

8 Views of other interested parties

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Introduction

8.1. We sought evidence and views from government departments, trade associations and institutes, academics and research organizations, car dealers and brokers, car finance, leasing, rental and hire companies, and other interested parties. This chapter summarizes the evidence we received.

Government departments

Department of the Environment, Transport and the Regions

8.2. The DETR gave written and oral evidence. It said that it had no direct responsibility for competition policy or car pricing. However, there was a link between the approval regimes for new vehicles (for which it was responsible) and freedom of access to the UK car market for manufacturers and their dealer networks and for independent traders.

EC whole vehicle type approval

8.3. The DETR said that since 1 January 1998 the majority of new cars in the EC had had to meet certain technical standards, together known as ECWVTA. Manufacturers had to submit vehicle prototypes to an EC Type Approval Authority (which in the UK was the DETR's Vehicle Certification Agency) for testing before the new vehicles were launched on the market. The prototypes had to comply with a wide range of standards and manufacturers had to demonstrate that all vehicles produced conformed to the approved type. Type approval was available only to manufacturers, not to independent traders or dealers. At national level a simpler form of type approval was available, the 'small series' exemption under which member states were allowed to give approval for vehicle types registered in numbers of less than 500 a year in their territory. In practice this was available only to manufacturers and persons who were able to obtain the full cooperation of the manufacturer.

Single vehicle approval

8.4. The DETR said that models produced for marketing outside Europe did not require EC type approval. An independent trader who wished to import such vehicles into an EC member state had to receive approval on an individual basis within that state. Under EC law member states were allowed to approve such vehicles singly provided they did not impose requirements over and above those for ECWVTA. The SVA scheme had been introduced in the UK in 1997 to help regulate such trade and to

ensure adequate safety and environmental standards. The scheme had been developed for non-type-approved vehicles imported by individuals for their personal use. It had also been intended to allow a small number of specialist vehicles to be approved with a view to helping small businesses and to allow the approval of amateur-built vehicles. The DETR said that the introduction of the SVA had coincided with a change of economic circumstances which had made it highly profitable to import cars from Asia. Unexpectedly, the SVA route had been used mainly by independent commercial importers of RHD cars designed for markets in Japan and south-east Asia. As a consequence of these and other developments Ministers had reconsidered the scheme, particularly the limit applying to commercially-traded vehicles (50 vehicles a year of each model).

8.5. On 13 May 1999 the DETR and the DTI had announced proposed changes to the SVA scheme, and the associated import procedures, which would be introduced from March 2000. The main elements of the changes were:

- (a) a progressive lifting of the numerical limits on commercially-traded vehicles;
- (b) the introduction of enhanced technical standards for key environmental, safety and security items on commercially-traded vehicles;
- (c) complete lifting of the limits on vehicles which had been approved to standards equivalent to the enhanced SVA in other EC member states; and
- (d) tightening of the rules for vehicles to qualify as personal imports.

8.6. In making the announcement the DETR had said that these proposals were intended to deliver increased competition and choice for car buyers, with better safety and environmental standards. The practical effect would be higher standards and an increase in the number of vehicles without EC type approval that could be sold in the UK.

8.7. On 15 July 1999 the DETR had announced that the proposal to remove the numerical restriction on commercially-traded vehicles approved to equivalent standards in other EC member states was to be implemented shortly, ahead of schedule. This change was implemented by Statutory Instrument 1999 No 2082 on 23 July 1999.

8.8. The DETR told us that the volume of commercially imported new cars approved under the SVA scheme had never exceeded 20,000 a year (less than 1 per cent of total registrations of new cars). (Personal imports of used cars (three years old or more) which did not require SVA amounted to about 60,000 a year.) The kinds of models imported had generally been niche products—including sports cars, specialist high-performance cars and all-terrain (4×4) vehicles—rather than ordinary saloon cars. Nevertheless, the DETR believed that the consumer would benefit through the extra stimulus to competition.

8.9. The DETR said that it had some safety concerns over facilitating the easier import of a wider range of cars. It had warned consumers that the vehicles were not to the usual European specification and it planned to issue written advice on the possible differences. The DETR said that, although models not specifically designed for EC countries might have been designed for different conditions, the enhanced SVA should ensure the safety of such vehicles. It was concerned about the recall arrangements for such cars. The current recall scheme was operated by the DETR in conjunction with the SMMT and, although generally adhered to by the leading manufacturers, it was voluntary. Consumers would be advised that this was something to be aware of and it was hoped that their inquiries would encourage independent importers' trade associations to participate in the scheme. In the past a number of commercial importers taking advantage of the personal import rules had not been able to service the vehicles; the enhanced SVA should eliminate such individuals from the trade and leave the more competent and professional traders. Such traders had already formed a trade association (BIMTA) which was in touch with the DETR and was keen to ensure proper customer service.

Environmental, welfare and social aspects

8.10. The DETR outlined the potential effects which lower average car prices might have on the environment, welfare and safety. It said that because of the uncertainty surrounding many of these effects it was impossible to say whether such a change would have adverse or beneficial implications. Lower prices would be likely to increase car ownership and to encourage consumers to purchase larger cars or those with additional features (for example, air conditioning). There might be a resulting deterioration in the environment and in congestion on the roads. However, a fall in car prices could increase the replacement rate of older vehicles. Newer vehicles produced lower emissions which were less damaging to air quality, and were more fuel efficient. They could therefore bring environmental improvements. The precise effect would depend on how many older vehicles were removed from the road.

8.11. If a fall in new car prices fed through to second-hand car prices this could help to solve some social exclusion problems. Many neighbourhoods where there were such problems also had low levels of car ownership and this restricted the residents' access to job opportunities and local amenities. Any measure which improved their car usage would be beneficial.

8.12. The White Paper, *A new deal for transport: better for everyone*, set out the Government's overall policy for transport and the environment. The removal of any detrimental effects that might result from the arrangements for the supply of cars would be consistent with this policy. Some of the environmental impacts which might flow from such a change, through an increase in the number of cars available, would help to achieve the integrated transport objectives. Other impacts, such as an increase in traffic growth, might be less helpful and might need to be tackled through the mechanisms outlined in the White Paper.

8.13. The DETR said that in considering potential public interest implications, the Commission should be aware of the possible impacts it had outlined. However, the environmental effects of the use of road transport were best dealt with through instruments aimed directly at them, rather than through maintaining a supply system which was anti-competitive and led to artificially high prices.

Department of Trade and Industry

8.14. The Motor Vehicles Directorate of the DTI told us that it believed our report could play a key role in informing the debate on revisions to the Block Exemption. At a hearing it gave factual evidence. It said that the Directorate aimed to foster a strong strategic partnership with the car industry to ensure that its interests were taken into account in the development of policy and of any necessary regulatory requirements at national and EC level. The Directorate was working with the industry on practical measures to improve business competitiveness and sustainability. Since 1994 the Directorate had participated in an industry forum jointly with the SMMT. It had also been meeting with an informal group of manufacturers and dealers with a view to establishing a similar initiative in the retailing area.

Inland Revenue

8.15. The Inland Revenue gave written and oral evidence on the changes to the taxation system since the 1992 report. Its comments applied specifically to the taxation of the private use of company cars by employees. The main point of interest was that in 1994 the Inland Revenue had moved from a system based on scale charges depending on the car's engine size or original market value to one based on the car's list price. The change had taken place in response to criticisms of the previous system, including suggestions of tax distortions in the new car market by manufacturers producing 'tax cheaters' that fell just below a particular engine size threshold. From 1994, the benefit of having a car available for private use had been valued by reference to the supplier's list price as published the day before the date on which the car was first registered, plus accessories, delivery charges, VAT and car tax (if applicable). The full benefit was charged at 35 per cent of this price and the price was subject to an upper limit of £80,000.

8.16. Consultation prior to the change had shown that the list price was considered to be the fairest and most practical basis for measuring the benefit of a company car. It was also simpler than the previous basis because it provided an objective figure and the price could be found in published sources. By being applied to both new and used cars, it treated all employees with the same model variant equally.

8.17. Discounts were allowed against the full tax charge for those who needed their cars for business, as opposed to private use. A discount of one-third was given for those driving 2,500 to 17,999 business miles a year, and a two-thirds discount for those driving 18,000 business miles or more a year. A further one-third discount was given if the car was four or more years old at the end of the tax year, to recognize the lower value of an older car.

8.18. The Inland Revenue said that this regime had since been criticized on environmental grounds in that the discounts might provide an incentive to drive otherwise unnecessary miles in order to reach one of the thresholds and so qualify for a lower tax charge. To help protect the environment, in his March 1999 Budget, the Chancellor had announced a fundamental reform of the taxation of company cars. From April 2002, the existing discounts would be abolished and the charge would be based 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 car's list price would continue to be used as the starting point for the valuation of the benefit as this was a familiar concept and accepted as being fair. To pave the way for this reform, the Chancellor had also announced reductions to the existing discounts, taking effect from 6 April 1999.

8.19. The new regime would give rise to a complex pattern of changes in incentives to hold company cars rather than private cars, depending particularly on the business miles travelled and the level of emissions. Some employees with low emissions and low business miles would have an increased incentive to acquire company cars and others with high business miles and high emissions might prefer a private car for their business miles.

8.20. The higher tax on older cars might also lead to more private ownership of older cars and some tendency for company car owners to hold newer cars.

8.21. The Inland Revenue estimated that in net terms this change was likely to lead to a small increase in the number of company cars. Some 1.7 million people currently paid tax on company cars. At the time of the 1992 report, there had been 2 million. The Inland Revenue thought it unlikely that the changes of themselves would raise the number of company cars back to the 1992 level.

8.22. The main effect on the new car market was likely to be a switch of demand towards more fuel-efficient cars. There was, however, no reason to think that this would disadvantage UK manufacturers.

8.23. The Inland Revenue said that it was often asked how the price of a car should be determined when the car had been bought abroad. In fact this made no difference to the way it was taxed. The relevant legislation was framed entirely in terms of what the UK list price was, or would have been if there had been one. There was therefore no tax advantage from purchasing a car abroad more cheaply.

8.24. The Inland Revenue emphasized that the list price was only a means of arriving at the value, for income tax purposes, of the benefit of a car. It was not the amount on which tax was chargeable. The percentage charge of 35 per cent of the list price was merely intended to be a broad proxy, across all cars, of the full costs to an individual of owning and running a car for private use. It took account of running costs (such as maintenance and repairs) and standing charges (which included depreciation and financing costs).

8.25. Finally, the Inland Revenue drew our attention to the five-year programme of increases to the fuel scale charges for those company car drivers who were provided with fuel for private motoring. In the 1998 Budget, the Chancellor had announced that for 1998/99 and the following four years, the scale charges for free fuel would be increased by 20 per cent over and above the usual increases in line with pump prices, including fuel duty. He had also taken the opportunity to align the scale charges for petrol and diesel. The purpose of this programme was to discourage employers from providing, and employees from accepting, free fuel, so that more company car drivers faced the full cost of the fuel they used for private motoring. This should result in fewer private miles being driven and lower carbon dioxide emissions. The higher increases for diesel should help reduce urban pollution in the form of particulates and nitrogen oxides.

Remedies Statement

8.26. The only hypothetical remedy on which the Inland Revenue considered it appropriate to express a view was the possible prohibition of RRPs. It said that because the current system of company

car taxation was based on list prices, such a prohibition would force it to find an alternative method of valuing the taxable benefit. This should be achievable, subject to some difficult issues being resolved, but any new basis would have to be set out in primary legislation, which might not be possible until the 2001 Finance Bill. Additionally there would need to be changes to computer systems and staff training and wide-scale publicity would be required to advise employers of the change. Accordingly, the Inland Revenue would welcome a reasonable period of notice between the time of the announcement of such a prohibition and the date of its implementation.

Trade associations and institutes

British Independent Motor Traders Association

8.27. BIMTA is a trade association which was formed in 1997 to represent the interests of independent car retailers, repairers and parts specialists. It told us that it had about 100 members, many of which were engaged in the parallel importing of new cars from mainland Europe and the importing of new and used 'grey' cars, principally from Japan.

8.28. BIMTA gave evidence at a hearing, and also drew our attention to the memorandum on car pricing that it had submitted in October 1998 to the House of Commons Trade and Industry Committee's inquiry.¹

8.29. BIMTA was convinced that, at present, prices of new cars in the UK were significantly higher than in other EC member states even after taking account of discounts, trade-in values and financial benefits such as low-cost finance. Its members would not be in business if this were not the case.

8.30. Broadly speaking, consumers needed to see a potential saving of at least 15 per cent before they would consider buying a new car outside the normal channel of a franchised dealership. But BIMTA members were often able to offer much greater savings than this. They did not generally take orders: customers bought what they had in stock or 'on the water'.

8.31. BIMTA estimated the current level of parallel imports of new cars into the UK at around 50,000 a year or 0.5 per cent of the total volume of cars, new and used, sold in the UK. This did not have a major effect on the market, nor did BIMTA expect parallel imports to grow to a level at which they would have such an effect.

8.32. BIMTA considered that the Block Exemption was a major factor contributing to high UK prices for new cars. The other major factor was that the UK was the only large RHD market in Europe: this enabled manufacturers to ring-fence the UK market. It was difficult for British people to get dealers in the Republic of Ireland to sell new cars to them. BIMTA believed that the reasons which had led to the introduction of the Block Exemption no longer existed and that it should now be updated or abolished.

8.33. BIMTA supported the UK's SVA scheme, which facilitated grey imports, but objected to the constraints imposed on numbers of applications for its use (50 for each model in a year, and not more than 100 for each model over five years). The scheme had been intended for use by individual buyers, or by independent dealers acting on their behalf, wishing to import vehicles less than three years old, but several Japanese manufacturers had used it for their new cars, so taking up a large part of the limited volumes permitted.

8.34. The Government's intention to revise the SVA scheme (see paragraph 8.5) was welcome in principle but BIMTA wanted the quantitative restrictions on grey imports lifted in one move rather than phased out over a period. Moreover whilst BIMTA accepted the principle that grey imports should meet broadly the same standards as those set by the ECWVTA scheme, it was concerned that the tighter testing regime which was to be introduced for grey vehicles should be sensible and practicable.

8.35. Even when the new SVA regime was fully in force, BIMTA did not expect a major change in the level of grey imports into the UK. There were practical reasons for this, for example shipping

¹See footnote to paragraph 6.38.

capacity. Moreover demand for cars in Japan was rising and the yen was strengthening. In addition the Japanese car manufacturers would themselves be likely to react to the liberalization of the regime by marketing niche products.

British Vehicle Rental and Leasing Association

8.36. The British Vehicle Rental and Leasing Association (BVRLA) told us that it represented about four-fifths of the daily rental and contract hire companies in the UK. In April 1999 it had in membership about 275 such companies and about 700 franchised dealers, together running about 1.2 million cars and buying about one-third of the 2.2 million new cars registered annually in the UK.

8.37. The BVRLA said that about 300,000 of these purchases were by rental companies and about 400,000 by contract hire and fleet management companies. Rental companies typically held their cars for six or seven months and then disposed of them, usually by returning them to the suppliers at prices determined at the time of the original purchases. (It followed that rental companies were not greatly interested in discounts, which could be anything from zero to 40 per cent. It was the difference between the purchase and buy-back prices that was critical.) These ex-rental cars were then reconditioned by the suppliers and sold through their franchised dealers. Contract hire companies, on the other hand, took the risk in the residual value of their vehicles and in the provision of maintenance and all the other services they would require during the contract hire period. This commonly would be three or four years for use as a company car allocated to an employee. After that many of these cars would be sold at trade auctions.

8.38. The practice of repurchase of rental cars by suppliers had developed rapidly over the last five or six years. To work satisfactorily it was essential to have stable residual values (which were a matter of concern to all vehicle owners, but critical for contract hire companies because of their greater exposure). Residual values were inherently uncertain but were best ensured in both the contract hire and rental sectors by using quality cars. In consequence, the high-volume UK manufacturers had lost ground. Rover's sales, in particular, were much reduced. The rental companies were not concerned to find the cheapest cars but to find those of the requisite quality which would be available immediately when wanted.

8.39. Contract hire companies always bought their cars through carefully-chosen dealers so as to be sure of securing satisfactory service over three or four years. (These purchases were usually at 9 to 10 per cent dealer discount, plus £200 to £500 rebate from the supplier.) The largest rental companies, on the other hand, bought the great majority of their cars direct from suppliers, because dealers could not provide pre-sales services (ie cleaning, checking and registration) for the numbers involved. The smaller rental companies, however, might buy from suppliers (to secure volume discounts) but look to dealers for services.

8.40. The administrative burden of securing lower-priced RHD cars from mainland Europe was prohibitive, quite apart from the impracticability of obtaining them in the numbers required, and at the precise time they were needed.

8.41. The BVRLA said that its members would favour an orderly reduction in prices for new cars in the UK. But a sudden and unexpected reduction would affect all used car prices, and particularly the residual values that contract hire firms had assumed. It would be desirable, therefore, for any reduction to be phased, perhaps by freezing any increases until such time as car prices in the EC became harmonized.

Remedies Statement

8.42. The BVRLA said that it did not wish to comment at present on the future of the Block Exemption. It made the following points on the possible remedies which concerned matters outside the scope of the Block Exemption.

Offering dealers similar terms to those offered to fleet customers

8.43. The BVRLA agreed in theory that purchasers of the same volume of cars should benefit from similar terms. However, all the terms should be of equal application, not just the price of the vehicles but also terms such as the minimum retention clauses with which BVRLA members had to comply to receive a discount. Clearly dealers would not be able to comply with such terms but, more importantly, dealers were not customers in their own right, only intermediaries. Therefore there was no reason why they should receive the same terms as genuine fleet users. The BVRLA refuted the assumption that fleet purchasers enjoyed far better terms than the retail sector. Retail purchasers benefited from incentives denied to fleet customers, such as interest-free credit. There was therefore already a degree of parity in terms of the effective transaction price enjoyed by the retail sector as opposed to the fleet sector.

Non-discrimination in the terms offered to contract hire companies

8.44. Terms offered to contract hire companies should be identical regardless of the nature of the contract hire company's customer. It was for the contract hire company to decide the use to which the vehicles were to be put and the way in which the contract should be drawn up.

The prohibition of recommended retail prices

8.45. In the view of the BVRLA, RRP's were necessary as a price guide. The Inland Revenue used them for taxation purposes, and fleet purchasers used them when setting their company car policies. Furthermore RRP's aided transparency for consumers. Some guideline was needed even though RRP's might differ from the actual prices paid by fleet and retail customers. Setting a guide did not prevent the negotiation of individual or volume-related pricing.

Finance and Leasing Association

8.46. The Finance and Leasing Association (FLA) said that it was the major UK representative body for the finance and leasing industry, representing companies offering business finance, consumer credit and motor finance. These services were provided through the branches of finance houses and at the point of sale through thousands of retailers and dealers. Motor finance to industry and the consumer was the single largest area of FLA members' business.

Remedies Statement

8.47. Commenting on the Remedies Statement (see Appendix 2.3), the FLA said that the members of its motor division were either independent finance houses (mostly bank-owned) or manufacturers' in-house finance operations. Some of the proposed remedies had different implications for these two distinct groups.

General comments

8.48. The FLA supported the drive to bring down prices, but questioned whether the Block Exemption was the major contributor to price disparities within the EC. The variations in the EC were due to a number of factors, including tax differentials and exchange rates. Manufacturers set post-tax prices at a level the individual markets would bear. Comparison of pre-tax prices between markets was not particularly useful.

