in the coming years. The aim will be to answer the question of whether the EU competition law will again have something to say on the distribution of cars, in particular, whether the shift to online shopping will create new risks to open and undistorted competition in new car sales and, last but not least, to propose possible solutions to prevent future breaches of the competition rules.

2. Stormy beginning of the 21st century

The purpose of this chapter is to show through the examples of significant case decisions that the classic model of relations between the manufacturers and their authorized dealer network was, in the years immediately after 2000, closely watched and shaped by EU competition law decisions of precedence, which even exceeded the boundaries of the automotive sector.

At the beginning of the century, in 2002, the Commission issued “a third generation” Block Exemption Regulation No 1400/2002 (European Commission, 2002a, Ramirez Pérez, 2020) for the automotive sector. The sale of new motor vehicles was dealt with hand in hand with sales of their spare parts and provision of repair and maintenance services (the current Regulation No 461/2010 – which replaced the Regulation 1400/2002 – already covers only the so-called aftermarket, which is the supply of spare parts and repairs). In addition, the Commission accompanied this relatively detailed act on the conditions of exemption from cartel prohibition under Article 101 (3) TFEU (former Article 81 (3) EC Treaty) by the comprehensive *Explanatory Brochure* dedicated to

Distribution and Servicing of Motor Vehicles in the European Union (European Commission, 2002b). The Commission's goal at that time still was to prevent automakers from restricting distributors or repairers from engaging in pro-competitive behaviour, such as active or passive sales to foreign consumers, multi-branding etc. Among other things, the Commission referred there to its recent decisions on the distribution cases of carmakers *DaimlerChrysler*, *Volkswagen* or *Opel*, which were subsequently reviewed by the Court of Justice of the EU and has remained relevant case law up to now.

In the 2005 *DaimlerChrysler* decision, the General Court interpreted and completed the criteria for determining whether, in competition law terms, the dealers in a car distribution network are part of the car manufacturer's undertaking or, on the contrary, independent undertakings (European Commission COMP/36.264; T-325/01). This was a matter of fundamental importance, as EU competition law does not regulate relations between parts of the same undertaking (economic unit), but only between undertakings competing independently. The fact that commercial agents have a legal identity of their own, or that they represent several competing brands, does not automatically guarantee them the status of independent undertakings under EU competition law. Therefore, at that time, the Commission distinguished between the so-called genuine and non-genuine agency agreements; and as a decisive factor as to whether an agency agreement was not genuine and fell within the scope of competition law considered the existence of "the financial or commercial risk borne by the agent in relation to the activities for which he has been appointed as an agent by the principal" (European Commission, 2000, para 13). According to the Commission, the level of risk borne by the genuine commercial agents – integral parts of carmaker undertakings – should be insignificant. It means that an agent will be considered as part of the principal's undertaking if he does not purchase distributed goods into his ownership, has to participate neither in financing transportation or storage of goods, nor in promoting sales or training of personnel. An agent also shall not be liable for damage caused by the product sold and would only lose his commission if a customer does not meet the terms of the contract. Conversely, if an agent does really bear any of these risks, he has a status of an independently competing undertaking (European Commission, 2000, para 15).

However, in its decision concerning Mercedes-Benz sales agents, the General Court conducted quite a detailed examination of the actual functioning of their relationship with the car manufacturer. On this basis, it concluded that the risks borne by the dealers could not have been assessed as real, genuine or representing "the main share of the price risk", and thus the agents were integral parts of the carmaker undertaking (T-325/01, paras 98, 111, 118). The risk criterion should further be applied on the basis of the actual functioning of the dealers' relationship with the car manufacturer and tested in terms of whether it is the real and the main one, rather than not being just insignificant.

The cases of *Volkswagen* (VW I, T-62/98 and C-388/00 P and VWII, T-208/01 and C-74/04 P), *Opel* (General Motors, T-368/00 and C-551/03 P) and later also *Peugeot* (T-450/05), have fundamentally shaped the approach of EU competition law to situations where seemingly unilateral measures by which the supplier binds its dealer network to a certain behaviour are actually vertical cartels between it and its distributors. In all these cases, the carmakers were trying to get their dealers, as independent undertakings, to sell more in their territories and not to other EU countries, respecting carmakers' pricing instructions, or both. As a unilateral practice of a non-dominant car supplier, such

behaviour would be outside of the reach of EU competition law. On the contrary, as part of the agreement between the car supplier and its distributors, it would be a hard-core vertical cartel consisting of the so-called resale price maintenance, export ban and/or market sharing. In its decisions, the Commission often relied on the existence of a cartel agreement as it took the restrictive requirement of the carmaker for an integral part of the relationship established *ab initio* by their general dealership agreement (even if it had been entered into in full conformity with competition rules).

