

6 Dealer agreements and the regulation of distribution within the EC

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Background

6.1. As described in paragraphs 5.5 to 5.32, new cars are distributed and sold to the general public in the United Kingdom through networks of specialised retailers, ie dealers, who operate within the framework of a legally binding agreement between themselves and suppliers of new cars. This method of distributing new cars has been chosen by all but the smallest United Kingdom car suppliers, and is used in preference to forms of distribution found in other trades. For example, retail outlets owned by the manufacturer are exceptional in car distribution, and the use of agents, travelling salesmen, general wholesalers, mail order, supermarkets and department stores is virtually unknown.

6.2. This was not always the case. In the very early days of the motor industry many forms of distribution, including mail order and door-to-door salesmen, were tried and for a number of years wholesalers played a key role in retail sales and distribution. However, the system of distribution characterised by a direct link between manufacturers and dealers who specialise not only in the car trade but in particular makes of car has been established generally for 60 to 70 years. It evolved over a number of years following the advent of mass car production, the popularisation of personal transport and the development of an international car industry. Similar dealer systems now exist in all countries where cars are freely bought and sold.

6.3. A number of reasons have been advanced as to why the contracted or franchised dealer system became so widespread and so popular with car suppliers almost to the exclusion of all other channels of distribution. It has been said that the early car makers regarded themselves as experts in engineering and production but did not consider that they had a particular aptitude for selling. It was thought that an appropriate division of skills would allow the manufacturers to concentrate on the technical improvement of their products (which at that time were not always reliable) and on the economies of large-scale manufacturing, while a network of independent entrepreneurial units operating on a percentage commission basis would be given every incentive not only to maximise sales volumes and provide widespread service but also to control costs in a way that neither a wholly-owned subsidiary nor agent could be expected to do.

6.4. A small local business, it was thought, could develop and maintain contacts in the community in which it was situated and could more readily demonstrate the models available. Because of the personal element and the commitment of his own capital, there would be an incentive for such a dealer to maintain a high reputation and develop customer loyalty. This personal aspect in car distribution continues to be a significant feature in many present day dealerships.

6.5. A further factor which may originally have influenced car manufacturers to contract out their retail operation was that it was not easy to raise capital for what was then considered a risky business. By contracting out they were absolved from finding the additional capital required to set up the retail system and finance the stocks of new cars in the showrooms. The capital cost of the premises and stock was provided by the dealer; the overheads could be spread, not only over the new car retailing activity but also such other enterprises as the dealer might conduct on the site, primarily, as markets developed, second-hand car selling and car repairing.

6.6. One of the potential drawbacks of any system of contracting out a retailing activity is the loss of direct interface between the manufacturer and potential customers. The reputation of the manufacturer and its products depends heavily on the quality of the retailers. This is especially true for a complex product such as a car, requiring both pre-sale and post-sale inspection, service and repair. The need for car retailers to possess the appropriate understanding of how a car works, to be able to explain this to potential buyers and convince them that the technical expertise was available to keep the vehicle serviceable, became very apparent to car manufacturers as the number of competitive marques on the market multiplied. The expertise had to be imparted by the manufacturers and, as there was a limit to the number of retailers who could be effectively instructed, some system of selection had to be adopted.

6.7. In the early years of the century the car was an expensive luxury bought only by the wealthy. With the spread of mass production methods in the inter-war years it became more available and affordable but still remains a purchase involving substantial expenditure to which much time and thought are given. For the private customer intervals between purchases are measured in years. Because of marque loyalty, a customer's first purchase of a new car was (and still is) considered of great importance in the industry,

requiring aggressive promotion to attract the customer to the showroom and salesmanship and service involving the resources of both the dealer and manufacturer.

6.8. It became evident to the manufacturers that to succeed in the market, and to ensure that specialised service would be available, they needed a system of incentives and constraints which would encourage the dealers to concentrate their efforts on promoting the sale and subsequently undertaking the servicing of individual marques, preferably to the exclusion of competitors' products, and to concentrate these efforts in a particular locality rather than dilute them over a wide area.

6.9. From these various strands the car distribution system evolved over a number of years into the structured but complex and interdependent supplier/dealer relationship seen today with its characteristics of both selectivity and exclusivity.

6.10. In a selective distribution system a supplier appoints dealers who may resell the products to end-users without restraint, but may sell only to the outlet specified or approved by the supplier. Appointment to a dealership will normally depend on the supplier's satisfaction with the quality of management, technical expertise, financial resources and quality of premises available for trading. Selective distribution is, in effect, a closed system of trading outlets, not normally subject to qualifications or exceptions. If the system is selective only, a supplier may appoint any number of dealers it likes, wherever it likes, and in whatever proximity to each other it wishes, and the dealer remains free to handle products from other suppliers, even competitive brands.

