

3 Background

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Introduction

3.1. This chapter begins with an account of the background to the reference and of the review of the Block Exemption currently being undertaken by the European Commission. This is followed by a brief account of the economic importance of the car industry and a description of some of the significant changes affecting the European car industry which have taken place in recent years. An outline of the way cars are sold in the EC is then given, followed by a more detailed indication of certain key elements of the position in the UK. A fuller description of sales of new cars in the UK is given in Chapter 5.

Background to the reference

The 1990/91 inquiry

3.2. A monopoly reference under the FTA on the supply of new motor cars was made by the DGFT to the Commission in 1990. In its report published in 1992 the Commission noted that there were

benefits from the SED system which was permitted under the EC block exemption¹ (see paragraphs 3.30 and 3.31). It considered, however, that some of the restrictions on dealers imposed within the system had adverse effects on competition. It concluded that UK prices, and especially those for the private buyer, were higher than would obtain in a more competitive market.

3.3. The main causes, in the Commission's view, were VERs (see paragraphs 3.46 and 3.47) which raised the general level of UK prices, and the company car and the deep discounts that large fleet owners obtained from the suppliers, which together distorted the prices for other buyers. The Commission considered that greater competition between dealers, both inter- and intra-brand, would restrain these higher prices. It identified a number of practices which restricted new suppliers' entry and restrained the emergence of larger and more efficient dealers which would be in a position to offer lower prices, especially to private customers.

3.4. Accordingly, the Commission recommended the removal of any restrictions on franchised dealers which:

- (a) limited the dealer's freedom to advertise outside its designated territory;
- (b) limited the dealer's freedom to hold or acquire dealerships outside the designated territory from other suppliers;
- (c) prevented the dealer from holding or acquiring competing dealerships within its designated territory (although the supplier could require that any other dealership acquired was on a distinct and separate site, a reasonable distance from the other dealership and under separate management);
- (d) restricted the extent to which a dealer could sell car-related goods or services—such as car hire, second-hand cars and fast-fit or multi-brand servicing—outside its designated territory; and
- (e) limited the total number of the supplier's cars that the dealer or dealer group could sell during any given period, or the proportion of the total sales of its cars that could be made by any dealer or dealer group.

3.5. Following publication of the 1992 report, the DGFT and the Department of Trade and Industry (DTI) had exhaustive discussions with the major UK car suppliers with a view to securing undertakings from them to implement the recommendations. In March 1994 the DTI announced that it had not been possible to come to an agreement with all the suppliers concerned, but that the European Commission would be asked to ensure that its review of the block exemption took into account the Commission's recommendations.

3.6. The adjustments made to the block exemption in 1995, and the consequential changes in the franchise agreements between suppliers and dealers, are covered in more detail in Chapter 6. The adjustments made by the European Commission, which reflected most of the 1992 report's recommendations, were aimed in particular to:

- (a) give dealers greater commercial independence vis-à-vis manufacturers;
- (b) give independent spare-part manufacturers and distributors easier access to the various markets;
- (c) improve the position of consumers in accordance with the principles underlying the internal market; and
- (d) make the dividing line between acceptable and unacceptable agreements and behaviour clearer.

3.7. In addition to its formal recommendations, the 1992 report raised a number of other matters on which it made suggestions for a review of existing policies. These matters were VERs, the structure and

¹The block exemption then contained in Commission Regulation 123/85. That exemption has since been replaced by Commission Regulation 1475/95, which is due to expire in 2002 and is currently being reviewed by the European Commission.

level of company car taxation, the requirement in the UK to drive on the left-hand side of the road and parallel importing procedures.

3.8. On publication of the report, the Government said that on VERs it would continue to consider whether the UK should move to an unrestricted market in the light of views received following the report, and that the comments on parallel import procedures would be taken into account in future discussions with the European Commission. On company car tax, the Chancellor of the Exchequer had announced a review of the banding of company car tax charges with a view to changes along the lines suggested by the report. The Government's view was that there was no case for carrying out a major reassessment of the policy of driving on the left.

The 1998/99 investigations by the Director General of Fair Trading

3.9. In 1998 the DGFT undertook an investigation in order to identify any apparent anti-competitive practices or market failures. (An OFT press release referred to concerns over high and sometimes uniform prices in the UK market for new motor cars.) In the course of a seven-month inquiry, 17 leading suppliers and over 400 of their franchised dealers were questioned by the OFT on the relationship between suppliers and dealers. In addition, details of about 12,500 dealer transactions with customers were obtained to determine the level of discounts to consumers, and manufacturers were asked to give information on their discounts to fleet customers.

3.10. In a press release on 17 March 1999 announcing his findings, the DGFT said that it was clear that the market was not working properly and that there was an imbalance of power between manufacturers and dealers which was distorting competition. This imbalance was characterized by suppliers' continued refusal to give volume discounts to dealers which could be passed on to the consumer as lower prices and by other practices designed to exert a strong influence over selling prices. The DGFT noted that in the 1992 report the Commission had tried to redress the balance of power, but that the recommendations had not had the desired effect. In addition, RRP's were being used to mask the true selling prices of vehicles and there was evidence that suppliers and dealers tried to reinforce the consumer's belief that the RRP represented the value of a car.

3.11. The DGFT also said that RRP's were used by manufacturers to set the price at which they sold vehicles to dealers. He believed that this practice, coupled with a general reduction in basic dealer margins and a greater emphasis on discretionary bonuses, was limiting the ability of dealers to offer consumers lower prices. RRP's and trade prices seemed to be set at a level which allowed even the most inefficient dealership to make adequate returns. Most dealers appeared to be far from independent and seemed to be under the strong influence of manufacturers, not least because of the extensive information that manufacturers gathered on dealers' businesses. The DGFT concluded that overall the distribution of new cars appeared to be as inefficient as it had been eight years previously and that there was a strong case for re-examination by the Commission—particularly in view of the European Commission's review of the Block Exemption.