However, the Commission repeatedly encountered rejection by the General Court and, after that, by the Court of Justice (although the latter did not rule out that even a perfectly legal general dealership agreement may later lead to a cartel) and had to recognize that proof of at least tacit cooperation by dealers would be a more certain way to prove a cartel (Sousa Ferro, 2007, p. 205-209). The lessons learned from these cases, which are applicable to vertical distribution relationships in general, have been summarized by the Commission in its 2010 Notice – Guidelines on vertical restraints as two possible ways of proving vertical agreement in the absence of an evident concurrence of wills between the carmaker and its dealers. Either the clauses of their general dealership agreement provide for a unilateral policy of the carmaker which has to be then followed by their distributors, or it has to be shown that distributors at least tacitly acquiesced to the carmakers' appeals or instructions – for instance by implementing them in practice (European Commission, 2010c, para 25).

All in all, in the subsequent generation of the Block Exemption Regulations adopted in 2010 (No. 461/2010, applied together with the non-sector specific Regulation No 330/2010 for vertical supply and distribution agreements), due to the factors mentioned in the introduction and the declining number of competition cases involving new car sales, the Commission was able to exclude the distribution of new cars from the specific legislation and to include it under the general regulation. The importance and scope of the aforementioned case law also contributed significantly to this development. Thus, the first decade of the 21st century was undoubtedly crucial for the completion of competition rules governing the distribution of new cars.

3. A decade (almost) free of vertical car distribution cartels

Indeed, in the second decade of the 21st century, there have been noticeably fewer vertical cartel cases, which would be handled directly by EU institutions. On several occasions, the Court of Justice of the EU has answered preliminary references from national courts. As a rule, however, the issue was not the distribution of new cars, but for instance, the right of independent repairers to access information from a given manufacturer in order to repair its brand of cars (C-527/18), or the joint and several liability of members of the cartel of car suppliers for damage caused to clients (C-451/18). Thus, only the *Auto 24 SARL* case, heard by the Court of Justice in 2012, represented a ruling still relevant to vertical distribution relationships (C-158/11).

The subject matter of the dispute concerned the criteria for selecting dealers in a system of quantitative selective distribution. Selective distribution, i.e. supplies only to authorized distributors, is harmless to competition only if the criteria of the dealers' selection are *qualitative*. Such criteria must correspond to the complexity of the product being distributed and its brand's reputation, and must be applied in an objective, non-

discriminatory manner. Conversely, *quantitative* distribution systems based on the selection of a fixed number of dealers per territorial unit may, in the worst-case scenario, create local distribution monopolies to the detriment of consumer welfare. EU competition law therefore exempts the quantitative selective distribution system (or a mixed system) from prohibition when both the supplier and his distributor keep their relevant market share below 30%.

The dispute before the Court of Justice of the EU was whether the car manufacturer, if meeting the requirement for a limited market share, can determine the number of authorized dealers in its quantitative distribution network according to its own criteria, or whether it must proceed on the basis of objectively substantiated ones. The court has refused to impose additional requirements on carmakers and refused to obviate the distinction between the conditions required of quantitative and qualitative distribution systems. Within a safe harbour of a 30% share of the relevant markets, dealers can be selected for a quantitative distribution according to the criteria specified by the supplier and stipulated in advance, so that it would be possible to identify and verify them. Other requirements such as the objective need, proportionality etc., would be redundant. Undoubtedly, a conclusion that has long-term validity for distribution also outside the automotive sector (Bushell, 2012).

In that decade, the European Commission concentrated with great intensity on horizontal cartels, especially those established by suppliers of parts and spare parts for car manufacturers. At the very end of the decade, the Commission opened an investigation into the largest German carmakers suspected of mutually restricting the development of technology for clean emissions for passenger cars (DW, 2019). Rare complaints of dealers against car manufacturers, like that of Italian car distributors against the change of dealership contracts by Volkswagen for its Seat brand of cars, were rejected in 2012 by the Commission for lack of specific information that would have supported the suspicion of illegal conduct (Wegner and Oberhammer, 2015, p. 674).

