



3-1-2007

A Comparative Analysis of the EU Regulation Governing the Automotive Industry and the U.S. Antitrust Law: Suggestions for the Block Exemption Regulation 1400/2002

Chan Yong Jeong

Follow this and additional works at: <https://digitalcommons.lmu.edu/ilr>



Part of the [Law Commons](#)

Recommended Citation

Chan Yong Jeong, *A Comparative Analysis of the EU Regulation Governing the Automotive Industry and the U.S. Antitrust Law: Suggestions for the Block Exemption Regulation 1400/2002*, 29 Loy. L.A. Int'l & Comp. L. Rev. 309 (2007).

Available at: <https://digitalcommons.lmu.edu/ilr/vol29/iss2/4>

This Notes and Comments is brought to you for free and open access by the Law Reviews at Digital Commons @ Loyola Marymount University and Loyola Law School. It has been accepted for inclusion in Loyola of Los Angeles International and Comparative Law Review by an authorized administrator of Digital Commons@Loyola Marymount University and Loyola Law School. For more information, please contact digitalcommons@lmu.edu.

A Comparative Analysis of the EU Regulation Governing the Automotive Industry and the U.S. Antitrust Law: Suggestions for the Block Exemption Regulation 1400/2002

I. INTRODUCTION

The European Union (“EU”) has a number of sector-specific competition laws, called Block Exemption Regulations (“BERs”). Among them, the EU Commission (“Commission”) recently revised a BER governing the automotive industry, *Commission Regulation (EC) No 1400/2002* (“the third BER”).¹ While the third BER became effective in October 2003,² controversies have arisen about its rules and effects because it has unique and experimental features. Further, the expansion of the EU made the situation even more complicated.³ Within the automotive industry, car manufacturers, wholesalers, and dealers have been struggling to find out the third BER’s market impact and to develop strategies for maximizing profits and complying with the new rules.⁴ At the same time, they have been vigorously negotiating terms of their new relationship in the changing market environment.⁵

1. See Commission Regulation No 1400/2002 of July 31, 2002, on the Application of Article 81(3) to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector, 2002 O.J. (L 203) 30 (EC).

2. *Id.* art. 10.

3. See The EU at a Glance: The History of the European Union, http://europa.eu.int/abc/history/index_en.htm (last visited Oct. 7, 2005) [hereinafter History].

4. See, e.g., Press Release, Office of Fair Trading, TVR Reminds Dealer Network to Comply with EU Block Exemption Regulation (Jan. 24, 2006) (on file with Office of Fair Trading), available at <http://www.offt.gov.uk/news/press/2006/13-06>; *Wheels Turning for Big Changes, But Auto Sector Remains Flexible*, PRAGUE BUSINESS JOURNAL, Dec. 15, 2003 [hereinafter *Wheels Turning*].

5. See, e.g., *Wheels Turning*, *supra* note 4.

Even though the third BER made significant progress compared to the former BER, it does not fully integrate the automotive market and maximize consumer benefits in the EU. Thus, the third BER may adversely affect the automotive industry. This Comment will discuss the rules of the new BER⁶ and provide policy suggestions for the next legislation scheduled in 2010.⁷ Part II provides a general overview of the historical and legal background. Part III analyzes the new rules in comparison with rules of United States (“U.S.”) competition law.⁸ Part IV discusses the market impact of the third BER. Finally, Part V evaluates the progress and limitations of the third BER and makes policy suggestions.

II. BACKGROUND

A. *Historical and Legal Background*

Reflecting the goal of a unified market within the EU⁹ that will benefit the consumer,¹⁰ Article 81(1) of the Treaty Establishing the European Community prohibits any agreement directly or indirectly restricting competition and trade among countries.¹¹ However, Article 81(3) also provides that Article 81(1) would not apply to any agreement that improves the production or distribution of goods or promotes technical or economic progress while allowing consumers a fair share of the resulting benefit.¹² Whether the benefits outweigh the anti-competitive effects depends on the market structure and is generally determined through an individual assessment.¹³ Additionally, the Commission

6. This Comment focuses on the competition laws at the European Community level, which governs vertical restraints in the context of dealership agreements for the sale of vehicles and after-sales service.

7. Commission Regulation 1400/2002, art. 12, para. 3, 2002 O.J. (L 203) 30, 41 (EC).

8. In the end, the relationship between the EU member countries would be substantially the same as that of states in the United States. In that sense, the comparative analysis of the new BER and the U.S. competition laws governing automotive industries would be very useful background for evaluating the new BER and developing suggestions for the next legislation.

9. Consolidated Version of the Treaty Establishing the European Community art. 23, 2002 O.J. (C 325) 33 [hereinafter EC Treaty].

10. *Id.* art. 153.

11. *Id.* art. 81(1).

12. *Id.* art. 81(3).

13. European Commission, Competition Directorate General, *Distribution and Servicing of Motor Vehicles in the European Union: Explanatory Brochure on*

can grant exemptions for a whole category of agreements by enacting BERs.¹⁴ The Commission enacted Commission Regulation 2790/1999 as a general BER that applies to vertical agreements in all sectors of industry and trade.¹⁵ However, this regulation does not apply where the Commission adopts a sector-specific BER.¹⁶

Along this line, the Commission enacted sector-specific regulations for some industries including the automotive industry.¹⁷ After enacting the first¹⁸ and the second¹⁹ BERs governing the automotive industry in 1985 and 1995 respectively, the Commission published the third BER, which became fully effective on October 1, 2003, after a one-year transition period.²⁰

B. Legislative Intent

In 2000, the Commission issued a report that evaluated the second BER, Regulation 1475/95.²¹ The report found that: (1) consumers did not derive a fair share of benefits from the former system, (2) competition between car dealers was not strong enough, (3) car dealers remained too dependent on car manufacturers, and (4) consumers found it difficult to make use of their single market right to take advantage of price differentials between member countries.²²

Commission Regulation (EC) No 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, at 8 (2002) [hereinafter *Explanatory Brochure*], available at http://europa.eu.int/comm/competition/car_sector/explanatory_brochure_en.pdf.

14. *Id.*; Council Regulation 1215/1999, paras. (1)-(2), 1999 O.J. (L 148) 1 (EC); EC Treaty, *supra* note 9, art. 211.

15. See Commission Regulation 2790/1999, arts. 4-5, 1999 O.J. (L 336) 21, 23-24 (EC).

16. See *Explanatory Brochure*, *supra* note 13, at 8.

17. Memorandum, Competition Directorate General, The Commission Regulation for a New Motor Vehicle Block Exemption – Questions and Answers – Background Information on Press Release IP/02/1073 (July 17, 2002) [hereinafter *Questions and Answers*], <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/02/174&format=HTML&aged=0&language=EN&guiLanguage=en>.

18. See Commission Regulation 123/85, 1985 O.J. (L 15) 16 (EC).

19. See Commission Regulation 1475/95, 1995 O.J. (L 145) 25 (EC).

20. See Commission Regulation 1400/2002, art. 10, 2002 O.J. (L 203) 30, 40 (EC).

21. *Commission Report on the Evaluation of Regulation (EC) No 1475/95 on the Application of Article 85(3) of the Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements*, COM (2000) 743 final (Nov. 15, 2000) [hereinafter *Evaluation Report*], available at http://europa.eu.int/eur-lex/en/com/rpt/2000/com2000_0743en01.pdf.

22. Press Release, European Commission, Commission Adopts Comprehensive Reform of Competition Rules for Car Sales and Servicing, IP/02/1073, at 2 (July 17, 2002)

Along this line, the Commission decided to make “smooth but real” changes for the third BER.²³ Among the most important aims were to make cross-border purchases of new vehicles significantly easier, increase competition between dealers, and create greater price competition.²⁴ Thus, the third BER now prohibits many trade restraints allowed under the first and the second BERs.²⁵ Therefore, the third BER made significant and substantial progress toward creating a unified free-trade automotive market in the EU.

C. Standard of Review

BERs confer a presumption of legality.²⁶ Thus, a dealership agreement that meets the third BER’s requirements would be presumed legal under Article 81(1). However, if an agreement contains any restraints listed in Article 4 (Hardcore Restrictions) of the third BER, the whole agreement cannot benefit from the block exemption and will be subject to proceedings for individual exemption.²⁷ Because the individual exemption of vertical agreements containing Hardcore Restrictions is unlikely,²⁸ any violation of the rules in Article 4 would be deemed *per se* illegal²⁹

[hereinafter Comprehensive Reform Press Release], <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1073&format=HTML&aged=0&language=EN&guiLanguage=en>; Questions and Answers, *supra* note 17.