8.49. Manufacturers' ability to sustain price differentials so as to equalize tax-inclusive prices, or even to reduce the impact of tax rate variations, was limited by the facility for personal imports of cars and the rules whereby tax was paid at the rate in the customer's home state (rather than in the country of purchase).

8.50. The FLA said that exchange rate variations were a stronger influence on car prices than the Block Exemption. It seemed likely that within the Euro zone, as consumers became acclimatized to Euro

pricing, the differentials in pre-tax prices would be flattening out, notwithstanding the continuing operation of the Block Exemption. To a degree, the home market would bear a higher price than the export market in any country whose currency currently had a strong exchange rate when viewed, for example, in relation to indicators of price-competitiveness or comparative purchasing power. The converse would apply for any country with a weak currency. At least this would be so in markets where buyers incurred significant costs in trading internationally. The FLA said that the consumer car market was one such case.

8.51. UK car list prices before tax seemed comparatively high when the sterling exchange rate was strong, as over the three years to the end of 1999. At such times, manufacturers faced relatively high costs of production compared with competitors, or their own production centres, in other countries. Their sterling export selling prices would be depressed by the exchange rate factor, with no such strong and automatic effect on UK market prices. The FLA said that manufacturers with UK operations could limit the financial pressures resulting from the high exchange rate by differential pricing in favour of export buyers, to the extent that competition law and the structure of the market allowed. If they were prevented from doing so, for example through the ending of the Block Exemption, they could not simply reduce their UK selling prices to export market levels, since by doing so they would endanger their UK manufacturing operations by rendering them unprofitable. Instead, manufacturers in these conditions would have to raise export market prices whilst reducing home market prices, to meet somewhere in between the two. Substantial export sales could be lost as a result.

8.52. For these reasons, the FLA suggested that any changes introduced to reduce car prices should take account of wider knock-on effects and be phased in to avoid disorder in the market. For example, in the second-hand car market there was already significant evidence of falling prices causing negative equity. In car purchase, borrowing to buy was one of the largest commitments, apart from a mortgage, that a consumer made—indeed, for many it was the largest. Negative equity might delay the replacement cycle, impair buyers' ability to obtain further credit for car purchase, and diminish the capability of finance houses to lend on a hire-purchase basis. This had obvious ramifications for those who borrowed on that basis (a significant proportion of the working population) and for those who worked in the industry. On older cars, falling values might also cause problems for dealers, as the cars would be of little or no value and, therefore, unacceptable as trade-ins.

8.53. In the FLA's view, the early and sudden ending of the Block Exemption could have significant adverse effects for manufacturers, dealers and, ultimately, consumers. This was assuming that manufacturers did not react by acquiring the equity in their franchised dealerships, bringing the selling operations entirely in-house, in which case they might be able to retain the commercial substance of the existing arrangements.

8.54. The FLA believed that, even without the ending of the Block Exemption, UK car prices would begin to converge with those elsewhere in the EC through increased consumer access to international price information on the Internet and the resulting threat to price differentials from personal imports. If the UK joined the single European currency, greater price transparency was also likely to enforce price convergence. It might be less disruptive for prices to converge gradually as a result of these factors, rather than suddenly through a change in competition law. Enforced regulatory changes to UK car pricing without other changes (for example, in the tax regime to treat vehicles as taxation at source) would deprive the UK Government of considerable revenue. The UK industry would be the loser, with no real gain for the retail customer because there could not be true price harmonization without a common tax system and a common currency throughout the EC.

Separate sales and servicing operations

8.55. The FLA said that there could be no real justification for suppliers insisting that retailers provided servicing and repair. There was, however, an important link between sales and servicing. Dealers who sold new cars had to be available to rectify any faults, whether in the context of the PDI or after the customer had taken possession of the car. Indeed, the Ipsos report stated that customers were reassured by being able to return to the same site/dealership. At the very least, and in the interests of safety and good customer service, the FLA would expect suppliers to make details of approved maintenance and servicing outlets available to customers.

Servicing and repair operations

8.56. On the question of what conditions suppliers should be allowed to impose on approved servicing and repair operators, the FLA said that the fundamental issue was vehicle maintenance and safety. Safety and emission control equipment needed specialized maintenance, which meant that the dealer had to know the product. The FLA would strongly recommend that suppliers should be required to influence technical standards through accredited maintenance and service outlets. Accreditation should apply to staff skills, equipment and facilities, but no minimum size of operation should be required, nor should the number of approved operators in a region be limited. Suppliers should make tools, equipment and technical information and training available at commercially acceptable prices.

Offering similar volume discounts to dealers and fleet customers

8.57. The FLA agreed that volume discounts should be available to all operators. It pointed out, however, that 'equivalent' terms would be difficult to compare. Fleet purchases were part of a contract hire product with the dealers committing to buy in bulk to obtain the discount for passing on to fleet buyers, who had already lined up customers (for example, through employee schemes). If retail dealers wished to buy in bulk rather than operate on a sale-or-return basis, no doubt many suppliers would be delighted to offer the same discounts. It was, however, unlikely that many, if any, dealers would wish to operate in that way and risk having a stock of vehicles that they had purchased without ready customers.

8.58. The FLA suggested that if the proposed remedy were adopted, its scope should be extended to include situations where customers of contract hire companies were acquiring cars under purchase agreements as well as leasing/hire agreements.

Recommended retail prices

8.59. The FLA acknowledged that the removal of RRPs in other industries had stimulated competition and enabled large retailers to exploit economies of scale. It argued, however, that the purchase of a car was a different matter: it was often the biggest outlay the customer made and there was no valid comparison with other commodities where a retailer simply provided a range of goods from which consumers made their choice.

8.60. The main reason the FLA supported the maintenance of RRPs was because it believed that customers found it difficult to compare the packages available. Finance packages could be advertised only by reference to the specified price. Currently a substantial proportion of finance advertising (including that regulated by the Consumer Credit Act 1974) took place with reference to the RRP. Consumers were therefore able to compare different suppliers' finance packages because they were based on a set price throughout the country. They could then negotiate with individual dealers.

8.61. Abolishing RRPs would prevent finance houses from advertising nationwide and individual dealers would have to undertake their own finance advertising. This was because the advertisements would need to relate to a specific price at which the dealer was prepared to sell the specific car. Dealers could not combine to carry out local advertising because this would contravene the regulations against price fixing.

8.62. The outcome would be that consumers would be faced with various finance packages based on various different prices for vehicles that would be impossible to compare. Furthermore, if RRPs were abolished dealers would charge the highest prices they could, which in the case of models in great demand could be well in excess of the price that the supplier would have recommended.

8.63. The FLA believed, therefore, that RRPs provided a useful guide to consumers, a constraint on dealers charging higher prices and an essential role in nationwide price advertising, to the benefit of consumers.

8.64. The FLA was also concerned as to how a prohibition on RRPs would affect benefit-in-kind taxation, where decisions would be needed on whether the transaction price would be used, what exchange rate mechanism would be used for purchases abroad and how the system would be policed. It

noted that the Inland Revenue would need to change the basis for P11D company car tax charges on the employee's benefit in kind.

Bundling of financial and other benefits

8.65. On the issue of whether dealers should be able to opt for an equivalent reduction in wholesale price in place of bundled benefits, the FLA said that it would not expect dealers to have subsidized credit replaced by cash as this would impose an unnecessary restriction on suppliers. Dealers should be able to have the same options available from both captive and independent finance houses. The FLA wondered what the gain to customers would be if the remedy denied them access to special promotions (for example, customers should be able to opt for discounts on 'special edition' campaign models, and suppliers to offer them, without fears of claims from customers who had bought the 'normal' model).

Pre-registration of cars

8.66. The FLA said that there would be no benefit to consumers in prohibiting the pre-registration of cars, which reduced the price of nearly-new stock, putting downward pressure on new car prices. The current practice should be allowed to continue. The FLA recognized that it distorted market size data, but said that this could be remedied by keeping statistics of the 'true' state of the market. It would strongly support such a move.

In-house finance companies

8.67. Commenting on the proposal that suppliers should be prohibited from requiring dealers to use in-house finance companies, the FLA said that it supported an open market and believed this already existed. Subventive finance could bring significant savings through the supply chain, so the remedy would not necessarily bring costs down. Dealer stock financing could even rise, because it would be difficult to justify investment in electronic links to facilitate faster and cheaper processing of orders/stock finance as the return flow of retail finance and the ability to fund whole stock would be diminished.

The Institute of Insurance Brokers

8.68. The Institute of Insurance Brokers said that the insurance industry had an interest in the consequences of relationships between car suppliers and dealers. Where such relationships inflated new car prices by restricting competition, the effect was to increase the cost of insurance claims and therefore to increase insurance premiums. This effect was compounded if the sale of cars incorporated terms which effectively bound purchasers to franchised and directly owned dealerships for future repair work, whether by reference to manufacturers' warranties, or by supposedly discounted repair rates which were subsidized by inflated new car sale prices.

8.69. Many of the major car suppliers now incorporated selected additional benefits as part of the new car sales package. These benefits included 'free' insurance, 'free' breakdown and accident recovery, 'discounted' maintenance and repair, and many finance and trade-in deals. The prospective purchaser had little or no effective option but to accept these benefits from the car manufacturer. Either there was no discount if the benefits were not taken up or such discount was clearly very small in relation to the market value of the benefits offered. Incorporation of these benefits served to conceal and inflate the effective price of the car. In so far as such benefits were presented as being of exceptional value, it should be recognized that any notional retail cost was effectively subsidized out of inflated margins on the price of the vehicle itself.

8.70. The ability to offer supposedly free insurance had a distorting effect on the open insurance market and in the long term this might be expected to have adverse consequences for consumers. Insurance arrangements of this kind were able to cut out competition, by virtue of the subsidy from the margin obtained through the sale of the car. These insurance arrangements effectively tied policyholders into repair schemes which used the manufacturers' own parts, which carried substantial margins and were considerably more expensive than parts from alternative sources.

8.71. It was quite possible that suppliers were using, or would use, this sale of insurance to minimize their overall tax liability in respect of car sales. Insurance Premium Tax was much lower than Value Added Tax. The allocation of an excessive proportion of the total sale price to the insurance account would minimize the supplier's tax liability within the sale price obtained. Insurance premiums transferred to an overseas captive insurer would offer the supplier additional opportunities to engineer the tax liability to its advantage. The scope for such tax re-engineering arose solely as a consequence of the bundling of insurance into the new car package.

8.72. The Institute believed that, in the public interest, suppliers should be required to break down the total price into its constituent parts. The appropriate tax liabilities could then be assessed properly. Suppliers should be required to allow the prospective purchaser to select what, if any, benefits—at these transparent price levels—to purchase. In this way, the true price charged for the car would be visible. Artificial distortion of the car market and other markets would be avoided and the buyer would be free to determine whether or not to maintain a long-term relationship for services with the supplier without financial penalty. Greater competition would be introduced into the car market and consumers would continue to benefit from the high level of competition in the established personal motor insurance market.

Institute of Trading Standards Administration

8.73. The Institute of Trading Standards Administration (ITSA) commented on the Remedies Statement (Appendix 2.3). It saw the issues raised as being relevant to its members, who were constantly advising on consumer rights and enforcing legislation in these areas, for example the Trade Descriptions Act, the Consumer Credit Act, and laws relating to price marking and misleading prices. ITSA welcomed the opening of markets to full competition so as to promote wider consumer choice and the lowest possible prices and it generally supported the proposed remedies.

Selectivity vis-à-vis new car retailers

8.74. ITSA said that the suppliers' ability to select retailers clearly gave them a considerable ability to restrict local competition. The issue was similar to that affecting other consumer goods in the high street, for example the supermarkets' attempts to make parallel imports of sports clothing to undercut what they saw as inflated prices through UK approved dealerships. Whilst recognizing that suppliers in such markets might be disadvantaged if consumers perceived a loss of expensive brand image, ITSA believed that open distribution should be the norm and remained unconvinced by the car suppliers' arguments.

Separate sales and servicing operations

8.75. The suppliers' case for requiring main dealers to offer servicing and repair would be stronger if the dealers' service was superior to that provided by the independents. Recent CA surveys on servicing standards did not support the suppliers' assertions of higher competence, integrity and quality.

8.76. ITSA would be concerned if reliance on the supplier affected consumers' rights under the Sale of Goods Act. By law consumers were entitled to seek their remedy for faulty goods from the supplying dealer even if there was a manufacturer's warranty. These civil law rights might indeed be stronger than a warranty, for example to reject the goods and obtain a full refund. It was essential that this remedy was not eroded by enabling dealers to shift responsibility back to the supplier.

Solus dealerships, full-range forcing and advertising

8.77. ITSA supported the hypothetical prohibitions in the interest of a fully competitive market. In relation to imposing standards and restricting prices that cars might be offered at, it said that Trading Standards Officers frequently encountered the detrimental effects of enforced price maintenance. The cash price of goods was a datum for the calculation of interest and APRs of credit agreements. Restrictions on the advertising of reduced cash prices for new cars could mean that APRs were main-

tained at a deceptively low level. Indeed it was often difficult to calculate the true cash price of a car because of the complexities of part-exchange allowances, credit deals, extended warranties, insurance packages, etc. A real separation of all these aspects, with price competition on all of them individually, would be in the consumer's interest. For this reason ITSA also supported the proposal that suppliers should be required to offer franchised dealers, wishing to buy cars outright, similar terms to fleet customers.

8.78. ITSA also supported the two additional potential remedies issued on 21 October 1999 (see Appendix 2.3) on the obvious grounds of greater transparency and competitiveness in the market.

Retail Motor Industry Federation Limited

8.79. The RMI serves and represents businesses concerned with the provision of motor industry products and services. The RMI includes the National Franchised Dealers Association (NFDA) and other bodies and works closely with the Scottish Motor Trade Association (SMTA), which has similar functions in Scotland. The RMI submitted written and oral evidence to us on behalf of itself and the SMTA. It also played an active part in our open hearing (see Appendix 1.1).

8.80. The RMI said that the UK retail trade was highly efficient and far superior to that of other EC member states. But the returns in the retail high-volume motor trade were low, and many dealerships had gone out of business (although over-representation had accounted for much of this). Entry to the UK new car retail trade was possible, but only by starting a used car sales or repair business, and then moving to a small import franchise. The RMI said that (contrary to many reports) the UK retail dealer body was unable to influence new car prices to any large extent, although the NFDA had striven hard to reduce distribution costs. There was substantial excess capacity in the car manufacturing industry, and intense competition, but there had been relatively little rationalization that would facilitate economies of scale.

8.81. The European car market had experienced serious recession in the early 1990s and the UK had been the first market to recover. This, coupled with the stability of the UK economy, had provided the ideal basis for higher than average prices as manufacturers sought to balance volume and profit opportunities across the EC. The RMI believed that manufacturers sought to match their competitors' prices, even if this entailed selling some models at a potential loss. Consumers in member states with high taxes on cars were being subsidized by consumers in member states with lower taxes. The strength of sterling had an effect on UK new car prices, but the disparity between them and those elsewhere in the EC could not be attributed to this factor alone.

8.82. The RMI thought that the demand for company cars had had a profound effect on the UK new car market, much greater than in other EC member states. It believed that fleet and company cars were the principal reason for current price differentials in the UK new car market. Levels of fleet discounts had increased, and when these low-cost vehicles were sold the whole of the used car market was affected. Thus the retail customer paid a price to subsidize company cars. In addition, company cars were built to high specifications which, for efficiency and convenience, were extended to all the models that were marketed in the UK. Again the retail customer was adversely affected.

8.83. The RMI thought there was no evidence that the Block Exemption had any effect whatsoever on price levels. The inability of dealers to obtain greater discounts on high-volume purchases meant that they were unable to influence prices to any great extent. The RMI was greatly concerned at any suggestion that the removal of the Block Exemption would resolve the difficulties of pricing relativities. It believed that the Block Exemption should be extended indefinitely after 2002, but in a simpler form that allowed new retail formats to emerge. The RMI was particularly concerned about the vulnerability of the franchised dealer, whose investment in a marque could be wholly lost or greatly reduced in value if the franchise were withdrawn unexpectedly, perhaps through no fault of the dealer. If the industry were to move to a substantially different system there would eventually be many fewer retail outlets, reduced consumer choice and convenience, and higher prices.

8.84. The RMI was extremely concerned that the change in the SVA regulations in 1998 had permitted rapid growth in 'grey' imports of Japanese new cars. It did not wish the regulations to be further eased. It expected that when the VER constraints were withdrawn there would be aggressive competition from Japanese manufacturers.

Jurisdiction of EC member states in relation to the cars Block Exemption

8.85. In the RMI's view, the amendment to Regulation 19/65 effected by Regulation 1215/99 (see paragraph 2.395) did not give a member state the right to withdraw unilaterally the benefit of EC Regulation 1475/95. It said that the amendment had been made to empower—but not to oblige—the European Commission to issue a general vertical agreements block exemption by amending Regulation 19/65. In the several consultation papers on the proposed new block exemption regulation, clear reference had been made to its non-applicability to the motor vehicle sector and therefore to EC Regulation 1475/95. As a result motor vehicles were not included should member states wish to consider withdrawing unilaterally the general block exemption. In the RMI's view Regulation 1475/95 therefore continued until 30 September 2002 unless before that date it was withdrawn by the European Commission. Any anticipated withdrawal before then on the ground that the rules had changed would be a violation of the legitimate reliance of vehicle suppliers and dealers on Regulation 1475/95.

8.86. The RMI believed that it would be unacceptable and disruptive to the chain of distribution for a member state to have the ability to withdraw the benefit of such a sector-specific block exemption which regulated the distribution of motor vehicles in all the EC member states. It would also be a disproportionate penalty having regard to the other remedies available, and would punish dealers who would be innocent parties. It would also have adverse effects on consumers.

Remedies Statement

8.87. The RMI said that it broadly welcomed the views expressed in the Remedies Statement. In its response it concentrated on what it regarded as the key issues.

Selective and exclusive distribution

8.88. It was the suppliers' behaviour and pricing policies, rather than the current form of SED, that had led to the differences between car prices in the UK and other EC member states. The RMI supported the retention of a distribution system with effective prohibitions on the supplier behaviour which had remained unchecked under the current system. It believed that a largely unregulated system of the type contemplated in paragraphs 11 to 18 of the Remedies Statement would disadvantage customers and that the current EC Regulation should be replaced by another regulation specific to car distribution. This should address and correct the imbalance of power between the supplier and the dealer, affording the dealer greater opportunity for price arbitrage without the fear of losing its business.

8.89. The RMI believed that a system of limited regulation would weaken the benefits which the current SED system was designed to deliver to customers. If retailers were able to choose their areas of activity they would gravitate to the higher-margin, lower-cost or lower-investment activities. This could disadvantage customers in areas of the UK where there were unacceptably low returns on investment, such as areas with low-density population or higher operating costs. The ability of retailers to choose their product lines would also influence manufacturer development and innovation because of the cost of bringing new models on to the market. This would result in a 'more of the same approach' which would also reduce customer choice.

Relationships between manufacturers and dealers

8.90. The RMI believed that dealers should have rolling contracts requiring five years' notice by the supplier with the dealer having the opportunity to withdraw after two years' notice. Where suppliers terminated an agreement without just cause the dealer should be entitled to sensible commercial compensation and have access to a court of appeal when a dispute arose. The RMI also believed that consideration should be given to amending the law to enable dealer or trade associations to act on behalf of individual or groups of dealers.

