

8 Conclusions

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Introduction

8.1. We have been asked to investigate and report on whether a monopoly situation exists in relation to the wholesale supply of replacement car parts in the United Kingdom. There are links between this inquiry and the inquiry into the supply of new cars which we were asked to undertake at the same time, and on which we reported to the Secretary of State on 31 October 1991, particularly since the car suppliers' distribution system handles both cars and parts. We have also taken account of the MMC reports in 1982 and 1985¹ on certain aspects of the supply of car parts and of changes in the market that have subsequently occurred.

Background

8.2. This reference is about the wholesale supply of replacement parts. However, it should be noted that almost all replacement parts are used in servicing and repairing cars. At that stage the consumer generally receives a servicing or repair bill that includes both parts and labour charges. It is at this point that the consumer is affected, rather than at the wholesale level we are examining.

8.3. The structure of supply is complex. Car parts are produced by car suppliers themselves and by component manufacturers either as original equipment (OE) for fitting during the assembly of the car or as

¹The findings of these reports and subsequent action taken are summarised in paragraphs 2.3 to 2.10.

replacement equipment (RE) for the repair and servicing of cars. Where component manufacturers supply OE parts to car suppliers they usually supply the same parts as RE parts for distribution by the car supplier under its own brand together with RE parts the car supplier has produced itself.

8.4. At the wholesale level there are two distinct streams of supply of RE parts. The first is by the car supplier to its own franchised dealers, who are free then to sell on into independent garages, or over the counter, as well as using them in service and repair. The car suppliers see the supply of replacement parts as an essential part of their selective and exclusive distribution (SED) system for new cars. Under this system cars are only supplied for resale to selected dealers who are allocated individual areas within which only they are supplied. These franchised dealers not only sell the cars but are required to provide continuing service and repair facilities. They are the only source of the car supplier's replacement parts for other users.¹ Franchised dealers buy most of their parts from their car suppliers. There are more than 40 different car suppliers to the United Kingdom, ranging from Ford with over one-quarter of the car market to specialist suppliers which sell only a few hundred cars a year. Virtually all use the SED system to distribute both cars and parts to their franchised dealers.

8.5. The second stream of supply is that in which the component manufacturers supply replacement car parts to the independent sector. Distribution is mostly through motor factors (wholesalers) to non-franchised garages and independent outlets but also directly to operations such as fast-fit centres and autocentres.

The monopoly situation

8.6. Under the terms of the reference made by the Director General of Fair Trading (DGFT) and dated 9 May 1990 we are required to investigate and report on whether a monopoly situation exists in relation to the wholesale supply within the United Kingdom of motor car parts for resale as such or for the replacement of parts fitted to a motor car as standard equipment when sold new,² and if so, by virtue of which provisions of section 6 of the Fair Trading Act 1973 (the Act) the monopoly situation is to be taken to exist, and in favour of what person or persons that monopoly situation exists. If we identify a monopoly situation we have to consider whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or those persons to exploit or maintain the situation, whether any actions or omissions on their part are attributable to the situation and whether any facts found in pursuance of these investigations operate or may be expected to operate against the public interest. We first here consider the existence of a monopoly situation or situations. The subsequent questions are dealt with later, in paragraphs 8.115 and 8.116.

8.7. Section 6 of the Act defines two kinds of monopoly situation in relation to the supply of goods. First, a monopoly situation under section 6(1)(a) or (b), usually described as a 'scale' monopoly, is taken to exist where at least one-quarter of all the goods of a particular description which are supplied in the United Kingdom are supplied by or to the same person or corporate group. Table 3.5 gives our estimates of the shares of the main suppliers of replacement car parts. We estimate that Ford, the largest supplier, has about 14 per cent of the United Kingdom market. Accordingly we conclude that there is no monopoly situation in relation to the supply of parts by virtue of section 6(1)(a) or (b) of the Act.

The complex monopoly situation

8.8. Under the provisions of section 6(1)(c) and 6(2) of the Act a complex monopoly situation is taken to exist when at least one-quarter of all goods of a particular description, which are supplied in the United Kingdom, are supplied by or to members of one and the same group consisting of two or more persons (not being a group of interconnected bodies corporate) who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict or distort competition in connection with the production or supply of these goods.

¹The car suppliers supply direct to a few large purchasers, eg Ministry of Defence, police forces.

²Throughout this report we refer to the reference goods as 'replacement car parts'.

8.9. In April 1991 we notified all those companies which we identified at that stage as suppliers (ie either manufacturers or importers, or both) of new cars and of replacement parts for those cars within the United Kingdom that we had provisionally concluded that a complex monopoly situation existed in their favour, relating to a number of practices which we had identified as affecting the distribution arrangements for car parts in the United Kingdom. We also put to them a number of issues arising from the provisional finding. Later in the inquiry we put for comment to the parties and a number of other interested parties possible remedies which might be considered by the MMC if they were to find any effects adverse to the public interest. The public interest letter and the list of issues annexed are at Appendix 7.1 and the possible remedies are at Appendix 7.2.

8.10. A number of suppliers put views to us in response to the provisional conclusion. It was argued that several of the practices identified did not prevent, restrict or distort competition. It was also argued that the practices identified were so disparate that they could not amount to conduct which constituted a single complex monopoly situation.

8.11. We find that the suppliers of replacement car parts listed in Appendix 8.1, who are all suppliers of new cars, are persons who conduct their respective affairs by adopting one or more of the following practices:

- (a) taking into account parts sales in providing dealer bonuses, rebates or other benefits based on overall dealer performance and thereby inducing their franchised dealers to supply the car supplier's parts at the expense of other suppliers' parts;
- (b) preventing franchised dealers concluding distribution agreements for parts which compete with the suppliers' own parts;
- (c) refusing to supply their branded parts except to their franchised dealers and to certain other designated customers;
- (d) withholding diagnostic equipment, or related information required for servicing the car suppliers cars, from other than franchised dealers; and
- (e) applying conditions which restrict the ability of component manufacturers to supply the independent market.

We set out in paragraphs 8.71, 8.76, 8.85, 8.98 and 8.109 whether the practices listed above prevent, restrict or distort competition and for the reasons given in those paragraphs conclude that each of these practices does have the effect of restricting or distorting such competition. We accordingly conclude that these persons so conduct their affairs as to prevent, restrict or distort competition in connection with the supply of replacement car parts in the United Kingdom. We do not consider that the other practices provisionally identified in the provisional finding prevent, restrict or distort competition.

8.12. As shown in Table 3.5, five of these suppliers together provide more than 30 per cent of the replacement car parts supplied in the United Kingdom. The suppliers of replacement car parts listed in Appendix 8.1 therefore together provide more than one-quarter of the wholesale supply of replacement car parts in the United Kingdom.

8.13. All the practices listed in paragraph 8.11 must be seen against the background of the SED system adopted by the car suppliers. This is an integrated system under which they supply new cars for onward sale only through their franchised dealer network. They require the dealer to service and repair the supplier's cars, and to supply replacement parts for these cars, both to support this servicing and repair requirement and as a profitable operation in its own right. Offering bonuses and other benefits on car sales linked to performance in selling the supplier's parts discourages the stocking of competing parts. Preventing these dealers concluding distribution agreements for competing suppliers' parts ensures that only the supplier's parts are sold on through its network. Refusal to supply parts or the diagnostic equipment and information required to identify which parts need replacing outside the network, together with restrictions on those component manufacturers which supply parts to the car supplier's network which

prevent them supplying the same parts for distribution through other channels, limit the purchases of parts by independent garages. Each of these practices has the effect of limiting the use of parts by independent garages in repair and servicing and thus in limiting the extent to which others can compete with the car suppliers in the wholesale supply of parts.

8.14. We consider therefore that the relationship between these practices is such that the conduct of suppliers in adopting the practices provides the basis for finding a single complex monopoly situation.

8.15. After considering the arguments put to us and recorded in paragraph 8.10 we confirm our conclusion that a complex monopoly situation, as defined in section 6(1)(c) and (2) of the Act, exists in relation to the wholesale supply of replacement car parts within the United Kingdom. We find that the complex monopoly situation we have identified exists in favour of the suppliers listed in Appendix 8.1. In reaching this conclusion in relation to the companies listed in the Note to Appendix 8.1, and in the subsequent consideration of the public interest in relation to these companies, we have left out of account the practice referred to in paragraph 8.11(b). In the case of these companies the practice derives from a provision in an agreement which is, for the reasons given in paragraph 4.18, a provision by virtue of which that agreement is one to which the Restrictive Trade Practices Act 1976 applies or appear to us to apply. We are required to leave such provisions out of account by virtue of sections 10(2) and 54(5) of the Act.