6.11. In an exclusive distribution system, however, a supplier agrees to supply specified products for the purposes of resale only to one dealer situated in a designated area usually known as a 'territory'. The grant of such an exclusive right is intended to focus the dealer's interest on the promotion of sales in the territory. In most cases the supplier itself lacks any sales organisation in the territory and relies on the appointment of such an exclusive distributor as the only way to achieve effective sales penetration. The dealer remains free to choose his customers, either as resellers or as end-users. He may also accept some reciprocal degree of exclusivity, for example not to sell competitive products of other suppliers at all, or not within the territory, or simply not at the same outlet.

6.12. It has been a characteristic of car distribution for many years that features of both the selective and the exclusive systems are combined. By its nature the selective element is normally unqualified but the exclusive element may be either qualified or unqualified. This means that the supplier may reserve the right in certain circumstances to introduce other dealers into some part of the original territory and the dealer may still be entitled to sell cars manufactured by other suppliers. These rights may be absolute or subject to the approval of the other party.

6.13. Even recent supplier entrants into the United Kingdom car market, with no long-established trading methods or links with particular dealers, have chosen to make use of the selective and exclusive dealer system. This may be not only because it is considered the most effective method of distributing cars but also because there may be difficulties in acting contrary to custom and practice well established in the motor trade and because of practical difficulties of acquiring good dealers who are not already operating under the present system.

Legislation

United Kingdom law

6.14. Contractual restrictions of the kind found in the SED system used for cars are normally regarded as restrictive of competition. In the United Kingdom the Restrictive Trade Practices Act 1976 (the Act) provides a number of exemptions which mean that, for the most part, car distribution agreements containing such restrictions are not subject to registration. However, a number of the agreements between suppliers and their dealers have been registered under the Act by the DGFT (see Appendix 6.1). These agreements have been registered because they contain at least one restriction outside the scope of the exemptions in the Act.

If an agreement contains such a restriction, all the restrictive provisions in the agreement, including those which would otherwise be exempt, fall to be registered. A number of other agreements contain similar restrictions- all relating to prohibitions on the manufacture of cars-and these are also listed in Appendix 6.1. Under the Fair Trading Act 1973 we are precluded from taking these registrable restrictions into account in considering the monopoly situation and from expressing views on the effects on the public interest of such restrictions.

EC law

The Treaty of Rome

6.15. For the purposes of this inquiry our main concern is with the provisions of EC law and it is, therefore, necessary to describe the legislation in some detail.

6.16. Article 85(1) of the Treaty of Rome prohibits agreements and concerted practices between undertakings which may affect trade between EC member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market (ie within the EC). However, Article 85(3) outlines certain conditions which, if met, can lead to some agreements which contain anti-competitive provisions being declared nevertheless exempt from the force of Article 85(1). These conditions are that the agreements and concerted practices should contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and should not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; or
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

EC Regulation 123/85

Introduction

6.17. In terms of administration it would be unworkable for every agreement between suppliers of cars and their dealers (amounting to many thousands in total) to be examined for restrictions on competition and a decision made in each case as to whether it contravened Article 85(1) and, if so, whether it qualified for exemption under Article 85(3). The EC Commission had been authorised in 1965 to adopt the practice of granting, to certain categories of agreements, 'block' or 'group' exemption and, in the case of new car distribution agreements, after lengthy consultation between interested parties, the EC Commission promulgated in December 1984 EC Regulation 123/85 ('the Regulation': see Appendix 6.2). This grants exemption to various provisions in the agreements between car suppliers and their dealers, for the ten years from 1 July 1985 to 30 June 1995.