23. Mario Monti, European Commissioner for Competition Policy, Speech at the Ninth Annual European Automotive Conference: Car Retailing at a Crossroads, The New Legal Framework for Car Distribution (Feb. 6, 2003), <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/03/59&format=HTML&aged=0&language=EN&guiLanguage=en>.

24. Comprehensive Reform Press Release, *supra* note 22.

25. *Id.*; Questions and Answers, *supra* note 17, at 2.

26. Commission Notice 291/01, Guidelines on Vertical Restraints, section III, para. 1(21), 2000 O.J. (C 291) 1, 6 (EC).

27. Commission Regulation 1400/2002, art. 4, 2002 O.J. (L 203) 30, 38-39 (EC); *Explanatory Brochure*, *supra* note 13, at 28.

28. Commission Notice 291/01, Guidelines on Vertical Restraints, section III, para. 3(46), 2000 O.J. (C 291) 1, 11 (EC).

29. *See, e.g.*, Case C-235/92, *Montecatini SpA v. Comm’n*, 1999 E.C.R. I-4539, para. 132 (holding that analysis on competitive effects was not necessary because there was no doubt that an agreement to fix prices and to limit production constituted *per se* infringement); Case T-112/99, *Métropole Télévision v. Comm’n*, 2001 E.C.R. II-2459, paras. 72-78 (“[T]he existence of a rule of reason in Community competition law is doubtful.”).

similarly as certain vertical restraints are *per se* illegal under U.S. rules.³⁰

Where an agreement includes any of seven restrictions prohibited by Article 5 (Specific Conditions), the block exemption would not apply, and the restriction would be subject to the individual assessment while the remaining part of the agreement may continue to benefit from the block exemption.³¹ For the individual exemption, a party must show its agreement meets the conditions of Article 81(3), which are similar with the considering factors under the rule of reason.³² If an agreement does not meet any of five conditions in Article 3 (General Conditions) other than the market threshold requirement, a party must show why the absence of relevant provisions helps to attain, or does not obstruct the attainment of, the positive effects mentioned in Article 81(3).³³

D. Scope

The third BER governs vertical agreements among car suppliers and buyers³⁴ regarding the sale of new passenger and commercial vehicles, parts, and after-sales service³⁵ within the European Economic Area ("EEA").³⁶ The EEA includes EU

30. See, e.g., *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 50 (1977) (Certain agreements or practices which have pernicious effect on competition and lacks any redeeming virtue would be conclusively presumed to be illegal without elaborate inquiry as to the actual harm they have caused or the business justification for their use. In the context of vertical restraints, the *per se* illegality applies to minimum resale price maintenance (RPM) while the maximum RPM is subject to the *per se* rule unless it involves predatory pricing or horizontal arrangements); see also *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997).

31. Commission Regulation 1400/2002, art. 5, at 39; *Explanatory Brochure*, *supra* note 13, at 30.

32. *GTE Sylvania*, 433 U.S. at 49-50. Under U.S. rules, Agreements or practices falling outside the *per se* illegal category are subject to the rule of reason. Under the rule of reason, the fact-finding weighs all of the circumstances of a case in deciding whether the anti-competitive effects outweigh the pro-competitive effects; therefore, a restrictive practice should be prohibited.

33. Commission Regulation 1400/2002, art. 3, at 37-38; *Explanatory Brochure*, *supra* note 13, at 25.

34. "Buyer" is a party who sells goods or services on behalf of a supplier. A wholesaler in an agreement with a car manufacturer, a dealer in an agreement with a wholesaler, and a repairer in an after-sales service contract would become a buyer. A customer is not deemed a buyer but categorized as an end user. Commission Regulation 1400/2002, art. 1(k), (w), at 35-36.

35. *Id.* para. (3), at 30. Used motor vehicles or motor cycles are not subject to this regulation; see *Explanatory Brochure*, *supra* note 13, at 40.

36. Under the principle of primacy of Community law, the Commission regulations uniformly apply throughout the Common Market without being prejudiced by any

member countries, Norway, Iceland, Liechtenstein, and territories in Africa and Latin America such as Canary Island, Merilla, Ceuta, and Reunion.³⁷ Due to the enlargement of the EU, the scope and market impact of the third BER have become even more extensive. In addition to the ten Eastern European countries that became new members of the EU since May 2004,³⁸ Romania and Bulgaria are scheduled to become members of the EU this year, and Croatia and Turkey are negotiating for membership.³⁹

However, the exemption of the third BER from Article 81(1) would not apply to a vertical agreement where a contracting party has dominant market power.⁴⁰ In the situation that a supplier or a buyer has a high market share⁴¹ within a relevant market, the agreement would be subject to the proceeding for individual exemption.⁴² In the proceeding, the Commission bears the burden of proving that the agreement fails to comply with Article 81(1) and that the agreement does not meet all four conditions of Article 81(3).⁴³ If the parties fail to get an individual exemption, they may be exposed to fines or damages before national competition authorities or the Commission.⁴⁴

national authorities. *See, e.g.*, Case C-6/64, Flaminio Costa v. E.N.E.L., 1964 E.C.R. 585 (holding that the laws of the European Community bind and directly apply in all member states and their nationals without being prejudiced by any precedent or subsequent law of member states).

37. Explanatory Slides, Competition Directorate General, The New Motor Vehicle Block Exemption Regulation - The Current Rules and the New Rules 3, http://europa.eu.int/comm/competition/car_sector/ber_slides_en.pdf (last visited Mar. 3, 2007) [hereinafter The Current Rules and the New Rules].

38. Treaty Establishing a Constitution for Europe, Protocol 9, Dec. 12, 2004, 2004 O.J. (C 310) 297, 298-301.

39. History, *supra* note 3.

40. Commission Regulation 1400/2002, art. 3, paras. 1-2, 2002 O.J. (L 203) 30, 37 (EC).

41. The threshold for a supplier or a buyer's market share is generally 30 percent. However, the threshold is 40 percent where a quantitative selective system is established. *See* discussion *infra* Part III.A.2.

42. Commission Notice 291/01, Guidelines on Vertical Restraints, section IV, para. 2(84), 2000 O.J. (C 291) 1, 17 (EC).

43. *Id.* section IV, para. 1(72), at 16.

44. The Commission and national competition authorities (NCA) have the right to make decisions on cases which involves in Article 81. While any individual can claim damages for loss caused by a contract or by conduct which restricts competition, only national courts can grant damages to an individual in case of an infringement of Article 81. The Commission focuses on the most serious infringements or the cases that the Commission should act on to define Community competition policy or to ensure coherent application of Article 81. Commission Notice 101/05, section II.A-B, 2004 O.J. (C 101) 65, 65-67 (EC); *see* Council Regulation 1/2003, arts. 6-7, 2003 O.J. (L 1) 1, 9 (EC).

On the other hand, where the contracting parties' market shares are so low⁴⁵ that the agreement would not appreciably restrict competition under Article 81(1), the exemption would apply to a vertical agreement as long as it does not contain any of thirteen severely anti-competitive restraints listed in Article 4 of the BER.⁴⁶ Thus, the exemption may apply to an agreement between parties with low market share even when the agreement does not comply with the general or specific conditions provided in Article 3 and 5 of the third BER.⁴⁷

III. RULES OF THE THIRD BER IN COMPARISON WITH U.S. ANTI-TRUST LAWS

Whereas the third BER applies quite similar rules to vertical price restraints, it generally applies stricter rules than U.S. law. Even though it would promote intra-brand competition and independence of dealers more efficiently than the former BER, the third BER may have some adverse effects on market efficiency and consumer benefits.

A. Direct Restraints on Trade: Sales to Customers, Resellers, and Intermediaries

To avoid confining car manufacturers, wholesalers, and dealers to a single rigid system,⁴⁸ the new Regulation allows them to choose one of three different types of car distribution systems: (1) exclusive system, (2) selective distribution system, and (3) combined system.⁴⁹ While some direct restraints on vehicle trade among the countries would be allowed under one system, the Hardcore Restriction rule prohibits the same restraints under another system.⁵⁰ However, U.S. law generally applies the rule of reason to vertical non-price restraints unless it involves a horizontal arrangement or a monopoly.

45. Generally, market share thresholds for this exception are 15 percent for vehicle sales and 5 percent for after-sales service. Commission Notice on agreements of minor importance, section II, para. 7, 2001 O.J. (C 368) 13, 13-14 (EC); *Explanatory Brochure*, *supra* note 13, at 21-23.

46. *Explanatory Brochure*, *supra* note 13, at 23.