8.16. Having concluded that a monopoly situation exists under section 6(1)(c) and (2) of the Act we now have to consider whether any steps (by way of uncompetitive practices or otherwise) are being taken by any of those persons in whose favour the monopoly situation exists, for the purpose of exploiting or maintaining that situation; whether any action or omission on the part of those persons is attributable to that situation; and whether any facts found in pursuance of our investigations operate or may be expected to operate against the public interest.

EC aspects of the inquiry

8.17. In considering the matters before us we must take into account the relevant provisions of both United Kingdom and EC law. The distribution of cars and of replacement car parts within the European Community is subject until 30 June 1995 to the terms of a specific block exemption, EC Regulation 123/85 (see paragraphs 4.20 to 4.30). Since the Regulation exempts from individual examination under Article 85(3) of the Treaty of Rome suppliers' agreements which contain certain detailed requirements or obligations, it effectively determines the form of distribution agreements that may be used by suppliers throughout the EC (although use of agreements conforming to the Regulation is not compulsory). In addition to the fact that the Regulation has only a limited life, Article 10 of the Regulation provides that the EC Commission may withdraw the benefit of the Regulation where it finds that in an individual case an agreement which falls within its scope nevertheless has effects which are incompatible with the provisions of Article 85(3) of the Treaty.

8.18. Most suppliers' agreements with their dealers closely reflect the provisions of the Regulation as they apply to parts, in particular in exempting the requirements that dealers stock suppliers' parts, that suppliers' parts are used in warranty and recall work, and that consumers are notified when non-supplier parts are used.

8.19. We recognise that United Kingdom competition authorities must have regard to EC law in dealing with the rights and obligations which arise from its provisions. In considering the present arrangements for the supply of parts within the United Kingdom distribution system we have kept in mind the provisions of the Regulation and its current endorsement of those arrangements within its scope. We have also had regard to relevant decisions of the European Court of Justice.

The market for replacement car parts

8.20. A car contains thousands of different parts, any of which may need to be replaced at some time. Many of these parts will be specific to the car model or model variant.¹ Parts range from body shells, transmission and engine components, through brake parts, batteries, tyres to minor components such as windscreen wipers. In recent years there has been increasing use of sophisticated computer-controlled systems, first for engine management but increasingly in other systems such as braking and suspension.

8.21. Some car parts need replacing at regular intervals during the life of a particular car, others relatively infrequently or never, and it is this that determines whether the parts are slow- or fast-moving and the size of the aftermarket. Accident repairs create a steady demand for certain types of part, particularly body parts. Older cars tend to require parts to be replaced more often. Demand for replacement parts is thus linked to the size and age of the car parc. In 1990 just over 20 million cars were registered in the United Kingdom (see paragraph 3.7), compared with the 15.4 million in 1980 quoted in the MMC's 1982 report. At the end of 1990 about 20 per cent of these cars had been registered in the previous two years and a further 10 per cent in the previous year. About 15 per cent of the parc was ten years old or older.

8.22. Market research estimates suggest that the retail value of the replacement car parts market in 1989 was nearly £3.4 billion. Our terms of reference require us to examine the wholesale supply of parts at the stage at which these parts are supplied by car manufacturers or importers, by other parts importers and by component manufacturers, into the next stage of their distribution chains. On this basis we estimate, from our own surveys, that in 1989 the value of the United Kingdom market for replacement parts for cars at the wholesale level, on this definition, was a little over £2.5 billion (see paragraph 3.4). This can be compared with the estimate made by the MMC in their earlier inquiry that the size of the market in 1980 was approximately £1.48 billion at wholesale prices. When allowance is made for inflation it appears that there has been very little growth in the total RE market in real terms. There has been little change in the proportion of younger cars (ie those three years old or less) in the parc, which are likely to have lower parts requirements, and it appears likely that this stability in the parts market reflects the increasing reliability of car components and the extended intervals between servicing. Set against the 30 per cent growth in the car parc over the period these figures imply a substantial fall in real terms in expenditure on parts for servicing and repairing the average car, both when measured absolutely and compared with the value of the car itself. The main parts supplied to the replacement market by sales value are brake parts, transmission components, steering and suspension parts, tyres and exhausts. Parts such as lighting components, batteries, spark plugs and wipers, although smaller in total value of sales, are also important since they are fast-moving and frequently replaced.

8.23. Although tyres are replacement parts within the terms of reference, and are thus covered by our market estimates, they have their own distribution system outside the regular distribution channels of other car parts, and their distribution and stocking at the wholesale level is effected either by the larger tyre manufacturers or their local importing agents or by specialist wholesalers. Batteries are also mainly sold through specialist outlets. These parts therefore, which we estimate together account for 15 per cent of the wholesale parts market, largely fall outside our subsequent discussion of parts distribution.

Manufacture of car parts

8.24. As noted in paragraph 8.3, car parts are produced by car manufacturers themselves and by component manufacturers either as OE used in the assembly of cars or as RE for the repair and servicing of cars. Car manufacturers and many component manufacturers produce for both purposes but some component manufacturers supply only the independent RE market. Other component manufacturers supply only to the car suppliers where they may be acting essentially as sub-contractors. The importance of the two markets for individual component manufacturers thus varies widely.

¹We use these terms as in our report on the *Supply of new motor cars*. The terms we have adopted are: make, model range, model, model variant, and variation—each being progressively more detailed. By way of illustration, 'Ford' is the make; the 'Escort' is a model range; the 'Escort 1.3L' is a model; and the 'Escort 1.3L 3-door' is a model variant.

8.25. According to official statistics there are over 1,000 component manufacturers supplying car parts in the United Kingdom. At the one extreme there are a large number of very small companies; at the other a small number of very large groups manufacturing and supplying a wide range of parts, which account for a high proportion of total sales. Many supplement domestic manufacture by importing some part of their requirements. Car parts are also imported by other (non-manufacturing) component suppliers (including motor factors) which package and/or market components in the United Kingdom and by the United Kingdom distributors of foreign cars which source all or most of their replacement parts from an overseas car manufacturer or its OE parts supplier (see paragraph 3.24 onwards).

8.26. Like the production of cars, production of components is increasingly organised on an EC-wide basis. A larger component supplier, for example Bosch, may produce in a number of countries OE and RE parts for a car model which is itself being produced in different locations, whilst the contract for the parts may be negotiated at a central point in one of those countries.

8.27. The supply of RE parts cannot be considered in isolation from the supply of OE parts. Where component manufacturers supply OE parts to car suppliers¹ they usually supply the same parts as RE parts for distribution by the car supplier to his franchised dealers under his own brand. For many cars currently in production the supply of RE parts from the component manufacturer may not be distinguished from that of the OE parts and the car supplier will allocate supplies as appropriate. For others, and for cars no longer in production, the component manufacturer may package and despatch the RE parts separately, perhaps in a different format.

8.28. There has been a tendency over recent years for car manufacturers to increase the proportion of parts which are bought in, and for component manufacturers to co-operate with the car manufacturer in the technical development and design of parts. More parts are now specific to the individual model of car rather than standard components designed by the component manufacturer; often the costs of research and development are shared. The nature of the relationship will depend on the extent to which each party contributes technical knowledge or expertise. In some cases the component manufacturer is an industry leader in its field, in others the car manufacturer designs the part and finances or provides the tooling required (though not the machinery that uses the tooling). In such cases the car manufacturer will generally require the component manufacturer to supply the parts only to it. Car suppliers also seek to have their brand name put on bought-in parts in place of that of the component supplier.

¹For our purposes United Kingdom car suppliers include manufacturers of cars in the United Kingdom, some of which, like Ford, Vauxhall and Peugeot, import substantial numbers of cars manufactured by overseas associates, and importers which distribute marques not produced in the United Kingdom. Some of these importers are associates of their car suppliers, others are independent distributors. We describe members of all these three groups as car suppliers.