6.18. The 'group' or 'block' exemption granted by the Regulation specifies in considerable detail the potentially restrictive clauses which are legally permitted to be included. However, it does not explicitly state whether the inclusion of any other restriction not expressly prohibited in an agreement would affect its exemption.¹

Main elements

6.19. We turn to consideration of the Regulation, and the EC Commission Notice issued with it. The Regulation opens with Recitals which set out the background to its adoption and the principles upon which

¹In earlier EC Regulations dealing with the exemption of agreements in exclusive distribution (EC Regulation 1983/83) and exclusive purchasing (EC Regulation 1984/83) such a provision had been included.

it has been prepared. They refer, *inter alia*, to the fact that many distribution agreements in the motor vehicle sector have already been notified under Article 85 of the Treaty of Rome. The reason for granting this group exemption is, however, to be found at Recital 4:

the exclusive and selective distribution clauses can be regarded as indispensable measures of rationalisation in the motor vehicle industry because motor vehicles are consumer durables which at both regular and irregular intervals require expert maintenance and repair, not always in the same place. Motor vehicle manufacturers co-operate with the selected dealers and repairers in order to provide specialised servicing for the product. On grounds of capacity and efficiency alone, such a form of co-operation cannot be extended to an unlimited number of dealers and repairers.

6.20. Recital 29 states that:

it [the Regulation] is without prejudice to laws and administrative measures of the member states by which the latter, having regard to particular circumstances, prohibit or declare unenforceable particular restrictive obligations contained in an agreement exempted under this Regulation; the foregoing cannot however affect the primacy of EC law.

This Recital is important since it permits EC member states to declare unenforceable particular restrictive obligations on the dealer that may be found within such agreements. For the views of the parties on the extent to which this allows the member state to declare unenforceable restrictions permitted by the Regulation see, for example, those of Vauxhall, in paragraph 12.2.103).

6.21. Articles 1 and 2 of the Regulation define the products covered by it, state that the exemption applies only to two party agreements between a supplier and a dealer, sanction the concept of exclusive supply within a defined territory of the common market (ie within the EC) and make it legitimate for the supplier to agree not to sell in the territory in competition with the dealer.

6.22. Article 3 provides a list of 12 clauses normally restrictive of competition which may be included by the supplier in its contract with the dealer. In some instances the absolute nature of the restriction is qualified by a corresponding obligation on the supplier under Article 5. The purpose of these restrictions is to support both the selective and exclusive features of the system by forbidding the use of subcontractors, preventing supply to unauthorised resellers or sales to intermediaries who do not have prior written authority from a customer to purchase a particular vehicle on his behalf, limiting the dealer's sales promotion to inside his territory, and restricting the dealer's rights to display, sell and enter into distribution or servicing agreements for competitive products. It is accepted that the supplier's consent has to be obtained before distribution or servicing agreements for contract goods or corresponding goods are concluded, altered or terminated. These restrictions do not include an exclusive purchasing obligation.

6.23. Article 4 expressly permits categories of obligation which the supplier can impose on the dealer. These relate *inter alia* to standards of premises, staff training, ordering methods, sales targets, stock levels, demonstration cars, performance of warranty work, free servicing, the use of spare parts and recall work.

6.24. Article 5 sets out certain basic obligations (intended to represent benefits to the consumer) which the supplier and dealer must continue to honour if the block exemption is to remain effective throughout the life of the agreement. These obligations relate to the conduct of the parties during the period of the agreement. They cover such matters as honouring guarantees; undertaking recall work for cars covered by the agreement (which may have been sold originally in another member state); the operation of quantity, rebate or discount schemes; and the obligation on the supplier to fulfil the dealer's orders for cars required by individual customers for registration in other member states. This last obligation is designed to ensure that parallel importing (discussed more fully in paragraphs 5.47 to 5.62) can take place. The Article also contains provisions which serve to qualify certain of the restrictions listed in Article 3.

6.25. Article 10 specifies the circumstances in which the benefit of the Regulation can be withdrawn from any specific agreement or agreements. These circumstances are where the cars covered by the block exemption are not subject to competition from other similar products, where the supplier makes it difficult for consumers to obtain these types of cars or to have them serviced, where prices or conditions of supply for 'contract goods' or 'corresponding goods' differ between member states substantially over a

considerable period due chiefly to obligations exempted by the Regulation, and where prices or conditions are applied to the supply to dealers of cars 'corresponding' to those in their contract programme which are not objectively justified with the object or effect of partitioning the common market, ie the EC market.

6.26. Article 13 deals with definitions, of which the most important is that contained in Article 13.10, namely 'a passenger car which corresponds to a model within the contract programme'. This is defined as a 'passenger car manufactured or assembled in volume by the manufacturer and identical as to body style, drive-line [ie transmission], chassis, and type of motor [ie engine] with a passenger car within the contract programme'. The 'contract programme' is the list of those model variants which a manufacturer supplies to its dealers within a member state.