47. *See id.*

48. Comprehensive Reform Press Release, *supra* note 22.

49. Commission Regulation 1400/2002, art. 1, 2002 O.J. (L 203) 30, 35-36 (EC).

50. *See id.* art. 4, at 38-39.

1. Exclusive System

An "Exclusive System" is a distribution system in which the supplier sells the contract goods only to one buyer within the territory defined in the contract.⁵¹ Moreover, this system allows the supplier to prohibit the buyer from performing active sales⁵² to end users⁵³ outside the territory.⁵⁴ For example, while the supplier cannot directly sell a vehicle to any wholesaler or dealer other than those within the contracting parties in Germany, the supplier can prohibit its wholesaler or dealer from actively approaching end users outside the German market.

However, the supplier cannot prohibit the buyer from selling to resellers⁵⁵ inside or outside the territory⁵⁶ or passively selling vehicles or services to end users outside the territory.⁵⁷ Therefore, the dealer in The Netherlands can sell vehicles to the end users who directly or indirectly approach its shops and make orders. Further, the dealer in The Netherlands can sell vehicles to any reseller inside or outside The Netherlands who does not have any contractual relationship with the supplier, and the reseller can sell the vehicles to any end user in Italy or France.

51. *Id.* art. 1, para. 1(e), at 35.

52. *Id.* art. 4, para. (1)(b)(i), at 38. "Active Sales" means selling vehicles or services by actively approaching to end users. For example, the seller may directly send mails, visit end users through advertisement in media or other promotions or establish a warehouse or sales or delivery outlet to facilitate dealings with customers or their intermediaries. *Explanatory Brochure, supra* note 13, at 30.

53. "End user" includes "end users who have given authorisation to an intermediary or purchasing agent to purchase, take delivery of, transport or store a new motor vehicle on their behalf." Commission Regulation 1400/2002, art. 1, para. 1(w), at 36.

54. *Id.* art. 4, para. 1(b)(i), at 38.

55. "Reseller" is any undertaking that purchases vehicles for the purpose of resale before they receive any order from its customers. In this comment, it generally addresses car dealers with whom a specific car manufacturer does not have any contractual relationship. *See Explanatory Brochure, supra* note 13, at 45.

56. Commission Regulation 1400/2002, art. 4, para. 1(b)(iii), at 38.

57. *See id.* art. 4, para. 1(d)-(e); "Passive sales" include vehicle sales through intermediaries. An "intermediary" is a person or an undertaking that purchases vehicles under prior authorizations of consumers. Even though the intermediary sales was allowed under the second BER, its effect in promoting cross-border sales has been limited because dealers could not be independent enough to use this scheme in the exclusive dealing context and suppliers could use other indirect restrictions on intermediary sales which the third BER prohibits. However, because internet sales have been increasing and the third BER would strengthen independence of car dealers, the intermediary sales would substantially increase cross-border sales. Commission Regulation 1475/95, art 3(11), 1995 O.J. (L 145) 25 (EC).

These new rules would more effectively promote intra-brand competition than those of the second BER. Under the second BER, the supplier could not prohibit its dealers from passively selling vehicles to end users outside the territory.⁵⁸ However, the supplier could prohibit its dealers from actively selling⁵⁹ and from selling vehicles to resellers.⁶⁰ Therefore, car manufacturers could effectively control the flow of vehicles among EU member countries. However, the supplier under the exclusive system cannot limit systematic and massive cross-border sales performed through unauthorized resellers. This is one of the important reasons why many car manufacturers did not choose the exclusive system.

However, the new rules are somewhat less flexible than U.S. law. Under U.S. rules, the rule of reason generally applies to a vertical non-price restraint about territory, reseller sales,⁶¹ and customers, unless it involves horizontal arrangements or monopolies.⁶² To determine the legality of a restraint under the rule of reason, courts examine whether its pro-competitive effect outweighs the anti-competitive effect by considering various factors such as market power of a supplier or a dealer, the purpose and nature of the restraint, and a business justification for the restraint.⁶³ On the other hand, under the third BER, while restraints on active sales are legal *per se*, Article 4 prohibits vertical restraints on reseller sales and passive sales to the territory of exclusive system.⁶⁴ Therefore, even when the restriction on reseller sales promotes competition, it would be prohibited, while the restriction on active sales would be simply allowed even when it limits competition.

58. Commission Regulation 1475/95, art. 3, 1995 O.J. (L 145) 25 (EC).

59. *Id.* art. 3(8)-(9).

60. *Id.* art. 3(10).

61. A supplier often obligates, in its contracts, dealers not to sell the products to any person other than end users who purchases the products for the purpose of resale.

62. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 57-58 (1977) (overruling *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)).

63. HERBERT HOVENKAMP, *FEDERAL ANTI-TRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICES* 483-88 (Thomas West 2005) (1994).

64. Further, Recitals 12 to 26 of the third BER expressly set out some indirect restrictions which may constitute Hardcore Restrictions. For example, if an agreement includes a supply quota based on a sales territory as set forth in Recital 16, the whole agreement including the supply quota clause would not benefit the block exemption. Commission Regulation 1400/2002, art. 4, para. 1, 2002 O.J. (L 203) 30, 38-39 (EC); see *Explanatory Brochure*, *supra* note 13, at 29.

2. Selective System

A "Selective System" is a distribution system where a supplier sells vehicles only to dealers selected on the basis of specified criteria.⁶⁵ Under a selective system, the supplier can prohibit dealers from selling vehicles to unauthorized resellers⁶⁶ but cannot prohibit dealers from actively or passively selling vehicles to end users outside the territory.⁶⁷ For example, the dealers in Germany cannot sell vehicles inside or outside Germany but can directly advertise to end users, establish sales or delivery outlets,⁶⁸ and actively sell vehicles in France or Italy.

There are two types of selective systems: quantitative selective distribution systems and qualitative selective distribution systems. Under a quantitative selective system, suppliers can use criteria directly limiting the number of wholesalers or dealers.⁶⁹ However, under a qualitative selective system, suppliers set forth qualitative criteria⁷⁰ for selection and should authorize any dealer that satisfies such criteria. Therefore, it cannot directly limit the number of dealers.⁷¹

For non-luxury car manufacturers, the quantitative selective system was a better choice than the qualitative selective system. Unlike luxury brands,⁷² most car manufacturers cannot set forth a high level of criteria.⁷³ Therefore, under the qualitative selective system, many car manufacturers cannot effectively limit the number of authorized dealers who can actively and passively sell vehicles to end users outside the territory.

In contrast, if the manufacturer sets forth criteria limiting the number of the wholesaler to just one, the quantitative system becomes the most similar system to the exclusive system under the second BER. Further, until October 1, 2005, car manufacturers

65. Commission Regulation 1400/2002, art. 1, para. 1(f), 2002 O.J. (L 203) 30, 35 (EC).

66. *Id.*

67. *Id.* art. 4, para. 1(d), at 38.

68. *Id.* art. 5, para. 2(b), at 39.

69. *Id.* art. 1, para. 1(g), at 35.

70. Examples of qualitative criteria include training requirement for sales personnel, qualification of after-sales personnel, requirements on product display, and dedicated space for each brand in showroom. The Current Rules and the New Rules, *supra* note 37.

71. Commission Regulation 1400/2002, art. 1, para. 1(h), at 35.

72. In the case of luxury brands, car manufacturers usually have very high level of criteria which dealers cannot easily satisfy; therefore, luxury brands may prefer qualitative selective system. The Current Rules and the New Rules, *supra* note 37.

73. *Id.*

could use a “location clause” prohibiting wholesalers or dealers from establishing sales or delivery outlets outside the territory.⁷⁴ Therefore, many car manufacturers have chosen the quantitative selective system over other systems and maintained a location clause in their contracts.⁷⁵ However, since October 1, 2005, a supplier under the selective system cannot effectively limit systematic and massive cross-border sales through sales outlets outside the territories.⁷⁶

Unlike U.S. law,⁷⁷ the third BER again applies *per se* rules to vertical restraints on reseller sales, passive sales, and active sales in the context of selective system.⁷⁸ Therefore, even when the restriction on active sales has a justifiable purpose and effect, it would still be prohibited, while the restriction on reseller sales would be simply allowed even when it limits the competition.