Parts distribution

8.29. At the wholesale level there are two distinct streams of supply for most types of RE parts, one through franchised dealers and the other through the independent aftermarket. (As already noted in paragraph 8.23, tyres are distributed through separate channels and a significant proportion of some other types of part, in particular batteries and to a lesser extent exhausts, are also sold through specialist outlets.) The first main stream of supply is distribution by the car supplier, through its franchised network, of parts bought in from component manufacturers, together with parts which the car supplier has produced itself. In 1990 there were over 40 car suppliers in the United Kingdom. Three of the major suppliers, Ford, Vauxhall and Rover, had 25, 16 and 13 per cent respectively of the market for new cars and five other suppliers had between 3 and 10 per cent of the market. There are also a large number of suppliers each with less than 1 per cent of the new car market. Over the last two decades the major feature has been the increase in sales of imported cars. Setting aside the substantial imports by Ford and Vauxhall, which are often seen as indigenous companies, the proportion of imports in new car sales rose from under 15 per cent in 1970 to 38 per cent in 1980 and to 41 per cent in 1990. Distributors of imported cars source most of the replacement parts from their overseas car supplier, although some also purchase some OE and replacement parts from United Kingdom component manufacturers. For such cars a high proportion of RE parts are likely to be supplied through the franchised network, since the volume of sales of the imported models may not be enough for a component manufacturer to find it worth providing parts to the independent aftermarket.

8.30. All the major car suppliers use broadly the same distribution system for their cars through franchised dealers. Under this system cars are supplied only to selected dealers who are allocated territories within which only they are supplied. Dealers may sell to customers outside their territory but freedom to promote sales outside the territory is usually restricted. A dealer is usually required not to sell other suppliers' new cars from the same site.

8.31. Car suppliers see the provision of RE parts as part of the total sales and servicing package that they offer through the SED system for their cars. They put forward as one of the major benefits of this system that the franchised dealers can provide an expert servicing and repair service, including warranty and recall work and supply parts of guaranteed quality, for a complex, expensive and potentially dangerous machine. The car suppliers adopt substantially the same system for the distribution of car parts as for cars. There are, however, some differences, noted below.

8.32. Franchised dealers are required to stock a wide range of the car suppliers' parts and can quickly acquire others using the computerised ordering systems maintained by the supplier. The car supplier (with some minor exceptions) supplies parts only to its franchised dealers. In addition to their use of suppliers' parts for their own servicing and repair work franchised dealers sell parts over the counter to retail and trade customers-independent garages-who themselves use them for service and repair; they are the only source of the supplier's parts for almost all other users. Many dealers also wholesale their car supplier's parts to other dealers within that supplier's franchise. Few suppliers place restraints on their dealers seeking parts business outside their own territory. Following the MMC's 1982 report and implementation of its recommendations, franchised dealers are free to buy parts from sources other than their car supplier. Many car suppliers, however, prohibit their franchised dealers from taking on a more active commitment to sell competing parts by entering into distribution agreements for such parts.

8.33. Car suppliers will provide all parts for their models, usually for up to ten years after the car goes out of production. In addition to parts carrying their own brand a number of the major car suppliers also supply, specifically for the aftermarket, a separate range of fast-moving parts such as spark plugs etc, suitable for a wide range of models (usually referred to as 'all-makes' parts) to widen the scope of their dealers' servicing and sales activities.

8.34. The second stream of supply is that in which component manufacturers and others may supply replacement car parts to the non-franchised sector. The main demand for replacement parts comes from the commercial servicing and repair sector, since apart from a small and declining DIY sector servicing and repair is carried out either by franchised dealers or by independent garages. Distribution is mostly through motor factors (wholesalers) or the component manufacturers' own distributors to independent garages and independent outlets but also directly to operations such as fast-fit centres and autocentres. There are about 8,000 franchised dealers and perhaps 9,500 independent garages. Over the last ten years fast-fit centres

specialising in tyres, exhausts and batteries have expanded rapidly from about 200 in 1980 to about 4,500 in 1990 and some are offering a wider range of servicing and repair. In addition there are several hundred mobile servicing operators and autocentres offering 'menu servicing', ie a standard service for a number of different car models at fixed prices. Component manufacturers supplying the independent market tend to concentrate on particular types of part and on faster-moving items providing reasonable volumes, although some buy in parts in order to provide a full range of the types in which they specialise.

8.35. Of the wholesale supply of parts in 1989 amounting to approximately £2.5 billion we estimate that car suppliers accounted for £1.391 billion (55 per cent), much of which is bought in from component suppliers, and independent component manufacturers and factors importing parts for about £1.144 billion (approximately 45 per cent). These figures include about £320 million of replacement tyres which are supplied by independent tyre distributors, outside the two streams of supply we are examining. If these were excluded from the market estimate the car suppliers' share would be rather higher, at 63 per cent. Also included in the figures are body parts, amounting to over £300 million, the vast majority of which are supplied by the car suppliers, and 'captive' parts, discussed in the following sections, which are, by definition, only supplied by car suppliers. The largest supplier of replacement parts is Ford (14 per cent of the replacement parts market, 25 per cent of the car suppliers' share), followed by Vauxhall (8 per cent of the market, 13 per cent of car suppliers' share) and Rover (5 per cent of the market and 10 per cent of car suppliers' share).¹

8.36. Parts for which alternatives are available through both the franchised and independent sector are known as 'competitive' parts. Parts which are available only through the car suppliers' network are known as 'captive' parts. Whether a competitive part exists depends on a number of factors including whether the car supplier, through owning tooling or design rights, is able to restrict the OE supplier's ability to supply the independent market and on whether the size of this replacement market for the part justifies the setting up of any necessary design, tooling and manufacturing facilities, either by the OE supplier or by others. Costs of supply in the two markets may not be similar and while the parts may be equivalent in terms of use the quality of the part supplied to the independent market may not be identical. Parts can move from being captive to competitive and for some parts (which we describe as semi-captive) an alternative is available but has secured only a tiny part of the market; categorisation is to some extent a matter of judgment. Estimates from the car suppliers suggest that about 40 per cent of their sales of parts, about £550 million in 1989, can be regarded as captive (see paragraph 3.49). Independent garages that require these parts can purchase them only from franchised dealers.

8.37. For the servicing and repair of cars the independent and the franchised sectors can be regarded as two largely separate markets appealing to different types of customer. Most franchised dealers deal mainly with cars three years old or less and are asked to service only a small proportion of cars over five years old. The sectors are, however, in direct competition at the point when the owner considers changing his servicing arrangements. In addition, as noted earlier, in recent years the numbers of fast-fit and menu servicing outlets have grown rapidly. These have taken business from both franchised garages, mainly in the fitting of exhausts and other relatively standard items, and from the rest of the independent sector.

Developments in the market

8.38. In 1982, following their first inquiry into the supply of car parts, the MMC found that exclusive purchasing requirements for replacement parts imposed by car suppliers on their franchised dealers were against the public interest, and their recommendation that these should be prohibited was implemented by the Government.² In making their recommendation the MMC commented:

We recognise that, even in the absence of any formal requirement to buy parts exclusively from car manufacturers and importers, it is virtually certain that franchised outlets would in practice continue to buy mainly from them. Removal of the restrictions could probably not be expected to result in any sudden or dramatic change in the pattern of trade. Nevertheless

¹These percentages are calculated on the market including tyres and batteries.

²By means of the Restriction on Agreements (Manufacturers and Importers of Motor Cars) Order 1982 (SI No 1146).

component manufacturers and factors appeared to be confident that if the formal restrictions were removed they would in practice be able gradually to penetrate the franchised sector of the market to a significant extent.

8.39. As noted above we estimate that, of the total United Kingdom wholesale car parts market in 1989, 55 per cent was supplied through the car suppliers. This can be compared with the estimates in the MMC's 1982 report that in 1980 the car suppliers' share of the wholesale market was 43 per cent and that of the component manufacturers and independent importers was some 57 per cent. This apparent change, taken with the changes in market size discussed in paragraph 8.22, suggests that the volume of sales of replacement parts by component manufacturers direct to the aftermarket has been falling while that of car suppliers has been rising. Our inquiry has shown that most franchised dealers continue to purchase nearly all of their parts from the car supplier. Although we received no evidence to suggest that car suppliers are not observing the Order requiring that franchised dealers be free to purchase parts from other sources, independent component suppliers and factors have thus made little progress in supplying the franchised sector. In addition, the franchised sector appears to have increased its share of the total market.

8.40. There are probably a number of reasons for the increase in supply through the franchised sector. First there are the considerations influencing franchised dealers themselves to continue to purchase their parts from the car supplier. Under their agreements with suppliers they are required to stock a full range of the suppliers' parts. They are required to use these parts for warranty and recall work and they must normally be used for work under insurance claims. A dealer must also notify the customer if he uses parts other than the supplier's parts for other work on cars of the supplier's brand, such as routine servicing. Suppliers also set sales targets and give bonuses on parts sales and sometimes performance against parts targets is taken into account, with a number of other factors, in giving 'linked bonuses', ie additional discounts to the dealer on his sales of new cars.