8.91. If dealers were to continue with the levels of investment currently required, two issues needed to be considered. Any regulation should give dealers the right to clearly defined, secure territories. Also, in view of the goodwill and commitment built into a business, they should have the right to sell their businesses with or without the franchise.

Bonuses and margins

8.92. The RMI thought it important to re-establish adequate and transparent dealer margins that were not clouded by suppliers' bonuses. It also believed that fleets should not enjoy business terms better than those offered to the franchised dealers. Equally, dealers within a network should enjoy common terms, to avoid the re-creation of a two-tier market, dependent on a customer's location. Against this background it was important that dealers were given freedom from supplier-imposed costs that did not add value to the business or customer relationships.

Parallel importing

8.93. The RMI believed that dealers should be able to make parallel imports of vehicles from dealers of the same franchise within the EC. This would achieve consumer benefits in terms of opportunities for lower prices and would influence market price variations (see paragraph 8.97). At present such action was contrary to what was expected of dealers by their suppliers.

Recommended retail prices

8.94. Whilst the RMI supported the need for lower prices, it believed that RRP's should not be abolished. They were beneficial in providing a benchmark for customers to compare against actual prices.

Supplementary Remedies

8.95. The RMI said that an end to pre-registration would benefit all parties. Many of its members had pre-registered cars because they had been induced to do so by the suppliers' offers of additional bonuses. This was done to inflate sales figures artificially and so increase the suppliers' market shares. Although it was true that some car buyers could achieve savings by buying a pre-registered car rather than a new one, the practice had an effect on residual values and in the long term was detrimental to all buyers of the particular model of car. The RMI stressed that any new mechanism should be sufficiently robust to prevent the rules being bypassed. It believed that suppliers might encourage dealers to hold larger demonstration and courtesy car fleets in order to create synthetic registrations.

8.96. The RMI supported any proposal that promoted freedom of choice in the finance area for franchised dealers. Technically suppliers could not require their dealers consistently to use their in-house finance company. Sometimes such companies did offer competitive deals but equally within some brands there was an inherent willingness by the customer to take all the branded services. The difficulty that many dealers faced concerned the lack of flexibility and consistency within some in-house finance companies. It was not uncommon for such companies to reject customers initially and then offer a competitive deal on hearing that another finance company was prepared to finance the deal. There was no doubt that a totally free market would help to put downward pressure on financing costs.

Possible imports of new cars

8.97. Shortly before we were due to report, a story appeared in the press to the effect that about 20 of the largest dealer groups were collectively considering importing cars from their counterparts in other EC countries. The RMI told us that there had been discussions in a committee of the NFDA (comprising representatives from dealer groups) about what dealers saw as the current excessive wholesale prices which they paid their suppliers of new cars. Dealers had considered various possible ways of tackling this problem. One possibility had been that dealers might import cars from franchised dealers in other EC member states. However, the conclusion of the discussion had been that this course could not be recommended to NFDA members because it would run too great a risk of damaging their relationship with the suppliers in the UK. The relevance of sales targets had been mentioned in this connection. The RMI was unable to say whether suppliers had done or said anything recently which had led the NFDA committee to reach this conclusion.

The Society of Motor Manufacturers and Traders Limited

8.98. The SMMT is a trade association of UK vehicle and component manufacturers and vehicle importers. The SMMT told us that its principal activities were exhibitions work, promoting safety standards, compiling data on the motor industry and the provision of a wide range of support services for its 880 members.

8.99. The SMMT gave evidence at a hearing, having previously provided us with a factual note on the car industry and with copies of its submissions to the House of Commons Trade and Industry Committee's inquiries into Vehicle Pricing¹ and into Trade Marks, Fakes and Consumers.² At our open hearing the SMMT made presentations on all four of the topics chosen for discussion (see Appendix 1.1). The SMMT told us, however, that it was both undesirable and unlawful for it to be aware of its members' pricing policies and the ways in which its members competed in the new car market. Moreover the SMMT had no knowledge of the details of arrangements between its members and their dealers.

8.100. The SMMT thought that there was a degree of substitutability between new, nearly-new and used cars but thought it difficult to identify separate markets for categories of cars.

8.101. The SMMT believed that most UK car manufacturers did not have problems of over-production. But Rover was one of the notable exceptions, and another UK manufacturer was working short-time.

8.102. The SMMT said that the UK industry, working through the SMMT Industry Forum, was taking important steps to increase its competitiveness by improvements in quality, cost, delivery and partnership. Competitiveness would be promoted by the heavy capital investment planned in the UK by several of the largest manufacturers, by improvements in product design (enhanced by siting research and development facilities in the UK), and by improvements in workforce practices.

8.103. The SMMT was concerned that the Block Exemption should be renewed in 2002, that the EC regulatory structure should remain stable and that the SVA should ensure that vehicles imported from outside the EC met standards equivalent to those required by ECWVTA.

Comparisons of new car markets in different EC member states

8.104. The SMMT said that comparisons of new car prices within the EC were highly sensitive to exchange rate fluctuations: thus the UK, for example, which had been the second cheapest market in May 1996, had become the most expensive in May 1998. But for new car prices to be continually adjusted in line with currency fluctuations would lead to great market instability, customer dissatisfaction and potential collapse in the values of second-hand cars. That was not to say that the market should not react to long-term changes in exchange rates: in fact there were such changes, and list prices were falling in consequence. Harmonization of tax regimes between EC member states would promote greater price uniformity. The transaction price paid by the UK customer for a new car was a complex combination of elements. Volume discounts for bulk purchases by fleet customers were available from manufacturers but a wide range of incentives was offered to the private purchaser.

8.105. The SMMT said that during the last five years, and in particular in 1997 to 1998, new car prices in the UK had been rising at a slower rate than had the retail price index. It should especially be recognized that the costs of improved safety and environmental equipment, now common in most cars, had not been reflected in price increases.

8.106. The SMMT believed that in some EC member states' new car markets there was a powerful disposition to buy from a domestic manufacturer, but that this was not so in the UK. There were, too, more competing marques in the UK than in any other EC member state. Leading manufacturers sought to promote their brand images, associating their models with the consumer's pursuit of a distinctive lifestyle.

¹See footnote to paragraph 6.38.

²House of Commons, Trade and Industry Committee, Eighth Report, *Trade Marks, Fakes and Consumers*, The Stationery Office, HC 380, 29.6.99.

8.107. In the UK the influence of status in the choice of a company car seemed to have declined in importance although, in general, perceptions of status remained more significant in the UK than elsewhere in the EC. The company car sector was growing in the EC as a whole but was in decline in the UK, reflecting the altered tax regime (which the SMMT thought was becoming increasingly penal). If (as adumbrated by the Chancellor of the Exchequer) the tax regime were to be based on carbon dioxide emission levels, the distribution of the tax burden would be greatly altered.

8.108. The SMMT believed that there was little demand in the UK for austere-equipped cars, nor for standard specification models. Within the EC the member states' markets presented widely differing requirements, so that features that were in heavy demand in one state were held in little esteem in another.

Selective and exclusive distribution

8.109. The SMMT believed that SED addressed the needs of consumers, manufacturers, retailers and the European Commission. The principal disadvantage of SED was that it provided no opportunity for comparative shopping at any one retail outlet, and in particular it had no attraction for large retailers (ie supermarkets). The franchised dealer system, in the SMMT's view, provided much the most effective mechanism for dealing with recall defects, with routine servicing of what were technologically complex products, and with the provision of spare parts. But the SMMT had no evidence on the relative merits of servicing by franchised dealers compared with that of independent repairers.

Other points

8.110. Other points made by the SMMT in oral evidence are set out below:

- (a) If the alleged 30 to 40 per cent discounts given to fleet operators were to be reduced to a common level for all new car sales in the UK, the average unit price of a private retail sale would be perhaps £100 lower.
- (b) The SMMT had formulated no view on the likely outcome of the European Commission's review of the Block Exemption. There were a great many factors to be taken into account and it was too soon to say what the best method of distribution might be if the Block Exemption was not renewed.
- (c) Pre-tax price comparisons of new cars in EC member states produced widely different results from post-tax comparisons. Much publicity was given to the most favourable pre-tax figures but little attention was given to post-tax comparisons. Nor was attention paid to comparisons of prices of other goods and services where price differences between EC member states were much greater than those for new cars.
- (d) Because of the attempt to adjust for different specifications, the periodic price surveys undertaken by the European Commission related to notional cars, not to cars actually marketed in each member state. The SMMT thought that this made cars in the UK look more expensive. Moreover it believed that at the level of transaction prices the differences between the UK and other EC member states were less than at the level of list prices.
- (e) The SMMT thought that RHD cars did not warrant prices much higher than those of LHD cars, but the cost incurred in building RHD cars was much greater for some manufacturers than for others.
- (f) The ending of VERs on Japanese cars was unlikely to have a marked effect on the UK market, but it would probably be helpful to the smaller Japanese manufacturers whose quotas had been consistently inadequate under the VER regime.
- (g) The SMMT had never canvassed its members' views on the usefulness of RRP. Its own view was that RRP provided a useful benchmark when prospective buyers were making price comparisons of new cars.

- (h) Larger fleet sales were effectively a separate sub-market in the sense that no advertising or promotional costs or expensive retail distribution overheads were incurred.

Remedies Statement

Selective and exclusive distribution and the Block Exemption

8.111. Commenting on the Remedies Statement (Appendix 2.3), the SMMT said that it believed there were significant factors outside the SED system which accounted for the alleged price differentials between the UK and other EC member states. It pointed out, however, that our basic contention was that prices of new cars in the UK were higher than they would be without SED, despite the fact that we had reached no conclusions to substantiate this view or as to whether prices were persistently higher in the UK than in other member states.

8.112. The SMMT believed that there was arbitrage within the system and that this had been increasing during the period of our inquiry, possibly as a consequence of the publicity given to it. If arbitrage was limited it was a result of factors outside the SED system, including the following:

- (a) the LHD/RHD issue, acknowledged as being an issue in the 1992 report;
- (b) the limited opportunities for a UK consumer to part-exchange an RHD vehicle in a dealership in mainland EC;
- (c) financial packages, facilitating the purchase in the UK, were not commonly available from mainland EC dealers; and
- (d) the general lack of awareness as to the possibility of making a purchase in mainland EC. However, the SMMT contended that there were already signs that transparency across the market was being facilitated by developments in, for example, the Internet.

8.113. The SMMT did not support our proposals to vary the existing system, whether by altering the balance of power, removing features of the system or by introducing UK-specific remedies. It said that the Remedies Statement gave the impression that we had attempted to link price issues with SED. This had been done to enable us to suggest remedies to vary SED to resolve price issues so as to avoid suggesting that other factors affecting these issues needed to be addressed across the whole EC, namely purchase tax harmonization and exchange rate stability.

8.114. The SMMT was concerned that our systematic listing of the features of SED as being against the public interest failed to acknowledge advantages which the Ipsos report found that consumers favoured. The removal of such features would remove the very essence of the SED system. The SMMT believed that the advantages of the system outweighed the features of SED that we had suggested were disadvantageous.

8.115. The SMMT believed that the possible remedies relating to termination of agreements would unjustifiably freeze inefficiency in a distribution network and be detrimental to the supplier and ultimately to the consumer. It was also unclear why the motor sector should be singled out for treatment which would stifle innovation in distribution arrangements.

8.116. With regard to the possible prohibition on the suppliers varying a dealer's territory, the SMMT questioned the potential benefit of any measure which would prevent a network from responding to a dynamic market. Such a prohibition would preclude marketing initiatives in response to developments and customer demands.

Other matters

8.117. The possible remedy in subparagraph 23a of the Remedies Statement set out to remove differential volume discounts. However, the alleged adverse impact on price caused by fleet discounts had not been proven. Further, equal treatment would favour the larger dealers because smaller dealers

would have insufficient buying power to command a discount as high as their larger counterparts. This would put their businesses at risk and ultimately lead to the contraction of the distribution network with resulting implications for employment, local economies and consumers.

8.118. Further, the SMMT believed that the restriction would remove one of the elements that drove competition. Suppliers sometimes offered discounts to encourage the throughput of cars in a particular region, but it would be uneconomic to offer such discounts to all retailers. This would result in an averaging upwards of prices.

8.119. The SMMT said that although RRP's gave the impression in the media of manufacturers fixing consumer prices, in reality consumers used the prices as a benchmark against which to negotiate a discount. This view was supported by the findings of the Ipsos report. The abolition of RRP's might also be problematic as regards the calculation of company car tax.

8.120. Bundled financial and other benefits were an example of the breadth of competitive initiatives present within the UK market. The benefits offered invariably enabled the consumer to obtain an extra feature at a lower cost than if it was purchased separately.

Supplementary Remedies

8.121. The SMMT said that it was not immediately apparent to which issue the proposed remedy concerning pre-registration related. The opportunity to pre-register had been part of the distribution system for many years and the SMMT believed it was not anti-competitive. There were many reasons for the practice, for example when fleet cars were registered and subsequently called off. When it occurred, pre-registration was offered as an incentive to dealers. However, all views on the practice were speculative as published figures of registered cars did not record the number of pre-registered cars.

8.122. The SMMT believed that prohibiting a dealer's use of the supplier's in-house finance company was an unnecessary attack on an optional benefit which was already subject to regulation. The supplier provided this option to enable a consumer to purchase a car at a more favourable rate than might otherwise be negotiated.

Jurisdiction of EC member states in relation to the Block Exemption

8.123. The SMMT commented on the question whether the amendment to EC Council Regulation 19/65 (Council Regulation 1215/99) could be used to withdraw the benefit of the cars Block Exemption in the UK (see paragraph 2.395). It said that its members had separately submitted detailed legal opinions to us on this issue, the general thrust of which was that the UK Government could not use Regulation 1215/99 to withdraw the benefit of the Block Exemption in the UK. Further, several of its members would be minded to consider instigating a judicial review through the SMMT were such a step to be taken.

Other associations and organizations

The Automobile Association Limited

8.124. The Automobile Association Limited (AA), which gave written and oral evidence, said that it was the largest roadside assistance organization in the UK, with a total of 9.5 million members and vehicles covered at the end of 1998. Within this number were fleet vehicles which had roadside assistance bought for them and those drivers on the Motability scheme. In addition to breakdown services the AA provided a wide range of other services including general advice on new cars. This advice typically included comments on the technical merits of specific vehicles, their suitability for particular tasks, their weaknesses and comparative rate of depreciation. The AA did not usually give advice on the selection of a dealership, finance options or purchase contracts. Until spring 1991 it had provided its members with direct help in purchasing new cars overseas. This service had been discontinued because of lack of

demand. The AA now provided a leaflet outlining basic UK technical requirements in relation to overseas purchases.

8.125. The AA had arrangements with 14 car manufacturers under which the drivers of over 1.5 million new and used cars were entitled to AA services. One of the AA's aims in pursuing these contracts was to build partnerships with vehicle manufacturers. To ensure that there were no conflicts of interest and provide an independent consumer voice, the AA's arrangements with manufacturers were dealt with by its business services division which was totally separate from the division representing its members.

8.126. The AA told us that in September 1999 it had completed its conversion from a mutual organization, and the sale to Centrica plc, as the culmination of a long-running review of its ability to compete, the decision being in the best interests of its members.

New car prices

8.127. The AA assessed the specifications, overall performance and prices of an average of 70 new cars annually and in 1997 had provided 50,000 to 60,000 car test reports to its members who generally requested reports on a few cars at one time. The AA believed that when choosing a new car consumers selected a price band, looked at the various models within that band and then tried to negotiate the best deal.

8.128. The AA said that the European Commission's surveys of new car prices, published in February and September 1998, had shown that the prices for about 60 of the 72 best-selling models were higher in the UK than in other EC member states. The AA noted that these surveys were based on list prices and did not take account of financial benefits such as free insurance (some of which were pan-European) or allowances for vehicles taken in part-exchange. It said that the publication of the European Commission's reports coincided with media investigations which suggested that the internal market in new car sales was being thwarted because some manufacturers put pressure on dealers to refuse to sell new cars to residents of other member states. The most recent views of AA members about purchasing new cars had been to express outrage that prices for most models of new cars in the UK were by far the most expensive in Europe. This disparity had not been satisfactorily explained.

Market structure

8.129. The AA said that it was difficult to detect any significant change in the market structure for the sale of new cars since the 1992 report. Most consumers still purchased from a local franchised dealer and there appeared to be little competition between dealers in different localities. This might be much more to do with consumer preferences for dealing with someone local rather than any industry practices. However, it could reflect consumer belief that prices were likely to be the same wherever one went and no price advantage was to be gained.

8.130. Dealer rationalization had tended to reduce consumer choice. For example, an AA member had provided information which suggested that since all the Fiat dealerships within the M25 had come under one company, prices for repairs and maintenance had increased considerably.

8.131. The role of franchised dealers in vehicle safety recalls was important and appropriate alternative arrangements would need to be identified if the franchised network was reduced. This might be necessary in any case if other distribution channels (for example, the Internet or supermarket customer clubs) became commonplace. There appeared to be no compelling reason why, even if a franchised dealer structure was maintained, the sale of a new car should be linked to the after-sales servicing and support.

8.132. The AA expected that a considerable number of new developments would affect the UK car market in the near to medium term, including:

- company car taxation reforms;
- the review of the Block Exemption;

- new distribution channels for car buyers, especially the Internet;
- euro currency;
- the ending of the VERs which would bring a new competitive dynamic to the UK market; and
- manufacturer alliances and mergers.

The Block Exemption

8.133. The AA said that the Block Exemption as revised in 1995 contained several adjustments designed to stimulate competition. However, the absence of adequate monitoring and policing meant that, in practice, the adjustments were not sufficiently effective. The AA believed that the principal deficiency in the Block Exemption was that it put too much power in the hands of the manufacturers, a point which had been made by the House of Commons Trade and Industry Committee in its recent report on Vehicle Pricing.¹ This had been highlighted by the refusal of some manufacturers to allow mainland European franchised dealers to sell cars to UK residents. AA members had provided graphic examples of how they had been prevented from making a purchase that, under the Block Exemption, they were entitled to make. The AA said that there was also anecdotal evidence that after such a purchase had been made, UK franchised dealers had refused to carry out warranty work, despite the fact that the Block Exemption required them to do so.

8.134. In these areas, the Block Exemption had all the appearances of working against the interests of the consumer by stifling competition. However, in other areas it provided specific benefits, for example in the provision of spare parts; the free availability of technical information; and in vehicle recalls. The AA had not yet formed a view whether the Block Exemption should be ended, or be renegotiated so that the real consumer benefits were retained while overcoming the anti-competitive elements that had come to light.

Bundling of additional benefits

8.135. The AA said that it had become commonplace in the UK for new car sales to include as an automatic benefit such things as free breakdown cover, free servicing, free extended warranties, low-cost or free finance and low-cost or free motor insurance. Such additions reduced the transparency in new car pricing and undoubtedly increased prices with consumers having little choice according to whether or not they required the extras. The AA had no information on its members' views on this subject.

Fleet purchasing

8.136. The AA believed that the discounts available to fleet purchasers might be reflected in the high prices paid by consumers. There was anecdotal evidence to this effect.