This shift of focus from vertical to horizontal cartels was reported also from the national competition authorities (NCAs) level. The NCAs were focusing on dealers too, but mainly on their own horizontal agreements or concerted practices aimed at lessening their mutual price competition. These cases were reported in the last decade from Spain, Slovakia (Wegner, Oberhammer and Berger, 2016, p. 700), Romania or Czechia (Wegner, Oberhammer and Berger, 2018, p. 271-272). In vertical relations, cases of disputes about admission to or vice-a-versa exclusion from the manufacturer's authorized network have been brought before national courts. The only classical hard-core vertical cartel agreement between a car manufacturer and its dealers of new cars apparently took place in Czechia, where Škoda was fined approx. €2 million in 2014 for resale price maintenance in distribution of a whole range of its cars (ÚOHS 2014, Radio Prague International, 2015).

Nevertheless, even during a decade so short of vertical car distribution cartels, there were signs of new developments that would then mark the beginning of the next decade. As the distribution in general goes online, so does the distribution of new cars. In 2015, the German *Bundeskartellamt* closed its investigation of car manufacturers Ford, Opel and PSA Peugeot Citroen which implemented bonus systems that, with certain variations, rather deterred dealers from using independent online marketplaces. No sanction,

however, was imposed as all three manufacturers clarified that their bonus systems were not aimed at preventing dealers from co-operation with internet-based car portals in the position of true customer intermediaries (and not dealers' sales agents) (Wegner, Oberhammer and Berger, 2016, p. 705). In the UK in 2017, the Competition and Markets Authority was addressed with a complaint against BMW, which allegedly prohibited its dealers from cooperating with car price comparison websites. As BMW was committed to changing the policy, no formal investigation was initiated (Wegner, Oberhammer and Berger, 2018, p. 276). A qualitatively new field of potential vertical restraints has thus been opening in the second half of the decade.

4. Online distribution of cars and the rules of free and undistorted competition

Current car market surveys show that the conventional sales method for vehicles is becoming obsolete (Schmidt, Trenka and Franzén et al., 2019, p. 4). The ever-strengthening trend is "the Amazonification of the auto industry" (Winkler, Mehl and Schatz et al., 2016, p. 8). Surveys conducted in countries like Germany or Sweden confirmed that, already in the period before covid-19, at least half of the customers would like to buy their next car online, either directly from the manufacturer or via a third party's online platform (Holmblad, Haldén and Sundin et al., 2018, p. 5; Stroem, Fischer and Hourmouzis, 2019, p. 8). The covid-19 pandemic seems to have turned this interesting trend into a standard procedure for choosing the next car (AmOnline, 2021). This, of course, changes the role of traditional dealers, who may find themselves "out of the game" in the sale of new vehicles (not in their subsequent servicing and repair). So far, they have been an indispensable link between the carmaker and its clients, especially since they gathered information on what clients are asking for and how they react to specific models and their offers. Therefore, without their cooperation or subordination, the manufacturer could not plan and implement its marketing and sales strategies. Suddenly, there is an opportunity to communicate with clients directly through the company's e-shop or indirectly through third parties' online marketplaces, and it is hard to imagine that any large carmaker would not want to profit from this dominant trend in distribution.

In addition to technology and market developments, manufacturers' relationships with their authorized dealer network are also affected by the evolving regulation of online trading by EU law. Under Regulation No 2018/32, the EU banned the so-called geo-blocking. It is nowadays firmly prohibited to block or limit a customer's access to a trader's online interface for reasons related to the customer's nationality, place of residence or place of establishment. Purchase of new cars online from other EU Member States cannot be hindered by an automatic redirecting of customers to websites of their home-country distributors. In the well-known ruling on the distribution of luxury cosmetics, *Pierre Fabre*, the Court of Justice of the EU condemned an absolute ban imposed by a manufacturer on distributors to sell its branded products on the internet as a hard-core vertical cartel (C-439/09).