8.41. There is thus a strong incentive for the franchised dealer to purchase parts from the car supplier. Moreover, as noted in the earlier report, given that a dealer has a stock recording and ordering system through which in any event he has to obtain parts for stocking, parts for replacement under warranty and all captive parts, and from which he can obtain all the parts he needs, he is likely to prefer to source from his car supplier however much freedom his agreement allows him. To order from alternative suppliers would involve him in extra trouble by duplication of records, separate invoicing and so on and this will be a sufficient deterrent. Moreover, the dealer can reasonably assume that his customer expects the suppliers' parts to be used unless he specifies otherwise, and in any case the use of the parts warranted by the suppliers relieves the dealer of problems should a part used turn out to be defective.

8.42. At the consumer level there have been other developments encouraging customers to have their cars serviced by franchised dealers and hence to have car suppliers' parts used. Most car buyers have their car serviced by franchised garages while under warranty and most tend to do so for a few years until the car changes hands. This is particularly the case with company cars. The proportion of new cars bought as company cars has continued to rise over the last ten years. The company car owner, who will be anxious to preserve the resale value of the car and is often able to negotiate special prices for parts and servicing, is also likely to use the franchised dealer network. Standard warranties have been lengthened by some car suppliers to three years or 36,000 miles. Even outside the warranty period the consumer who has his car serviced by a franchised dealer has the reassurance that the car supplier stands behind the quality of parts used and can be turned to in the case of any subsequent difficulty.

8.43. In addition most car suppliers now sponsor extended warranties, essentially insurance contracts bought for cover by the car owner after the standard warranty expires and requiring the use of franchised servicing and parts. Most parts are bought as part of a servicing or repair transaction, and in that situation the consumer is generally not in a position to compare parts prices. Over the longer term the consumer may take some account of the comparative costs of parts in deciding on a new car but in the short term may not be sensitive to the element of parts prices in the total bill, particularly if the main concern is to get the car back on the road.

8.44. A number of factors may have contributed separately to the decline in the independent RE sector at wholesale level. Total numbers of component manufacturers have fallen and there has been some tendency towards rationalisation and amalgamation. It seems probable that for those which supply OE this

has become a more important part of their business. Increasing reliability of many parts has led to a decline in the demand for RE parts and increasing dependence on the OE market. There also appears to be closer co-operation between car suppliers and component manufacturers on the design of components. The design of such parts as lighting units is more likely to be unique to the individual model and numbers of models and model variants have been rising. The tooling for such parts is often provided or financed by the car supplier who reserves the output to its own use and the smaller volumes for the individual part may make it less economic for the OE component manufacturer, or others, to set up alternative production. We have been told also of an increasing tendency among car suppliers to allow only their brand names to appear on bought-in parts, thus limiting the buyer's awareness of possible alternative sources of supply for replacement parts.

8.45. On the other hand, since the 1982 report design protection has been reduced under the Copyright, Designs and Patents Act 1988. The most important change affecting car parts is that design features enabling one article (such as a car part) to be functionally or aesthetically matched to another-the 'must-fit' 'must-match' condition-now get no design protection, nor do parts whose design features do not possess 'eye appeal'. This first relaxation is of particular importance to independent makers of body parts but they do not appear to have increased their sales significantly since 1988 either into the franchised sector or generally. The main impediment appears to be the requirement by insurance companies that car suppliers' parts be used for repair, in order to return the car to the original condition. A number of component manufacturers are currently seeking accreditation to BS 5750, which provides a quality assurance of the recipient's manufacturing processes but will not provide a direct guarantee for the quality of their parts.

8.46. An important development is the introduction of electronic engine management systems (EMS) on an increasing number of car models, and the spread of electronic controls to such systems as braking and suspension. The introduction of engine emission standards, which requires the use of catalytic converters, means that in a few years all car models will be fitted with EMS. These electronic EMS require special diagnostic equipment for diagnosing faults, and the information to interpret the results when the cars are serviced or repaired.

Prices and profitability

8.47. Looking first at the absolute level of prices, we do not have historical data on the movement of the whole range of car parts prices over recent years. The gross and net margins on car parts sales by the car suppliers and on sales of motor vehicle parts by the component manufacturers are discussed more fully below, and are subject to a number of qualifications.

8.48. Any attempt to establish valid price comparisons for car parts as between suppliers raises considerable difficulties. Given the enormous range of parts available, direct comparisons of prices of competitive parts can only be done on a sample basis. Given further that there are no accepted parts standards, it is impossible to establish that parts of similar quality are being compared and, indeed, some parts of a lower standard may provide an acceptable performance and represent good value for money, particularly when used in an older car; others may not. For captive parts no direct comparisons are possible.

8.49. Our survey of retail prices and margins on competitive parts in three sectors, the franchised dealers, independent garages and retail outlets, described in paragraph 3.87 onwards, led to no conclusive evidence on relative prices between the first two of these groups. The main difficulty was that independent garages were unable to provide us with reliable information on the prices they paid. They tended to buy parts from a variety of sources on a day-to-day basis, and we were told that availability of the part rather than price was the main consideration. In the retail sector we discovered a wide range of prices for competitive parts. Quality comparisons were not, however, possible.

8.50. We also carried out an exercise to examine the five major United Kingdom manufacturers' prices and margins on a range of captive and semi-captive parts used in popular models and where possible to examine them against prices and margins on similar parts supplied by component manufacturers and motor factors (see paragraphs 3.99 to 3.105). The survey suggested that prices and margins of all these suppliers were extremely variable; if car suppliers' prices to franchised dealers were compared with those of motor

factors to independent garages for the parts included in the survey, there was no consistent pattern, but the latter tended to be a little higher.

8.51. There are problems in examining levels of profitability on RE parts. For both component manufacturers and car suppliers the supply of RE parts is usually one part of a wider business. The car suppliers have pointed out to us that they operate integrated businesses and some have put to us that it is misconceived to attempt to separate their results on parts from those on cars, since the provision of a parts service is necessary to support the sale of the car, and subsequent parts sales themselves are dependent on the original sale of the car. In their view we should therefore examine profitability only on the total cars business. They stated that the allocation of capital and of costs, including expenditure on research and development, between parts, cars and other activities, and between manufacture and wholesaling, involves difficult judgments and produces unreliable results. Some costs, eg marketing costs incurred on the sale of new cars, are allocated to that sector although they affect the sale of parts subsequently. Similar problems arise for component manufacturers in allocating costs and returns between car and other vehicle parts and between supply for OE and RE purposes.

8.52. We recognise the difficulties in identifying RE parts results for both groups of suppliers and that qualifications may have to be attached to the results. We note that car suppliers have provided figures that they regard as providing the breakdown we requested, except for certain unallocated costs, eg the marketing costs mentioned above. Two major suppliers have indicated that full allocation of these costs might reduce the net margins quoted later by about two percentage points, ie about 15 per cent overall. We think it necessary to examine as closely as possible the subject of our reference and consider that the results of the exercise have increased our understanding of the industry. We recognise that the results have to be treated with caution bearing in mind the various reservations noted above.

8.53. Examining first the results for those component manufacturers which provided information (see paragraphs 5.12 to 5.29), there appears to have been some growth, on the basis of results restated at constant prices, in component manufacturers' turnover and absolute gross profit on car parts, including OE and RE supplies, over the five-year period 1986 to 1990. Information at the net profit level and segmented between OE and RE parts is only available for motor vehicle parts¹ as a whole. Net profits on motor vehicle parts rose sharply in the middle of the period but then fell back and the net margins over the period averaged 4.5 per cent. Over the period 1986 to 1990 component manufacturers made a small net loss overall on their supplies of OE motor vehicle parts and were dependent on their sales of RE parts for almost all net profits. However, since production of OE and RE parts is often interdependent and we were told that in such circumstances joint costs tend to be allocated to the OE stream, the differences stated may be exaggerated. Return on capital employed (ROCE) for motor vehicle parts for respondent component manufacturers rose sharply in 1988 from 1986 before falling back again; over the period 1986 to 1990 it averaged 11 per cent.