3.12. In the light of these findings the DGFT made a monopoly reference to the Commission, in exercise of his powers under sections 47(1), 49(1) and 50(1) of the FTA. The terms of reference for the inquiry are set out in Appendix 1.1.

3.13. The DGFT's press notice announcing the reference included a statement that the OFT was continuing to conduct a separate inquiry into allegations of cartel activity in the car industry. On 9 July 1999 the OFT issued a news release entitled 'Volvo involved in car pricing cartels'. This explained that an investigation by the OFT had uncovered evidence of an agreement by Volvo dealers not to offer discounts beyond set levels and that further evidence indicated that Volvo ensured that dealers would comply with the set levels of discount by penalizing them if they did not. The DGFT stated that, rather than sending the case to the Restrictive Practices Court, he had decided to accept from Volvo a number of assurances as to its future business conduct. Volvo provided us with information surrounding the

circumstances of the OFT's investigation as set out in the Memorandum of Agreement entered on the Register of Restrictive Trading Agreements. It told us that its internal investigations had revealed that a small number of its employees had been involved, during a period of about 12 months from early 1995, in working with certain dealers in the South of England to try to enforce agreements on levels of dealer discounts. Volvo told us that it had not supported the agreements in any way and that its management had not been aware of these activities which were against its express written and oral instructions (see paragraph 9.1392).

The EC background

3.14. As noted above (see paragraph 3.2 and its footnote), there is a Block Exemption concerning the distribution and servicing of new cars within the EC. If a supplier complies with the conditions set out in the Block Exemption, its distribution agreements are automatically exempt from the provisions of EC law prohibiting certain restrictive agreements (see paragraph 3.30). During the inquiry we had contact with the Directorate General for Competition of the European Commission (which is responsible for monitoring the Regulation) on various matters of relevance to the inquiry, including the comparative information on new car prices within the EC which the Directorate publishes at six-monthly intervals. In September 1999 the Directorate began to collect information from the car industry and consumer bodies throughout the EC in connection with the review of the current Block Exemption. Under the Regulation a report by the European Commission on its assessment of the Block Exemption, which is due to expire on 30 September 2002, has to be completed by 31 December 2000.

3.15. During the late 1980s a number of bodies, including The European Bureau of Consumers' Unions (BEUC), carried out studies of car prices in EC countries. A survey by BEUC in 1989, published in 1990, showed wide price variations between the UK and neighbouring EC member states. The BEUC study was comprehensively criticized by major suppliers and for its 1990/91 inquiry the Commission engaged consultants to carry out a detailed study of the extent of price differences, for both list and transaction prices, between the UK and other EC countries.

3.16. Since 1993 the European Commission has published regular comparisons of both pre-tax and post-tax retail list prices (but not transaction prices) of about 70 best-selling models from over 20 suppliers. List prices are adjusted for differences in specification and are given in both local currency and in euros (ecus until 1999). According to these surveys, in May 1993, after the UK had left the European exchange rate mechanism and sterling had depreciated, the UK was, at the pre-tax level, one of the lowest-priced member states in which to purchase a new car; by May 1994 it was one of the highest-priced member states; and by May 1996, after sterling had fallen again, it was second only to Portugal in having the lowest prices. Sterling strengthened subsequently, and by May 1997 the UK had become the highest-priced country for the majority of models. This remained the position up to the time of the most recent survey in May 1999,¹ with specification-adjusted pre-tax price differences between the UK and some other EC countries of up to nearly 50 per cent. The relative positions of countries are considerably different at the post-tax level, since the tax payable varies between 15 and 213 per cent (see paragraph 3.48 and Table 3.4). For instance, Denmark is currently one of the cheaper countries at the pre-tax level, but when tax of around 200 per cent is added, post-tax car prices there are higher than in most other member states.

3.17. Article 8 of the Block Exemption provides that the European Commission may use its power to withdraw the benefit of the Block Exemption in an individual case if prices continually differ substantially between member states and the differences are due chiefly to exempted obligations (see Appendix 6.1). A European Commission Notice² issued in 1985 was concerned with, among other things, the question of withdrawing the block exemption in individual cases on the grounds of pricing. The Notice indicated that the European Commission did not propose to carry out an investigation with a view to a withdrawal so long as certain conditions were met. One of the conditions was that:

¹A survey was carried out in November 1999 but the results had not been published at the time we completed our report.

²Commission Notice 85/C 17/03.

Recommended net prices for retail sale to final consumers (list prices) of a motor vehicle within the contract programme in one Member State and the same or a corresponding motor vehicle in another Member State differ, and

(a) the difference expressed in ecu does not exceed 12 per cent of the lower price, or over a period of less than a year, exceeds that percentage either

— by not more than a further 6% of the list price, or

— only in respect of an insignificant portion of the motor vehicles within the contract programme, or

(b) the difference is to be attributed, following analysis of the objective data, to the fact that

— the purchaser of the vehicle in one of those Member States must pay taxes, charges or fees amounting in total to more than 100% of the net price, or

— the freedom to set the price or margin for the resale of the vehicle is directly or indirectly subject in one of those Member States to restriction by national measures lasting more than one year,

and that such measures do not represent infringements of the Treaty.

A guide¹ published by the European Commission when the 1995 Block Exemption was introduced said that the Notice remained applicable. Recital 31 to the 1995 Block Exemption states that where the European Commission makes use of its power of withdrawal it should take into account any price differentials which do not principally result from the imposition of national fiscal measures or currency fluctuations between member states. The current pre-tax list price differentials between the UK and some other EC member states are higher than 18 per cent (ie the sum of the 12 per cent and the 6 per cent mentioned above). However, the question whether the European Commission ought to be carrying out an investigation, on the basis set out above, depends on the view taken as to whether these price differences are due principally to national tax differences and/or currency fluctuations or whether they are principally due to exempted obligations.