Even more interesting for the distribution of cars, especially luxury brands, is the decision of the same Court in the (again cosmetic) case *Coty* (C-230/16). The Court of Justice of the EU acknowledged that a luxury brand manufacturer can adequately protect the image of its products by restricting its authorized dealers through which online marketplaces they sell their products. However, this limitation must also be set in qualitative terms as

part of a qualitative selective distribution system. It means that the manufacturer can determine on the basis of which objective criteria he will agree to offer his products through a third party's online platform. Other types of restrictions on online sales agreed between the carmaker and his dealers, or targeted boycotts of only certain online channels, will therefore very likely amount to a prohibited vertical cartel.

In terms of coordination of a dealer network by the carmaker, these “new” rules are merely an adaptation of the well-known competition rules to new distribution possibilities. The radical novelty of the situation today lies in the fact that similar restrictions may no longer be of interest to a car manufacturer, who used to be the main offender in the above-mentioned classical distribution cases, and usually also the only undertaking fined. Direct availability of new cars through channels other than just authorized dealerships, coupled with a fast and broad online comparison of offers and prices, exposes individual dealers to an unprecedented competitive pressure. Online distribution simply leads to intensified intra-brand competition, which inevitably reduces the profitability of traditional car dealerships (Schmidt, Trenka and Franzén et al., 2019, p. 18). In essence, they are coming under pressure from several concurrent trends.

Firstly, the more manufacturers are involved in direct sales, the more they will become direct competitors of their dealers. The Austrian Supreme Cartel Court decided a case in March 2021 in which the importer, *PSA Peugeot Austria*, competed with franchised dealers through subsidized vehicle prices on the end customer market at its own vertically integrated sales outlets, and passed on the costs of its mystery shopping and audit system for the new car and workshop business to these dealers (Rose, T. 2021). It was a nice illustration of a situation in which the branded supplier needs independent dealers less than before and is all the more likely to abuse its market power against them. In a similar situation, which could be typical of future development, one can imagine other forms of abuse of this imbalance to the detriment of independent dealers tied to the brand (margin squeeze, delayed deliveries of the most desirable models, unequal sharing of the costs of marketing campaigns, etc.).

Secondly, new car sales will come under increasing pressure from new mobility patterns, in particular car sharing, but also from a greater expansion of publicly supported urban and intercity transport. A significant part of the upcoming generation of drivers may prefer lending and sharing cars to their personal ownership. This phenomenon brings about a new competitor in the form of online ad hoc car rental or share service – which is already becoming commonplace in all major EU cities. Researchers at Ericsson Consumer & IndustryLab have found that in the coming years, 27 % of the respondents expect car-sharing services to be used as a regular commuting alternative by a large portion of city dwellers (Laya and Wias, 2021).

The expected contraction of the traditional car dealer market will inevitably intensify competitive pressures that will lead to concentrations among distributors, as only a large dealership with a very professional e-shop and delivery system and diversified services will be able to compete with large online marketplaces or direct online sales of the manufacturer. The Commission's recent market research found that large groups of dealers have continued to grow, while numbers of small dealers have continued to decrease over the past decade. Only large distributors, in addition to the manufacturers themselves, are now able to develop such modern sales channels as mobile pop-up stores,

supermarkets, experience centres, platforms... and last but not least, to pay rising real estate prices in inner cities. (European Commission, 2021b, p. 22, 92). Not surprisingly, the Commission has already identified a trend in recent years towards a lower density of authorised car dealers' networks and the corresponding extension of the geographic reach of the remaining dealers (European Commission, 2021a, p. 7).

This development can lead to clashes with the competition rules in several ways. It could increase the market share of a large, concentrated dealer in the relevant market, which, with a share of more than 30%, will push the contract between the distributor and the car manufacturer out of "the safe harbour" laid down by the Commission Block Exemption Regulation on vertical restraints 330/2010. The fact that, according to the Commission's findings, this market share has so far served well to exempt the majority of contracts from cartel prohibition may thus not be the case in the future. For the same reason, the Commission also expressed concerns that if these larger distributors hold a portfolio of brands in a particular local area, they may be potentially reducing inter-brand competition in that area (European Commission, 2021a, p. 5,7). And any attempt by them to mutually cooperate would usually mean sharing information on sales and clients, so a horizontal cartel between independent undertakings – direct competitors. For similar reasons, even the concentration at the distribution level may not always be a simple solution from the perspective of competition law. Concentrations of higher-turnover undertakings holding important market shares are subject to ex-ante control at national or EU-level and may not be permitted in all cases (or allowed only on restrictive conditions).