8.54. When the major car suppliers² businesses are segmented between parts and other businesses, on the basis of allocations provided by the companies, the major car suppliers' gross and net margins on the supply of car parts shown by our analysis are significantly higher than those on the rest of the business. For the period 1986 to 1990 gross and net margins earned by the major car suppliers on their parts business averaged 32.6 per cent and 14.5 per cent respectively, whereas the gross and net margins earned on car suppliers' total business averaged 12.7 per cent and 3.5 per cent. Although parts accounted over the period for only 8 per cent of turnover of the 17 major suppliers, they provided about one-third of net profits. ROCE on the parts business over the period 1986 to 1990 was 45.3 per cent, compared with 13.9 per cent on their total business. We note that these results on the parts business are made up of a range of returns, with very much higher rates of return on the business of the tied car importers, which depend on transfer prices set within the companies concerned and on intra-group supply and financing arrangements, discussed in paragraph 5.42. ROCE on parts business for the five major United Kingdom car manufacturers within the group averaged 36.3 per cent over the period (before allocation of the marketing costs discussed in paragraph 8.52).

¹Motor vehicle parts include motor car and all commercial vehicle parts; car parts include motor car and some light commercial van parts which are interchangeable.

²During the period 1986 to 1990 the 17 major suppliers together accounted for 90 per cent of the total turnover of the respondent car suppliers and 93 per cent of their parts turnover.

8.55. In commenting on the relative margin figures some car suppliers stressed again the difficulty of allocating costs between the cars and parts sectors. They also pointed to the different nature of the cars and parts businesses with the need to tie up substantial amounts of capital in the parts business in stocks and warehousing.

8.56. The various qualifications discussed earlier mean that absolute levels of margin and profit in the industry must be treated with some caution. For the car suppliers returns from their main business are volatile and overall profits over the period were not high. The replacement parts segment of their business, however, makes a regular and substantial contribution to profits. Component manufacturers' overall returns fluctuate very much in line with returns on the car suppliers' car business.

The public interest

8.57. We now consider a number of practices affecting the supply of parts, which relate to our finding on the existence of a complex monopoly situation, against the background of a review of competitive forces in the market.

8.58. In our *Supply of new motor cars* report we pointed out that within the constraints of voluntary export restraints (VERs), which limited the extent of competition by Japanese car suppliers, and the distortions caused by the company car and right-hand drive, there was active inter-brand competition and some intra-brand competition in the sale of new cars.

8.59. The market for replacement parts (£2.5 billion at the wholesale level) is large and heterogeneous, covering a wide range, some tens of thousands, of disparate parts. At the production stage there are many producers in the United Kingdom ranging from major companies to very small firms, and parts are imported from Europe, the United States and recently Japan. There is ready availability of parts. In many cases production of replacement parts is an extension of the process of supplying OE. There do not appear to be any significant barriers to entry to supply of OE. OE suppliers have an advantage in selling into the replacement market, but there are many firms which are only involved in replacement supply. For the latter there are constraints on the range of parts it is worth producing. Nevertheless, at the production stage there is active competition.

8.60. In examining the wholesaling of replacement parts a distinction must be drawn between the two main sectors. The car suppliers sell their parts only into their own franchised network where dealers buy virtually all their parts from their particular car supplier. There is also a vigorous independent aftermarket supplying parts independently of the car suppliers and this ensures the availability of a wide range of alternative products, particularly the more fast-moving parts and parts suitable for a range of older cars.

8.61. Competition in the consumer market takes place for servicing and repairs, rather than for parts. While the vehicle is new and under warranty, and more particularly in the company car sector, the servicing, and hence supply of replacement parts, is almost entirely within the franchised dealer area. The independent sector deals mainly with older cars. There is, however, competition at the margin between these sectors, particularly when an owner may be considering changing servicing arrangements. The rapid growth of the fast-fit and menu servicing sector which take trade from both sectors is evidence of new competitive forces taking advantage of market opportunities.

8.62. As far as wholesale supply to the franchised dealers are concerned, the independent component manufacturers or wholesalers have made little penetration into this market and in spite of action taken following the MMC's 1982 report to prohibit the requirement for exclusive purchasing of car suppliers' parts by franchised dealers, franchised dealers still buy virtually all their requirements from the car suppliers. The share of the car suppliers in the wholesale market for replacement parts has risen and that of the independent sector fallen. We discussed the reasons for this trend in paragraphs 8.40 to 8.44. The component manufacturers' RE sales to the independent aftermarket appear to have fallen in real terms, although this fall has been offset to some extent by increased sales of both OE and RE parts to the car suppliers, reflecting the growing proportion of parts bought in by car manufacturers and a shift in their activities to assembling and marketing the finished product.

8.63. We expect that the trend to increasing reliability of parts which has recently limited the growth of the market will continue. This development, itself an indication of inter-brand competition, has benefited consumers by reducing car owners' real expenditure on parts. We also foresee the maintenance of present trends in the design of increasing proportions of parts specific to individual models and the growing technical complexity of some parts and of vehicle control systems. All these developments are likely to restrict opportunities for sales in the independent RE market and to increase the reliance of many component manufacturers on the OE market and on RE sales to car suppliers.

8.64. Thus, looking at the wholesale supply of replacement parts, within the franchised area there is limited direct competition from other wholesalers, either independents or other car suppliers, for the franchised dealers' business and each car supplier has a strong hold on the wholesaling of captive, semi-captive and even competitive parts by its own franchised network. Once the consumer has made a new car purchase he is largely committed to servicing and repair within that supplier's franchised network for a period. The car suppliers are nevertheless subject to constraints on their freedom to set their own wholesale prices and terms by the reputation of their particular brand, and by the prices and terms of other car suppliers to their own franchised dealers. Over the longer term the supplier cannot afford to have a reputation for high parts prices since they are a factor in the consumer's choice of car. They are noted in the specialist press and affect insurance ratings. In our report on the *Supply of new motor cars* we drew attention to various practices of the car suppliers which restricted competition in the supply of new cars. We made recommendations designed to remove or modify these practices and increase both inter-brand and intra-brand competition in the supply of new cars. We also made suggestions for the removal of VERs and the distorting effect on competition of the company car, with a view to increasing competition in the new car market. In our view, if these recommendations and suggestions are adopted, the resultant increase in competition in the new car market should also have the effect of increasing competition for servicing and for the supply of replacement parts.

8.65. The independent sector competes successfully for servicing and repairing the older cars and has some influence, though more limited, on the cost of servicing the newer cars. To continue to compete effectively it needs continued access to parts from component manufacturers and car suppliers and to the information needed to fit them.

8.66. Against this background it is important to examine whether practices by the car suppliers may reduce the existing area of competition and the ability of the independent garage to offer an alternative source of competitive parts to the car owner. We consider first practices relating to the franchised dealer sector and then those affecting the independent garage sector and component manufacturers.

Bonus and rebate schemes

8.67. In their 1982 report the MMC noted that, even if the exclusivity requirement were removed, certain practices, such as setting stocking levels, sales targets and volume-related discounts and bonuses, could be operated in ways that ensured that dealers continued to buy exclusively from the car suppliers. They suggested that if in the future it appeared that any car supplier were adopting any practice which led to exclusive buying to the extent that it was materially anti-competitive, it could be made the subject of further inquiry by the MMC. In making the present reference, which accompanied the reference into the supply of new cars, the DGFT commented in the accompanying Press Notice that the inquiry would enable the MMC to consider various aspects of the market for the sale of new cars and replacement parts including their distribution through manufacturers' franchised dealers, but did not draw attention to the practices earlier identified by the MMC as special areas of concern.

8.68. Most car suppliers give their franchised dealers varying levels of bonus or rebate for achieving specified levels of parts purchases or sales against a previously agreed parts target. A number of independent component suppliers offer similar bonuses or rebates on parts to customers although this is on a narrower range of products than car suppliers are selling to their franchised dealers. We do not think that bonuses or rebates or other incentive schemes give rise to concern where they are calculated on sales levels of parts alone. They are recognised methods of remuneration and the current levels of bonus are not such in our view as to be likely to distort competition.

8.69. In addition a number of suppliers operate schemes-linked bonus schemes-in which points towards extra bonuses on car sales are earned for meeting various targets, both for sales of new cars and for related matters as sales of extended warranties, operating standards achieved and, in some cases, achievement of targets for the sale of parts. Some dealers have suggested that such schemes do restrict their choice in sourcing spare parts. On the other hand the amounts contributed by achievement of parts targets to these bonuses are not large.