Importance of the car industry

3.18. There were estimated to be some 510 million cars in use throughout the world in 1997, while in each of the years 1994 to 1998 the number of new cars produced ranged between 36 million and 39 million. Vehicle manufacture and distribution play a significant part in the economies of most developed countries. Many governments place considerable importance on fostering national automotive manufacture and this is borne out by the incentives often made available to attract new investment into the industry or to keep existing plants open. One factor in such a policy is the importance of vehicle assembly plants in generating business for suppliers of components and raw materials, another is the implications for a country's balance of payments.

3.19. The ONS estimates that the UK motor manufacturing industry accounted for around 1.5 per cent of GDP in 1997. The automotive industry as a whole was estimated to generate, directly and indirectly, nearly 800,000 jobs in 1998, including some 225,000 in motor manufacturing. Employment in

¹See press release IP/95/648 of 21.6.1996.

motor manufacturing tends to be concentrated in certain areas. Table 3.1 shows that production, exports and employment in the UK automotive industry have all risen between 1994 and 1998.

TABLE 3.1 **Output and employment of the UK automotive industry, 1994 to 1998**

	'000				
	1994	1995	1996	1997	1998
<i>Production</i>					
Cars	1,467	1,532	1,686	1,698	1,748
Commercial vehicles	228	233	238	238	227
<i>Of which, for export</i>					
Cars	619	745	908	962	1,021
Commercial vehicles	96	92	112	103	103
<i>Employment</i>					
Manufacture*	173	204	222	223	227
Sale, maintenance and repair of motor vehicles	515	511	535	565	571

Source: ONS, Annual Abstract of Statistics.

*Includes parts, accessories, commercial vehicles, caravans and trailers.

Production of cars in the UK peaked in 1972 at 1.92 million, then fell to 0.89 million in 1982 before rising again to 1.75 million in 1998 largely as a result of the output of the new Japanese-owned plants. Production rose by a further 2.2 per cent to 1.79 million in 1999. Over 60 per cent of cars produced in 1999 were exported, while 72 per cent of the cars registered in the UK in that year were imported. Employment in 1998 by major UK-based manufacturers included 38,700 at Rover (including overseas subsidiaries), 27,400 at Ford, 9,800 at Vauxhall, 4,700 at Nissan, 3,600 at Peugeot, 3,100 at Toyota and 2,600 at Honda.

Developments in the car industry

3.20. The car industry is highly international. There is a large volume of trade between countries; the major car producers have set up assembly plants and other facilities (such as research centres) in a number of countries; cars assembled in one country frequently include a substantial proportion of imported components; and there are alliances of various sorts between car makers in different countries. In designing new models, manufacturers increasingly plan to make sales in all or most major countries in order to achieve the necessary return on the investment involved. International links have continued to increase in recent years as a result of further mergers, acquisitions and joint ventures, often undertaken in pursuit of scale. At the same time some earlier alliances and joint ventures have been dissolved.

3.21. The largest transaction in the last five years involved the merger in 1998 of Daimler-Benz AG with Chrysler Corporation to form DaimlerChrysler AG. Other changes in structure affecting the industry in Europe included the following significant transactions. In 1994 BMW AG purchased Rover Group Holdings plc in the UK from British Aerospace plc. As a consequence, Rover unwound its cross-shareholding arrangements with Honda Motor Co Ltd of Japan. In the same year the Peugeot SA group (which includes the Peugeot and Citroën marques) and Fiat started operating a common plant in northern France which manufactures multi-purpose vehicles for the three marques; the Ford group increased its shareholding in Mazda Motor Corporation of Japan from 24.5 to 33.4 per cent and acquired control of the management of the company; and AB Volvo and Renault SA brought to an end the alliance which the two groups had formed in 1990 for technical and industrial cooperation. In 1998 Volkswagen AG, through VOLKSWAGEN Group United Kingdom Limited, acquired Rolls-Royce Motor Cars Ltd from Vickers plc. At the same time BMW AG acquired all the rights to use the name Rolls-Royce in respect of cars, but the rights were leased to Rolls-Royce Motor Cars Ltd until the end of 2002. In the same year Volkswagen AG also acquired Lamborghini of Italy, and since 1994 it has increased its shareholding in Skoda AS of the Czech Republic. In 1999 the Ford group acquired Volvo Cars AB of Sweden from AB Volvo, while Renault SA and Nissan Motor Co Limited entered into a global partnership which involved Renault SA taking a 36.8 per cent shareholding in Nissan Motor Co Limited and participating in the

management of the company. Also in 1999, the Ford group sold its 50 per cent interest in the AutoEuropa joint venture to its partner Volkswagen AG. AutoEuropa is a Portuguese company which manufactures the Volkswagen Sharan, Seat Alhambra and Ford Galaxy models.

3.22. The financial results of some of the main automotive companies worldwide are shown in Chapter 4.

Trends in production and sales

3.23. Table 3.2 shows the number of new cars produced and registered worldwide in 1998, together with the position in the five largest EC countries.

TABLE 3.2 New cars produced and registered by country, 1998

	<i>Production*</i>		<i>Registration</i>	
	'000	%	'000	%
Germany	5,348	13.7	3,736	10.2
France	2,603	6.7	1,944	5.3
Spain	2,216	5.7	1,192	3.3
UK	1,748	4.5	2,247	6.1
Italy	1,402	3.6	2,364	6.4
Other EC countries	<u>1,835</u>	<u>4.7</u>	<u>2,443</u>	<u>6.7</u>
Total EC	15,152	38.9	13,926	38.0
Japan	8,056	20.7	4,093	11.2
USA	5,504	14.1	8,143	22.2
South Korea	1,625	4.2	558	1.5
Canada	1,457	3.7	740	2.0
Brazil	1,244	3.2	1,198	3.3
Other countries	<u>5,929</u>	<u>15.2</u>	<u>8,007</u>	<u>21.8</u>
Total	8,967	100.0	36,665	100.0

Source: *Financial Times* Auto Survey.