EC Commission Notice¹

6.27. At the same time as the Regulation was issued the EC Commission at the request of 'some of the commercial sectors involved' published a Notice providing guidance as to its approach to the exercise of its powers under Article 10 (see Appendix 6.2). This Notice deals with those conditions which are a requirement for continuing the block exemption, namely, those with respect to cross-boundary movements and relative price differentials between member states. It starts from the premise that 'the European consumer's basic rights include above all the right to buy a motor vehicle and to have it maintained or repaired wherever prices and quality are most advantageous to him'. However, it admits some qualifications. Thus, a manufacturer is not required to produce cars which it would not otherwise offer for sale in the common market (ie the EC) nor sell particular models in any particular part of the common market (ie the EC) where it does not or does not yet wish to market them. Suppliers, however, are expected to co-operate in the trade in new cars between member states by the following means:

- (a) Any authorised dealer must be able to order from his supplier any volume-produced passenger car which a final consumer has ordered from him and intends to register in another member state in the form and specification marketed by the supplier or with its consent in that member state provided the dealer already has a contract to sell similar cars in his own territory.
- (b) The EC consumer must not be subject to obstruction or hindrance either in the exporting country, where he wishes to buy the vehicle, or in the country of destination. Refusal to honour warranties, excessive delivery time or lack of co-operation in registering vehicles imported from other member states would be considered obstructive but operation of an exclusive and selective distribution system in accordance with the exemption would not.
- (c) An intermediary, provided he has specific authorisation from an identified customer to make a purchase on behalf of that customer, should be able to act on the customer's behalf.

6.28. The EC Commission accepts that there may be differences in prices between member states because of normal supply and demand factors. However, it believes that if the differences are substantial, continuing and applicable to a significant proportion of cars being sold then there may be restrictive forces at work which merit investigation. The EC Notice indicates that the EC Commission would not generally intervene where price differences were no more than 18 per cent for those which continue for less than a year and 12 per cent for those which continue for a year or more. The EC Commission recognised that market distortions caused by abnormally high sales taxes or price controls would have to be taken into account as would exchange rate fluctuations in a member state.

6.29. The price payable by individuals wishing to purchase a car in one EC member state for export to another should be the price applicable in the state of purchase with only such adjustment as may be objectively justified for any equipment, specification, delivery and administration differences. Where the price in the member state of purchase is affected by price controls or very high taxes, suppliers are allowed to impose an additional price supplement based on the lowest price in an unrestricted market.

¹OJ 1985 C.17/3.

MMC discussions with EC Commission

6.30. During the course of this inquiry the MMC sought the views of Directorate General IV of the EC Commission, which is responsible for competition matters, on the interpretation of certain articles in the Regulation in relation to features found in the United Kingdom both in dealer agreements and the distribution system. The questions posed and the definitive comments given in response are contained in Appendix 6.3. These questions and comments were subsequently conveyed to the suppliers, many of which have made it known that they disagree with a number of the views put forward, particularly in relation to Articles 3.3 and 3.5. The companies' views are contained in Chapter 12.

United Kingdom dealer agreements

General

6.31. This section, a review of United Kingdom dealer agreements, is based on an analysis of the agreements and associated documents submitted to us by 35 suppliers.

6.32. A dealer agreement is the contract entered into by the dealer and the supplier in respect of each dealership. There is little or no individual negotiation on terms and conditions; the contract normally comprises a series of standard forms drawn up by the supplier completed with details of the prospective dealer's business.

6.33. Taken together the documentation generally falls into five distinct parts:

- (a) appointment forms or letters relating to the individual dealership; these may include details of ownership, management, premises, location, other dealerships of the supplier and other suppliers, and demarcation of the territory;
- (b) a standard contract containing a series of conditions covering territorial rights and obligations, sales and stock targets, ordering procedures, prices, servicing and warranty obligations, trade mark rights, a range of other restraints and obligations on the dealer (for further details see paragraphs 6.43 to 6.50) and other provisions of a sort normally to be found in a commercial agreement;
- (c) an integral or separate set of conditions covering the consignment or sale or return terms on which new cars are supplied;
- (d) a range of manuals and guides covering technical and operating standards and practices, descriptions of special bonus programmes, informative and instructional booklets, pamphlets and leaflets, all designed to supplement the basic obligations and rights contained in the standard agreement; and
- (e) *ad hoc* bulletins and notices concerned with specific events as they arise from time to time, eg price changes, recalls, promotions and special offers.

Apart from the contract in (a) these documents are standard for all dealers in a supplier's distribution network and, *mutatis mutandis*, for second-tier dealers and those dealers handling only a specialised product range.