3. Combined System

The new BER does not obligate a supplier to use only one system within the common market.⁷⁹ Therefore, a supplier can use the exclusive system in one territory and the selective system in another. Under this combined system, a selective distribution agreement cannot restrict passive sales to any end user or unauthorized distributor located in territories under the exclusive system, nor can an exclusive distribution agreement restrict active or passive sales to any end user or unauthorized distributor located in markets under the selective system.⁸⁰ Thus, because it would be extremely hard to control cross-border flows of vehicles under the combined system,⁸¹ manufacturers may not choose this system

74. DaimlerChrysler, Ford, Toyota, and BMW adopted the selective system maintaining location clause in their distribution agreements. See Wim Oude Weernink & Bradford Wernle, *Carmakers Can Keep EU Location Clause*, AUTOMOTIVE NEWS EUROPE, Aug. 22, 2005.

75. *Id.*

76. *Explanatory Brochure*, *supra* note 13, at 52-55.

77. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 57-58 (1977).

78. Commission Regulation 1400/2002, art. 4, para. 1(d), 2002 O.J. (L 203) 30, 38 (EC).

79. European Commission, Competition Directorate General, *Frequently Asked Questions on the New Motor Vehicle Block Exemption*, available at http://europa.eu.int/comm/competition/car_sector/distribution/faq_en.pdf [hereinafter *FAQ*]; see Commission Regulation 1400/2002, art. 4.1(d), 2002 O.J. (L 203) 30.

80. Commission Regulation 1400/2002, art. 4, para. 1(d), at 38.

81. *FAQ*, *supra* note 79.

unless they need to incur vigorous intra-brand competition among dealers.

B. Indirect Restraints on Trade

In addition to the rules governing direct restraints for different distribution systems, the new BER also provides rules governing indirect restraints of vehicle trade among countries, regardless of the system. Under the new rules, car manufacturers cannot effectively restrict cross-border sales of vehicles as they could in the past by means of indirect constraints.⁸²

1. Agreement Requirement and Refusal to Deal

Both Article 81(1) of the EC Treaty⁸³ and Section 1 of the Sherman Act⁸⁴ require a plaintiff with a vertical restraint claim to show an agreement or a concerted arrangement between a manufacturer and a dealer. Where a dealer expressly or impliedly agrees to follow a vertical restraint set forth by a supplier, a claim would usually be initiated by competition authorities such as the Federal Trade Commission or the European Commission, and the dealer's consent would form an agreement. However, where a dealer refuses to follow such a restraint and a supplier in response terminates or refuses to renew the dealership agreement, after initiating a claim, the dealer or a competition authority as a plaintiff has to show an agreement between the manufacturer and another dealer.

In the latter case, the third BER confers more protection on dealers from retaliatory terminations by suppliers than U.S. rules while it takes quite similar approaches with U.S. rules as to a non-renewal of a dealership agreement.⁸⁵ The third BER expressly prohibits a supplier from terminating an agreement for the reason that a dealer or a repairer engages in pro-competitive behavior such as active or passive sales, reseller sales, or price-cutting.⁸⁶

82. Commission Regulation 1400/2002, art. 4, at 38-39.

83. EC Treaty, *supra* note 9, art. 81(1); *see also* Case T-208/01, Volkswagen A.G. v. Comm'n, 2003 E.C.R. II-5141.

84. Section 1 of the Sherman Act provides "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states . . . is hereby declared to be illegal." 15 U.S.C. § 1 (2005); *see* United States v. Colgate & Co., 250 U.S. 300 (1919).

85. *Explanatory Brochure*, *supra* note 13, at 58-60.

86. Commission Regulation 1400/2002, art. 3, para. 4, at 37; *Explanatory Brochure*, *supra* note 13, at 58-60.

When terminating a dealership or service agreement before the end of the contract term,⁸⁷ a supplier has to give to a buyer prior notice in writing that includes “detailed, objective and transparent reasons” for the termination.⁸⁸ Further, the regulation expressly manifests that it requires the prior notice in order to prevent a supplier from terminating an agreement based on a buyer’s pro-competitive conduct.⁸⁹ Therefore, whether the reasons for termination are well-founded are a question of fact, and any retaliatory termination for a dealer’s pro-competitive conducts would be deemed a “serious indirect restriction” of competition.⁹⁰

In contrast, under Section 1 of the Sherman Act, a supplier can legally terminate a dealership agreement even after receiving another dealer’s complaint about price-cutting.⁹¹ In *U.S. v. Colgate & Co.*, the U.S. Supreme Court held that “in the absence of any purpose to create or maintain a monopoly,”⁹² a supplier can freely exercise its own independent discretion as to parties with whom he will deal; further, a supplier may announce in advance the circumstances under which he will refuse to sell.⁹³ Therefore, a court would not infer the existence of an agreement merely from the fact that a supplier terminated a contract with a dealer after another dealer complained about the terminated dealer’s price-cutting.⁹⁴ Rather, there must be evidence tending to exclude the possibility that the manufacturer and the non-terminated dealers

87. Commission Regulation 1400/2002, art. 3, para. 5, at 37 (providing that under the new regulation, a contract term should be indefinite or at least five years); *see also Explanatory Brochure*, *supra* note 13, at 59.

88. Commission Regulation 1400/2002, art. 3, para. 4, at 37 (providing that the block exemption shall apply only when a vertical agreement provides that a supplier must give such prior notice to a buyer).

89. *Id.*

90. *Id.*

91. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 763-64 (1984).

92. The issue of refusals to deal can appear in various forms such as horizontally concerted refusals, vertically concerted refusals, and unilateral refusals. Generally, the refusal to deal based on a supplier’s best interest would be lawful unless it is to create or maintain a monopoly, there is neither horizontal nor vertical agreement for the refusal, and the supplier’s conduct does not amount to threat or intimidation. *See Eastern States Retail Lumber Dealers’ Ass’n v. United States*, 234 U.S. 600 (1914); *United States v. General Motors Corp.*, 384 U.S. 127 (1966); *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951); *Monsanto Co.*, 465 U.S. at 763-64; *Bus. Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717, 735-36 (1988); *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); 15 U.S.C. §§ 1221-1222 (2005).

93. *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

94. *Monsanto Co.*, 465 U.S. at 763-64.

acted independently.⁹⁵ Therefore, a plaintiff has to show direct or circumstantial evidence that the manufacturer and the non-terminated dealers had a “conscious commitment to a common scheme designed to achieve an unlawful objective.”⁹⁶ Technically, under the Sherman Act, a “manufacturer is free to establish resale pricing standards and to refuse to sell to distributors not conforming to the manufacturer’s standards”⁹⁷ while the third BER expressly prohibits such retaliatory terminations.⁹⁸

In the case of the refusal to renew the contract, under the third BER, a supplier can give its dealer just six months prior notice without explaining reasons for its refusal to renew a fixed-term contract.⁹⁹ However, the third BER still improves dealers’ independence from the supplier by requiring a dealership contract term to be more than five years¹⁰⁰ and enables dealers to engage in the sale of competing vehicles.¹⁰¹ In general, the new Regulation would significantly promote the independence of dealers in performing pro-competitive activities.

2. Price Restraints

In the context of a vertical agreement, the third BER better protects a dealer’s ability to determine independently resale prices of vehicles than U.S. law.

a. Minimum RPM

As U.S. law applies a *per se* rule to minimum resale price maintenance (“RPM”),¹⁰² the new BER categorizes minimum RPM as a Hardcore Restriction.¹⁰³ Therefore, in both the U.S. and the

95. *Id.*

96. *Id.*

97. William K. Jones, Book Note, *Concerted Behavior Under the Antitrust Laws*, 99 HARV. L. REV. 1986, 1991 (1986) (reviewing PHILLIP E. AREEDA, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION (1986)) (citing *United States v. Parke, Davis & Co.*, 362 U.S. 29, 33 (1960)).

98. *Explanatory Brochure*, *supra* note 13, at 40-45.

99. *Id.* at 60.

100. Commission Regulation 1400/2002, art. 3, para. 5(a), 2002 O.J. (L 203) 30, 37 (EC).

101. See discussion *infra* Part III.B.4 (discussing the issue of non-compete obligation).

102. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51 (1977).

103. Commission Regulation 1400/2002, art. 4, para. 1(a), at 38. Even under the second BER, the Commission strictly applied the rule to Volkswagen’s retail price maintenance measure in Germany in spite of Volkswagen’s justification that the measures were necessary to support its dealers’ profitability and to preserve the brand image of the new

EU, minimum price RPM is prohibited even when such a measure has a justifiable purpose and effect on competition.