*Production statistics are official figures, not cleared of double counting.

Japan is the leading country in terms of production with 1998 output representing 20.7 per cent of worldwide production, nearly half as much again as the next largest-producing countries, the USA and Germany. The USA, on the other hand, is the leading country in terms of sales of cars, accounting for 22.2 per cent of registrations. The EC as a whole accounted for 38.9 per cent of worldwide output and 38.0 per cent of registrations.

3.24. Within the EC in 1998, some 87.9 per cent of production and 82.5 per cent of registrations were accounted for by five countries—Germany, France, Spain, Italy and the UK—of which the last two were net importers and the rest were net exporters. The SMMT told us that there were over 50 marques of car on sale in the UK, considerably more than in the USA and most EC countries, though many have a share of sales of below 1 per cent. Details of suppliers with a share of UK sales of more than 1 per cent are shown in Appendix 5.4.

3.25. Of the estimated total number of cars in use in the world in 1997—some 510 million—26 per cent were in the USA and around 33 per cent in the EC. Only 10 per cent were in Japan and 5 per cent were in the UK. Densities of car ownership in terms of people per car were 3.9 in Europe, 4.2 in North America, 35.4 in Asia and 63.0 in Africa. The density in the USA was 2.0 people per car, in the EC 2.2 and in Japan 2.6. Among major countries in Europe, density ranged from 1.9 people per car in Italy to 2.6 people per car in Spain, with the UK in an intermediate position at 2.2 people per car.

3.26. Table 3.3 sets out the changes in production and registrations for a selection of countries.

TABLE 3.3 Annual change in car production and registration by country, 1994 to 1998

Year	per cent						
	Japan	USA	Germany	France*	Italy	Spain	UK
<i>Production</i>							
1994	(8.2)	10.3	9.1	11.9	20.0	21.0	6.6
1995	(2.4)	(3.8)	6.6	(3.9)	6.1	7.5	4.4
1996	3.3	(4.3)	4.1	3.2	(7.3)	(1.2)	10.1
1997	8.0	(2.4)	3.1	6.5	18.6	3.3	0.7
1998	(5.1)	(6.1)	14.3	13.4	(11.8)	(2.9)	2.9
Cumulative	(5.2)	(7.1)	42.5	33.9	23.4	28.8	27.1
<i>Registrations†</i>							
1994	0.3	5.6	0.5	14.6	(1.3)	22.1	7.5
1995	5.6	(3.8)	3.3	(2.1)	3.6	(8.3)	1.8
1996	0.6	(1.4)	5.5	10.4	0.0	9.2	4.1
1997	0.5	(2.8)	0.9	(19.7)	39.2	11.3	7.2
1998	(8.9)	(1.2)	6.0	13.5	(2.0)	17.5	3.5
Cumulative	(2.5)	(3.9)	17.1	12.9	39.6	60.0	26.4

Source: EIU, *Motor Business International*, October 1999.

*Production represents worldwide production of French manufacturers.

†Sales numbers have been used in place of registrations in the case of the USA.

3.27. The main differences in production have been increased output in the EC, where all five of the largest car-producing countries achieved significant cumulative increases over the period compared with 1993. This contrasts with small cumulative falls in production over the same period for Japan and the USA. Registrations in Germany, France, Italy, Spain and the UK were all substantially higher in 1998 than they were in 1993. On the other hand registrations in Japan were 2.5 per cent lower than in 1993 reflecting the sharp downturn in economic activity in the Far East in 1998. Table 3.3 indicates that there was considerable volatility from year to year in the production and registration figures for all countries. A forecast in the *Financial Times* Auto Survey of 3 December 1999 suggested lower growth in the EC in 1999. In the UK, 1999 registrations were 2.2 per cent lower than in 1998 at 2.2 million.

Capacity and production

3.28. There is a widely-held view within the car industry that there is considerable excess productive capacity, both worldwide and specifically in the EC. We noted that the consultants A T Kearney, citing statements made by senior industry executives, claimed that in 1998 overcapacity worldwide was at least 20 to 30 per cent and quoted the view of the President of Ford of Europe that overcapacity in Europe was nearer 50 per cent.¹

3.29. The Economist Intelligence Unit Limited (EIU) carries out regular productivity reviews of car plants worldwide, rating productivity on the basis of output per employee for the cars actually produced. The most recent survey² was based on performance in 1998 when productivity increased at many car production plants, partly owing to strong demand and partly owing to improvements in plant operation. Output per employee at the 55 plants covered by the EIU review ranged from 51 (GM, Doraville, USA) to 165 (Daewoo HI, Changwon, South Korea). Such comparisons are affected by a number of factors, including whether a plant is working at or near capacity and the extent to which functions are outsourced. Twelve plants achieved a production level of at least 100 cars per employee year in 1998, including one UK plant (Nissan's plant at Sunderland with an output of 105 cars per employee). The next-ranked UK plants were Toyota's at Burnaston, near Derby (72 cars per employee) and Honda's at Swindon (64 cars per employee). Sunderland, Burnaston and Swindon are all relatively newly-built plants (see paragraph 3.51). The only other UK plant included in the review was Ford's at Dagenham where output was 61 per employee. The EIU noted that the three plants with the highest level of productivity all produced high proportions of very small cars.

¹The future of automotive distribution, A T Kearney, 1998 (FT Automotive).

²The world's leading car plants: a comparative productivity audit, EIU, *Motor Business International*, October 1999.