National taxation rates

8.137. The AA said that in answer to a parliamentary question tabled by Graham Mather MEP, EC Commissioner van Miert had stated: '... the Commission has found that pricing policies pursued by the manufacturers in individual member states take into account taxes to be paid on car purchases. In member states with high taxes, list prices tend to be lower than those with no particular tax on car purchase, such as the United Kingdom'.

8.138. The AA stated that new car tax rates in the EC varied from over 200 per cent in Denmark to 15 per cent in Luxembourg. (The UK rate was 17.5 per cent—ie VAT.) In its report on Vehicle Pricing¹ the House of Commons Trade and Industry Committee had said: 'we are disturbed to have discovered

¹See footnote to paragraph 8.28.

that consumers in lower taxed countries such as the UK are, as a result of manufacturers' policies, paying higher prices for new cars than their neighbours so that the national treasuries in those higher taxed countries can be assured of more revenue'.

8.139. The AA said that in 1996 the UK had been the second cheapest country in the EC in which to buy a new car, but at a time when the pound was weak. In a free market, prices would be expected to converge over time. The fact that they had not done so suggested that suppliers were operating on the principle of charging what each national market would bear, and that UK consumers might be subsidizing new car consumers in higher-taxed EC countries.

Consumers' Association

8.140. CA gave oral evidence and provided us with copies of reports it had commissioned and other written evidence. It also played an active part in the open hearing (see Appendix 1.1).

The UK market for new cars

8.141. In its initial written evidence CA gave its views on competition in, and the behaviour of, the UK car market. The main points CA made are set out below:

- (a) There was compelling evidence of the existence of a complex monopoly in the supply of new cars in the UK. This monopoly was against the public interest; it was in favour of car manufacturers, particularly those whose UK-derived profits were important. Nor was the complex monopoly in favour of dealers, although CA believed that they often engaged in anti-competitive practices.
- (b) Suppliers' RRP's for new cars had an important effect in preventing consumers from forcing reductions in UK prices. The combination of RRP's with other market and supply restrictions effectively locked dealers into patterns of behaviour best suited to the suppliers.
- (c) Dealers were unable to buy new cars in bulk and so offer discounts to private customers, whilst organizations buying in bulk for their own use were channelled into direct relationships with manufacturers. In consequence there was a close relationship between the prices paid for new cars and the purchasers' buying power (where it could be exercised).
- (d) The suppliers' practice of setting the supply prices of new cars and substituting bonuses for dealers' margins left dealers with virtually no pricing discretion. This was retail price fixing in all but name.
- (e) There was an enormous difference in the retail price of cars offered as new and those offered as nearly new. This difference (of perhaps 20 to 30 per cent) indicated how overpriced some new cars in the volume sector had become in the UK: the existence of large stocks of nearly-new cars reflected overproduction of models that neither private nor fleet buyers wished to buy at the supplier's prices. This was a remarkable phenomenon, given the immense body of information about public taste that dealers provided to suppliers.
- (f) The fleet and contract hire market was now conducted largely on the basis of suppliers undertaking to repurchase at pre-arranged prices the cars they had sold; this practice, in effect, had been extended to private buyers, but at a much higher price level (concealed by heavy advertising of apparently low monthly outgoings). The proliferation of these marketing schemes reflected suppliers' recognition that the retail prices of new cars were too high, but a belief that in their new guise they would appear affordable.
- (g) The suppliers contended that exchange rate movements explained new car price discrepancies between the UK and other EC member states. But 70 per cent of new cars sold in the UK were imported and so should have become cheaper in recent years (as should imported components for cars manufactured in the UK).

- (h) The manufacturers' argument that franchised dealers provided a better quality of after-sales service than did independent dealers was not supported by CA survey results, which showed no difference between them in effectiveness (see Appendix 6.6).

The work of Autopolis

8.142. As part of its initial written evidence CA provided a draft of a report on car retailing that it had commissioned from Autopolis, a firm of consultants specializing in the motor industry, before our inquiry began (and which was published subsequently on 13 January 2000).¹ CA said that, following its submissions to the House of Commons Trade and Industry Committee inquiry in 1998, it had concluded that debate on the future of the car industry had concentrated too much on comparisons of new car prices within the EC. CA had therefore asked Autopolis to look at wider issues. The principal points in the Autopolis report are set out below:

- (a) The European car market was mature and virtually saturated but it remained fragmented, with no single dominant manufacturer. The Japanese had established themselves but not broken through, to a large extent because of the VERs (which would be withdrawn at the end of 1999). Important product innovations were rare and rapidly imitated, but overproduction and overcapacity were endemic. Product branding was intense, and advertising expenditure large, in an attempt to create model differentiation (in the face of many influences that led to uniformity).
- (b) Each manufacturer had an exclusive distribution network through dealers tied to it by contracts. These were specific, restrictive and subject to termination at short notice. Larger dealer groups had so far been unable to negotiate purchasing prices for cars related to their greater sales volumes.
- (c) The structure of dealer networks and of new car markets varied widely between EC member states. The UK had the highest proportion of new car sales to fleets and companies, with discounts often directly negotiated between buyer and supplier. This greatly weakened the UK dealer network.
- (d) Analysis of the European Commission's data on new car prices in EC member states showed that the prices of UK imports rose when sterling was weak and that the prices of UK-produced cars rose as well. The reverse did not happen when sterling fell. The rigidities lay partly in the difficulty of adapting supply sources and production capacity to movements in currency exchange rates. But they were also partly attributable to the structure of car distribution in the UK.
- (e) 80 per cent of new car sales in the UK were to corporate bodies, usually with some degree of direct price negotiation with the manufacturer. Within this total, one-quarter was with large fleets, which negotiated substantial discounts. Three-quarters was with business buyers for small fleets, often through a financing intermediary. Only 20 per cent of UK sales were to private customers. Buy-back contracts with pre-arranged prices, and lease and contract hire charges based on forecast residual values, create a vested interest in maintaining the level of new car prices.
- (f) It would be possible to improve the system by bringing in mass retailers. Redeploying the existing assets—both of franchised and independent dealers—in independent networks would allow transfer of power without loss of substance. These changes would require the abolition of the Block Exemption.

Points made at the oral hearing

8.143. In subsequent oral evidence CA made the following points:

- (a) CA thought there were three distinct car markets: new, nearly new and used. The distinction between new and nearly new was often extremely fine, but manufacturers put great effort into maintaining it.

¹*The forecourt revolution: the future of the car industry*, Consumers' Association.

- (b) CA had some evidence about levels of discounts on new car sales within EC member states, but none about transaction prices (reflecting, for example, benefits of financial packages, or over-allowance on trade-ins, or free or low-cost insurance or roadside assistance). CA believed that manufacturers advanced spurious arguments about these benefits, endeavouring to obscure the extent to which exchange movements should bring much lower retail prices.
- (c) A large proportion of manufacturers' profits was derived from the retail finance packages they promoted.
- (d) The initial annual depreciation, of anything up to 50 per cent of the retail price of a high-volume new car, bore no sensible relation to normal depreciation accounting practice. In subsequent years the depreciation rate was normal—as it was from the outset for upmarket cars.
- (e) The list prices of new cars competing within a defined category were all within £500 of each other. This should not happen where some cars were imported and some were not and where there were frequent fluctuations in exchange rates.
- (f) The average annual volume of non-fleet sales for each UK retail outlet was about 60. The average margin on each sale was about 7 per cent, so the resulting cash flow was insufficient to meet the outlet's overheads. Hence there was little scope for dealers to offer retail customers price reductions other than through larger trade-in allowances. But the scope for these was reduced: used car prices had fallen by about 20 per cent in 1998, and inevitably would be heavily influenced by prices of nearly new cars in future. For most dealers, therefore, the cash flow from servicing and parts sales had to subsidize new car sales.

Issues Letter

8.144. Later in our inquiry CA responded to our Issues Letter (see Appendix 2.1). The principal points made on the material in the annexes to the Issues Letter were as follows:

- (a) CA agreed with our provisional view that the relevant market should be defined as that for new cars, excluding nearly-new cars (however defined). CA considered, however, that the argument for a chain of substitutability across all models was weak: it believed substitutability was limited to the type of car that fitted a consumer's needs. CA agreed that the geographic market should be the UK, but believed consumers' unwillingness to travel a long way to inspect cars should be taken into account. CA thought that the overall fall in new car prices in the UK in recent years needed to be seen in the context of what could have happened had prices followed exchange rate movements more closely.
- (b) CA thought it right for us to stress the problem of relying upon registrations as a proxy measure of sales and thought the EIU estimate (that 20 per cent of all new car registrations were pre-registrations by suppliers and dealers) was not excessive. CA said that the suppliers' use of the JATO database was a particularly worrying indication of collusive behaviour: it appeared that price collusion between suppliers existed on the basis of a market leader for each sub-market. CA was dubious about using the HHI as an indicator of overall competition; whilst it agreed that, in geographical terms, the new car market covered the UK as a whole, it believed that in product terms the market consisted of a series of sub-markets (segments based on different types of car). CA therefore thought it more realistic to calculate an HHI for each of these sub-markets, and it provided appropriate analyses of some of them.
- (c) CA noted that our analysis of dealer discounts showed a lack of dispersion for volume marques. It took issue with the view that financial packages were well-publicized, citing a recent ruling by the Advertising Standards Authority that the way such packages were promoted was neither transparent nor readily understandable. CA could see no reason, apart from suppliers' wish to preserve their dominant position, why retailers should not be able to negotiate discounts similar to those available to fleet operators.
- (d) In respect of the issues which we had identified CA believed that there were adverse competitive effects of varying degrees of severity arising on each. CA believed that there was nothing to choose between the servicing standards of franchised and non-franchised dealers, and referred us

to the conclusions of its most recent survey of the subject (not then published but appearing subsequently in the September 1999 issue of *Which?*: see Appendix 6.6).

8.145. CA provided us with verbatim transcripts of telephone conversations that members of its staff, purporting to be prospective purchasers, had had with representatives of Mazda, Subaru and Mitsubishi in December 1998 and January 1999. CA had stated publicly (in the March 1999 issue of *Which?*) that the information given in these conversations by these suppliers about the feasibility of importing their cars from abroad was misleading or wrong in several ways.

Remedies Statement

8.146. Commenting on the Remedies Statement (Appendix 2.3), CA said that it agreed with the statement that car prices were higher in the UK than they would be in a less restrictive environment. It believed that this was largely a result of the SED system which allowed suppliers to divide their markets geographically and by customer, and restricted alternative routes of supply. CA thought that any benefits claimed for the system could be more easily achieved through a more liberal regime for supplying and servicing cars. Although centrally important to the future direction of the industry, CA said that the issue of the renewal, or non-renewal, of the Block Exemption was a secondary issue in our inquiry.

Exclusive territories

8.147. CA thought that exclusive territories had served only to restrict competition. In the age of the Internet they were outdated and should be removed from any future regulation governing the sale of cars.

Selectivity vis-à-vis new car retailers

8.148. Regarding the retailers' modification of cars, CA said that it was necessary to clarify the degree of modification proposed. Whilst it saw no particular reason why retailers should not be able to alter aspects of the vehicle to suit customer needs, it was aware of potential problems that might undermine other aspects of a relaxed regime. CA thought it necessary to distinguish between internal/component alterations and external design alterations. Although not suggesting that the latter should be exempted completely, CA recognized that manufacturers might be concerned if vehicle designs were substantially altered without their consent.

8.149. Sales quantities should be governed by the contract negotiated between supplier and retailer. Minimum quantities should not be imposed. If a small number of vehicles was requested this should be reflected in the price charged to the retailer.

8.150. CA believed that concerns over standards of presentation should not be allowed to limit supply. If a supplier did not think a retailers' display was beneficial to its products it could offer additional materials or investment, as was common in other retail sectors. It could also be argued that consumers should be allowed to make their own evaluation of sales premises. A retailer with a poor display and viewing area was unlikely to sell many vehicles, unless its pricing was particularly keen. CA also noted that presentation requirements were incompatible with Internet retailing.

8.151. CA saw no benefits in allowing suppliers to impose physical criteria. The issues of collection, storage and delivery should be left to the contractual relationship the retailer had with other elements of the distribution chain.

8.152. As with other retail sectors, if suppliers wished retailers to install IT systems they should fund them. If retailers themselves wished to invest in such tools for competitive reasons then it was their decision, not the supplier's.

8.153. CA thought that suppliers should not impose training or sales personnel restrictions. Schemes already operating in the industry to improve dealers' sales practices had so far achieved relatively little. Consumers should be able to choose the level of service and sales style they required. The issue of demonstrator cars was more complex. However, the suppliers provided such cars as a means of generating

sales, not just as a public benefit, and it was their concern rather than the retailers'. A requirement to supply demonstrator cars was also a problem for Internet companies and would impede the development of alternative distribution channels.

8.154. CA said that a relatively straightforward way of preventing suppliers from undermining the intention of the proposed remedy would be to require them, and retailers, to produce similar information to that available for consumers in the USA (details of list prices and the dealer supply prices). The discount available to the dealer was then clear. CA thought that a mechanism should be established under which dealers could appeal in national courts against a supplier's refusal to supply. However, as CA supported a *de minimis* approach to the restrictions a supplier would be able to impose, such a provision might not need to be called upon.

Separate sales and servicing operations

8.155. CA thought that suppliers should be prohibited from requiring retailers to offer sales and servicing on the same site. Retailers should be able to make their own decisions about offering servicing arrangements. Because of the complex nature of the product and the inability of the consumer to check the car's condition prior to use, PDI by an independent third party should be a requirement of new car sales. Given the changing nature of the retail relationship that CA envisaged, it thought that the retailer should take more responsibility for warranty and recall work. It believed that the industry should adopt a uniform system of product recall. However, there was no reason why a market for warranties, which after all were insurance products, should not be encouraged at the retail end.

Servicing and repair operations

8.156. CA thought that suppliers should be able to specify service standards for warranty work, although they should not be able to specify who could carry out the work. When consumers were paying they should be able to choose where the car should be repaired. If they were tied to a particular operator, that operator would be able to charge whatever it wished. However, CA saw no reason to prevent suppliers from recommending particular repair and servicing organizations, provided that the criteria for their evaluation were transparent and did not restrict the retailer's operation with other marques.

8.157. CA did not believe that suppliers should have control over the number, or size, of approved service operators. Operators in different areas were unlikely to be similar in size, throughput of cars or staff requirements. Limitations on the number of approved operators within a given geographic area, however, might be acceptable, provided that consumers were not penalized if they had work carried out elsewhere. Indeed only having a small number of approved service/repair sites might generate competition in service provision and help to raise standards in the sector. It was important that consumers were able to choose to have paid-for work carried out elsewhere.

8.158. Independent garages should be allowed access to tools, diagnostic equipment, information and training at a reasonable charge. There was no apparent reason why approved operators should receive preferential rates for such training and equipment. The main purpose of an approval system was to give consumers a signal of trustworthiness and direct them towards a specific retailer. CA would like to see transparency in the provision of training. In other industries, for example in the computer software business, companies other than the manufacturers carried out training, and CA thought that this should happen in the car industry.

Solus dealerships

8.159. CA thought that suppliers should be prohibited from requiring retailers to sell one make of car from a given set of premises. Retailers should be able to make their own choice.

Full-range forcing

8.160. Retailers should be allowed to specify which vehicles they wished to stock and sell and not be allocated stock on the basis of what the supplier wished to move. This would indicate which vehicles

should be produced. Under the present system manufacturers chose what to produce then tried to sell them on to the market.

Advertising and promotion

8.161. There should be no restriction placed by suppliers on retailers' advertising. This was particularly true of prices.

Other aspects of the Block Exemption

8.162. CA thought that the current Block Exemption was anti-competitive and anti-consumer and should not be renewed in its current form. The suggested changes in suppliers' relationships with dealers, assuming the worst case scenario, were sub-optimal to say the least. It believed that the *de minimis* block exemption, based on creditworthiness and an ability to enter into a contract, was the ideal option.

Other matters

8.163. CA welcomed and supported the proposals on the possible remedies which might be implemented within the UK irrespective of the future of the Block Exemption. It said that to work properly the proposals should all be implemented. For example, abolishing RRP's was irrelevant if retailers were not able to negotiate discounts and compete on price. CA liked the idea of the 'most favoured customer' clause being inserted into contracts. There was already a knowledge of discount levels being offered to fleet customers and this change, on its own, could quickly act to bring UK new car prices down to the level that a competitive market would bring. The most favoured customer clause would probably lead to a slight fall in the level of discount given to fleets, but this would more truly reflect the real cost of supply as the cross-subsidy by retail customers would end.

8.164. On contract hire, CA believed that current fleet and car-hire operators should be allowed to offer lease cars directly to private consumers.

8.165. The ability of dealers to opt for reductions in wholesale prices in return for not using financial and other benefits offered by suppliers would, to some extent, be covered by the 'most favoured customer' clause. However, assuming that such an option was available, CA would welcome it.

Supplementary Remedies

8.166. CA said that pre-registration of cars masked the reality of new car sales and allowed manufacturers to inflate sales figures. It also enabled dealers to sell nearly-new pre-registered cars as new. However, CA was not sure that a ban on pre-registration was necessarily the right solution. One of the reasons that nearly-new cars had been a problem was the fact that consumers were unaware of their existence, but that was changing. A better solution might be to require suppliers to list actual sales and sales to themselves and so make consumers and dealers aware of the numbers involved. Such transparency might stop the practice because manufacturers would not wish to admit to levels of pre-registration. CA would prefer that pre-registered cars were shown as such and sold through dealers at significant reductions. If this were combined with the 'most favoured customer' clause CA would expect to see an evening out of the pricing disparity.

8.167. CA supported the proposal to allow dealers to access sources of finance as they chose.

Further consumer representations

8.168. CA told us that at its stand at the London Motor Show (from 19 to 31 October 1999) it had invited consumers to e-mail the Secretary of State with comments on UK car prices. It had given the following suggested wording:

I want to express my dissatisfaction with the high price of new cars in the UK compared with the rest of Europe; UK consumers pay the highest price for 62 out of 75 best-selling cars. I think the motor manufacturers have too much control in the new car market as you have to buy a car their way, on their terms, at their price, or you don't buy one at all. I want to see an end to the great British car rip-off and I want the government to ensure that UK consumers are given a fair deal. The first step towards this would be the removal of the Block Exemption.

8.169. We noted that the DTI received nearly 3,000 e-mails in response to CA's invitation: they were forwarded to us. Most used the above text, although some had slight variations.

RAC Foundation for Motoring Limited

8.170. RAC Foundation for Motoring Limited (RAC Foundation) told us that RAC members were dissatisfied with the prices paid by private buyers of new cars in the UK compared with those paid by fleet purchasers and customers in other countries. The list prices of new cars in the UK were typically between 15 and 40 per cent greater than those in other European countries and the USA.

8.171. The RAC Foundation questioned the manufacturers' assertions that the price differentials reflected higher vehicle specifications for the UK market, the cost of converting vehicles to RHD and the strength of the pound. It said that the strength of sterling made the disparity between UK list prices and those in the rest of Europe even more difficult to explain because a strong pound should have had the effect of reducing the price of imports whilst increasing the price of exports.

8.172. The RAC Foundation believed that UK list prices offered to private buyers were strongly influenced by two factors:

- (a) the market distortion caused by fleet operators whose purchasing power enabled them to negotiate substantial discounts from the suppliers. Suppliers were able to achieve bigger profits by charging higher prices to private purchasers who had less market power; and
- (b) the price distortion arising from the manufacturers' desire to achieve market penetration in countries with high levels of vehicle purchase tax or VAT. This led them to reduce the pre-tax prices of vehicles in those countries and increase prices in countries with lower levels of tax.