6.34. In addition a number of the major suppliers have policy statements or internal guidelines, which they follow with various degrees of flexibility, concerning the number, location and proximity of dealerships which the supplier is prepared to allow any one dealer or dealer group to hold at any one time. These statements or guidelines can be put to their dealers either in writing or orally; they may be generally known or disclosed only when the occasion arises.

Subjects covered by agreements

6.35. In this section we cover the general relationship between the supplier and dealer, the main restrictions and obligations normally found in the agreements, any unusual features of the contracts and the types of contractual support provided by suppliers.

6.36. Agreements between car suppliers and their dealers are about the terms and conditions for the sale and purchase of new cars and car parts. However, as will be seen from paragraphs 6.8 to 6.13, the relationship between the supplier and the dealer is considerably more complex than that of buyer and seller. The scope of the agreements and of the supplier's concern with the dealer's conduct of his business is shown in the following list of matters relating to a dealership which most suppliers either determine or require their dealers to refer to them for approval:

- | | | | |
|---------------|-------|----------------|---|
| A. PHYSICAL | (i) | Territory | - location
- dimension |
| | (ii) | Premises | - location
- size
- layout
- appearance (signs, decor)
- cleanliness
- equipment, tools
- opening hours |
| | (iii) | Supply of cars | - model ranges
- stock levels
- delivery |
| B. MANAGEMENT | (i) | Corporate | - ownership
- directors, managers |
| | (ii) | Organisation | - structure and staffing
- dress
- training
- computer systems for ordering and stock control |
| C. FINANCE | (i) | Operating | - accounting systems
- performance reports
- liquidity and credit
- payment systems |
| | (ii) | Capital | - asset acquisition
- asset disposal |
| D. TRADING | (i) | Sales | - targets, promotion
- recommended prices
- channels of trade
- customer records
- service standards
- margins/bonuses/penalties |
| | (ii) | Audit | - field staff inspection
- customer surveys
- 'mystery shoppers' |
| | (iii) | Development | - additional franchises
- other suppliers' franchises
- expansion of premises |

6.37. Notwithstanding this degree of supplier control, dealer agreements usually declare that the dealer is not an agent of the supplier. The dealer and his staff are considered to be independent parties and are prohibited from acting as, or giving the impression that they are, the supplier's agents, and from taking on any legally binding commitment on behalf of the supplier. This separation and independence is reinforced by the suppliers' imposing severe limitations on the use of their trade marks and trade names (although it was put to us that the same provisions, to protect the validity of the marques, would also be required in an agency agreement).

6.38. The questions of the degree of control exercised by suppliers over dealers was included in a Dealer Attitude Survey conducted by the RMIF in January/February 1991 among a 25 per cent sample of dealers of the top 20 suppliers. The survey showed that the dealers for most marques hold the view that their supplier exerts, or probably exerts, a considerable degree of control over their business and, in the majority of cases, dealers remain unsure whether the many requirements and procedures placed upon them by their supplier are fair.

6.39. Dealers' and suppliers' views on the dealer agreements and the resulting distribution system are contained in Chapters 11 and 12. In brief, dealers, while generally supporting the system, have a number of complaints covering the restrictive nature of exclusive territories, the restrictions on handling competitive products within a territory; stock policies; discounts; restrictions on the sale of used cars; restrictions on the operation of body shops or repair centres for cars outside the territory; and concern with company-specific standards. Suppliers consider that the restrictions and obligations they impose on their dealers are no more than those required for an efficient distribution system, keen inter-brand competition and for customer satisfaction and safety.

Special features of dealer agreements

6.40. There are many features in the standard provisions of dealer agreements which are common to the generality of agreements covering the sale and purchase of goods of any kind. These features have not been analysed since we have focused on the exclusive and selective elements and particular obligations which may give rise to practices which prevent, restrict or distort competition in the supply of new cars.

6.41. Much of the Regulation, particularly in relation to the restraints in Article 3 and the obligations in Article 4, was based on dealer agreements in existence when the Regulation was drafted. It is to be expected, therefore, that clauses of dealer agreements (especially of those suppliers that have recently entered the EC market or have recently amended their standard provisions) which contain such restrictive or obligatory features will be phrased in either the same or very similar words to those contained in the Regulation. But it should be emphasised that not all agreements contain all of the restrictions and obligations permitted by the Regulation, or are confined to them. Those practices, however, which are sufficiently widespread to give the car distribution system its individual selective and exclusive character are commented on in the following paragraphs.