Although the trends described above will manifest themselves in different strengths and at different times in different markets (the EU is not yet a completely homogeneous market in terms of passenger car distribution, although differences are increasingly blurring), car dealers should be aware of the competition law pitfalls of the future they are entering.

5. Benefits of integrating production and sales from a competition law perspective

For all the above reasons, the gradual transition from independent dealerships to the position of dependent sales agents appears to be much less risky – precisely from the perspective of competition law. Such agents are, in accordance with the *DaimlerChrysler* case law cited above, incorporated into the undertaking of the supplier, and although they do not legally lose their identity, competition law will not affect their relationship with the carmaker. Agents will become, for manufacturers, the endpoints of the real-world contact with customers who previously booked their preferred car model online. Of course, dealers will lose a large part of their existing independence. Carmakers will not be able to transfer part of the risks to an independent intermediate link. Otherwise, the transition to this distribution model provides an escape from most competition law risks caused by the rise of the digital economy.

There would be no risk of competition rules' infringement when sharing current customer data between dealers, or between them and the car manufacturer. While if one maintains a network of independent dealers, the same data sharing would most likely lead to the coordination of the network's behaviour or could easily be abused by the carmaker exerting pressure on the dealers acting outside its unifying instructions. As the collection and utilization of customer data become ever more important, such obstruction by

competition law on their sharing may put at disadvantage those independent distributors' networks that do not convert themselves in agents' networks (Krauskopf and Babey, 2016). Car manufacturers would acquire through the network of dependent sales agents full control over online and offline channels, over prices charged and discounts granted by each agent and over their overall performance. Manufacturers will be able to plan and execute all marketing and sales activities, to standardize and optimize them, as well as to further develop their sales network etc. without risking the conflict with the EU ban on cartels (Schmidt, Trenka and Franzén et al., 2019, p. 24). Markets open to global competition should ensure continued inter-brand competition, which the Commission has so far found to be sufficiently intense in the passenger car sector (to a lesser extent in light commercial vehicles, trucks and buses sectors) over the long term (European Commission, 2021a, p. 11).

In theory, the offered solution seems to be a clear choice. In practice, however, some clashes with competition law, as suggested above, are likely to occur because the choice of an independent market breakthrough may be more attractive to many dealers than the loss of independence. The transformation of the distribution of new cars online into an innocuous form will therefore also bring new competition cases. In 2022-23, a new Commission Block Exemption Regulation for vertical restraints, together with the one for the motor vehicle sector, are expected, accompanied by a new Notice – Guidelines (European Commission, 2020b; Chowdury, 2019). According to the current information, these crucial documents for the formation of distribution systems should be innovative precisely in terms of new developments forced by technological, environmental and mobility pattern changes and their impact on the selective distribution systems. Answers to a number of current questions about “the end of car dealerships as we know them” are already being worked on in the European Commission offices (European Commission, 2020c, 2021a,b). The ongoing transformation of the passenger car sales sector calls for due attention to this upcoming regulatory innovation.

Conclusion

The present analysis showed that the mission of EU competition law to tame distribution cartels in the sale of new cars could have been accomplished in the pre-digital era. At the beginning of the 21st century, rules for “the brick-and-mortar” car dealership networks had been fixed by the case law of the Court of Justice of the EU. The European Commission's Notices-Guidelines had led carmakers and their distributors – at least in new car sales – outside the conflict zone with EU competition law. The lessons learned from these EU bodies' conclusions and statements are still valid and the case law cited above maintains its relevance today. At the same time, however, the ongoing expansion of online trading creates new situations and new challenges that move the classical model of car sales through dealership networks off the track. New types of car sellers and new models of car use change the competitive situation in the industry. The dependence of market success on the ability to collect, evaluate and effectively use clients' data creates new competitive risks. The future is therefore open, and competition law's fight against distribution cartels in the sale of new cars has definitely not ended yet. The merger of production and distribution under one roof seems to be a possible safeguard against distortions of competition rules. However, compliance with competition law is only one aspect that may not prevail easily or quickly when setting strategies.

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