8.173. The RAC Foundation had received complaints about non-price obstacles encountered by private buyers seeking to order and buy cars elsewhere in the EC. Despite action taken against Volkswagen AG by the European Commission, UK residents continued to experience difficulties in ordering RHD cars from dealers outside the UK and delays in delivery times.

Academics and research organizations

International Car Distribution Programme

8.174. The ICDP told us that it was the world's largest industry-supported research programme into all aspects of car distribution. Although financed chiefly by car manufacturers, the ICDP was an independent body and also received support from dealers, component suppliers, representative bodies and governments (but not consumer interests). The ICDP provided us with written evidence, with copies of several of its reports, and with a video on the application of lean distribution to retailing; it also gave us oral evidence at a hearing.

8.175. The ICDP believed that the following points were pertinent to the operation of the new car distribution system and the balance of benefits between consumers, dealers and manufacturers:

- (a) There appeared to be no lack of competition in the UK market; the system organization and management supported a high level of brand, product and retailer choice.

- (b) The consumers' view of competition could not be defined simply by price discounts: many issues were taken into account in shopping decisions.
- (c) More information was available to consumers on discount structures and rebates for new cars than on most consumer goods.
- (d) Important intangible consumer benefits might be lost if the existing distribution system were abandoned: brand and product choice, dealer density and convenience were the most important.
- (e) Manufacturers threatened with the loss of exclusive franchises could be expected to take control of retailers. This would not necessarily be in consumers' long-term interests.
- (f) The uniform discount structure for retailers (and the absence of volume discounts) sustained a high level of competition and choice at the retail level. There could be disadvantages to consumers where there was high concentration of retailer power: these could include the disappearance of small retail outlets and adverse effects on small suppliers. Volume discounts for car dealers would not necessarily benefit consumers.
- (g) The ICDP considered that a change to a build-to-order system would benefit customers but could be achieved only if strong manufacturer/retailer ties were maintained. One element in suppliers' thinking in this regard was that, since cars would be supplied only against specific orders and to customers' individual specifications, there would be less need for dealers to offer discounts to persuade customers to accept cars which did not meet their precise preferences.
- (h) Nearly all suppliers were moving towards build-to-order systems which would make and deliver cars within two to four weeks.
- (i) The reorganization of car dealerships and the encouragement of higher standards and better service should benefit customers, but would depend on the profitability of retailer investment. Extensive parallel sales outside the franchised system, relying on the sales and demonstration facilities provided by franchised dealers, would undermine the changes now under way.
- (j) Brand values were an increasingly important element of consumer choice and perceived value. In other competition cases (notably fine fragrances) much emphasis had been placed on the consumer's desire for a distinctive brand shopping experience. This had to be borne in mind in any examination of the car distribution system.
- (k) The range of benefits that could be offered to retail customers for new cars had to be taken into account when considering any change to the sales structure.

8.176. In assessing the competitive nature and consumer benefits of the car distribution system, the reasons for the near universal adoption of exclusive, tied distribution needed to be understood. The principal reasons were as follows:

- (a) Manufacturers needed to underwrite high product development risks by controlling sales channels. Even the largest car manufacturers had sufficient resources to sustain only a sequential product renewal programme. Continued dealer attention to older ranges kept sales up as models became older and less competitive.
- (b) Manufacturers could be sure of securing retail space for any new lines they introduced. Models of controversial or innovative design were guaranteed a route to market.
- (c) Car marketing was characterized by strong brand focus; product branding and positioning were inseparable parts of a manufacturer's strategy. The values of top car brands were among the highest of all global brands.
- (d) Franchised dealer chains invested on behalf of manufacturers in a geographically dense network, offering sales and service support to customers. Manufacturers could not readily release capital to invest in large dealer networks: the franchise system was particularly beneficial to smaller, less well-funded car companies.

8.177. Other points made by the ICDP are set out below:

- (a) SED regimes were, with the exception of Saturn (in the USA) and Daewoo (in the UK), the standard form of new car distribution in all new car markets. But the levels of prices for the same models varied widely in different markets. Thus it did not appear that SED alone was the cause of these price differences.
- (b) There was evidence from the USA that the unit costs of small retailers of new cars (selling 100 cars a year) were higher than those of larger retailer groups (selling 500 cars a year). But there was no difference between the unit costs entailed in selling 500 cars and those in selling 1,000.
- (c) Experience outside the car industry suggested that retail success largely depended on the exercise of good retail buying judgment. But new car retailers exercised no control over the judgments of car manufacturers about retail aspects of their products. The physical and financial scale of the manufacturers' decisions was far greater than that of retailers, and the effort was much more highly concentrated. Retailers were small and often had many other interests: new cars were only one aspect of their business. This was one of the causes of tension in the car industry.
- (d) The evidence showed that for a volume manufacturer there was little chance of substantial cost reductions being achieved from rationalization of the UK new car retail sector. Larger retailers would seek higher margins and, because there were no economies of scale in retailing new cars, these could be found only in higher prices.
- (e) Research showed that there was a high correlation between franchise profitability and exclusivity. Hence dealers operating a profitable franchise had little incentive to add another.
- (f) There was no evidence to suggest a correlation between customer satisfaction and multi-franchise operation by a new car retailer; indeed, most evidence suggested an inverse relationship.

Professor D G Rhys

8.178. Professor Rhys said that he was the head of the Economics Section in Cardiff University Business School and Director of its Centre for Automotive Industry Research. The Centre undertook ad hoc consultancy studies, and occasionally studies for vehicle manufacturers (but not at all at the time when he gave us oral evidence).

8.179. Professor Rhys provided us with detailed papers on a wide range of matters bearing on the economics and history of competition in the car industry in the UK and abroad; he attended a hearing; and he contributed to our open hearing discussion (see Appendix 1.1).

8.180. On SED, and with close reference to competition in the food retailing and beer industries, Professor Rhys made the following points:

- (a) Evidence from the brewing industry suggested that in the absence of vertical links there was no guaranteed access to the market. Large dealers might want to stock the most successful brands to the exclusion of others. This would reduce the number of vehicle makers and inter-marque competition. Any increase in intra-brand competition from multi-franchising would be scant compensation for this.
- (b) The presence of so many car manufacturers with their individual retail networks meant that no local monopoly existed. If the manufacturers became mere suppliers of product to huge car retail chains then a local monopoly could emerge, and even if national chains appeared their market power could be alarming from the consumers' point of view. Already in the UK one retail chain had about 3.5 per cent of annual UK car registrations, a larger share than most of the suppliers operating in the same market. Hence, huge retailer outlets were not a fanciful concept.
- (c) The experience of the UK beer industry suggested that vertical relationships between suppliers and dealers preserved more firms in the retail sector than would otherwise exist. Without vertical links the suppliers in effect would be wholesalers supplying independent outlets which had

rationalized the industry in their own interests: the retail sector would find its own equilibrium with a reduced number of outlets.

- (d) SED included elements of monopoly power, but it was essential that its beneficial effects were identified before any decision was taken on whether to eliminate them in the interests of promoting competition. It should be recognized, for example, that the single franchise on a single site promoted innovation and increased growth.
- (e) The issue of the single franchise site also had much wider implications for trade policy. Barriers to entry might not be harmful on competition grounds if potential entry existed, but trade was harmed if actual entry did not occur. Open economies tended to have faster productivity growth than countries that distorted international trade. If a restricted car distribution system could be shown, especially in the long term, to have inhibited imports and hindered trade it would be reasonable to think it would be harmful on economic grounds. But efficient and competitive importers succeeded in the end. The problem facing Japanese companies in Europe was not so much SED but the limitation on their European sales through VERs, which made it difficult to justify large retail networks. The other trade issue was whether SED partitioned the internal market. Inter-brand competition generated huge cross-border flows of cars. The European Commission had not been prepared to say that limitations on intra-brand trade effectively partitioned the market.
- (f) Car manufacturers had sufficient market power to prevent prices in the UK or elsewhere in the EC varying too much outside their control. SED might not set price levels or cause price differentiation but it would prevent adjustment. A combination of different price elasticities between countries and ignorance of the relative base price was enough to establish price levels and price differences.

8.181. Regarding fleet sales, Professor Rhys said that the relationship between private and company car prices was subtle and complex. But there were few fleets which received large discounts and a distinction had to be made between price differentiation and cross-subsidy. Only if cross-subsidy existed would the private motorist unequivocally benefit from the large fleet being charged more. But it was unlikely that such a cross-subsidy was paid, so the private motorist might not benefit from a price realignment. Indeed, if the company car market was reduced because of higher prices the transfer of common costs to private car sales could be substantial.

Professor F Verboven

8.182. Professor Verboven, from the University of Antwerp, attended a hearing. In the 1990s he had produced a number of papers on the issue of car prices, one of which, 'International price discrimination in the European car market,' was published in the *Rand Journal of Economics* in the summer of 1996. Following this, Professor Verboven, together with Professor P K Goldberg, produced a National Bureau of Economic Research Working Paper entitled *The evolution of price discrimination in the European car market*.¹ During the course of our inquiry Professor Verboven analysed new car prices across the EC using the European Commission's price surveys from May 1993 to May 1999. Professor Verboven provided us with the initial findings of this work. His findings are briefly summarized in paragraphs 7.260 to 7.263.

Professor M Waterson

8.183. Professor Waterson of Warwick University gave us notes on the market and attended the open hearing (see Appendix 1.1). He said that it was difficult to argue that relatively high prices in the UK were a direct result of SED arrangements, because these arrangements applied throughout Europe. However, it was feasible to argue that, as a result of SED, existing market power in particular markets was not competed away by the dealership structure. Thus if market power differed from country to country, prices would be expected to differ because mark-ups would be higher in countries with more inelastic demand. The current system not only kept margins from falling too far in any one country but

¹NBER Working Paper no 6818.

prevented most consumers from shopping in another country and so preserved differences across countries.

8.184. Professor Waterson noted that the pattern of margins across Europe was for the 'domestic' product to be marked up by a relatively large amount, so that, for example, Fiat cars were expensive in Italy. This might be because they suited Italian tastes and were therefore in relatively inelastic demand. Thus under the current system, relatively low prices might be expected in non-producing countries. In these circumstances, removing the dealership system in all countries might reduce price differentials.

8.185. If the exclusivity arrangements in the UK were relaxed in favour of sales to any suitably qualified garage, prices were likely to fall given the evidence of fleet sales prices. Unlike exclusive dealers which had to carry the full range, these dealers would have little incentive to supply the weaker offerings in the market. Without this burden, and carrying a large throughput of the models they favoured, they would be able to undercut the franchised dealers if they could purchase on favourable terms.

8.186. Weak suppliers, finding demand for weaker offerings falling, would have to cut prices and might be forced out of the market. Excess capacity in the industry might be squeezed out more quickly if exclusive dealerships were disallowed. With the increased emphasis on price, there might be a lack of service and repair facilities for particular cars. However, many dealers and accident repair shops did not specialize in one make and repair facilities could be unbundled from sales facilities. Larger suppliers might engage in increased vertical integration in order to maintain their presence in the market. Used car supermarkets were likely to increase, so that new car pricing became more transparent.

Franchised dealers

Buckrose Motors Ltd

8.187. Buckrose Motors Ltd (Buckrose Motors) in Bridlington, a Rover dealer for 52 years, told us that in 1994, after Rover had confirmed its long-term representation, it had upgraded its premises at Rover's request to meet the franchise standards (with only one item outstanding due to the manufacturing company's late delivery). This upgrading was at considerable expense which was entirely borne by Buckrose Motors. In April 1996 Rover had given it three months' notice of termination on the grounds that the Bridlington area would now be covered by a dealer in Scarborough. (Buckrose Motors said that at the date of termination the Rover customer service index rating had placed it eighth nationally out of 529 dealers.) After seeking legal advice Buckrose Motors had contacted Rover which had eventually extended the three months' notice to two years ending on 31 August 1998. Rover had then delayed the termination payment (which was required by the dealer agreement to be paid within two months of termination) and had paid only after repeated requests from Buckrose Motors. Both the original three-month notice period and the delayed termination payment were in breach of the franchise agreement. In the immediate period prior to termination, Rover had not contacted Buckrose Motors to resolve the outstanding matters or even to acknowledge 52 years of loyalty.

8.188. Buckrose Motors said that the Bridlington area was now covered by a dealer with premises in Beverley and Hull who covered the Hull, Beverley and Driffield areas, as well as Bridlington. This was after the original Rover dealers in Beverley and Hull had had their dealerships terminated. Buckrose Motors had been informed that Rover had a substantial interest in the dealer in Beverley.

8.189. In January 2000 Buckrose Motors said that it had still not received compensation for the work it had carried out at Rover's request on the strength of what it believed was written assurance of its long-term dealership.

Dixon Motors PLC

8.190. Dixon Motors PLC (Dixon) told us that its business was split into three main activities. These were the cars business, comprising 52 sites selling new and used cars, and providing servicing and parts; the motorcycles business, comprising 12 sites selling new and used motorcycles and accessories, and providing servicing and parts; and the accident repair business.

8.191. Dixon said that although both its car and motorcycle sites had SED arrangements with manufacturers, the arrangements were very different. Motorcycle manufacturers did not restrict the number of brands of motorcycles sold from individual premises. Dixon thought that this was probably because the new motorcycle market was much smaller than the new car market. It would therefore be difficult for a motorcycle retailer in a small town or rural location to make a profit from a business selling only one brand of motorcycle. In the advertising and marketing field the arrangements with motorcycle manufacturers were much more relaxed than those with car manufacturers. Different brands could be displayed next to each other and there were no restrictions as to marketing territories.

8.192. Dixon said that the ability to sell different brands of motorcycles from one site had a marked effect both on its customers and its business. The arrangement increased customers' choice and made it easier to compare different brands. By providing a one-stop shop for motorcyclists it reduced their search costs. Dixon benefited from economies of scale in terms of advertising, management, storage, cost of premises and utilities. These savings were passed on to the customer. The more relaxed motorcycle agreements increased Dixon's profitability, reduced its investment because it did not have to invest in individual sites for individual brands, and led to lower inter-brand prices because it was more difficult for individual brands to raise prices. These lower prices had a stimulating effect on the motorcycle market. Dixon had been able to advertise nationally and this had assisted with competitive prices and helped its motorcycle business to grow. Dixon believed that the relaxing of restrictions imposed on franchised car dealers would benefit car suppliers and dealers and that these benefits would be passed on to customers by way of cheaper prices. It would also give the customer more choice, ease of product comparison and fair and open advice about products, as opposed to the bias created by one single manufacturer's products being displayed in a single showroom with no opportunity of direct brand comparison.

Remedies Statement

8.193. Dixon said it agreed that the current SED system mostly disadvantaged the dealer and obviously advantaged the manufacturer. However, if manufacturers were required to supply cars to all retailers wishing to sell them, subject to a limited number of narrowly defined restrictions, the following disadvantages to consumers might occur:

- (a) Retailers might opt for the areas of the business that were the most profitable, or had the lowest cost base, or lower investment requirements. This could lead to customers in smaller towns and rural areas enjoying less customer support than those living in more densely populated areas.
- (b) Retailers might choose to sell only the products with the highest demand. There could also be a poorer choice in terms of vehicle specifications and colours because larger retailers such as supermarkets might choose to sell one particular model of car in the same colour in order to obtain economies of scale.
- (c) The ability of retailers to choose which cars to sell might also influence manufacturer and vehicle development, resulting in a 'more of the same' approach.
- (d) Large car retailers might decide not to provide servicing or a part-exchange facility. This could result in more private sales of used vehicles and, because individuals were less likely to carry out safety checks before on-selling to other individuals, this could have a dramatic effect on the quality and safety of the used cars.

8.194. Dixon thought that the current Block Exemption should be replaced by another regulation which addressed the balance of power between the manufacturer and dealer. This regulation should have the following features:

- (a) Suppliers' direct sales should be limited to defence and emergency services; suppliers should not be allowed to supply direct to car rental firms, banks, fleet operators etc. Supplying both retail and fleet customers through the dealer network would address the difference in pricing structure between the two types of customer. It would also benefit the supplier by taking seasonal volatility out of the market, would assist with forecasting and might reduce manufacturers' costs.
- (b) Suppliers should not be allowed to own their own retail outlets or to invest in the retail network.

- (c) Dealers should not be set unrealistic targets related to bonus payments. Consideration should be given to dealer discounts from suppliers for bulk purchases, at a similar level to those enjoyed by fleet and daily rental companies. Most of these savings could be passed on to the consumer.
- (d) Suppliers should not be allowed to pre-register vehicles because this distorted the market and gave false information as to the motor economy. To some extent it also prevented dealers from offering the consumer consistently good deals because the suppliers 'blew hot and cold' and offered the best deals when stocks were high.
- (e) There should be no restriction on the number of dealerships a dealer might have with a particular brand.
- (f) The high level of investment required in retail sites warranted better security of contract with the supplier. Dealer agreements should be for a minimum of five years and suppliers should not be able to terminate dealerships without just cause or significant compensation.
- (g) Dealers should be able to sell their businesses without the approval of the supplier. They should also be able to choose their own decor etc and not have to pay inflated prices to suppliers who then passed rebates back to the supplier.
- (h) Dealers should have the right to sell several different brands from the same premises and should have the choice of servicing or not servicing vehicles in their retail sites.
- (i) Dealers should be allowed to choose their financial service suppliers and not be forced into using manufacturer-owned finance companies which paid uncompetitive rates of commission to dealers and whose terms disadvantaged the consumer.

8.195. Dixon believed it was the pricing policies of the manufacturers which underlay the higher prices in the UK compared with other EC countries. A similar situation had prevailed in the new motor-cycle market until, in response to a huge increase in cheaper parallel and grey imports, manufacturers cut their prices in 1998 sufficiently to remove all or most of the differential. As a result, franchised motor-cycle dealers had increased their market share, total UK registrations had increased and customers had benefited from lower prices, better specifications and warranties not available on imported motorcycles. Dixon was certain that both dealers and consumers would benefit from similar reductions to retail car prices.

Inchcape plc

8.196. Inchcape said that it was the world's largest independent (ie non-manufacturer) car distribution group, operating in 30 countries. In the UK it had over 50 dealerships, representing 18 different franchises and selling 25,000 new cars a year. Its contract hire and fleet management subsidiary managed over 40,000 vehicles annually. In April 1999 Inchcape had launched the UK version of Autobytel, the Internet-based car-purchasing service. The company gave written and oral evidence. It said it believed that, as an industry leader with a cross-section of motor businesses, it could provide a balanced view on new car pricing in the UK.

New car pricing and margins

8.197. Inchcape said that the dealer/supplier relationship was generally dominated by the supplier. The supplier set the wholesale price and the RRP, giving the dealer little room for manoeuvre in terms of the final selling price. During the 1980s suppliers had begun to give performance-related bonuses. This meant that dealers with particular franchises were not truly aware of their profitability until they achieved certain volume targets. Because they used their given margin to negotiate with customers they were totally dependent on the supplier's bonus for a return. Furthermore, dealers' margins had been declining steadily over the last ten years. According to the RMI, margins had fallen from a range of 15–17.5 per cent on wholesale price to 8–12 per cent. With the heavy investment required in premises, retained profits were low, averaging out among the top 50 dealer groups at just 2 per cent of turnover.