Dealer selection

6.42. The principle that the choice of dealer and judgment as to his suitability remain the supplier's prerogative is clearly evident in the agreements. Typically, details of the management and of the ownership of the premises to be used for the dealership (eg whether a company, a partnership or a sole trader) are registered as part of the contract and changes to them, without the supplier's consent, are causes for termination. The contract is expressly between the supplier and the dealer and the transfer of ownership of the premises used for the dealership or of control of the company holding the dealership does not imply reassignment or continuation of the dealer agreement.

Restrictions

Territory

6.43. Most agreements refer to a dealer's 'territory' (see paragraphs 5.23 and 5.24). In some, the expression 'territory' is specifically used; others refer to the dealer's 'area of prime responsibility' or 'area of influence'. (For convenience we use 'territory' throughout this report.) In most agreements the supplier agrees explicitly or implicitly that the dealer has the sole right within the territory to buy the supplier's cars for the purposes of resale. However, a number of agreements make it plain that the dealer does not have exclusive selling rights within the territory. Most suppliers reserve the right to sell in the territory themselves. Evidence suggests that most use this right for sales to special categories of customer (eg suppliers' own staff) but several major suppliers also sell direct to large fleet buyers, Government departments and local authorities: see paragraph 5.29.

6.44. Most suppliers retain the right to change the size of the territory or to establish other dealerships within it, but agree to exercise this right-reflecting the Regulation-only after giving 'objectively valid reasons' and, in many cases, after consultation with the dealer. The objectively valid reasons are usually not defined, but examples given were if the supplier perceived there to be serious shortcomings in the distribution or servicing of its products or if there were substantial population changes in the territory.

6.45. Many agreements contain provisions which prevent the dealer from subcontracting any of the rights and obligations of the contract within his territory without the prior consent of the supplier.

Restraints on promoting sales outside territory

6.46. The concept of the territory and the rights conferred on the dealer holding it are reinforced generally by a number of provisions designed to limit encroachment by other dealers. Many agreements contain provisions which restrict the dealer from actively seeking sales in the territories of other dealers (although there is no bar on his passively accepting orders from persons outside his territory).

6.47. In many cases there are specific business constraints. For example, dealers are prevented from setting up branches themselves or from arranging for a third party to carry on dealership operations on their behalf outside their own territories. There are often restrictions on advertising and promotion, limiting the dealer's advertising to local radio stations and newspapers and periodicals which are circulated in the same geographic area as the dealer's own territory. However, there is no attempt to suppress cross-advertising when the areas covered by the local media extend beyond the dealer's territory.

Limitations on resale

6.48. Nearly all agreements prevent the dealer from selling the supplier's new cars to resellers which are not themselves part of the supplier's authorised dealer network. This reflects the principle of selective dealing and is often supported by a requirement that a new car is sold only if registered (so that if the purchaser were to sell it the sale, by definition, would be of a used car). Such a transaction-reflecting the Regulation-is permitted only if the intermediary can supply evidence that it is not intending to trade by producing a written order from a named customer to buy a specified vehicle on his behalf. The evidence in the case of *Ecosystems SA v Peugeot SA* illustrates the way in which this requirement bore on the interests of a French intermediary.

Restrictions on dealing in competitive products

6.49. Nearly all agreements contain a restriction on the freedom of the dealer, without the consent of the supplier, to sell other suppliers' new cars. Some agreements contain restrictions preventing the dealer from concluding distribution or service agreements for competing marques (most with no geographic limit to their applicability). Some carry restrictions on the dealer's displaying, promoting or selling products

which compete with those of the supplier (again generally with no geographic limitations). Others impose restrictions on selling any other new cars from the same premises as those covered by the agreement. In some cases all three of these restrictions are imposed. However, as will have been seen from Appendix 5.2, there are a sizeable number of dealers operating multiple franchises with some suppliers showing considerable flexibility in the interpretation and operation of these restrictions.

Categorisation of restrictions

6.50. Each supplier's agreement has been analysed against the restrictions permissible under Article 3 of the Regulation. We have categorised the restraints found by three degrees of severity, *viz*:

- (a) where the prohibition is absolute;
- (b) where an action may be permitted provided the supplier's prior consent is obtained but the consent is at the supplier's discretion; and
- (c) where, if action is justified by the dealer through 'objectively valid reasons' (essentially that by so doing the dealer will not disadvantage the supplier or fail to honour the other terms of the contract), the supplier is required to consent.

It should be noted that the restrictions relating to trading in competitive goods fall generally into category (c) as required by EC Regulation 123/85 Article 5.2(1)(a). The analysis is attached as Appendix 6.4.