8.70. The Regulation lays down that in calculating bonus schemes the supplier must 'at least distinguish between supplies of cars, of spare parts ... for supplies of which the dealer is dependent on undertakings within the distribution network' and of other goods. The purpose of this provision, as set out in the Recitals to the Regulation, is 'to allow spare parts suppliers which do not offer as wide a range of goods as the [car] manufacturer to compete on equal terms'. We note also the comments of the Directorate General IV of the EC Commission on the provision, set out in Appendix 4.3. There appears to be some uncertainty about the interpretation of the wording of this provision and on whether it requires all branded parts or only captive parts to be distinguished for bonus purposes. Suppliers differ in the way they treat parts for bonus purposes. Some offer bonuses only on competitive parts, some on all parts. Some aggregate competitive parts with other goods and accessories in bonus schemes. As noted above, some include some parts-related targets in calculating the overall performance bonuses they offer.

8.71. We have identified bonuses linking performance on parts sales to other targets as one of the practices giving rise to the complex monopoly finding. Where a retailer is tied to the supplier for his main selling product the linking of sales performance on other items to bonuses on that product can be used as a powerful means of tying the retailer to others of the supplier's products with potentially damaging effects on competition. In the car industry we think that provisions which make bonuses on cars to some extent dependent on the dealers' performance in selling parts have an effect in encouraging dealers to buy parts from that source and therefore distort competition in the supply of parts. As noted in the 1982 report, the schemes could be operated in such a way as to ensure exclusivity. The present schemes are operated by only a few suppliers and the contribution of parts to the overall targets is not large. While we consider that the adoption of such schemes by some car suppliers is a step taken to exploit the complex monopoly situation, we do not think that the effects of the present schemes on competition in the supply of parts in the United Kingdom are significant by comparison with other factors encouraging the purchase of suppliers' parts. We do not, therefore, find that such schemes operate or may be expected to operate against the public interest. This appraisal might change if the incentive effect of the present schemes were to be increased or if such linked schemes were introduced by larger suppliers. If the effects of such developments appeared to be anti-competitive, the matter could be referred to us under the Competition Act.

8.72. We note that the potential for adverse effects from such schemes has been recognised in the Regulation provision described above and we think it desirable that the present wording be clarified when the occasion arises and all suppliers' bonus schemes brought into conformity with it.

Number plates

8.73. For the purpose of our reference number plates were included in the definition of replacement car parts. We received a number of complaints about the growing practice of car suppliers of sponsoring schemes under which their dealers are encouraged to source plates from nominated suppliers. Ford, Peugeot, VAG (UK), Renault and Fiat, among larger suppliers, all operate such schemes. The car supplier negotiates a price either for direct supply to the dealer or via the car supplier. In either case the car supplier takes a margin. Dealers are not compelled to participate but plate purchases count towards most schemes for parts rebates and bonuses. Our survey of franchised dealers suggested that the proportion of dealers who take part in them ranges between one-fifth and one-half for the various franchises offering these schemes.

8.74. It was put to us by some number plate suppliers that the schemes restricted the dealer's ability to choose his source of supply and forced him to buy at prices higher than he could buy independently. Plates were not OE, but were supplied separately to meet a legal requirement. All plates had to meet BS standards and there was therefore no question of car suppliers' ensuring quality.

8.75. It appears that car suppliers are exploiting a newly-recognised opportunity by using their buying power to negotiate favourable terms for purchasing number plates, retaining for themselves at least part of the benefit. Although it was put to us that by the time they reached the dealers the number plates were more expensive, we have no clear evidence that this is so for plates of equivalent quality. We see no case for treating number plates differently from other parts or accessories.

Refusal to allow dealers to enter into distribution agreements for competing parts

8.76. Most suppliers welcome over-the-counter sales by their franchised dealers to independent garages for use in repair and service and may actively encourage their larger dealers to wholesale their parts to others. Refusal to allow dealers to wholesale competing parts is a restriction imposed by only a small number of car suppliers, including Ford. Ford argued that, although its dealers were free to buy and resell parts of matching quality, to allow them to enter into distribution agreements for competing parts suppliers would divide loyalties and reduce inter-brand competition. The Retail Motor Industry Federation on the other hand supported the removal of restrictions. There are a number of franchised dealers with substantial operations wholesaling their suppliers' parts to other franchised dealers, who might well wish to enter into the same type of wholesaling agreement with larger component manufacturers that are already available to independent factors. The refusal to allow dealers to enter this business thus restricts the dealer's freedom to compete and thereby distorts competition in relation to the supply of parts.

8.77. In our report on the *Supply of new motor cars*, however, we recognised the force of suppliers' arguments that they should be allowed to require that their brand of car be sold alone at a site, in order to ensure that it is presented in the way they want and to encourage inter-brand competition. Given the need to allow the consumer access to parts from alternative sources, such arguments do not apply to the stocking and sale of competing parts. However, we recognise that for a dealer to enter into a distribution agreement for such parts might distract him from his main task of promoting the car suppliers' brand and we note that the present restriction is permitted under EC Regulation 123/85. We have received no evidence that component manufacturers or distributors which supply the independent market have any difficulty in securing adequate representation across the country. While we consider the restriction a step taken by car suppliers to exploit the complex monopoly situation, we do not think that its effects in relation to the market for parts are such that it operates or may be expected to operate against the public interest.

8.78. We should moreover draw attention to the recommendations made in our report on the *Supply of new motor cars*, designed to remedy the effects adverse to the public interest identified in that inquiry by strengthening the position of car dealers. If these recommendations are implemented, franchised dealers will be able to take on competing car dealerships, and with them the sale of the competitors' parts outside their designated territory and, subject to certain conditions, within it. Our recommendation that franchised dealers should be free to sell car-related goods outside their territory would also permit them to wholesale parts from any source.

Information on parts used

8.79. All suppliers make it a condition of their dealer agreement that the customer is informed when non-suppliers' parts are used in repair and servicing. Some dealers suggested that this discouraged franchised dealers from using such parts although they also said that from experience they knew customers expected and preferred the supplier's parts to be used.

8.80. While the effect of the suppliers' requirement may well be to dissuade the dealer from using competing parts, it seems to us difficult to criticise a requirement that improves consumer information or to endorse a position where the dealer would be free to fit other parts without informing the consumer, particularly if the use of other parts were to put a warranty or extended warranty at risk. It seems likely that to the extent that he considers the matter the consumer does indeed expect the use of franchised parts when he uses a franchised garage and thus accepts that he is forgoing the opportunity of parts of different and perhaps lower price. In cases where the price of the part is a major consideration, eg an expensive repair, he is free to discuss the alternatives with the dealer.

8.81. We do not consider that the requirement is a step taken by suppliers to maintain the complex monopoly situation, nor do we consider that any of the facts found in relation to it operate or may be expected to operate against the public interest.

Refusal to supply

8.82. We now consider other restrictions imposed by car suppliers. The restriction under which car suppliers supply car parts only through their own franchised dealers is allowed under the block exemption, EC Regulation 123/85, which applies to the distribution arrangements for both new cars and replacement parts for them. This restriction means that independent garages which need franchised parts, and particularly captive parts, to service customers' cars can get them only from the franchised dealers.

8.83. We received few complaints about the car suppliers' refusal to supply except through their franchised dealers. There were some complaints about prices for such parts being too high, particularly for captive parts. Equally there was a complaint from the motor factors that such parts were sometimes sold at artificially low prices. A sizeable minority of motor factors, in response to a question in an MMC survey, said that they would wish to purchase car suppliers' branded parts were they able to do so (see paragraph 3.86), but this is not to say that they would wish to purchase direct if they had to stock the whole range, as do franchised dealers.

8.84. In defending the system most car suppliers have pointed out that there are no restrictions on onward sales of all parts by their dealers over the counter or to independent garages, that dealers are actually encouraged to develop such sales and that market conditions ensure competitive prices. Suppliers also pointed out the practical difficulties of attempting to bring outside buyers into the computerised systems they had developed for supplying their dealers. It would be impractical to supply small independent garages and unreasonable that factors should be allowed to compete with the franchised dealer by selling the more attractive parts without accepting the same responsibilities as franchised dealers for holding and buying the whole range of parts. To extend the system more widely would undermine the efficiency of the network and lead to reduced inter-brand competition. Recital 6 to the Regulation recognises this point in stating:

It should be possible to bar wholesalers not belonging to the distribution system from reselling parts originating from motor vehicle manufacturers. It may be supposed that the system of rapid availability of spare parts across the whole contract programme, including those with a low turnover, which is beneficial to the consumer, could not be maintained without obligatory recourse to the authorised network.