However, in the context of vertical restraints, the third BER is stricter than the Sherman Act. While the third BER categorizes as the minimum RPM a restraint that affects the resale price, such as limitations, financial disincentives, pressures or obstacles,¹⁰⁴ a vertical agreement would not be deemed a price agreement in the U.S. unless the plaintiff can establish an “agreement on price or price level.”¹⁰⁵

b. Maximum RPM

The third BER’s approach to the maximum RPM differs from the approach under U.S. law because it expressly allows the maximum RPM,¹⁰⁶ while under U.S. rules the maximum RPM is subject to the rule of reason unless it involves predatory pricing or horizontal arrangements.¹⁰⁷ The third BER would generally allow the maximum RPM unless it amounts to a violation of other competition rules such as predatory pricing, while U.S. courts will examine the entirety of the circumstances such as its purpose and effect on competition.¹⁰⁸

3. Market Discrimination

Under the third BER, a supplier cannot limit a dealer’s sale to consumers outside the territory, in the form of any discriminatory product supply, since the new BER categorizes this as a Hardcore Restriction.¹⁰⁹ For example, a supplier may not provide different

model. See Commission Decision 98/273/EC, 1998 O.J. (L 124) 60; Press Release, European Commission, Commission Imposes a € 30.96 Million Fine on Volkswagen AG for Retail Price Maintenance Measures on the German Market, IP/01/760 (May 30, 2001), <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/760&format=HTML&aged=0&language=EN&guiLanguage=en>.

104. Commission Regulation 1400/2002, art. 4, para. 1(a), at 38; *Explanatory Brochure*, *supra* note 13, at 27-30.

105. *Bus. Elec. Corp. v. Sharp Elec. Corp.*, 485 U.S. 717, 735-36 (1988). However, in the context of a horizontal arrangement, even an agreement that merely affects price would be illegal *per se*. See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

106. Commission Regulation 1400/2002, art. 4, para. 1(a), at 38.

107. *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997). However, a *per se* rule applies to the horizontal maximum RPM. *Arizona v. Maricopa County Med. Soc’y*, 457 U.S. 332, 347 (1982).

108. The predatory pricing would be governed by Article 82 of the EC Treaty which prohibits the abuse of dominant position while it is subject to Section 2 of the Sherman Act in the U.S. See EC Treaty, *supra* note 9, art. 82; 15 U.S.C. § 2 (2005).

109. See Commission Regulation 1400/2002, art. 4, para. 1(b), at 38.

remuneration or a bonus based on destination of the vehicles or on the place of residence of the consumers.¹¹⁰ Further, a supplier cannot delay the delivery of the vehicles without justifiable reason.¹¹¹ Therefore, consumers can buy vehicles anywhere in the common market without unreasonable discrimination as to price or delivery. This rule is similar with U.S. rules. Under the Robinson-Patman Act, the supplier can justify the price discrimination by showing that there is cost justification¹¹² or that it is necessary to compete in good faith.¹¹³

4. Non-Compete Obligation: Exclusive Dealing

The new BER applies stricter rules to the non-compete obligation¹¹⁴ than either the second BER or the U.S. law.¹¹⁵ Under the second BER, a supplier could prohibit wholesalers and dealers from selling competitors' vehicles by obligating them to establish a separate legal entity and use different premises when selling competing products.¹¹⁶ As a result, a dealer's business was so heavily dependent on a car manufacturer's business that a dealer could not make independent business decisions in most cases.¹¹⁷

In the U.S., Section 1 of the Sherman Act, Section 3 of the Clayton Act, and Section 5 of the Federal Trade Commission Act apply to the exclusive dealing. Under the Sherman Act, the courts would apply the rule of reason. Even though the rule under the Clayton Act has not been settled yet, the courts basically adopt the rule of reason by considering the relevant market definition and the general effect of the arrangement.¹¹⁸

However, under the third BER, dealers can freely manufacture, purchase, display or sell competitors' vehicles.¹¹⁹ Further, a supplier cannot require wholesalers or dealers to purchase the contract goods more than thirty percent of their total

110. *Id.* para. (16), at 31.

111. *Explanatory Brochure, supra* note 13, at 41.

112. *See* United States v. Borden Co., 370 U.S. 460 (1962).

113. *See* United States v. United States Gypsum Co., 438 U.S. 422, 451 (1978).

114. "Non-compete Obligation" is any obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services." Commission Regulation 1400/2002, art. 1, para. 1(b), at 35.

115. *Id.*; *see also Explanatory Brochure, supra* note 13.

116. Commission Regulation 1475/95, art. 3(3), 1995 O.J. (L 145) 25 (EC).

117. *Evaluation Report, supra* note 21, at 73-77.

118. *See* Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320 (1961).

119. Commission Regulation 1400/2002, art. 1, para. 1(b), at 35.

purchases.¹²⁰ Although, to avoid brand confusion, a supplier can ask wholesalers or dealers to meet corporate identity requirements such as a separate showroom or brand specific area within a showroom, an obligation that makes sales of competing models “difficult in practical or cost-related terms” may amount to a non-compete obligation.¹²¹ Further, a supplier can require a dealer to have brand-specific sales personnel only when the dealer voluntarily decides to have such personnel and the supplier pays all additional costs.¹²²

5. Other Indirect Restraints

A supplier can indirectly restrain vehicle trade by limiting the number of vehicles supplied and the availability of products or after-sales services. Generally, the rule of reason applies to such restraints in the U.S.¹²³ while the third BER categorizes these practices as Hardcore Restrictions.¹²⁴ Thus, car manufacturers cannot limit cross-border trade as they could under the old rules, and dealers and repairers can make business decisions more independently.

a. Availability Clause

Under the third BER, suppliers cannot refuse to provide to dealers vehicles with specifications available in any other Member State.¹²⁵ Under the second BER, manufacturers could indirectly restrict cross-border sales by limiting availability of versions or optional features of a model.¹²⁶ For example, even when a consumer in the UK could buy a Corolla from Greece at a lower price, Toyota could hinder the customer from buying the car by

120. *Id.*

121. *FAQ, supra* note 79.

122. Commission Regulation 1400/2002, art. 1, para. 1(b), at 35.

123. These practices could be subject to the Robinson-Patman Act as the indirect market discrimination or Section 2 of the Sherman Act as the attempt to create or maintain a monopoly in a certain market. *See* discussion *supra* Part III.B.3. In the former case, a defendant can defend by showing business justification or good-faith meeting competition. In the latter, courts would apply the rule of reason in order to distinguish an efficient and competitive conduct from an inefficient and anti-competitive conduct. *See* *United States v. Borden Co.*, 370 U.S. 460 (1962); *United States v. United States Gypsum Co.*, 438 U.S. 422 (1978); *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911).

124. *Explanatory Brochure, supra* note 13, at 27-30.

125. Commission Regulation 1400/2002, para. (20), at 32, art. 4, para. 1(f), at 38.

126. Commission Regulation 1475/95, 1995 O.J. (L 145) 25.

not providing any right-hand-drive Corollas to dealers in Greece. Under the third BER, however, a supplier cannot hinder a dealer or a wholesaler from selling a new motor vehicle that corresponds to a model within its contract range.¹²⁷ Therefore, a consumer in the UK can buy a right-hand-drive Corolla from dealers in any other Member State.¹²⁸

b. Supply Quota and Cross-supplies

Under the new BER, a supplier cannot limit the number of vehicles that a dealer can purchase, in the form of sales quota based on a sales territory¹²⁹ and a dealer's ability to purchase contract vehicles from the supplier or other authorized wholesalers or dealers.¹³⁰ Therefore, a supplier can provide a dealer with sales targets only to the extent that the sales targets do not limit deliveries of vehicles to dealers.¹³¹ Moreover, the supplier cannot hinder a dealer from buying contract vehicles from other dealers within the supplier's sales network.¹³²

c. Parts and Service Distribution

The third BER would promote consumers' access to parts and after-sales service. First, a supplier must obligate its repairers to provide after-sales service, in a non-discriminatory manner, to any consumer who bought the supplier's car within the common market.¹³³ Therefore, an authorized repairer should honor warranties, perform free servicing, carry out recall work, and provide any other repair and maintenance services for all contract vehicles and corresponding vehicles sold in the common market.¹³⁴ For example, a consumer who purchased a vehicle in France can get any after-sales service from an authorized repairer of the manufacturer in any member countries.

Second, the third BER requires a car manufacturer to provide to unauthorized repairers who do not have any contractual relationship with the manufacturer, at their request, technical

127. Commission Regulation 1400/2002, art. 4, para. 1(f), at 38.

128. *Explanatory Brochure*, *supra* note 13, at 27-30.

129. Commission Regulation 1400/2002, para. (16), at 31.

130. *Id.* art. 4, para. 1(c), at 38.

131. *Explanatory Brochure*, *supra* note 13, at 47-49.

132. *Id.* at 55.