8.198. An independent importer's function was similar to that of a manufacturer's national sales company. It received a margin which was agreed with the manufacturer, normally for a set period, and included in the wholesale price charged to the dealers. Again, the margins available were relatively modest: for example, the operating margin on Inchcape's import and distribution businesses in the UK in 1998 averaged less than 3 per cent.

Price differentials

8.199. Many arguments had been put forward to explain the current price differentials between the UK and other European countries. Currency fluctuations, different tax and duty environments, higher specifications on UK models and more aggressive financing options in the UK were all contributory factors. The differing levels of tax in the various EC countries encouraged a policy of 'what the market would bear' pricing. Where taxes were high, manufacturers tended to keep wholesale prices low, whilst increasing wholesale prices for lower-tax economies. This meant that consumers in lower-tax markets such as the UK were effectively subsidizing consumers in higher-tax markets.

8.200. Inchcape thought that the biggest single factor influencing price differentials related to the unique structure of the UK market and, in particular, the dominance of the fleet or corporate buyer and the distorting effect of the discounts they received on the market overall. These 20 to 40 per cent discounts which were available to fleet customers were not available to dealers even when buying similar volumes, and therefore could not be passed on to the consumer. With estimates of the fleet/corporate sales varying from 60 to 70 per cent of the total this meant that the three or four customers in every ten who bought privately from dealers subsidized the fleet and corporate buyers.

8.201. Inchcape believed that the scale of the price differentials between new cars in the UK and other European markets could not be justified and should not be sustained. As a general principle, Inchcape supported greater transparency in car pricing, in product specifications (particularly the ability to compare them with other EC member states) and in vehicle financing so that meaningful comparisons could be made. It supported greater choice for the consumer both in terms of product availability and purchase channel and continued to explore and develop alternative distribution channels.

Lancaster plc

8.202. Lancaster plc (Lancaster) is owned by Jardine Matheson, a conglomerate based in Hong Kong, which has worldwide car-related activities. Lancaster told us that it was the second largest dealer in the UK, with over 100 dealerships. It represented most manufacturers and sold 40,000 new cars annually, currently accounting for about 5 or 6 per cent of each manufacturer's new car sales (with the exception of Ford where it accounted for about 8 per cent). Lancaster's contract hire operation, Appleyard, had around 21,000 contracts making it the eighteenth largest operator.

8.203. Lancaster believed that the current method of car retailing needed to change. In particular it was concerned about the lack of price transparency. Consumers did not like having to haggle. They distrusted the system and generally believed that dealers achieved far greater margins than they actually did. Lancaster had embarked on a number of processes to change car retailing. The latest of these was the recent joint venture with Ford (Polar Motor Group) under which Lancaster had sold to Ford a percentage of its Ford dealerships in the UK. This enabled Ford to increase its knowledge of retail operations. The arrangement was attractive to Lancaster because the initiatives developed in Polar Motor Group could be used across its other dealerships. The joint venture had been further expanded with the acquisition of the 20 Ford dealerships previously owned by Dagenham Motors, enabling Lancaster to look at urban dealerships as well as those in rural areas.

8.204. Lancaster said that there was no commonality of practice across the industry in suppliers' relationships with dealers apart from the fact that they had all reduced their margins. The luxury car suppliers had better relationships with dealers than other suppliers did and usually discussed policy changes with the dealers' representatives. Bonuses were essential to the dealers' overall profitability. This was the only sector of the retail industry that operated in this way. Whereas bonuses used to relate to sales targets and dealers had known whether or not they were likely to achieve them, there was now a range of criteria including meeting standards set by the supplier. Because some of these were subjective, dealers did not

know whether they would qualify for a bonus or not. This uncertainty made them reluctant to negotiate better deals with customers.

8.205. Lancaster believed that the large discounts given to fleet purchasers drove up the price of cars to private customers. It estimated that about 20 per cent of new cars were discounted in this way. It did not believe that the Block Exemption influenced UK car prices, pointing out that it applied in mainland Europe where prices were low. The main cause of high prices in the UK was the suppliers' complete control over the dealers' businesses, including their remuneration, the way they staffed their businesses and the costs they incurred.

Peugeot Dealer Association

8.206. The Peugeot Dealer Association (PDA) told us that it represented the interests of 365 Peugeot dealers in the UK. It believed that the UK car industry was one of the most competitive in the world, with nearly 40 manufacturers competing for market share. The PDA said that the franchise system offered advantages in many industries, including the motor trade. These included provision of expertise, support of technical advances, clarity of presentation and advice for customers, and a feeling of security for consumer, employer and employee.

Selective and exclusive distribution

8.207. Whilst accepting that SED gave manufacturers an element of protection, the PDA said that it also ensured a distribution system that provided geographical cover throughout the country. Despite extreme intra- and inter-brand competition it helped to support residual values and provided high levels of advice and technical expertise to consumers in all areas of the country (not just urban centres). By retaining wide geographical coverage SED maintained employment in all areas, including many rural locations where other retail industries had declined.

Remedies Statement

8.208. The PDA said that our Issues Letter had referred to the issue of prices but the Remedies Statement only reflected upon changes to the structure of the industry through alterations of the Block Exemption. We were therefore assuming that high prices were fundamentally caused by the Block Exemption. The PDA suggested that the two matters should be treated independently whilst accepting that there might be some common areas.

Pricing

8.209. With regard to price comparisons the PDA believed the main influences were the exchange rates and differential tax regimes. Manufacturers had reacted to the latter by artificially subsidizing car prices in some countries to generate sales. As there was unlikely to be parity of taxation throughout the EC, the PDA believed that the European Commission should remove the present inequitable situation which allowed tax on cars to be paid in countries of use rather than of purchase.

8.210. When governments were able to provide a fair tax base the PDA would like to see manufacturers take positive steps to equalize prices in the medium term but it accepted that differences in specifications and extras would always occur due to local customer demands. To protect residual values it would hope government and consumer associations would accept that price equalization should take place gradually in all countries over a minimum period of 12 months. The PDA accepted that UK prices were higher than those elsewhere in the EC but felt that the responsibility for adjustment rested with both governments and manufacturers.

Block Exemption

8.211. The PDA believed that the motor industry should continue to be treated as a special case with the continuation of the Block Exemption. It believed that the current system allowed for:

- (a) intense competition both inter- and intra-brand which was reflected by the large number of retailers and manufacturers in the industry which operated at non-excessive profit levels;
- (b) a wide geographical spread of varying sized companies all having an equal opportunity to offer the customer a fair deal;
- (c) a secure market place which stabilized residual values: this was essential in the unique motor trade environment of part-exchanges;
- (d) maximum investment by manufacturer and retailer to produce technically improving products and to give expert advice to the consumer; and
- (e) investment and customer feedback to ensure that development in safety and environmental features of motor cars was optimized.

Selectivity vis-à-vis new car retailers

8.212. The PDA believed that there should be no restrictions on retailers modifying new cars unless such modification invalidated the warranty of parts or created confusion in model identification which could adversely affect the customer's understanding of original and residual value.

8.213. The present system of bonus payments should remain. It allowed the high-performing dealer additional margin which it might utilize for commercial advantage. Suppliers should use their purchasing power to provide related services to franchised dealers (for example, finance, extended warranty and parts purchases). These, however, should not be a compulsory part of the franchise but should be selected by the dealer according to its own criteria and for the consumer interest.

8.214. The PDA said that suppliers should continue to insist on minimum standards of presentation, training and investment in technical expertise to support the product and to satisfy consumer demand both in sales and servicing facilities. It was important that a multi-tier level of service did not exist whereby some dealers purely obtained business on a price basis whilst encouraging their customers to utilize the services of those outlets that had been more committed to providing higher customer service and facilities.

8.215. The IT systems should be the choice of the dealer, but it would need to ensure a satisfactory link with the supplier to satisfy the demands of the business, which included technical support, supply data and registration of vehicles.

8.216. The PDA thought it was important that the supplier provided or insisted upon both sales and technical staff being adequately trained in order to provide correct information to the customer.

8.217. Recently consumer organizations had pressured the motor trade into incorporating on-the-road charges into their price lists to establish clarity for the consumer. The PDA agreed with this and now believed that RRP's should be retained in the interests of clarity for both customers and dealers. In retail industries without RRP's, prices were now established by major retailers, enabling them to make price offers on products which were available only through their outlets. Consumers were then unable to make fair and identical price comparison. The current system in the car industry avoided this confusion.

8.218. There should be no restrictions applied by suppliers on the way in which dealers advertised and promoted their products apart from the use of manufacturers' copyright logos. The growing use of the Internet already allowed for national advertising outside dealers' territories and the PDA was satisfied that Peugeot placed no restrictions on its existing dealers. Indeed in the establishment of its own Internet site Peugeot accepted and encouraged advertising outside dealer territories.

8.219. The PDA thought that the standard discounting structures should be maintained to all dealers to ensure equality and to enable the small dealers to trade against the large, thus ensuring geographical coverage and preventing a monopolistic situation of dominant retailers or financial institutions.

8.220. The PDA believed that dealer agreements should be available for a longer term to protect the high levels of investment. This could be achieved through the existing system of two-yearly agreements

that were automatically renewed unless the dealer was financially unstable or unable to provide the required level of services. In addition the dealer should be able to dispose of its business with the franchise subject to the purchaser satisfying the financial requirements of the supplier. It should not be possible for a supplier to withdraw a franchise as part of a reorganization of its dealer network.

8.221. Where relevant, suppliers should be allowed to appoint separate sales or service outlets to ensure geographical coverage and to maintain economic viability. Suppliers should extend the freedom for dealers to share their facilities so long as areas were clearly defined within a showroom to identify products separately and so long as the dealer fulfilled its obligations. Suppliers should not insist on separate after-sales services where it was more economical for dealers to utilize shared equipment.

8.222. The PDA understood dealers' frustration when fleet buyers and other companies outside the industry obtained higher levels of discount than they did. It believed that in areas where dealers were in direct competition, for example car hire, they should be able to negotiate with the supplier to obtain at least equal levels of discount. It accepted, however, that suppliers needed to be able to make competitive offers to secure business. The current system allowed for this freedom of competition but generally ensured that the supply of vehicles, and therefore an element of profitability, was able to be retained within the dealer network to justify their investment in providing support services for the customer.

8.223. The PDA believed that manufacturers should always produce a base model in each range without any retail incentives. This would present a minimal price offer for those customers to whom price was more important than specification.

Smith Parkinson of Brigg Ltd

8.224. Smith Parkinson of Brigg Ltd (Smith Parkinson) gave written and oral evidence. It had been in business since 1912 both as a franchised and a non-franchised dealer and was currently a second-tier Ford dealer.

8.225. Smith Parkinson saw other Ford dealers, rather than local dealers of different marques, as its direct competitors. It believed that consumers purchasing a new car had decided which model of vehicle they wanted before they visited several dealers to negotiate the best price. Smith Parkinson said that car salesmen had always received a low wage, with incentives and commission forming a major part of their income. It was therefore not surprising that the salesman's thoughts were not always in total empathy with the customer's requirements. Although a customer might be looking for a small car, the salesman would gain the maximum commission by selling a larger, more expensive model.

8.226. 45 per cent of Smith Parkinson's new car sales were fleet registrations and without this business it would not qualify for Ford's target-related bonuses. Ford negotiated some of the fleet sales and passed some on to particular dealers. There was an increasing trend for suppliers to deal direct with fleet buyers and cut out the dealers.

8.227. Smith Parkinson said that the current sale and distribution system was unsatisfactory. Dealers were being squeezed by the supplier on one side and by the customer on the other. The lack of profitability was forcing many out of business. For example, in the town where Smith Parkinson operated there had once been five franchised dealers and there was now only one. Suppliers were aware that the dealer structure could not make sufficient profit to justify the number of franchised dealers in existence and they were reducing the number in particular areas. Although this enabled the remaining dealers to increase the number of cars they sold and thus become more profitable, suppliers then tightened dealer margins on the grounds that the dealer was selling more vehicles. Ultimately it was the consumers who suffered because of limited choice of franchised dealers in their area and lack of servicing facilities. Consumers had lost confidence in the system. In addition, large numbers of cars were being imported by parties other than the manufacturer. The reducing returns together with the increase in operating, presentation and promotion costs and the prohibitive costs of new facilities had made many franchised dealers reconsider their position.

Autex

8.228. As a result of the situation described above Smith Parkinson had designed a new system of sales and distribution, Autex, which it believed would make the purchase of a new car much easier.

Under this system there would be uniform sites throughout Europe, each within close proximity to a motorway, where interested manufacturers would be able to lease sales units. The sites would have accommodation for supporting services such as finance companies and motoring organizations. Consumers would be able to see and test-drive all new vehicles in one location and in a non-pressured environment. Cars would be ordered direct from the manufacturer and supplied to a consumer-selected dealer who, for a pre-arranged handling fee, would be responsible for delivery and for repairs. The first site was due to open in summer 2000 on a dedicated 60-acre site in Burton-on-Trent. Six other locations were planned: two more in the UK and four in mainland Europe. Smith Parkinson said that most major manufacturers had expressed interest in the system.

A Renault dealer

8.229. A Renault franchised dealer alleged that special arrangements existed between Renault and its directly-owned dealers. A customer had been able to purchase a car from one of Renault's own retail branches with a discount of £1,170. The dealer making the allegation said that it could have given a discount of only £764; this moreover included an unguaranteed allowance receivable only if the dealer achieved certain operating standards. In addition the dealer could receive a possible £150 for achieving its quarterly sales volume objective. The dealer said that Renault's action meant that car consumers paid different prices depending on where they lived in the UK.

A Volkswagen dealer

8.230. A Volkswagen dealer said that although its relationship with Volkswagen was excellent, there were three areas where suppliers' actions restricted the competitiveness of dealers' overall service:

- (a) VW enforced the use of its financial services division, Volkswagen Financial Services (VWFS), whose packages were generally uncompetitive, and had implied that dealers which used other financial service providers would be penalized. Furthermore Volkswagen provided cross-subsidies to dealers via VWFS which were not available to non-VWFS supporting dealers.
- (b) Suppliers gave subsidies to fleet purchasers which resulted in big differences between the prices paid by fleet buyers and those paid by retail customers and dealers. Retail customers were effectively subsidizing the fleet buyers, which disadvantaged both retail customers and dealers. Although this was not a big problem with Volkswagen it was prevalent with some other large-volume brands and with weaker brands.
- (c) The relationship between suppliers and dealers was biased in favour of the suppliers. Although this dealer's relationship with Volkswagen was relatively benign, the dealer was left in no doubt as to who was the junior and potentially expendable partner when contentious matters arose and therefore had to work hard to cultivate the right relationships.

UK Ford Dealer Council

8.231. The UK Ford Dealer Council (UKFDC) told us that it represented the interests of all Ford dealers in the UK. It did not submit formal evidence during the earlier stages of our inquiry but responded to our Remedies Statement (Appendix 2.3).

General

8.232. The UKFDC believed that consumers had every right to expect a quality product at a fair price and that suppliers and dealers must never lose sight of this. Suppliers had responsibility for setting realistic and competitive prices. The UKFDC also believed that the actual transaction price (net of discounts and non-price benefits) that the UK consumer paid was the truest basis for comparison of prices with those in other EC member states. It did not believe that vehicle pricing in the UK was the direct result of SED as set out in the Block Exemption, since the same regulations applied equally to all EC member states with which price comparisons were made. The UKFDC supported the suppliers' view

that a tax regime under which, unlike most other commodities, the amount of tax payable was dependent not upon the country of purchase but upon the country of ultimate usage contributed significantly to the disparity of prices throughout Europe. The UKFDC would like current dealer margins to be enhanced. This would have the effect of securing a greater level of parity between fleet and retail customer acquisition terms, assuming that these were compared at the level of transaction prices (net of discounts and non-price benefits). The direct support of suppliers for major fleets might result in higher levels of RRP. Franchised dealers, whose investment in the business was substantial, were currently unable to acquire vehicles on such terms even for their own use.

The Block Exemption

8.233. In general the UKFDC believed that the current Block Exemption worked well and did not influence the level of RRPs available to new car customers. Through its trade associations the UKFDC would press for certain changes when the legislation came up for renewal in 2002 but these changes related to the length of agreements and freedom to represent more than one franchise.

Selectivity vis-à-vis new car retailers

8.234. The UKFDC had no serious objection to suppliers requiring retailers to meet the minimum standards identified in subparagraphs 14a to 14f of the Remedies Statement. In its experience, such requirements had been fairly applied and it did not believe that they acted against the consumers' interests in terms of their effect on prices. Indeed, the UKFDC believed that the setting of consistently applied, mutually agreed, retail standards added quality and value to the consumer's purchase and after-sales experience. So far as subparagraph 14g was concerned, as SED did not influence the level of retail prices, suppliers should continue to have the power to exclude unwanted retailers. More specifically, franchised dealers positively influenced consumer part-exchange allowances, thus reducing the cost of changing cars.

Servicing and repair operations

8.235. The UKFDC believed that, as part of an SED system, suppliers should have the right to require retailers to offer servicing and repair facilities. A car was a complex mechanical product requiring regular servicing and the widespread availability of maintenance and repair capability. This must be a primary responsibility and duty of retailers of new cars and their required investment to carry out this function was substantial.

8.236. The UKFDC believed that suppliers should have the right to specify objective minimum standards in such areas as range of equipment, training of staff and quality control before granting approval for the carrying out of warranty work. This was particularly relevant in the case of recall work which usually related to safety issues. Suppliers should also be able to require that their approved service and repair operations were of a minimum size in terms of premises and trained staff although this would vary geographically according to the size and age of the car population. Under the Block Exemption non-approved service/repair operators already had the right to obtain technical information from suppliers. The UKFDC understood that there was little demand for such information. It did not believe that there was any justification or demand for extending the regulation to include specialized tools, diagnostic equipment or training.

Solus dealerships and full-range forcing

8.237. The UKFDC believed that the application of the current rules affecting the ability of a retailer to offer products from more than one supplier had been less effective than Regulation 1475/95 originally intended. It believed that provided the retailer met the reasonable standards laid down by a supplier it should not be prevented from offering an alternative supplier's products from the same premises.

Advertising and promotion

8.238. So far as Ford products were concerned, there were currently no controls in place under which the supplier determined the price at which dealers advertised or sold vehicles. The UKFDC did not believe that suppliers should have such powers in the future.

Other aspects of the Block Exemption

8.239. The UKFDC did not believe it practicable to prohibit a supplier from terminating an agreement with a franchised dealer without cause or as part of a reorganization of its network. The current rules were vague and did not define precisely what was meant by a reorganization. The UKFDC believed that any future block exemption regulation should be more specific and allow some agreed form of arbitration in the case of a dispute.

8.240. The UKFDC said that the catchment areas of such media as television, radio and the Internet etc had resulted in suppliers being largely unable to enforce restrictions on dealers' ability to advertise outside their territories, except in local press and through direct mail. The UKFDC believed that, from a practical point of view, all remaining restrictions should be removed.

8.241. As far as varying the territory allocated to a dealer was concerned, under existing regulations a supplier was unable to do this without objective justification. The UKFDC saw no reason why this should be altered.

Other matters

8.242. The UKFDC believed that there was some misunderstanding about the reality of the sale-or-return agreement. This was, to all intents and purposes, a deferred payment system with the ability to return invoked only under rare circumstances. The UKFDC thought that the acquisition cost of cars should be the same for all dealers irrespective of size but, in recognition of the significant investment in the franchise, should be more favourable than the terms available to any other purchaser (and, in particular, fleet purchasers).