Car sales in the EC

The Block Exemption

3.30. In the UK and throughout the EC, suppliers of new cars can enter into SED arrangements with their franchised dealers. The SED system of car distribution is in widespread use throughout the world (see paragraphs 3.32 to 3.36). A supplier appoints a dealer for a geographical territory and agrees not to sell cars to any other dealer within that territory. A dealer is not permitted to sell cars of the supplier's brand together with cars of any other make from the same premises. Within the EC this situation would, in the absence of an exemption, be in contravention of Article 81 of the EC Treaty, but it is permitted under an EC Regulation covering the distribution and servicing of passenger motor vehicles. It is that Regulation that contains the Block Exemption referred to in paragraph 3.14.

3.31. Article 81(1) of the EC Treaty¹ prohibits agreements which may prevent, restrict or distort competition; however, Article 81(3) enables exemptions to be granted in certain circumstances. Exemptions for categories of common types of commercial agreement, such as franchising agreements, are known as block exemptions. In December 1984 the European Commission adopted Regulation 123/85 which created a block exemption for certain categories of motor vehicle distribution agreements. In 1995 the Block Exemption was renewed, with modifications, for a further seven years by EC Regulation 1475/95. The European Commission has started its assessment of the operation of the current Block Exemption prior to its expiry in 2002 (see paragraph 3.14).

Development of selective and exclusive distribution

3.32. Various reasons have been suggested for the development worldwide of a highly individual distribution system for cars based on parallel networks of franchised dealers. One explanation often given is that the founders of the early car manufacturing businesses were primarily engineers without any particular aptitude for selling. By establishing a linked network of dealers, manufacturers were able to concentrate on improving the technical performance of their cars and reducing production costs. The network of independent dealers could then be given an incentive to develop their local contacts and so maximize sales by the use of percentage commissions. Dealers could also provide an after-sales service throughout the country. A further reason advanced for the early development of franchised networks concerns the difficulty at the time of raising capital for what was viewed as a risky business. Contracting out the retail aspects of the business absolved manufacturers from finding the capital which would otherwise have been required to build showrooms and finance stocks of new cars.

3.33. There were some disadvantages in that manufacturers did not have contact with their actual and potential customers, with the result that the reputation of the manufacturer and its products depended heavily on the quality of the franchised retailers. As the industry developed, dealers needed both a good understanding of how their suppliers' cars worked and the technical knowledge to keep customers' cars serviceable. Manufacturers came to the view that there was a limit to the number of dealers that could be supported effectively and this led them to a take selective approach to the appointment of dealers.

3.34. Although mass production methods which were introduced between the wars reduced costs and hence prices, cars remained a substantial purchase to which customers gave considerable time and thought. In some countries, including the UK, most private customers expected to retain a new car for a number of years and then to be able to sell it to provide some of the finance needed to purchase a replacement vehicle. This led many car dealers to extend their businesses to include trading in used cars. Other services such as crash repairs, hire purchase finance, petrol retailing and car hire also came to be commonly provided by dealers.

3.35. Encouraging brand loyalty, and thus repeat purchases, has always been considered of great importance in the car industry. This led to the widespread use of advertising and other forms of promotion designed to attract customers to a manufacturer's brand and to its dealer network. From the point of view of manufacturers, for the image to be coherent the dealers had to present themselves as the public face of the manufacturer, so it became important for suppliers to influence the way in which many

¹Previously Article 85(1).

aspects of the dealers' businesses were carried out. For instance, the appearance of the dealership and the selling techniques used were increasingly expected to conform to standards established by the supplier. Suppliers also developed systems of incentives to encourage dealers to concentrate on promoting the sale and subsequent servicing of the supplier's own products, preferably to the exclusion of competitors' products. To ensure national coverage, suppliers divided a country into territories and dealers undertook to concentrate their efforts in a particular territory, rather than choosing for themselves where to engage in sales promotion.

3.36. As a result of these various considerations, car distribution in most major economies has evolved as a selective and exclusive system.

Type approval

3.37. For many years individual countries have had systems for ensuring that new cars could not enter into service unless they met acceptable standards of safety. For volume production cars this typically took the form of a type approval scheme, under which the government concerned approved a particular model and the manufacturer issued 'certificates of conformity' confirming that each car conformed with the approved model.

3.38. In 1970 the European Commission set out to establish a system of whole vehicle type approval for the European Community (ECWVTA) so that a model approved in a single member state, in accordance with harmonized EC standards, could be sold in any member state. The process of harmonizing standards took over 20 years and the ECWVTA scheme did not come into force until January 1993. In general a member state now cannot—on grounds relating to construction, design or equipment—refuse to register a car or prevent it from entering into service if it has a valid EC certificate of conformity. Conversely, a member state cannot in general register or permit a car to enter service if it does not have a valid EC certificate of conformity. The ECWVTA scheme and the exceptions to it are explained in more detail in Appendix 3.1.

Parallel imports in the EC

3.39. Under the Block Exemption, suppliers must not prevent or restrict consumers—or intermediaries acting on behalf of specific consumers—from buying a new car from any of their franchised dealers in any EC country, for use in another EC country. This process is known as parallel importing. As a result of the ECWVTA scheme there are no technical barriers to parallel imports between EC countries for cars which conform to ECWVTA standards. Suppliers have an obligation to supply cars to dealers for sale to a consumer from another member state if ordered by dealers, but dealers are not under an obligation to take orders from such consumers (see paragraphs 3.59 and 3.60).

3.40. The European Commission in a decision issued on 28 January 1998¹ concluded that Volkswagen AG and its subsidiaries Audi AG and Autogerma SpA had infringed Article 81(1) of the EC Treaty by entering into agreements with some of their Italian dealers in order to prohibit or restrict sales of new cars both to final consumers coming from another member state, whether in person or represented by intermediaries acting on their behalf, and to their authorized dealers in the distribution network established in other member states. Volkswagen AG was directed to bring an end to the infringements immediately. In view of the gravity of the infringement, a fine of 102 million ecu (£67 million) was imposed on the company. Volkswagen AG has appealed against the decision of the European Commission.