133. Commission Regulation 1400/2002, para. (17), at 31-32.

134. *Id.*

information, diagnostic tools or equipment, or technical training on the same condition that the supplier provides to its authorized repairers.¹³⁵ Further, a supplier cannot hinder its authorized repairers from selling original spare parts to unauthorized repairers.¹³⁶ Any repairer would have the same access to parts, information, or other necessary tools even when it does not have any contractual relationship with the supplier. Moreover, a supplier cannot limit an authorized repairer or parts maker's ability to purchase or sell original spare parts or spare parts of matching quality,¹³⁷ from or to any person.¹³⁸ Therefore, consumers, authorized repairers, and unauthorized repairers can freely access both original spare parts and spare parts of matching quality.

IV. MARKET IMPACT

Under the new BER, car manufacturers cannot effectively control the flow of vehicle sales and services among EEC member countries as they could under the old rules. This change will significantly change the relationship among car manufacturers, wholesalers, dealers, and consumers. Not only would the change bring more competition in the automotive market, but it would also adversely affect market efficiency, as well as customer benefit.

A. Price Convergence

While the price differences of new cars have generally decreased, especially among Western European countries,¹³⁹ customers' benefits from this trend would be limited. First, the price differences of top selling models are still substantial, especially between Western and Eastern European countries that recently attained EU membership.¹⁴⁰ For example, the price of a

135. *Id.* art. 4, para. 2, at 39.

136. "Original Spare Parts" means spare parts which have the same quality as the components used for the assembly of a vehicle. *Id.* art. 1, para. 1(t), at 36, art. 4, para. 1(i), at 38.

137. "Spare Parts of Matching Quality" means spare parts which a parts maker certifies that the parts match the quality of the original spare parts. *Id.* art. 1, para. 1(u), at 36. Car manufacturers can request authorized repairers to use only original spare parts for recall or warranty service. *Id.* art. 4, para. 1(k), at 38.

138. *Id.* arts. 4, para. 1(j)-(l), at 38-39.

139. Press Release, Competition Directorate General, European Commission, Convergence of Car Prices Improves Within EU While Remaining Constant in the Euro Zone, IP/05/1027 (Aug. 1, 2005) [hereinafter Convergence Press Release].

140. Competition Directorate General, European Commission, *Car Prices Within the European Union at 1 May 2005* (2005) [hereinafter *Car Prices 2005*], available at

Volkswagen Polo in 2002 was 22.6 percent higher in Germany than in Ireland.¹⁴¹ In 2005, it is 13.9 percent higher in Germany than Belgium while its price difference between Germany and Slovenia is 28 percent.¹⁴²

Further, the price convergence does not necessarily lower car prices; indeed, the average price of vehicles in the common market went up.¹⁴³ Generally, to minimize the impact of cross-border sales, car manufacturers would increase prices in low-price countries,¹⁴⁴ such as Greece and Slovenia, while lowering the price in high-price countries such as the UK.¹⁴⁵ This trend would disserve customer benefits in low-price countries, especially in Eastern European countries and some Western European countries with high tax rates.

While it is true that manufacturers have set different prices among European countries in order to optimize carmakers' profit and sales volume, the price difference also reflected differences in both customers' purchase power¹⁴⁶ and the tax system within Europe.¹⁴⁷ Without addressing these problems, any effort to reduce

http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/2005_05_rep_main_table.pdf.

141. Competition Directorate General, European Commission, *Report on Car Price Differentials within the European Union on 1 May 2002* (2002), available at http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/2002_05.pdf.

142. *Car Prices 2005*, *supra* note 140.

143. Compared to a year ago, car prices in May 2005 have increased 0.4 percent in the EU, even after Eastern European countries became EU members, which generally have lower prices than Western European countries. See Convergence Press Release, *supra* note 139.

144. Car manufacturers may also provide stripped-down models to the low-price countries. However, this cannot be a fundamental solution because the manufactures have to increase the option-adjusted price anyway in order to prevent customers in the high-price countries from purchasing vehicles from dealers in the low-price countries.

145. It is possible that this trend may increase inter-brand competition in both low-price and high-price countries because a carmaker may try to maintain the adjusted prices of its products lower than competing models. However, it is also possible that the price adjustment would result in merely general increases or decreases of prices while maintaining the same level of price differences among competing models.

146. As of 2004, GDP per capita in Luxembourg was more than twice the EU average while it was 55 percent below the average in Latvia. GDP per capita in Turkey which is negotiating its new membership was 81 percent below the EU average. *GDP Per Capita Varied by One to Five Across the EU 25 Member States*, EUROSTAT (Eurostat Press Office, Lux.) News Release 75/2005, June 3, 2005, available at http://epp.eurostat.cec.eu.int/pls/portal/docs/PAGE/PGP_PRD_CAT_PREREL/PGE_CAT_PREREL_YEAR_2005/PGE_CAT_PREREL_YEAR_2005_MONTH_06/2-03062005-EN-BP.PDF.

147. See *Q&A: Ford Needs German Fix*, AUTOMOTIVE NEWS EUROPE, Nov. 15, 2004.

the price differences is unlikely to succeed in maximizing consumer benefits.

B. Sales Network

1. Promotion of Dealer Competition

Under the third BER, competition among dealers will be more vigorous because the new BER substantially reduces a supplier's ability to directly or indirectly restrain cross-border sales. Under the selective system, a dealer can establish its sales or delivery facilities outside its territory and actively sell vehicles.¹⁴⁸ The third BER will promote competition among authorized dealers within a car manufacturer's sales network. Further, under the exclusive system, dealers can sell vehicles to any reseller inside or outside the territory.¹⁴⁹ Therefore, the third BER will promote competition among authorized dealers and other dealers outside a car manufacturer's sales network.

Moreover, under both systems, sales through intermediaries are allowed.¹⁵⁰ For example, customers in Germany can make orders to an internet seller, and the seller can purchase ordered vehicles from a dealer in Finland by presenting the customers mandates.¹⁵¹ In general, these trends would enable consumers to have better access to dealers outside the territory.

2. Promotion of Dealer Independence

Under the new regulation, dealers can make more independent business decisions under the third BER because it prohibits suppliers from using most of direct or indirect restraints on vehicle trade. For example, the third BER prohibits a supplier from directly or indirectly precluding its dealers from selling competing models.¹⁵² It also prohibits a supplier from requiring its dealers to establish an independent showroom or to hire sales

148. Most manufacturers are using selective system and, until October 1, 2005, they could effectively minimize the impact of active sales by using location clause. Weernink & Wernle, *supra* note 74.

149. Commission Regulation 1400/2002, art. 4, para. 1(b), 2002 O.J. (L 203) 30, 38 (EC).

150. *Id.* art. 4, para. 1(i), at 38.

151. See Commission Regulation 1475/95, art. 3(11), 1995 O.J. (L 145) 25; *Explanatory Brochure*, *supra* note 13, at 45-46.

152. Wim Oude Weernink, *Some German Opel Dealers Will Sell Chinese Cars*, AUTOMOTIVE NEWS EUROPE, Aug. 8, 2005.

persons only for the supplier's vehicles.¹⁵³ Finally, the third BER prohibits car manufacturers from indirectly restraining vehicle trade by imposing sales quota, a discriminatory bonus system or retaliatory termination of a dealership agreement.¹⁵⁴

Therefore, dealers can freely run their businesses and sell vehicles made by various suppliers inside or outside the territory. For example, after seeing Opel's market share plunge, some Opel dealers in Germany started selling a sports utility vehicle manufactured and exported by Jiangling Motors, a Chinese car maker, without informing Opel of the sales plan.¹⁵⁵ Some dealer groups from Spain, Italy, Belgium, and The Netherlands also considered selling the sports utility vehicle.¹⁵⁶

3. Free-rider Problem

Because the third BER prohibits a supplier from using most vertical restraints on vehicle trade, a "free-rider" problem might arise. For example, Dealer A in Germany invests in various marketing activities, local advertisement, and customer services, such as a large and expensive showroom and vehicles for test driving. Then, Dealer B in Slovenia simply establishes a sales outlet of minimum quality in Germany,¹⁵⁷ and sells the same vehicles at substantially lower price based on saved marketing costs in addition to the currently existing price difference.¹⁵⁸ Knowing this price difference, a customer will visit Dealer A's large showroom, collect information about vehicles, test drive the vehicles and then go to Dealer B and purchase the same vehicle at a lower price.¹⁵⁹

153. Commission Regulation 1400/2002, art. 1, para. 1(b), at 35, art. 5, para. 2(b), at 39.

154. Commission Regulation 1400/2002, art. 4.1(1), 2002 O.J. (L 203) 30.

155. Weernink, *supra* note 152.

156. *Id.*

157. Under the quantitative or qualitative selective system, a car maker can require dealers operating in a territory to meet minimum quantitative or qualitative standards. Thus, even a dealer from Slovenia should have its sales outlet or delivery point in Germany to meet the minimum standards given to the German dealers. *Explanatory Brochure, supra* note 13, at 52-55. On the other hand, the car maker would not be able to set forth the standards high enough to resolve the free-rider problem because the new BER prohibits any obligation rendering the sale of competing models unreasonably difficult. *Id.* at 31-33.