8.243. The UKFDC believed that prohibiting suppliers from setting RRP's would not serve any practical purpose. There was some evidence that consumers did not think that such a change would be in their interests.

8.244. Dealers should be able to seek a reduction in the wholesale price of a new car in place of bundled financial and other benefits. If retail prices were lowered the need for suppliers to offer such packages would be obviated.

Supplementary Remedies

8.245. The UKFDC had no information as to the extent of pre-registration of new cars by suppliers. From time to time, some Ford dealers registered cars in their own names but this almost invariably related to vehicles which had remained in stock for a lengthy period and/or were no longer of current specification. Such vehicles were resold as used cars and the consumer benefited directly from the lower price charged. It was difficult to see how this could be seen to be against consumers' interests.

8.246. Ford dealers were under no contractual obligation to use Ford Credit. Whilst new vehicle stocks on sale-or-return terms were financed through Ford Credit, Ford dealers could pay for vehicles on gate release if they wished to. So far as consumer credit financing was concerned, dealers could make arrangements with any finance house they or their customer chose, and regularly did so.

Other comments

8.247. The UKFDC said that in view of recent comment in the media it was appropriate to point out that the 1999 pre-tax profits (before tax) of its members, expressed as a percentage of sales, were 0.5 per

cent. Latest available figures to the end of November 1999 revealed that the average return on total capital employed was 3.5 per cent and return on average equity was 5.2 per cent. In the UKFDC's view this constituted no evidence whatsoever of profiteering.

A dealer

8.248. A dealer told us that suppliers expected it to invest profits above a certain level in their schemes. Although the suppliers would be unlikely to admit to a prescribed level, the dealer's experience suggested that they would apply intense pressure when a dealer achieved a return on sales of over 1 per cent. Two of the dealer's franchises were opposed to dealers building up any goodwill values in their businesses. On two occasions the dealer had heard the suppliers' representatives referring to this policy. He also knew of a dealer whose dealership was terminated because it was not willing to invest at the prescribed level. The dealer said that suppliers also made it clear that dealers sourcing new cars elsewhere in the EC or from other franchised dealers in the UK would jeopardize their franchises.

A dealer group

8.249. A dealer group told us that dealers had no control over retail prices and they objected to any implication that they themselves failed to offer a fair deal to the retail buyer. There was healthy competition between dealers who vied for business on equal terms but discounts offered by suppliers to fleet buyers had created a distorted two-tier market.

8.250. The fleet market had been expanded, and fleet discounts extended, to levels that the dealer group regarded as unacceptable. It contended that consumer offers did not adequately balance this differential so that retail buyers (and to some extent dealers) were subsidizing the fleet market. This situation had arisen for a number of reasons including import restrictions, a relatively affluent RHD market, price benchmarking etc as well as over-production, but the dealer group believed that the balance should be redressed.

8.251. The dealer group said that UK prices generally had become out of line with the rest of Europe and elsewhere in the world and this was evidenced by the now significant grey import market in the UK. The group accepted that there were difficulties in making comparisons because of quality, safety and other specification levels but these appeared to be relatively minor. There was a feeling that efforts to police price parity within Europe had probably not been made easy by manufacturers themselves. The dealer group believed that a realignment of prices was both necessary and overdue.

A dealer representative

8.252. A firm which had acted for a number of franchised dealers said that over the last few years the market in the sale of dealerships had changed dramatically and, notwithstanding the 1995 changes to the Block Exemption, the control of the supplier over the dealer had increased. The suppliers had total control over the change of ownership of franchised dealerships and all the mainstream suppliers adopted a policy of introducing preferred candidates as acceptable purchasers to the exclusion of all others. Although those franchises in greatest demand probably exerted the greatest degree of control, since 1995 certain suppliers had adopted a policy of providing dealers with larger territories such that the chosen dealer was required to acquire some of the surrounding dealerships. As a result of this policy some of the smaller dealers were forced to sell their businesses in circumstances where there was only one potential purchaser to which the franchise could be transferred.

8.253. In addition, some suppliers (particularly those where there was a strong demand for the franchise) imposed a limit on the price which could be paid for a dealership. They often used their position of power, in terms of being able to terminate a dealer agreement for any reason, to push the deal through at a lower price than could be achieved on the open market. Other suppliers also exerted a significant degree of control and particularly where they were providing the equity funding for their chosen purchaser. For example, one particular supplier indicated that the approval procedure did not allow any goodwill to be paid on acquisitions where the supplier was providing the equity funding. Other suppliers adopted the approach that the franchise was not transferable such that the goodwill of the business

related exclusively to the supplier and not the dealer. Suppliers justified influencing prices on the basis that they wished to ensure that the new dealer obtained a satisfactory return on the business following the sale and that purchasers who had a limited availability of funds had an acceptable level of gearing.

8.254. The effect of this degree of control was to restrict the natural expansion and resulting power of dealer groups and also to restrict new entry, thereby reducing the level of competition. In contrast, in the USA, where car prices were some of the lowest in the world, suppliers could not terminate dealer agreements without good reason. The ability of a supplier to terminate a dealership for no reason was the major factor which gave the supplier almost total control over the dealers. For example, the 1995 changes to the Block Exemption required suppliers to allow dealers to build an adjoining dealership provided certain conditions were met. However, this change had no impact on the market as a supplier could simply terminate a dealership which did not do as the supplier wished. Accordingly, until this fundamental issue was addressed, any cosmetic changes to the wording of the current Block Exemption would have little impact.

8.255. Furthermore, prior to the 1995 changes, when many dealerships were under notice of termination, there was considerable uncertainty over the future and the suppliers were able to exert even greater control. The only way to prevent this happening again would be to introduce retrospective legislation which would ensure a rapid transition to a more competitive market.

A former dealer

8.256. A former dealer gave evidence at a hearing. He had a wide experience of the industry, having held dealerships for several major car manufacturers from 1965 to 1999. In October 1991 he had acquired a controlling interest in a Mercedes-Benz dealership and had sold his interest in the business in April 1999. He was Managing Director of the company and hence 'dealer principal' throughout this period.

8.257. The former dealer had considered that his competitors were other Mercedes-Benz dealers rather than local dealers of different marques. He believed that most consumers knew which car they wanted before visiting a showroom. They might compare models and dealers (often telephoning several before making a decision) but very few consumers compared franchises. This was particularly true of Mercedes-Benz customers. The dealer would have liked to have had the opportunity to consider the concept of multiple franchising, but he would not necessarily have favoured it. Although stocking other marques would attract a wide range of customers it might not have been viable.

8.258. Franchised dealers had an undeservedly bad reputation. Their relationships with suppliers had become more restrictive than they were when the dealer first went into the business, with the suppliers making it clear who was in charge. Although Mercedes-Benz was generally reasonable in this respect, he had had problems with the company in 1991. At that time new car prices had been substantially lower in the UK than they were in the Far East (particularly in Thailand and Hong Kong), and customers were buying cars in the UK and immediately selling them in these countries (unbeknown to him). One of his earliest Mercedes-Benz customers had purchased and resold a car in this way and Mercedes-Benz had told the dealer that this was in breach of his dealer agreement (which did not allow him to sell to a customer who exported the car within six months of purchase). The dealer had subsequently supplied the purchaser with a further 13 cars, because he had agreed to do so before Mercedes-Benz had brought the matter to his attention. For these and other sales to unidentified exporters the company had fined him £61,000.

Recommended retail prices

8.259. The dealer believed that the suppliers' enforcement of RRP's restricted dealers' profitability and was one of the main problems in the supplier and dealer relationship. When he had raised this issue with Mercedes-Benz, its response had been that consumers needed to know where a vehicle was placed in the market. The dealer thought that suppliers could advertise a rough guide of the price at which dealers might sell, rather than giving RRP's. Dealers would then be able to sell very scarce cars at a price above that advertised. Mercedes-Benz cars were generally in short supply so when new models were introduced the dealer had sometimes had two years' supply of orders and customers had offered to pay prices substantially above the RRP.

The use of in-house finance companies

8.260. The dealer said that he had had to pay the stocking charges for all the cars he sold but had been unable to decide how best to do it. He believed that dealers should be able to make their own choice of financial service provider. He had belonged to the London (M25) group of Mercedes-Benz dealers who had collectively negotiated beneficial rates for the purchase of ancillary services. Although they could have obtained stocking finance at a better rate from other finance providers, the dealers had had to use Mercedes-Benz Finance (and have its IT equipment installed at a considerable cost). The dealer had considered alternative used car stocking arrangements but Mercedes-Benz Finance had threatened that he would be in severe trouble if he did not use its services.

Bonus and commission arrangements

8.261. Dealers' margins had declined in recent years, for example in 1991 his margin had been 17.5 per cent compared with 13 to 14 per cent in 1999. Bonus and commission arrangements had become too complicated and too unpredictable. Mercedes-Benz had two types of bonus, one on achievement, which was guaranteed if targets were reached, and one on performance, which was subjective. London-based dealers were always especially under pressure. They had high labour, property and transport costs but the same margin as dealers elsewhere. In that sense they were the least profitable.

Fleet purchasers

8.262. Discounts available to fleet purchasers were not available to dealers purchasing similar volumes. It should be possible for suppliers to allow such discounts to all purchasers of similar volumes.

Franchised dealers' comments on supplier control over dealer advertising

8.263. Several dealers commented on supplier-imposed restrictions on the way they promoted sales of new cars. One dealer said that, although he was permitted to advertise cars at an amount below list price, he was not allowed to state in the advertisement the discount that this represented. Another dealer said that most advertising was produced by the supplier, which used only list prices. Advertising arranged by the dealer would need to be sent to the supplier for prior approval, and would probably be rejected if it featured prices lower than list prices. Another dealer said that its supplier prohibited it from advertising new cars at below list price. Although it claimed not to have received any direct communication from its supplier in this respect, it alleged that dealers which promoted their cars at less than list price had their bonuses reduced and/or their allocations of new cars lowered.

Dealer groups' views on the possibility of their importing new cars

8.264. Following the appearance of a story in the press in January 2000 to the effect that about 20 of the largest dealer groups were collectively considering importing cars (see paragraph 8.97), we wrote to the dealer groups concerned. Half of them said that they had considered importing new cars from dealers in the manufacturers' franchised networks in other EC countries, though none had decided to go ahead.

8.265. Several of the dealer groups expressed doubts as to whether RHD cars would be available from dealers in mainland Europe in the numbers and timescale that UK dealers would require. Three mentioned that they thought the manufacturers would restrict the supply of RHD cars available in this way. Most said that the subject had not been discussed with UK suppliers but two said that, when the idea had been mentioned in the past, it had received a cool reception from suppliers. Nine groups said that their relationship with suppliers would be harmed if they began to import cars. Two others said that they considered such action would be outside the spirit of their agreements with suppliers. Six mentioned the possibility of franchises being terminated, three of them referring to the fact that suppliers could terminate agreements on two years' notice without cause.

Non-franchised dealers

Collier Motor Holdings Ltd

8.266. Collier Motor Holdings Ltd (Collier) believed that fluctuating exchange rates had a bearing on the price differences between the UK and mainland Europe and that overseas manufacturers took advantage of the situation. However, bringing prices into line would be disastrous for UK car manufacturers. Complicated issues were involved.

8.267. Collier believed that if suppliers were required to give quantity discounts to dealers, dealers would be able to 'cherry-pick' particular models with detrimental effects on consumer choice. A wide range of brands were now available in the UK and creating a 'supermarket' effect would limit the choice and increase margins.

8.268. Collier said that about 65 per cent of cars were company cars, bought with company funds, or otherwise subsidized. Statistics might be misleading because some companies allowed employees subsidized loans and negotiated deals. Cars purchased by this means were really private sales. Collier believed that few new cars were sold at list price, with discounts (ranging between 5 and 15 per cent) and bonuses being frequently offered. Although the list price was therefore an illusion, it was important as a reference point for cars in short supply or popular models on which premiums might be charged. Collier believed that the abolition of RRP's, together with quantity discounts, would lead to the disappearance of smaller dealers as had happened in the brown and white goods markets. In these markets where prices were uniform, the absence of manufacturers' RRP's meant that customers did not know what sort of deal they were getting.

Currie Motors Ltd

8.269. Currie Motors Ltd (Currie) believed that the effect of the UK pricing structure was that retail customers were subsidizing fleet buyers. In fact large fleet customers paid less for vehicles than dealers did. Currie acknowledged that, as a dealer, it had a vested interest. Its margins were low and could not be lower, irrespective of the price the manufacturer charged. Pricing was therefore totally out of its hands. Currie also operated in the USA where, despite there being a strong franchising system, consumer prices were lower, the manufacturing industry was stronger and the retail industry was stronger and more profitable than in the UK and provided more secure employment. It believed that this was because manufacturers there did not promote large-scale pre-registration of vehicles or give large discounts to fleet buyers. This meant that they had to tailor supply to demand and were unable to pass their inefficiencies on to either dealers or consumers.

Stanegate Garage

8.270. Stanegate Garage, a small non-franchised dealership specializing in the repair and servicing of Land Rover vehicles, said that vehicles produced in the last ten years were increasingly reliant on complex electronic systems for their operation. This had made it impossible to maintain such vehicles without dedicated computerized diagnostics systems, which were made available only to main dealers. Because manufacturers did not generally release data stream information, other diagnostic equipment manufacturers were unable to build this equipment. This had the effect of locking the independent sector out of the repair of new and nearly-new vehicles, forcing the customer to use the approved dealer network and pay whatever the network wished to charge.

Fleet customers

Motability

8.271. The Motability scheme was set up in 1977 on the initiative of the Government to help disabled people with their mobility problems. In particular it helps people entitled to the higher rate of

mobility allowance to obtain the use of a motor vehicle (or a powered wheelchair). The organization with overall responsibility for the scheme is also called Motability. At a hearing Motability told us that it was organized as a partnership between the public, private and voluntary sectors. As a registered charity the scheme's primary responsibility was to its own board of governors. It also had a responsibility to the Charity Commission and to the Secretary of State for Social Security. Motability's finance company, Motability Finance Ltd (MFL), acted as the principal service provider for the charity, carrying out the day-to-day transactions and running of the scheme, including dealings with suppliers. MFL was a private limited company owned by the six major clearing banks, which provided funding for the acquisition of the vehicles. MFL was a non-profit-making company (although there were retained surpluses which were covenanted to Motability which put them into a specific grant fund). Surpluses generated were also held in contingency reserves against prospective losses and liabilities. The banks took a fixed percentage on the money that they loaned to MFL and received an annual administration fee.

8.272. The higher rate mobility allowance was currently £37 a week. About 27 per cent of the 1.4 million people in the UK currently in receipt of this allowance had obtained cars through the Motability scheme. Prices were centrally negotiated by MFL and translated into monthly payments which were made direct to MFL from the Department of Social Security, following Motability's authorization. In 1998 MFL had purchased some 136,000 vehicles from 23 suppliers, with Ford and Vauxhall having the largest shares. Motability believed that, because the vehicles were purchased for the purpose of providing mobility to disabled people, they should be distinguished from fleets acquired for strictly commercial purposes. Motability vehicles were individually chosen by their future drivers from a list of models available under the scheme. The fleet buying was not centrally managed and should not be seen as a contract hire fleet. Rather than negotiating block discounts with manufacturers as fleet purchasers did, the scheme offered suppliers a discrete market which did not adversely affect the new car retail market place. Because manufacturers were able to sell particular cars at particular times—for example, cars for which normal commercial demand was falling short of supply—they were prepared to give bigger than normal discounts.

8.273. The Motability scheme operated through over 4,000 dealers which had to meet its service standards. It bundled various services, such as insurance and roadside assistance, into the customer contract so that the customer paid one price for a complete package of services. MFL benchmarked its costs against fleet operators in the UK and, even taking account of the tax benefits it enjoyed, aimed to be at least 30 per cent cheaper than any other operator. It purchased only new vehicles and over 2,000 models were available to its customers, 50 per cent of which were supplied at the allowance cost or less. Although in the past only basic vehicles had been available, this was changing. Agreements for individual vehicles were for three years and were between the hirer (the disabled person or their representative) and MFL. MFL then took back the vehicle and put it through its normal disposal route. From the onset of the scheme MFL had purchased the vehicles on buy-back agreements with the suppliers but on 1 March 1999 it had taken on the responsibility of selling them at the end of the three-year period. Motability expected this development to have little impact on the second-hand car market.

8.274. Motability was considering importing cars for those of its customers who required heavily adapted vehicles. It had looked at the importation of cars for its main hire scheme and to date had decided that the present arrangements were best for its customers.

8.275. On 1 March 1999 MFL had also assumed responsibility for the maintenance of its customers' vehicles. It was setting up a fleet management division and agreeing maintenance and quality standards with dealers. Under the new system MFL would remind customers when a service was due and they could then choose which Motability accredited garage to use.

Issues Letter

8.276. In commenting on our Issues Letter, Motability stressed that it operated in a distinct and important market. It believed that the scheme would be able to adapt to any proposed changes in the structure of the new cars market, providing that they were carefully managed. Any destabilization resulting from a rapid drop in new car prices would have a significant impact on Motability and the Motability scheme because its contingency reserves depended on it being able to achieve projected prices for the sale of its used vehicles. It was also concerned about any changes to the dealer network, whose profitability and success were important to the scheme. Its customers were reliant on having a local

contact point with a high standard of service and maintenance. Motability noted that other sales channels such as the Internet, and possibly supermarkets, could not provide this.

PHH Europe Ltd

8.277. PHH Europe Ltd (PHH) told us that it was a contract hire and fleet management company, and was the largest purchaser of new cars in the UK. It had joined in a marketing alliance with Woolwich plc, called Woolwich Motorbase, to provide a car-buying service for retail customers. One of PHH's roles was to use its purchasing power to enable the marketing alliance to offer attractive prices.

8.278. PHH said that in most cases manufacturers would not sell, and would not permit dealers to sell, at prices reflecting the volume of PHH's purchases, particularly if the cars in question were to be sold to individuals (as in the case of Motorbase) as opposed to fleet customers:

- (a) Some manufacturers offered extra discounts (that is, in addition to the dealer discount) for personal contract purchases (PCP), which was Motorbase's preferred method of retailing cars. But others would do so only where the individual selecting the PCP products was switching from a company car to a PCP package. In the case of all other staff who previously did not receive the benefit of a company car, these manufacturers would offer 50 per cent of the discount that would normally be available for these vehicles when purchased by their employer.
- (b) Two other manufacturers did not offer any discounts to PHH in respect of PCP products that were offered to employees, as opposed to the employing company. In these cases the only discounts available were dealer discounts.
- (c) One other manufacturer normally gave an additional percentage rebate to its dealers whenever they made a sale to PHH. However, when the manufacturer realized that a car being sold to PHH was going to be resold to a private individual, as opposed to a corporate customer, this rebate was denied.
- (d) In the case of all manufacturers, PHH was obliged to discuss the particular transaction with the manufacturer and reveal the identity of the consumer group that it was dealing with in order to obtain the applicable manufacturer discount.

8.279. PHH added that it had advertised on the Internet the prices at which the cars of two manufacturers were available on the service. Both manufacturers concerned insisted that PHH stop this practice. This had the result that PHH could not quote the monthly rental of the vehicles—because under the Consumer Credit Regulations PHH was also required to disclose the capital cost of the vehicles—thus removing one of the most powerful ways of promoting the service. Moreover PHH had to field numerous pricing enquiries from customers, which undermined one of the principal advantages of the Internet, ie that information was instantly available at the 'click of a mouse'.