Obligations

Combined sales and service facilities

6.51. All agreements contain obligations on the dealer to have facilities to service and repair the supplier's cars. Dealers are also expected to carry out pre-delivery inspections, any work required under warranty and to keep detailed customer records, for use in recall programmes if such become necessary. The dealer recovers the costs for warranty and recall work from the supplier and agreements often include significant details concerning the rate for labour, times allowed and prices of parts to be used for the charges.

Minimum or uniform standards

6.52. Suppliers seek to impose minimum or, in some areas such as computing and stock control, uniform standards and there are a considerable number of clauses devoted to this subject in the agreements. The standards may relate to the actual premises, their size, layout and decor, to the organisation and staff levels, to technical training and service facilities and equipment, to receiving and handling customers, to accounting and stocking systems, and to advertising and sales promotion. These standards are checked by field sales forces who have access to the premises at all reasonable times.

Sales and stock targets

6.53. There is usually provision for sales targets for each model range separately to be fixed for the dealership. The detailed targets are generally set by consultation between the supplier and the dealer although in a number of cases the supplier retains the right to impose a target failing mutual agreement. In a few instances failure to meet sales targets may be a cause of termination of the agreement. Most suppliers oblige their dealers to hold certain levels of stock related to the sales targets and there is usually a requirement for dealers to have demonstration models available.

Information requirements

6.54. Dealers are expected to keep full records of their dealings with customers, of their financial transactions and of their own credit position, and to have these available for inspection by the supplier. The supplier usually expects to review copies of the dealership's full financial results and, in this connection, the management accounting systems to be used are often specified by the supplier to facilitate its ability to aggregate results from the entire network.

Other features of dealer agreements

6.55. Other provisions which are commonly found in agreements and are worth recording are set out below.

Wholesale and retail pricing

6.56. Wholesale prices payable by dealers are usually expressed as list or recommended retail prices (sometimes described as base prices), which are established and published by the supplier, less a dealer's margin. Some agreements indicate that the recommended retail price is the maximum price at which a dealer may resell. Many suppliers operate bonus schemes with their dealers which may result in the margin being increased as a result of the dealer achieving certain standards with respect to sales and service (see paragraph 6.57). In some cases the margin varies with the model, being generally smaller for cheaper cars.

Bonus schemes

6.57. Most, but not all, suppliers give bonuses or awards for meeting or exceeding agreed sales targets. In many schemes points are awarded for meeting car sales targets, targets for sales of parts and extended warranties and for achieving a defined percentage of sales of new cars financed through the supplier's sponsored credit sale scheme. Often the reward for achieving an appropriate total number of points for all these categories measured over a given time period, for example a quarter or a whole year, is an additional percentage discount on the value of all new cars sold during that same period of time. In many cases too there will be certain categories of target which must be met fully if any award of extra discount or bonus is to be made at all. Operating standards are given a great deal of attention by all suppliers and, even where a points or other rating system as such does not exist, the achievement of a minimum standard is essential for bonus payments on parts and, in some cases, cars also. Analysis of the relevant documents has also shown that there is an increasing tendency among manufacturers when introducing new models of cars to reduce the common 17 per cent margin to dealers to a lower figure and to require the dealer to cover the difference by achieving points under bonus schemes.

Consignment or sale or return terms of payment

6.58. The new car stocks at a dealer's premises are generally not owned by him but are held on a sale or return basis. A dealer may lodge with his supplier a deposit approximately equal to the wholesale price, net of tax, of the cars held in stock, or he may enter into a financing arrangement which produces a similar result. When the dealer contracts to sell a car to a customer, or buys it for his own purposes, he 'appropriates' it and so becomes liable for Car Tax and VAT. Safe keeping and insurance of the cars held in stock is the responsibility of the dealer.

Delivery

6.59. Most suppliers retain the right and obligation to deliver vehicles to their dealer's premises or to locations nominated by the dealer and levy a separate standard delivery charge (irrespective of distance) additional to the wholesale price. (See paragraphs 5.33 to 5.35.)

Cause for termination

6.60. The list of eventualities that may give the supplier grounds for immediate termination is usually extensive. The most commonly cited causes for immediate termination are the death or incapacity of the dealer, dissolution of a partnership, change of company ownership, disputes between owners or managers, bankruptcy, fraud, misrepresentation, failure to pay monies due, and breaches of the agreement, but there are others relating to performance in respect of sales or service.