158. For example, as of May 2005, the price of Volkswagen Polo in Slovenia was 28 percent lower than in Germany which amounted about € 2,300. *Car Prices 2005, supra* note 140.

159. HOVENKAMP, *supra* note 63, at 456-57.

This free-rider problem will discourage dealers from investing in marketing activities and customer services, thereby making price competition among dealers more vigorous.¹⁶⁰ Not only do these trends usually damage brand image of car manufacturers, but they also limit the car makers' ability to compete among them.¹⁶¹

To resolve this problem, a supplier may consider three options: vertical minimum RPM, territorial restriction,¹⁶² and marketing allowance.¹⁶³ The minimum RPM would not necessarily resolve the free-rider problem because the free-rider still can choose to keep the added margin instead of increasing the investment in marketing and customer service,¹⁶⁴ or to provide different services.¹⁶⁵ Further, territorial restrictions would also have limited effect because it primarily purports to prohibit its dealers from selling vehicles outside the territory rather than directly induce the dealer investment in marketing activities. Therefore, the marketing allowance would be a more effective method to induce dealers to invest in marketing activities because the allowance would be given to the dealers after monitoring their marketing activities.¹⁶⁶ In the U.S., while the minimum RPM is per se illegal,¹⁶⁷ a supplier can prohibit its dealers from selling vehicles outside the territory to the extent it can satisfy the rule of reason.¹⁶⁸ Further, the remuneration system which merely affects the resale price, would generally be subject to the rule of reason in the U.S.¹⁶⁹

However, under the third BER, the supplier cannot use any of the above options because all three options are Hardcore

160. William S. Comanor, *Vertical Price-fixing, Vertical Market Restrictions, and the New Anti-trust Policy*, 98 HARV. L. REV. 983, 986-88 (1985) (citing Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J. L. & ECON. 86 (1960)).

161. Manufacturers driven by volume may, especially, have to lower showroom standards and use less effort to give customers a brand experience than luxury brands can control customer experience. Weernink, *supra* note 152.

162. HOVENKAMP, *supra* note 63, at 457-59.

163. LAWRENCE A. SULLIVAN ET AL., *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 304-06 (2000).

164. *Id.*

165. For example, while a dealer provides customers better showrooms and test-drives, the free-rider can provide customers an installed stereo system or an extended warranty. A customer will then obtain information from the former dealer and purchases a vehicle from the free-rider. HOVENKAMP, *supra* note 63, at 458-59.

166. SULLIVAN, *supra* note 163, at 305.

167. *GTE Sylvania*, 433 U.S. at 51.

168. *Id.* at 57-58.

169. *Bus. Elec. Corp.*, 485 U.S. at 735-36.

Restrictions. From the view of the supplier, it would be unreasonable to support a Slovenian dealer's marketing activities in the German market. The supplier would want to give remunerations to the dealer in order to support its marketing activities in Slovenia. However, such a territory-based remuneration system would be deemed a market discrimination that is a Hardcore Restriction.¹⁷⁰ Even though the Guidelines on Vertical Restraints expressly recognize solving a free-rider problem as one of the justifiable reasons for vertical restraints,¹⁷¹ it is unlikely to justify Hardcore Restrictions.¹⁷²

4. Downfall of Small Dealers

As dealer competition and cross-border sales increase, large multi-brand dealers would benefit from the economy of scale based on their sales network throughout the European market. In such a case, small dealers would lose their ground or become sub-dealers of big dealers.

For example, as long as there are substantial price differences between Germany and The Netherlands, a large dealer in Germany will try to buy,¹⁷³ or set up, a dealership in the The Netherlands and purchase all necessary vehicles through its dealer in the The Netherlands. In that case, a small dealer in Germany has two options: to keep losing market share to the large dealer or to find a source in the The Netherlands from which it can purchase cheaper vehicles. If the small dealer finds another small dealer in the The Netherlands, the two dealers may not be able to effectively compete with the sales network of the large dealer because the large dealer can take advantage of economy of scale by investing more money in marketing, customer services, and logistics than the small dealer. If the small dealer finds another large dealer in the The Netherlands to avoid the competitiveness problem, the small dealer in the end would function like a sub-dealer of the large dealer.

170. *Explanatory Brochure, supra* note 13, at 27-30.

171. Commission Notice 291/01, Guidelines on Vertical Restraints, section VI, para. 1.1.2(116), 2000 O.J. (C 291) 1, 23-24 (EC).

172. *Explanatory Brochure, supra* note 13, at 27-30.

173. The new BER prohibits a supplier to prevent its dealers or repairers from transferring their rights and obligations to another member who carries out the same kind of activity within the supplier's distribution system. Commission Regulation 1400/2002, art. 3, para. 3, 2002 O.J. (L 203) 30, 37 (EC); *Explanatory Brochure, supra* note 13, at 27-30.

As competition among dealers increases and dealers can sell various vehicles made by competing car makers, there will be a greater chance that large multi-brand dealers will become more influential in the market.¹⁷⁴ The small dealer cannot make enough investment on its own to compete with the multi-branded large dealers, which can set up luxurious and large showrooms and conduct vigorous marketing activities. According to a report, the number of mega dealers has actually increased while overall number of dealers has decreased.¹⁷⁵ Further, mergers between big dealers have been increasing the influence of big dealers in the market.¹⁷⁶ As a result, the ground for small dealers would be reduced and, in the long-run, multi-branded mega dealers would take dominant position in vehicle sales network.

5. Changed Relationship between Large Dealers and Car Makers

In the long run, under the third BER, the market control of multi-brand mega dealers would increase while car makers' control would decrease. To maintain the control over sales network, car manufacturers may have two options: to set up their own dealer networks or to improve their relationship with the mega dealers. In response, some automakers are increasing the number of sales outlets they control directly.¹⁷⁷ However, the number of showrooms owned by manufacturers amounts only to about three percent of total outlets in Europe, and it would not be a fundamental solution due to a cost issue.¹⁷⁸ Thus, the car makers would have to try to maintain good relationship with mega dealers.

On the other hand, because dealers are released from direct or indirect control by car manufacturers including the exclusive dealing obligation, dealers can exercise more control over the market.¹⁷⁹ Moreover, the multi-brand mega dealers who own

174. HOVENKAMP, *supra* note 63, at 449-53.

175. For example, in Germany, the market share of the top 50 dealer groups increased by 4 percent from 2001 to 2003 while the number of outlets dropped 16 percent. Luca Ciferri, *Rise of Big Multibrand Dealers Curbs Competition: Loss of Small Sales Outlets Hits Consumers*, AUTOMOTIVE NEWS EUROPE, June 27, 2005.

176. Sylviane de Saint-Seine, *Shareholder Value: Pendragon Heads Retail Stocks After Bramall Buy*, AUTOMOTIVE NEWS EUROPE, May 3, 2004.

177. For example, from 1999 to 2004, automakers increased the number of their own sales outlets from 263 to 388 in France and from 197 to 340 in Germany. Luca Ciferri, *Carmakers Tighten Grip on New-car Sales: OEMs Increase Direct Sales*, AUTOMOTIVE NEWS EUROPE, June 27, 2005.

178. *Id.*

179. *Id.*

community-wide sales network would have even greater market control.

In the long-run, the relationship between car manufacturers and mega dealers may become similar to that of department stores and clothes manufacturers.¹⁸⁰ Because the third BER prohibits suppliers from obligating dealers to purchase more than 30 percent of the dealers' sale,¹⁸¹ car makers would need to have more than one sales network, just as many cloth makers sell their products in many department stores. Car makers would have to compete to maintain a better relationship with the large dealers because those dealers would determine which vehicles will be more vigorously promoted and given better display space.¹⁸² Therefore, car manufacturers' power in the market may be lessened while large multi-brand dealers would become more influential.

6. Exportation to Countries outside the Community

Under the third BER, a supplier using the exclusive system cannot limit its dealers and repairers' ability to sell vehicles or parts to resellers.¹⁸³ Once a vehicle is sold to a reseller inside or outside the territory, a supplier cannot control vehicle trade at all. Therefore, a reseller can freely sell vehicles or parts to any person inside or outside Europe.