Control of the franchised network may also play some part in making it more difficult for counterfeit parts and those of unacceptably low quality to infiltrate the distribution system generally.

8.85. While we have received no evidence that the restriction prevents consumer access to the car suppliers' branded parts, such access is only available through the franchised network and thus competition in the supply of these parts is distorted. We accept it as an essential element in the present SED system for new cars. We consider it a step taken by all suppliers to maintain the complex monopoly situation but do not consider that it operates or may be expected to operate against the public interest. If the proportion of captive parts to competitive parts were to increase markedly, thus reducing the car owners' access to parts sold outside the franchised sector, the effects of this restriction might need re-examination.

Warranties and extended warranties

8.86. Standard warranties are provided by the car supplier at no extra cost when the new car is sold and usually cover replacement of defective parts free of charge for a year, but sometimes for three years. The use of the suppliers' own parts is required for all work done under warranty. It seems to us reasonable that in honouring a warranty a supplier should be able to insist on its own parts being used to remedy the defect and that if it so wishes it should be able to specify the standard of servicing required during the warranty period.

8.87. A few warranties require all servicing during the warranty period to be carried out by the franchised dealer. Others specify that servicing must be carried out in accordance with the supplier's recommendations. It was put to us that in the latter case customers were given the impression that franchised servicing was a condition for honouring the warranty and that difficulties had arisen over claims on cars which had been serviced outside the network, where the defect was in a part unaffected by servicing. Car suppliers and dealers both told us, however, that in such circumstances warranties were honoured.

8.88. If servicing by franchised dealers is not a specific requirement, the warranty provisions should not be capable of misrepresentation to prevent customers using outside servicing if they so wish. We think that suppliers should review the wording of their warranties to state explicitly in the warranty conditions what they have told us they in practice accept, ie that warranties will be honoured if the defect is not connected with any servicing outside the franchised network.

8.89. Concern was expressed that the trend towards longer standard warranties would tie more customers into the dealer networks. The provision of a longer standard warranty is a potential benefit to the consumer which in part reflects the increasing reliability of car parts. In our view it is up to the individual to weigh the advantages during this period of going outside the franchised network for repairs or servicing against the possible loss of the benefit of the warranty.

8.90. The Volvo Lifetime Care Warranty, was also drawn to our attention. Under this, provided that the customer continues after the expiry of the standard warranty to have the car serviced by a franchised dealer at the recommended intervals, the company will pay for all or part of the cost of replacement parts, the proportion depending on the age and usage of the part. The scheme was criticised on the grounds that it tied the customer to an expensive servicing commitment in return for an imprecise assurance and that some customers had not been satisfied with the contribution offered by Volvo. Again it is for the customer to judge the worth of the offer to him as against the possibly lower cost of going to the independent sector for servicing and repairs. Consumer acceptance of the scheme depends on the reputation of the supplier, and it is in its interest to offer its buyers a fair return if it wants to keep their loyalty.

8.91. Extended warranties, taken out to provide cover after the standard warranty has expired, are essentially different from standard warranties. They are a separate purchase and are an insurance contract between the car owner and the person providing the cover. They normally require servicing by a franchised dealer as a condition of cover. The car owner pays separately for the extended warranty, usually either when he buys the car or when the standard warranty expires. It is up to the car owner to decide whether the terms offer value for money.

8.92. We do not consider that the provisions of either extended warranties or the Volvo Lifetime Care Warranty operate or may be expected to operate against the public interest.

Withholding manuals, diagnostic equipment, etc

8.93. We received a number of complaints, including one from Halfords Ltd, about difficulties caused for independent repairers because they did not have access to all the information needed for repair or service of cars. Most suppliers make manuals, or the information required to produce them, freely available but specialised technical bulletins and diagnostic software programs are normally made available only to franchised dealers. The control of some parts of the car is becoming increasingly complex and computerised control of some car features has been introduced, in the form of electronic EMS, for example. These will become essential as emission control regulations require the adoption of catalytic convertors. There is also the prospect of braking and suspension systems increasingly using similar control mechanisms. The technician servicing or repairing the car will increasingly need diagnostic equipment and the relevant program to enable him to interpret the readings from the management systems of the individual car model.

8.94. Diagnostic equipment is made available by the car suppliers themselves (but by most only for their franchised dealers), by suppliers of the electronic management systems, such as Bosch or Lucas, and

by independent diagnostic equipment suppliers. The latter are given access to the information required to manufacture the diagnostic equipment when provided for franchised dealers but these suppliers are not normally allowed to sell this equipment and information to the independent sector, nor can the independent garage acquire equipment and information directly from the car supplier. We have been told by some diagnostic equipment manufacturers that some car manufacturers will not make available to them the information (protocols) to enable them to produce their own diagnostic equipment to interface with the management systems of some car models. In order to use diagnostic equipment when obtained from either source the independent garage requires other information, previously available in printed form but now often only in electronic form, to interpret readings from the diagnostic equipment and to check them against the correct standards of performance. In such cases, in order to design and program their equipment, equipment suppliers rely mainly on in-house expertise and sometimes on 'reverse engineering'. This is expensive, however, and feasible only for high-volume models. As a result the independent garage does not have access to the information required to diagnose and correct faults for the full range of cars now equipped with electronic management systems. We understand that some information is made available in the United States, through an industry body.

8.95. Car suppliers argue that they have put considerable investment into developing their diagnostic programs in order to enable their dealers to provide a good service and enhance their competitive position, and see no reason why they should be expected to share the benefits with others, who might in any case not be qualified to provide an adequate level of servicing.

8.96. Most cars with electronic management systems are still at that stage of their life when they are likely to be serviced and repaired within the franchised network but in future years, particularly with the need for emission control systems and as electronic control systems spread to all model ranges, the independent sector might find itself shut out from repairing an increasing proportion of the car parc.

8.97. Commercial pressures may eventually lead the car suppliers to make this information more freely available, particularly as the models become older and move into the independent sector for repair and servicing. At that stage the knowledge that certain models can only be repaired at the franchised dealer will considerably depress their resale value, and attractiveness to the consumer. The Automobile Association has suggested that suppliers' attitudes are changing. We have been told (see paragraph 3.22) that technical discussions on an international basis have started to try to standardise interface requirements for diagnostic systems, although it is still in its early stages. The Department of Transport also told us that the United Kingdom Government intends to set up a working group with the Society of Motor Manufacturers and Traders to define objectives for diagnostics within the EC.

8.98. Against this background we have considered the public interest issues involved. This is a highly technical area and one where technology is still developing rapidly. It appears that technical developments in electronic management systems have given the car suppliers the ability to withhold information required to diagnose faults that was formerly readily available and the responses of some major suppliers on the issue do not suggest that they are ready to hand over the information. We think that the refusal by some car suppliers to supply diagnostic equipment other than to their franchised network is less important than the withholding of information since the independent garage will be unlikely to want equipment specific to one marque if he can obtain equipment through the independent sector which will service a number of makes. We consider, however, that the consumer once he has bought a car should be free to decide where he wishes to have it serviced and that the car supplier should not be able to deprive him of this opportunity by exploiting technical advances. The withholding of information necessary to enable independent garages to diagnose faults would limit the extent to which independent garages can offer service and repair facilities, and through this restrict the purchases of parts by independent garages to use in servicing and repairs.

8.99. While we have been told by some equipment manufacturers that they are unable to get all the information they need from car suppliers, we have received no evidence of any specific refusals to supply this information. Most of the evidence suggests that this is a small problem at present, though over the next few years, as all new cars will have these systems fitted and start to move into the independent sector for servicing and repair, this position may change. However, as noted above, the potential problem is increasingly being recognised and moves are afoot in the United Kingdom and internationally to deal with it. We think it likely that the current developments and commercial pressures in the market, given the car suppliers' need to preserve their reputation for producing cars that represent good value, will lead to

satisfactory arrangements for the release of information, ie will ensure that sufficient information is provided to enable users of diagnostic equipment outside the suppliers' own franchised network to identify faults in the suppliers' cars. While therefore we consider these restrictions a step taken to maintain the complex monopoly situation, we do not consider, on the evidence presently available, that the present situation operates or may be expected to operate against the public interest.