Unilateral variation

6.61. A few agreements contain a provision under which the supplier has the unilateral right to vary the terms of the agreement for all dealers. Suppliers have told us that such a provision has not and would not be used to make material alterations to the terms of the contract to the detriment of the dealer. Its purpose is claimed to give scope for technical amendments which may become necessary as a result of, for example, changes in the law.

Suppliers' support for dealers

6.62. Obligations assumed by the supplier (in supporting or assisting the dealer both in terms of sales promotions and fulfilling the obligations imposed within the dealer agreement) are sometimes explicitly mentioned within the agreement. From the evidence of the contracts and other submissions, suppliers provide assistance to dealers in the forms set out in paragraphs 6.63 to 6.68. Sometimes a nominal charge is levied for the service.

National advertising

6.63. Suppliers undertake national advertising campaigns, exhibitions and promotions; promotional material is also provided to the dealer; assistance is also given to regional and local promotions.

Technical assistance

6.64. Current technical data and service advice relating to servicing and repairing the supplier's cars are provided. Specialist personnel are available to resolve unusual or difficult technical problems.

Training

6.65. The supplier runs training courses and seminars for the dealer's staff.

Business consultancy

6.66. The supplier provides assistance with the design and implementation of business systems for stock control, ordering and accounting. Expertise is also available to assist in the design and layout of the dealership premises, organisations and staffing.

Information

6.67. The supplier provides information on national market trends, competitors' activities and developments generally in the retail market.

6.68. These activities, although seemingly limited in number, call for considerable investment on the part of suppliers in terms of premises, specialised staff and equipment and managerial involvement.

Relation of dealer agreements to United Kingdom market

6.69. Dealer agreements are drafted for United Kingdom dealers retailing into the United Kingdom car market. The agreements cover models (and model variants) which the suppliers have decided they wish to market in the United Kingdom ('the contract programme') and the pricing and other provisions relate only to these cars and their parts. In many instances it is not clear from the agreements whether the warranties provided by manufacturers have EC-wide validity although suppliers have told us that this is so. If a dealer wishes to acquire from his supplier an LHD car for registration in another EC member state on behalf of a customer or authorised intermediary, such a transaction would not fall within the scope of his standard dealer agreement. However, a number of suppliers have provided separate guidance to dealers of procedures to be followed in such circumstances (see the discussion of parallel importing in paragraphs 5.47 to 5.62, particularly paragraph 5.53).

Suppliers' restrictions on number and location of dealerships and on car-related activities of dealers

6.70. Several major suppliers told us that they restrict the number of their dealerships which can be held by a single dealer or dealer group (see paragraph 6.34). In some cases suppliers prescribe the maximum share which one dealer or dealer group may have of the total of the manufacturer's sales or projected sales. Some suppliers also limit the number of adjacent territories or the proximity of dealerships under the control of one dealer or dealer group. Satisfactory performance within existing dealerships is also a factor taken into account in deciding whether an additional dealership may be granted. Appendix 6.5 contains a list of major suppliers and indicates whether, and to what extent, they apply such restrictions. Several suppliers told us that they had a flexible attitude, and regarded their restrictions as guidelines rather than hard and fast limits. The suppliers' reasons for imposing limits on the number and location of their dealerships under one ownership are to be found in Chapter 5. In brief, their purpose is to limit the supplier's market vulnerability to dealers' actions or misfortunes and to maintain diversity and competition in particular geographic areas. Some suppliers have stated a strong preference for sole traders owning only one dealership.

6.71. Ford's distributor policy also requires a dealer to obtain its consent before acquiring motor trade-related facilities (including those for selling used vehicles). Ford told us that this constraint applied only within the dealer's territory but the terms of the policy statements are not specific on the point. Ford's reason given for this restriction is that, in its view, dealership facilities should generally be integrated on a single site in a preferred location and that, if the dealer's facilities are to be split, it is necessary to ensure that, for example, the additional facility does not encroach unfairly on a neighbouring dealer. Before undertaking a self-drive hire business outside its territory, a Ford dealer is required to obtain Ford's consent-which we are advised is given provided that there is adequate disassociation between that business and the existing Ford dealership. Ford's consent is also required where a dealer wishes to establish fleet, contract hire or leasing activities outside its territory. Ford said that such activities would normally be contrary to the dealer's obligation (contained in its dealership agreement) not, without Ford's consent, to establish facilities for Ford vehicles outside its territory or to deal in competing new motor vehicles.

Suppliers' practices arising from the franchised dealer system

6.72. In Appendix 6.6 we list suppliers' practices which form the basis of the second complex monopoly finding.