3.41. The European Commission is investigating a number of other alleged infringements of EC competition law involving, respectively, DaimlerChrysler AG; Renault SA; Opel Nederland BV (Opel), a subsidiary ultimately of General Motors; Volkswagen AG; and Peugeot SA. According to press reports published during the course of our investigation—the accuracy of which was confirmed to us by the European Commission—and information provided by manufacturers, the position regarding each of these cases is as follows:

¹98/273/EC, Case IV/35.733—VW.

- (a) *DaimlerChrysler AG*. A European Commission spokesman said that in April 1999 a Statement of Objections had been sent to DaimlerChrysler AG alleging, inter alia, that between 1985 and 1996 DaimlerChrysler AG had pursued an anti-export strategy in certain member states to prevent sales of Mercedes-Benz cars to final customers in other member states. This followed a two-year investigation which included raids at the Stuttgart headquarters of Mercedes-Benz (now part of DaimlerChrysler) and at subsidiaries in Belgium, the Netherlands and Spain. DaimlerChrysler AG confirmed that legal proceedings were being taken against it but said that it was confident it could refute all the European Commission's allegations.
- (b) *Renault SA*. A European Commission spokesman said that, following a wave of complaints from British consumers who found themselves blocked from buying new Renault vehicles in the Republic of Ireland, where they were cheaper than in the UK, European Commission inspectors had in March 1999 raided the French headquarters of Renault SA because the company had allegedly told its Irish distributor not to sell new cars to British residents; the premises of the Irish distributor and of a number of individual Renault dealers were also raided. Renault SA confirmed that the raid had been carried out and said that it had taken place in an atmosphere of complete openness; the European Commission inspectors had examined all the files to which they had sought access. Renault SA added that, being concerned to comply with competition law, it would cooperate fully with the European Commission's investigation.
- (c) *Opel*. Following confirmation from Opel in April 1999 that the European Commission had raided the offices of its importer in the Netherlands in December 1996, a European Commission spokesman said in May 1999 that the European Commission had issued a Statement of Objections based on (unspecified) evidence collected during that raid. A spokesman for GM Europe said that it would challenge the European Commission's allegations, adding that the company did not hinder sales to individual customers but blocked unauthorized dealers from buying in one country for resale in another.
- (d) *Volkswagen AG*. A European Commission spokesman said in September 1999 that a Statement of Objections had been sent to Volkswagen AG in June 1999 concerning alleged price-fixing attempts at the time of the launch of the new Passat, between 1996 and 1998, as a result of which the Passats sold in Germany (where they had 15 per cent of the family car market) were among the most expensive in Europe. In particular, it was alleged that Volkswagen AG had exerted substantial pressure on dealers in Germany which had been offering discounts of 7 to 12 per cent on the Passat to stop them from doing so; that in five cases it had threatened dealers and in three cases had said that it would take legal steps; and that it had asked dealers not offering discounts to put peer pressure on those which were because the price reductions were affecting the reputation of the Passat as a top-of-the-range model. The company declined to comment but said that it had responded to the Statement of Objections.
- (e) *Peugeot SA (including Automobiles Peugeot and Automobiles Citroën)*. In September 1999 it became public that the European Commission was about to raid Peugeot SA's Paris headquarters and administrative offices in the Netherlands and Germany. The investigation was in part triggered by complaints from individual French car buyers. Peugeot SA responded that it had always dealt within the EC in accordance with the law and that it was very confident that no wrongdoing would be found.

Grey imports

3.42. For the reasons given in paragraphs 3.37 and 3.38, a car cannot generally enter into service unless it meets the technical requirements of the ECWVTA scheme. Manufacturers, however, produce models for sale outside the EEA (see Appendix 3.1) that do not meet those requirements. Imports of new or used cars originating outside the EEA which do not meet ECWVTA requirements, and which are imported by parties other than the manufacturer or its national sales company, are generally known as grey imports.

3.43. An exception to the rule that a car cannot enter into service without an EC certificate of conformity is where the car has been approved by the member state as a single vehicle. The UK has had an SVA scheme since July 1997. A car falling within the scheme can enter into service within the UK if the Vehicle Inspectorate, following an individual examination of the vehicle, issues an approval certifi-

cate. The only way that a commercially imported grey import car can be approved is on the basis that fewer than 50 cars of that model have previously been approved in that year. The DETR told us that the total number of imported cars entering into service on that basis had never exceeded 20,000 units in a year, less than 1 per cent of sales of new cars in the UK.

3.44. Following a review in 1998, the DETR and the DTI jointly announced proposals in May 1999 for removing the numerical limit of 50 cars per model per year. The proposals provided for the numerical limits to be progressively lifted, starting with a total of 1,000 vehicles per model in March 2000 and increasing by 1,000 vehicles each month until the end of that year, when all limits would be lifted. This would mean that an unlimited number of grey import cars could enter into service following individual examinations. At the same time, however, the technical standards with which the vehicles had to comply would be strengthened to make them broadly consistent with the ECWVTA regime.

3.45. Another exception to the rule that a car cannot enter into service without an EC certificate of conformity concerns models of which no more than 500 are registered per year (see Appendix 3.1). The number of vehicles entering into service under that exception is small and is not considered further in this report. The arrangements for personal imports of cars are also described in Appendix 3.1.