8.100. If, contrary to our expectations, it became clear that satisfactory arrangements had not been agreed in time to avoid the potential adverse effects on competition outlined above, and that some car suppliers refused to make available the necessary information to achieve its objectives set out above, we would hope that the Office of Fair Trading (OFT) would consider the position again, particularly in the light of the provisions of section 144 of the Copyright Design and Patents Act 1988. These extend the powers available to the Secretary of State under Schedule 8 of the Fair Trading Act.

Restrictions on component manufacturers

8.101. We estimate that more than half of the car parts used by United Kingdom car manufacturers are bought in and the business of many component manufacturers is based on contracts to supply both OE and RE parts to car manufacturers. The relationship is often very close and the two will frequently co-operate on the design and development of parts for new car models, leaving some uncertainty about ownership of the design. Car manufacturers frequently either provide tooling directly or finance the tooling. Vauxhall, for example, told us that it financed all specific tooling for its parts and estimated that it paid for and owned the tooling on 80 per cent of its bought-in parts. Where tooling is provided or financed the component manufacturer is usually not allowed to use it to produce parts for the independent aftermarket. The component manufacturer is, however, free to provide its own tooling to produce the parts unless the manufacturer also has industrial property or design rights.

8.102. Where the car supplier provides the design and the tooling for the component manufacturer the latter is in effect acting as a subcontractor. As car suppliers have increased the proportion of bought-in components this type of arrangement appears to have increased. It seems probable that a sector of the component industry will find it in its commercial interest to enter into arrangements for exclusive supply. For many types of part the great improvements in reliability mean less demand for replacements so that the component manufacturer will increasingly have to rely on OE supply. This again will increase its dependence on the car supplier.

8.103. In other cases, where there is little or no design input from the component manufacturer, a contribution to tooling costs from the car supplier may be a way of adjusting the pricing of the part over time. We were told that in such cases car suppliers were exercising increasing pressure to be given exclusivity, ie that the component manufacturers' total production of the part would be dedicated to the car supplier.

8.104. At the same time recent changes in industrial property and design law under the Copyright, Designs and Patents Act 1988 have made it easier for independent component manufacturers to provide certain competing parts where previously they were prevented from doing so by design protection enjoyed by the owners of the original design. Under the 1988 Act, design features enabling one article (such as a car part) to be functionally or aesthetically matched to another get no design protection. These so called 'must-fit' and 'must-match' exceptions were introduced to ensure that competing designs for spare parts are not kept out of the market. The developments in EC law referred to in Chapter 2 may also help the independent supplier.

8.105. Comments by a number of component manufacturers accepted that some restriction was reasonable when tooling was paid for. It was suggested, however, that there might be a time limit on the restriction; alternatively a royalty might be paid.

8.106. Where the car supplier has designed the part and provided the tooling it seems to us reasonable that it should control the supply of parts from the tooling. Equally where the component supplier wishes the car supplier to finance the tooling because the former is unwilling to take on the financial commitment, it seems reasonable that the car supplier should be entitled to exclusivity in the parts produced.

8.107. Where, however, no financial or technical assistance has been provided and the part is entirely the component manufacturers' product we consider that a requirement for an exclusivity undertaking is an unjustified attempt to prevent a potential source of competition and to limit the consumers' choice of parts. While some substantial component manufacturers told us that they were under increasing pressure to grant exclusivity in such circumstances, they also told us they had not yet done so. We have received no evidence that such agreements are currently entered into and the car suppliers have told us that they do not do so. While we have identified various factors that may increase component manufacturers' reliance on the car supplier in the future, their ability to retain their independence ultimately depends on their technical advantage and level of expertise and we see no grounds for assuming that this will decline. We do not therefore consider that the evidence supports a finding that such restrictions operate or may be expected to operate against the public interest.

8.108. Exclusivity may also be sought in circumstances where some financial or technical assistance short of providing the tooling has been given. Here the arguments against its being granted are less clear. The outcome will depend on the bargaining position of the two parties discussed above and the property rights involved.

8.109. We consider that the present restrictions, described in paragraph 8.101, prevent competition by preventing component manufacturers supplying the independent aftermarket, and are steps taken to maintain the complex monopoly situation. We do not find that they operate or may be expected to operate against the public interest. We recognise, however, that the developments in the market that we have discussed may lead component manufacturers to agree to further demands for exclusivity of the kind described in paragraph 8.103 and that this might limit the availability of parts to the independent sector and its ability to compete. If there were evidence that this practice was becoming widespread with potential effects on competition of this kind, the DGFT might wish to consider action under the Competition Act.

Conclusions

8.110. To sum up this disparate and fragmented industry and to set out the intricate channels of distribution of such a large variety of parts which essentially enable a car to be serviced or repaired has been challenging. However, various generalisations can be made.

8.111. First at the manufacturing stage there is strong competition to supply OE parts to car suppliers, even within the specialised areas on which some even of the bigger component manufacturers concentrate. This competition runs through into the RE market where the larger manufacturers have so far withstood pressure for exclusivity from the car suppliers. There is market entry into component manufacturing and supply from Europe, the United States and recently Japan. There are no VERs on components. These are all signs of a healthy and competitive industry.

8.112. At the wholesale level the franchised sector's share of the market has increased since the MMC's 1982 report. We accept that the reasons for this are related to technical developments and other commercial factors and have not found that any conduct by the car suppliers in their relation with franchised dealers operates or may be expected to operate against the public interest.

8.113. We consider it a matter of concern that the consumer-the buyer of a car whether new or second-hand-should have free choice about where he takes it for repair and service. The ability to exercise choice sustains competition between the franchised and independent sectors and practices that limit choice will, in the long run, have anti-competitive effects.

8.114. Cars up to three years old, under warranty or in first ownership, are usually serviced by the franchised dealer. The independent garages and the fast-fit centres compete for the older cars and have some influence even on the cost of servicing the newer cars. To maintain their ability to compete they must have two things: parts and the information needed to use them. Restrictions that denied the independents and fast-fit centres these two would distort the structure of the parts market. That is why we have identified practices designed to ensure exclusivity of supply and the withholding of electronic-based information as areas of concern. New technology and buying power, reinforced by the comparative decline of the RE

market and consequent greater dependence on the OE market for many component suppliers, should not be used to tilt the balance unduly in favour of the franchised dealer against the independent garages and fast-fit centres by preventing them acquiring replacement parts and the information needed to fit them.

8.115. We have concluded in paragraph 8.15 that certain practices of car suppliers (set out in paragraph 8.11) give rise to a complex monopoly situation in favour of those car suppliers. We have identified the adoption of certain practices as steps taken, by persons in whose favour the complex monopoly situation exists, to exploit or maintain this situation (paragraphs 8.71, 8.77, 8.85, 8.99 and 8.109). We do not consider that there are any actions or omissions which are attributable to the monopoly situation within the meaning of sections 48(d) and 49(1)(a) of the Act.

8.116. The car suppliers' share of the car parts market is increasing and we have identified a number of reasons, unconnected with these practices, for this trend and why it may be expected to continue. Against this background we have carefully considered the facts found in our investigation, including the effects of the practices identified above, and conclude that none of these facts operate or may be expected to operate against the public interest.

8.117. We have, however, identified potential concerns about several of these practices-linked bonus schemes, refusal to supply replacement parts except through the franchised network, restrictions on component supply and withholding of information required for diagnostic equipment-which we do not find currently operate or may be expected to operate against the public interest. Of the first three of these practices, linked bonus schemes are operated on a modest scale by a minority of suppliers; refusal to supply except through the franchised dealer network is not currently damaging car owners' choice of parts; and restrictions on component suppliers are not at this time being applied in an unreasonable form. However, the developments we foresee in the market may tend to weaken the competitive position of the independent sector relative to that of the car suppliers and the franchised dealers and may thus give rise to a need to reappraise one or more of these practices and their potential anti-competitive effects. We have suggested that in such circumstances action under the Competition Act might be considered.

8.118. On the withholding of information required for the use of diagnostic equipment, we note the potential for future damage to competition from the independent garage sector if satisfactory arrangements are not made for the release of such information. We suggest that, if our expectation that current developments and competitive pressures will ensure this proves mistaken, the OFT should consider a further reference to us under the Act or the Competition Act bearing in mind the additional powers made available to the Secretary of State in section 144 of the Copyright Designs and Patents Act 1988.

M S LIPWORTH (*Chairman*)

D G GOYDER

C C BAILLIEU

I S BARTER

A P L MINFORD

S N BURBRIDGE (*Secretary*)

20 December 1991