This could be unfair because, in other countries, usually a car manufacturer can legally limit such an indirect exportation by limiting reseller sales. For example, a dealer in Slovenia can sell vehicles provided by a car manufacturer to a reseller, and the reseller again can export the vehicles to another reseller in the U.S. Meanwhile, the same car manufacturer in the U.S. can use vertical non-price restraints to prevent its dealers from performing

180. The clothes manufacturers can be divided into two categories: one with no brand value and the other with substantial brand value. The car makers' position would be similar with that of the latter because brand reputation is one of the most important considering factors of consumers. Thus, as luxury clothes makers do, the car makers may sell vehicles through their own dealer shops and many multi-brand mega dealers at the same time.

181. Commission Regulation 1400/2002, art. 1, para. 1(b), 2002 O.J. (L 203) 30, 35 (EC).

182. HOVENKAMP, *supra* note 63, at 459-60.

183. Commission Regulation 1400/2002, art. 4, para. 1(b), at 38.

reseller sales and exportation of vehicles, to the extent the rule of reason would allow.¹⁸⁴

The actual impact of this phenomenon has been limited because many car manufacturers did not adopt the exclusive system.¹⁸⁵ However, theoretically, there can be significant impact as long as the price difference between the inside and the outside of Europe is substantial.

C. Service Network

The third BER significantly promotes consumers' access to after-sales service. Car manufacturers must obligate their repairers to provide warranty services to customers who purchased vehicles anywhere within the EC.¹⁸⁶ Further, unauthorized repairers can provide full repair and maintenance services because the new BER requires suppliers to provide them the same access to technical information, training, and other necessary tools, and purchase original spare parts and spare parts of matching quality from parts makers or authorized dealers.¹⁸⁷

This change will induce manufacturers to develop strategies for better service to maintain the share in after-sales service market¹⁸⁸ because after-sales service has been a large source of profit for manufacturers.¹⁸⁹ On the other hand, even though some manufacturers are trying to limit independent repairers' access to technical information and equipments,¹⁹⁰ the influence of independent repairers in after-sales service market would become stronger, which would increase the competition within the after-sales service market. Therefore, customers would be given better service.

184. This might have been another serious reason why many car manufacturers have chosen selective system over exclusive system.

185. Commission Regulation 1400/2002, para. (37), at 34.

186. *Id.* paras. (17), at 31, (21), at 32.

187. *Id.* para. (26), at 33, art. 4, para. 1(j), at 38.

188. Jens Meiners, *Auto Industry Fights for its Aftermarket Presence*, AUTOMOTIVE NEWS EUROPE, Oct. 4, 2004.

189. Profits from spare parts and service amounts about 40 percent. *Id.*

190. Sylviane de Saint Seine, *AutoDistribution Threatens to Sue Carmakers*, AUTOMOTIVE NEWS EUROPE, July 11, 2005.

V. CONCLUSION

The new BER would effectively serve its legislative purpose¹⁹¹ by making cross-border sales of new vehicles significantly easier, increasing competition among dealers, and creating greater price competition. Further, quality of after-sales service would improve. As a result, consumers can more easily access dealers and repairers inside or outside the territory. This trend will benefit customers in some Western European countries, such as Germany and the UK in which car makers have sold vehicles at higher prices than other countries.

In spite of dramatic changes in the third BER, the automotive market has not yet shown any corresponding changes because many car manufacturers have chosen the quantitative selective system and maintained the location clause in their dealership agreements.¹⁹² After October 2005, however, the car manufacturers can no longer maintain the location clause.¹⁹³ Even though the dealers are moving slowly because they do not want to ruin the longstanding relationship with car makers yet, in the long run, fundamental change is unavoidable under the third BER.¹⁹⁴

These changes would entail potential problems that a more flexible approach can resolve. The problems may adversely affect consumer benefits and market efficiency unless the Commission substantially changes the regulation in 2010¹⁹⁵ after reviewing the impacts and limitations of the third BER in 2008.¹⁹⁶

A. Price Convergence and Consumer Benefits

Price convergence may disadvantage the consumers residing in countries with high tax rates or weak purchasing power. In the end, there should be measures to reconcile substantial differences in consumer purchase power and tax system.

In the short term, the solution may be a more flexible application of rules. Rather than categorizing price restraints or territory-based remuneration programs as Hardcore Restrictions, the regulation could adopt a more flexible approach such as the rule of reason. Under such an approach, courts could allow car

191. Comprehensive Reform Press Release, *supra* note 22.

192. Questions and Answers, *supra* note 17.

193. Commission Regulation 1400/2002, art. 12, para. 2, 2002 O.J. (L 203) 30, 41 (EC).

194. *Id.* art. 3(4).

195. *See id.* art. 12, para. 3, at 41.

196. *Id.* art. 11, at 41.

makers to use some price restraints or territory-based remuneration programs to deal with the differences in consumer purchase power and tax system, as long as pro-competitive effects outweigh anti-competitive effects and consumers can share resulting benefits.

B. Free-rider Problem

The problems of free-riders may also reduce consumer benefits. Because of the free-rider problem, dealers may provide low quality customer services, and inter-brand competition may be reduced. The Guidelines for Vertical Agreement expressly recognize that the free-rider problem may justify some vertical restraints. Thus, theoretically, car makers can use such measures as long as it does not constitute a Hardcore Restriction and its anti-competitive effect does not outweigh pro-competitive effect. In reality, however, it would be difficult for car manufacturers to find any effective measure to deal with this problem because the third BER categorizes as Hardcore Restriction the most effective measures including territory-based marketing allowances.¹⁹⁷

C. New Vehicle Distribution System

The new relationship between car manufacturers and dealers may not necessarily benefit consumers. Rather, it may just transfer power from one to another. Under the traditional model, a car maker gives a dealer an exclusive territory for a certain period. Based on the commitment, the dealer can aggressively invest in sales outlets, local advertisement and customer services, and reinvests its profits in the marketing activities based on the long-term market strategy. The car maker supports its dealer's activities based on the dealer's investment and sales achievement in pursuit of mutual interests. Along this line, the traditional model has maintained its own efficiency and inter-brand competition.

Under the third BER, there is substantial possibility that in the long run, the relationship between the car makers and the multi-brand mega dealers may become similar with that of department stores and clothes manufacturers. There is no territory restriction, no exclusive dealing, and almost no reason for dealers to try to maintain a close relationship with a car manufacturer as they did in the traditional system. Rather, based on their increased

197. *Id.* para. (12), at 31.

market control, the mega dealers may maintain retail prices at a certain level and may try to control vehicle trade among member states. These changes would not necessarily increase the intra-brand competition while it may adversely affect the inter-brand competition. Thus, there should be a thorough review to determine which model would better serve the goals of market integration, market efficiency, and consumer benefit.

D. Hardcore Restrictions: Per Se Rules

The third BER expressly allows certain vertical restraints notwithstanding their anti-competitive purpose and effects. For example, under the exclusive system, the third BER allows a supplier to prohibit active sales even though it is generally true that the supplier prohibits active sales with anti-competitive purposes and the prohibition would not have any pro-competitive effect.¹⁹⁸ Under the selective system, the third BER basically does the same in allowing a supplier to prohibit reseller sales.¹⁹⁹ Therefore, the competition rule allows direct restraints on trade with anti-competitive purposes and effects, while it prohibits some vertical price or non-price restraints even when the restraints have pro-competitive purposes and effects by categorizing them as Hardcore Restrictions.

*Chan Yong Jeong**

198. *Id.* art. 4, para. 1(b)(i), at 38.

199. *Id.* art. 4, para. 1(b)(iii), at 38.

* J.D. Candidate, May 2007, Loyola Law School, Los Angeles. Prior to law school, the author worked as the legal manager in the export planning team of Hyundai Motor Company. He wrote and negotiated contracts involving various international transactions including share acquisition, joint venture, technical license and distributorship. He was also in charge of analyzing EU regulations and directives including the third BER, developing strategies for legal compliance, and negotiating new distributorship agreements and after-sales service agreements in the EEA.

The author wishes to express gratitude to Professors John A. Donovan, Warren S. Grimes, Mary F. Dant, Daniel E. Lazaroff, Ralph C. Hofer, Jeffery Atik, Scott E. Woods, and John K.J. Kim for their invaluable time, advice and support in the preparation of this comment. The author wishes to dedicate this comment to his loving wife, Hye Kyung (Sharon) Jung, for her unwavering love and support.