Voluntary export restraints

3.46. In order to protect UK manufacturers, Japanese exports of cars to the UK were, between 1975 and the end of 1999, the subject of VERs. The underlying intention of VERs was to limit Japanese new car imports to about the same share of total sales in the UK that they held in 1975, that is around 11 per cent. Within the EC there are four other member states—France, Italy, Spain and Portugal—which have been the subject of VERs on new car imports from Japan. From the beginning of the 1980s, the European Commission had a role in the negotiations regarding VERs and in 1990/91 the European Commission had discussions with the Japanese Government with a view to making arrangements on an EC-wide basis.

3.47. The results of these discussions were announced in 1991: the main points were that VERs would continue until 1999, that there would be no restrictions on cars produced by Japanese-owned factories within the EC and that there would be no restrictions at all from 2000. The proposed restrictions from 1991 covered cars, off-road vehicles and light commercial vehicles. In terms of percentages of relevant forecast sales of new cars, the limits were 8 per cent in the EC as a whole, 7 per cent for the UK, 5.3 per cent for each of France, Italy and Spain and 8.4 per cent for Portugal. The lower percentage for imports to the UK (7 per cent, compared with 11 per cent previously) took account of the substantial inward investment into Japanese-owned plants set up in the UK. Among the underlying assumptions were that by 1999 roughly half the sales of Japanese cars in the EC would be imported and half locally produced. VERs ceased to apply from the beginning of 2000. Further details of sales of Japanese cars in the EC are given in Chapter 5. With the ending of VERs, there are no quantitative restrictions on imports into the EC.

Taxes on vehicle purchases

3.48. One of the major influences on new car prices in the EC is the taxes which apply in each country on the acquisition of a vehicle. The VAT structure for vehicles, but not the rate of VAT, has been harmonized across the EC. Vehicles may also be subject to other domestic taxes on acquisition (of a non-turnover tax nature) based on a variety of factors. VAT and, where applicable, those other taxes can add between 15 and over 200 per cent to the price of a car. Where an individual purchases goods for private purposes in one member state for use in another member state, VAT is generally payable in the country of purchase. With cars, VAT and any other tax are payable in the country of intended use. This procedure is facilitated by the fact that the authorities involved are able to establish where a car is to be used through their registration systems. The same tax treatment applies to aeroplanes, yachts and certain other motor vehicles, but to no other goods. The rate of VAT applied to vehicles ranges from 15 per cent (the lowest standard rate permitted under EC VAT Directives) in Luxembourg to 25 per cent in Sweden and Denmark. The UK standard rate of VAT of 17.5 per cent is toward the lower end of this range. Additional taxes on car acquisitions, besides VAT, are no longer imposed in the UK (see paragraph 3.57)

but are imposed by 11 other EC member states. The tax payable is determined in a number of ways: some taxes vary according to engine size, some are fixed rates and others vary according to the type of fuel used. Table 3.4 shows the tax rates as a percentage of pre-tax price.

TABLE 3.4 Motor vehicle taxation levels in the EC as a percentage of pre-tax price

	<i>Car capacity 1501 cc</i>	<i>Car capacity 2001 cc</i>
Luxembourg	15	15
Germany	16	16
UK	17.5	17.5
Italy	20	20
France	20.6	20.6
Belgium	22	23
Spain	23	28
Sweden	25	25
Austria	28	32
Netherlands	45	50
Portugal	47	66
Ireland	57.6	57.6
Greece	66	125
Finland	90	90
Denmark	198	213

Source: Association des Constructeurs Européens d'Automobiles (ACEA) Tax Guide 1998.

In addition to taxes applied by member states, a common tariff of 10 per cent of the imported value is payable on vehicles manufactured outside the EEA and imported into it.

Key elements of the UK scene

Structural changes in the UK car industry

3.49. Recent changes in the structure of the car industry in Europe were referred to in paragraph 3.21. The three main areas of structural change within the UK in the 1990s have been the acquisition of Rover by BMW AG, the increased output of cars from Japanese-owned plants in the UK and some reorganization among car-importing companies.

3.50. The purchase by BMW AG of Rover from British Aerospace occurred in 1994 and the unwinding of the Honda/Rover joint working and cross-shareholding arrangements took place later in the year. The management arrangements between BMW and Rover are still evolving, but BMW AG has made clear its support for the Rover marque. Substantial investment, supported by UK Government assistance, is planned for the Rover plant at Longbridge and a number of new models are under development for production in the UK. The first major new model introduced under BMW AG's ownership was the Rover 75 which was launched in the UK in June 1999, while more recently major 'facelift' changes to some existing models were announced pending the intended introduction of new models in the next three years.

3.51. Three Japanese manufacturers—Honda, Nissan and Toyota—now have car plants in the UK. Production at the Nissan factory at Sunderland began in 1989, when 77,000 vehicles were produced. By 1998 production had grown to 289,000 vehicles. In October 1999 Nissan indicated that it would be undertaking further expansion in the UK, against a background of substantial reductions in capacity elsewhere in the group arising from the management review conducted following the acquisition by Renault SA of a major shareholding in Nissan Motor Co Limited. Production at both Toyota's Derby plant and Honda's Swindon plant started in 1992, though Toyota had been producing engines in the UK since 1989. Output at both car plants increased substantially between 1992 and 1998, and Honda has recently announced plans for the further expansion of its Swindon plant. The UK output of the Japanese-owned plants has to some extent replaced cars previously imported from Japan and subject to the VERs (see paragraphs 3.46 and 3.47). These plants also export cars to other EC countries, and as further Japanese-owned plants are built elsewhere in the EC (for example, in France and Spain) Japanese cars produced in other EC countries are being imported into the UK.

3.52. Some suppliers both manufacture cars in the UK and import them from overseas plants, others supply only imported vehicles. At the time of the 1992 report, six of the major suppliers which imported new cars were owned by the supplying manufacturer and six were, at least in part, independently owned. Since that date three of the independent importers (those handling Nissan, Volkswagen and Volvo cars) have been acquired by the relevant manufacturer; one (Toyota) has become a 51 per cent subsidiary of the manufacturer which previously had only a minority stake; one (Lada) has ceased importing at least for the time being; and only one (Mazda) remains an independent importer, Mazda Motor Corporation having no shareholding in MCL Group Limited, the company that imports Mazda cars into the UK.

Sales to fleet customers

3.53. The UK differs from other EC member states in the extent of sales to fleet customers, predominantly company cars, which have grown substantially since the beginning of the 1970s. The exact volume of sales to fleet customers is a subject of some debate as there is no universally observed definition of what qualifies as a fleet or business car; the position is discussed in greater detail in Chapter 5. The initial growth in sales to fleet customers was to a considerable extent brought about by the tax advantages available for private use of company-owned cars, particularly at a time when income restraint applied, as in the early 1970s.

3.54. The taxation treatment of the private use of company cars has changed considerably since the 1970s and further changes are in prospect. Current government policy is that the private benefits of company car use should be fully taxed so that the tax system is neutral as between company and private ownership of cars.

3.55. Until 1994 taxation of personal use of a company-owned car was based on engine size or original market value. Since 1994 tax has been charged on the beneficiary by reference to the list price published by the supplier on the day before the car was first registered—plus accessories, delivery charges, VAT and car tax (if applicable). The full benefit is assessed at 35 per cent of this price each year, subject to an upper limit of £80,000 for the price. Where business use of the car is substantial, a discount from the full charge was, until April 1999, given at the rate of one-third where business use in a year amounted to between 2,500 and 17,999 miles (since April 1999 this has been replaced by a charge on 25 per cent of the car's list price) and two-thirds where business use in a year amounted to 18,000 miles or more (since April 1999 this has been replaced by a charge on 15 per cent of the car's list price). The chargeable amount of 35 per cent of list price is set so as broadly to take account of the effect of depreciation, finance, servicing and insurance costs met by the employer. Fuel supplied free for private motoring is taxed separately.

3.56. The present regime has been criticized on environmental grounds in that the discounts for business use are said to provide a perverse incentive for users to drive additional business miles so as to reach one of the thresholds for a discount and so to qualify for a lower tax charge. In his March 1999 Budget the Chancellor of the Exchequer announced a significant reform of the taxation of company cars. From 6 April 1999 the existing discounts were reduced (see paragraph 3.55) and in April 2002 they are due to be abolished and the taxation charge will be based instead on a percentage of the car's list price graduated according to the level of the car's carbon dioxide (and possibly other) emissions. The Inland Revenue told us that its best judgment at present was that in net terms the changes to take effect from 2002 were likely to lead to a small increase in the number of company cars.

Abolition of car tax

3.57. In 1973 when purchase tax at the rate of 25 per cent was replaced by VAT at a rate of 10 per cent, an additional car tax—also at 10 per cent—was introduced to provide a comparable tax yield. Car tax was phased out in 1992, with a reduction to a rate of 5 per cent on 10 March and complete abolition on 13 November.

Change of registration arrangements

3.58. From 1963 the year of registration of new cars in the UK has been denoted by an alphabetical prefix or suffix in the car's registered number, with the letter changing at yearly intervals. Initially the letter change took place at the beginning of the calendar year, but this was moved to an August change in 1967, in view of the distortion said to be caused to the pattern of car buying over the year. In 1999 there was a further move to a twice-yearly change in March and September.

Use in the UK of right-hand drive cars

3.59. A distinguishing feature of the UK, compared with most other EC countries, is the requirement to drive on the left-hand side of the road. Although it is not illegal to use LHD cars, in practice sales of new cars in the UK are confined almost entirely to RHD models. Ireland is the only other EC member state where the rule of the road is to drive on the left. There are other countries where this rule applies, chiefly Japan and parts of the Commonwealth, but the regulations governing type approval requirements (see paragraphs 3.37 and 3.38) and other factors limit the extent to which products sold there are brought into the UK.

3.60. Car manufacturers are required, under the Block Exemption, to supply RHD cars at local prices to their dealers in LHD countries within the EC who place orders for such cars for registration in the UK, provided the manufacturer markets a corresponding model in the UK. Purchasers of cars in RHD form in LHD countries will usually be required to pay a supplement. The European Commission told us that it had issued guidance in Notice 85/C 17/03 (see paragraph 3.17) that, inter alia, allowed all undertakings involved in car distribution to charge 'an objectively justifiable supplement on account of special distribution costs and any differences in equipment and specification'. Supplements for RHD cars sold in mainland Europe (which the European Commission told us had been criticized by a limited number of consumers) had to be compatible with this. The European Commission told us that, following customer complaints, it had checked the RHD supplements of two manufacturers in 1998. It had asked the manufacturers to explain the basis for their RHD supplements and, in particular, to demonstrate that they were based on objectively justifiable costs. One manufacturer subsequently reviewed its RHD supplements and based them on the additional costs involved. This had led to a decrease in RHD supplements for the manufacturer concerned in nearly all member states. The other manufacturer's supplements were found to have been based on additional costs and as such could not be challenged by the European Commission. The European Commission also told us that RHD supplements, on a model to model basis, were 'nearly the same' throughout Europe but Professor Verboven found that the average price for the RHD option had a tendency to be bigger in countries nearer to the UK than in others. For example, the average price in Austria and Italy was much lower than in Belgium, which was the most expensive country for this option (see paragraph 7.263). Prices for the RHD option are now quoted in the European Commission's price surveys for the great majority of the models covered.

Sales of second-hand cars in the UK

3.61. Another feature distinguishing the UK from most other EC member states is the extent of transactions in second-hand cars. One reason for this is the volume of new car sales to fleet customers, which provides a steady flow of used cars from six months to three years old for sale second-hand. Sales of second-hand cars are dealt with in greater detail in Chapter 5.