Finance companies

Capital Bank Motor

8.280. Capital Bank Motor (part of the Business Banking Division of the Bank of Scotland) gave written and oral evidence. It told us that it provided finance to dealers (both franchised and independent) and to consumers. In addition it had established joint ventures with a number of car suppliers in order to provide finance for their customers. Each joint venture company's board would include representatives of Capital Bank Motor and of the supplier concerned. Capital Bank Motor also had joint ventures with trade unions, professional bodies and building societies which, in turn, provided finance for their members, often for the purchase of motor vehicles. Capital Bank Motor said that its latest accounts showed that 23 per cent of its assets were classed as consumer motor vehicles. It was concerned that an uncontrolled lifting of the Block Exemption or a change in the way cars were priced might have an adverse effect on the consumer.

8.281. Capital Bank Motor believed that the new car market could not be considered separately from the used car market. When consumers bought new cars, they usually traded-in used cars. Capital Bank Motor's particular concern was residual values because, in addition to the obligation to its shareholders, it had an obligation to the end-user to ensure the vehicle that it was financing was actually worth the asset value on which Capital Bank Motor was taking the risk. The traditional form of hire purchase was declining in favour of PCP terms. Under this scheme the future value of a vehicle was guaranteed and at the end of the agreement period the customer would be able to put that amount towards a new car. The number of customers using PCP had doubled in the last year and was continuing to grow, now accounting for about 15 per cent of Capital Bank Motor's business.

8.282. The Bank of Scotland's Asset Finance Division operated three businesses on the contract hire side, catering for the entire market from one car to large fleets. The first business targeted small companies and individuals and had a large amount of business sold through dealership introductions. The second targeted small and medium-sized company fleets and the third targeted large fleets and blue-chip customers. Its operation usually included some form of subsequent management of the fleet. Capital Bank Motor supplied the vehicles via the suppliers' franchised dealers. Suppliers tended to set a non-negotiable fixed volume rebate for the contract hire industry. Older models from the volume manufacturers had the largest rebates. Suppliers might give clients of contract hire companies additional negotiated discounts or rebates, in return for an exclusive or high-volume share of the client's fleet.

Issues Letter

8.283. In its comments on Annex 5 of the Issues Letter (Appendix 2.1) Capital Bank Motor made the following points:

Selective and exclusive distribution within the UK

- (a) Capital Bank Motor had no evidence that the distribution system had led to any of the adverse effects we had identified. It emphasized the importance of the availability of servicing from a competent network in line with the supplier's terms. Failure adequately to maintain vehicles would adversely affect their residual values.

Prices

- (b) RRP's provided a guideline for valuation purposes. For the purposes of lending money against the asset value of the vehicle the finance house and the consumer relied on this figure as a benchmark of its market worth. Capital Bank Motor noted that the Inland Revenue used list prices as the benchmark for company car taxation.

Bundling of financial benefits

- (c) Capital Bank Motor had no evidence that the bundling of non-price benefits helped to maintain suppliers' price structures based on RRP's.

Price comparisons within the EC

- (d) Capital Bank Motor believed that a number of factors, including variations in levels of taxation and exchange rates, contributed to the substantial price differences throughout the EC. A strong pound had magnified the negative price differentials between the UK and other EC countries. There was a case to be made for price adjustments but equally there was a case for stable car prices which were not prone to constant rises and falls. From the perspective of the consumer and the lender, asset value stability was an important consideration but not one that precluded managed adjustments.

Pre-registration of cars

- (e) Pre-registered cars were sold to consumers at a price which reflected status. Capital Bank Motor was not aware of any lack of transparency on this issue.

Grey imports

- (f) Capital Bank Motor was unwilling to provide finance on grey imports which did not match European specification vehicles. In its experience vehicles which featured diagnostic systems in Asian languages or parts not readily available in the UK suffered greater depreciation than EC specification vehicles. In other words the market determined that those vehicles were worth less than their EC equivalents.

Internet

- (g) Capital Bank Motor believed that this would provide a new method of selling vehicles complementary to the dealer-based network.

First National Motor Finance

8.284. First National Motor Finance, a subsidiary of First National Bank, told us that it believed it was in the interests of the consumer that the process of obtaining credit to buy a car was as open as possible. Consequently the intermediary, in this instance the car dealer, should be unrestricted in its ability to choose the best possible arrangement for the customer. Inevitably this meant choosing between more than one finance company and also having free choice over whether that credit deal was best for the consumer, independently from any car supplier's related conditions.

HSBC Vehicle Finance (UK) Limited

8.285. HSBC Vehicle Finance (UK) Limited (HSBC) told us that it was a major provider of financial services in the personal and business fleet sectors. Commenting on the Remedies Statement (Appendix 2.3) it made the following points.

The Block Exemption

8.286. HSBC questioned whether the Block Exemption was the main cause of new car price disparity in the UK, pointing out that it applied throughout the EC and did not have a similar effect in other countries. The Block Exemption was only one of many factors influencing pricing disparities, including differing tax regimes, exchange rates and market forces. HSBC would support the introduction of a less restrictive regime if it resulted in lower consumer prices but was concerned that there should be sufficient safeguards in the new system to ensure that car safety was not compromised.

Separate sales and servicing operations

8.287. HSBC said that as in all markets PDIs should be the responsibility of the supplier through its dealers. However, in the interests of greater competition and consumer choice, suppliers should be prohibited from requiring that the dealers undertook subsequent servicing and repair. To ensure that technical standards were met suppliers should provide consumers with lists of approved maintenance and service outlets. They should not be allowed to limit the number of approved operators in a region or to set a minimum size limit, providing that the operators had the required staff skills, equipment and facilities. Suppliers should also provide the outlets with specialized tools, diagnostic equipment, technical information and training at commercially acceptable prices.

Terms given to dealers and fleet purchasers

8.288. HSBC believed that as in all markets similar volume-based discounts should be available to all operators in the market.

Pre-registration of cars

8.289. HSBC thought it inconsistent that suppliers and dealers should not be able to purchase vehicles outright in their own names, thereby securing appropriate terms. However, vehicles should not be registered before they were actually under the dealer's control. Separate reporting for cars in this category and for those sold directly to end-users would aid transparency.

The use of in-house finance companies

8.290. HSBC believed that suppliers should be prohibited from requiring their dealers to use the suppliers' in-house finance company. This would introduce greater competition and might lower financing costs.

Implementation of changes

8.291. HSBC emphasized that any changes to the market structure resulting from our inquiry should be carefully managed. A sudden reduction in the price of new cars would affect residual values and this could damage finance companies such as HSBC and existing car owners.

Other companies

Autopolis Strategy Consultants

8.292. Autopolis (see paragraph 8.142) commented on the Remedies Statement (Appendix 2.3). It questioned paragraph 5 which stated that franchised dealers in the UK were normally supplied on sale-or-return terms, which meant that they did not have to pay for a car until they had a buyer. In reality, Autopolis said, dealers accepted cars, with or without buyers, in conformity with their sales objectives and the suppliers' allocations. Suppliers customarily financed this inventory for a pre-agreed period of days, during which time, in theory, the dealer could return the goods. After that the cars were financed by the dealer. In practice, dealers did not attempt to return vehicles unless they were grossly defective, which was rare. Attempting to do so on any significant scale would endanger the dealer's franchise agreement.

The Block Exemption

8.293. Autopolis said that the new vertical agreements block exemption was too simplistic to be applied to the car industry. It was based on a concept of a market share threshold, below which participants were exempt. Unless the threshold was lower than announced, the car industry would escape the provisions of the regulation and manufacturers would be free to apply any restrictive regime they wished. All available evidence showed that they achieved control of their distribution networks, and thereby an effective price cartel, without any individual supplier reaching the trigger threshold.

8.294. A new specific regime was needed for the car industry. It could be a variant of the vertical agreements regulation, with much lower thresholds, or preferably could prohibit all vertical contractual restraints unless good cause could be shown for them. This would include suppliers selling direct to end-users through their owned outlets and web sites. The important point was that the exclusivity of channel should be banned. The French concept that it was an offence to refuse to sell to a bona fide buyer without good cause might be relevant.

Exclusive territories

8.295. Exclusive territories directly inhibited competition between retailers. They were not usual in other retail trades, where consumers were expected to make their own decisions about the radius within which they would shop.

Selectivity vis-à-vis new car retailers

8.296. Suppliers should be allowed to prohibit retailers from modifying new cars only if the cars were genuinely supplied to the retailer on a sale-or-return basis. Once the retailer owned them it should be free to modify them, subject to laws on safety and emissions.

8.297. Minimum sales quantities should not be imposed. Each supplier should be free to apply a volume-related schedule of prices, to reflect the cost of supplying outlets with different characteristics, especially volumes.

8.298. If cars were supplied on a sale-or-return basis it was reasonable that suppliers should require minimum standards of presentation and facilities for collection, storage and delivery. Retailers should be able to choose whether or not they invested in IT and electronic communication systems. Suppliers could legitimately offer financial incentives to retailers which adopted systems that facilitated the suppliers' tasks and reduced their costs. Training requirements and the provision of demonstrator cars should be agreed between the parties, although suppliers might be free to make it a condition for their financing the floor plan.

8.299. It was common practice in the distributive trades for the scale of terms and conditions to be made public. This prevented exclusions. Some provisions might, however, be needed to protect suppliers from dealers which wilfully abused their products and brands. This could be provided for in the terms of distribution contracts.

Separate sales and servicing operations

8.300. Autopolis thought that suppliers should be prohibited from requiring retailers of new cars to service and repair those cars. The necessity of this link was at the heart of the arguments put forward by suppliers in favour of the existing SED system. PDIs and warranty and recall work should be the responsibility of the supplier, as the warrantor of the product's quality and safety. The supplier could subcontract these functions to third parties, including retailers.

Servicing and repair operations

8.301. Autopolis had no objection to suppliers entering into agreements with servicing and repair operators and setting the conditions, provided that the operators were not additionally given exclusivity. Specialized tools, diagnostic equipment and technical information should be made available to the independent repairers at normal, competitive rates.

Solus dealerships

8.302. Autopolis saw no reason for restrictions on retailers' freedom, subject to contractual requirements for the protection of products and brands being respected.

Full-range forcing

8.303. This was one of the most powerful inhibitors of multi-brand retailing of cars. It inhibited the retailer who wished to offer consumers full comparison shopping within a product category. It was also the major instrument through which the industry protected marginal or uncompetitive products and thus its own excessive multiplicity of products and economic inefficiency.

Advertising

8.304. No restrictions on dealer advertising were appropriate, particularly on price. Advertising derogatory to the product or manufacturer could be the subject of normal recourse to law, within the framework of the distribution agreement.

Other aspects of the Block Exemption

8.305. Autopolis believed that if the Block Exemption were renewed in its present form there should be clauses in the agreements specifying reasons why they could be ended, and possibly stated penalties for ending the agreement for other reasons. These terms should apply to the dealer and to the supplier so that both were protected. A supplier should not be allowed to terminate an agreement as part of a reorganization of its network. (This, too, should work both ways.) If the allocation of exclusive territories were allowed to continue, dealers should be allowed to advertise and pursue clients freely, following their own commercial judgment. This was fundamental to ensuring competition, even within an inherently highly restrictive system. Unilateral action in respect of changes of territory should be subject to the provisions of contract and compensation for the breach thereof.

Other matters

8.306. If the Block Exemption were not renewed, matters would probably resolve themselves through commercial negotiation and remedies might not be necessary. Dealing with them explicitly would, however, be a useful safeguard. Outright purchase should be possible on terms and conditions (notably volume-related prices) for all purchasers, without discrimination. This was the pre-condition for an open, transparent, equitable market. The only discrimination allowed in the terms offered to contract hire companies should relate to identifiable differences in product specifications or in the level of support services offered. RRPs reflected a desire to control the whole of the distribution and retailing chain. They had been abolished in most sectors and should be abolished in the car sector. Conversely, suppliers should be required to publish their wholesale price lists, including volume-related discounts. In the USA the customer knew what the dealer had paid for the car. Although manufacturers did not officially support the availability of this information, they tolerated the sourcing of it by third parties. Autopolis thought that the concept of a reduction in the wholesale price was erroneous. The wholesale price of the base vehicle and of all options and other benefits should be separately and clearly identified. Both dealers and consumers could then make their own choices about bundling or unbundling.

Pre-registration of cars

8.307. Autopolis strongly supported the suggestion that pre-registration by suppliers and dealers should not be allowed except for vehicles for their own use, such as employees' or demonstrator cars. In fact Autopolis believed that there should be no pre-registrations at all, only genuine registrations for a legitimate purpose. Pre-registration was at the heart of the control mechanism. It protected the manufacturers and their dealers from the consequences of the production of less attractive models and of the full product range of a given manufacturer, and was one of the major obstacles to the proper functioning of the new cars market.

Broadspeed Engineering

8.308. Broadspeed Engineering (Broadspeed) gave oral evidence at a hearing. It also attended the open hearing (see Appendix 1.1). Broadspeed told us that it was an international arbitrage vehicle importer. In 1997 it had carried out a study of car distribution in Europe, including an EC and non-EC analysis of parallel imports. Its research highlighted the large differences between the price of cars in the UK and elsewhere in Europe. In January 1998 Broadspeed had started to import RHD cars but found this practice difficult and time-consuming.

8.309. Broadspeed had then approached the ferry company, Stena Line, about offering a 'car-cruise' service to Holland to enable customers to negotiate direct with Dutch car dealers. This had commenced on 2 March 1999. By October P&O North Sea Ferries and DFDS were offering similar cruises. Broadspeed had initially hoped to have representatives from the dealers in the Stena ferry terminal at the Hook of Holland to serve customers as soon as they arrived. However, the 11 dealers (main agents) which were to take part had subsequently withdrawn. Broadspeed believed that this was not coincidental or voluntary, but it had no written evidence to support this.

8.310. On the basis of its experience Broadspeed had produced the *DIY car importers' guide* (which was updated and published twice a year) to provide assistance to consumers interested in purchasing cars outside the UK. There had been considerable demand for the guide and by November 1999 Broadspeed had sold over 30,000 copies. It had also contacted dealers in mainland Europe and in Ireland to find out which were English-speaking and willing to sell UK-specification RHD cars to UK consumers. The resulting list of dealers was updated every six weeks and sold to interested consumers. Broadspeed also operated a telephone helpline.

Issues Letter

8.311. In its comments on Annex 5 of the Issues Letter (see Appendix 2.1), Broadspeed made the following points.

Selective and exclusive distribution within the UK

- (a) Because suppliers had complete control over the marketing and distribution of new cars in the UK, there was no possibility for meaningful competition. This resulted in high prices and restricted consumer choice because there was little benefit in searching for dealer discounts.
- (b) Dealers were unable to innovate if what they proposed varied the suppliers' official line. True efficiency could not be found in a rigged market.
- (c) SED brought no benefits to the consumer and did not ensure the availability of servicing, repair, and parts throughout the EC. Many Broadspeed customers returned to Holland for service and repair work. Ford's purchase of Kwik Fit demonstrated its vision of the future without a dealer network. Motor vehicles would soon be 'sealed for life' and in need of little or no regular maintenance—just replacement parts.

Prices

- (d) Prices were fixed by the suppliers simply to maximize their own UK profitability. If a manufacturer could afford to sell the same model for up to 57 per cent less in other EC markets and still make a return on capital, clearly UK prices were increased to the level the market would bear. Prices were set at what UK consumers would pay; this also increased residual values. Many volume car manufacturers earned more from retail financing and used car sales than from new car sales. Both these businesses relied on managed high residual values. RRP's were also operated in Holland, Denmark and Finland where RRP's were 20 to 50 per cent below the UK's (before tax). Dealer margins varied between 4 and 15 per cent in those countries. Even in these lower-priced markets, RRP's were restrictive because car importers dumped excess stock themselves at appreciably lower prices.

Bundling of financial benefits

- (e) Suppliers aimed for maximum confusion in all EC market places and this was another price support mechanism.

Price comparisons with other EC member states

- (f) Broadspeed said that its research showed there were high price differentials between EC countries. The main historical causes were the EC multi-market boom and recession leading to inflation rates between 0 and 30 per cent over an extended period; high EC currency fluctuation; and variations in car taxation.

Bonuses to dealers

- (g) All EC dealers received annual retrospective bonuses and this was another control mechanism. Bonuses for the sale of extended warranties and other supplier-promoted services distorted consumer choice. Additionally, widely differing warranty periods and costs were used to confuse

UK buyers. Branding was vital in all these areas. It was practically impossible for unknown brands to break into the car showroom marketing process.

Dealer discounts

- (h) Suppliers' collection of information on dealers' businesses enabled them to monitor and influence dealer discounts to customers. Because there was effectively no competition, their influence over dealer discounts made prices higher.

Discounts to fleet customers

- (i) Discounts to fleet customers did not necessarily depress residual values because these were set by the market and not by the suppliers. Such values were remarkably similar (before tax) across the EC, despite the wide pre-tax price differentials for new cars.

Dealers' costs

- (j) The suppliers' control over showroom appearance did not contribute to higher prices. Supplier and dealer investment in marque presentation and brand building in low-priced and even emerging markets was not visibly lower than in the UK.

Dealers' sourcing of cars in other EC member states

- (k) A dealer would lose its franchise if it sourced new cars in other EC member states. Given a free market, dealers would naturally buy in the market offering the widest margin.

Specifications

- (l) High specifications were a simple way of increasing UK list prices (and profits). In the UK consumers did not usually get the chance to choose the cheaper, more basic specification enjoyed by buyers elsewhere in Europe.

Grey imports

- (m) The free importation of new and used non-EC (especially Japanese) vehicles could (assuming a low yen) flood the UK market and potentially create a damaging free-for-all. Non-EC vehicles sometimes had different technical specifications and equipment and could potentially become difficult to insure and maintain in the long term.

Warranty

- (n) The use of restrictive warranty terms caused confusion and increased prices.

An Internet start-up company

8.312. We received comments from an Internet start-up company which proposed to offer consumers central purchasing of new cars, together with insurance, retail finance, and breakdown and recovery services. The company intended to deliver the cars direct to the consumers with whom it did not expect to have previous contact other than through a call centre. It was negotiating with service and repair operators and local dealership groups to provide after-sales service. Its ultimate aim was to source cars directly from the manufacturer.

Remedies Statement

Selectivity vis-à-vis new car retailers

8.313. The company could see no benefit from the suppliers imposing minimum sales quantities. It thought that rather than insisting on minimum standards of presentation, particularly if these required a

physical showroom or special equipment, suppliers should rely on general minimum standards, such as a requirement that the presentation should not bring the brand name into disrepute or be misleading. The requirement to satisfy physical criteria could be used to exclude virtual on-line retailers, and thus limit competition.

8.314. The company said that the requirement for specified IT and electronic communication systems had confused several other industries. This experience suggested that the process should not be driven by the suppliers. It believed that the most efficient method would be to have one industry data and communication standard. Suppliers should make available open standards for information exchange with retailers, which would encourage the most cost-effective solutions from third party IT providers.

8.315. The success of car importation and of virtual car sales in the USA indicated that trained sales personnel and demonstrator cars were not necessary from a customer point of view. Their requirement by suppliers would prejudice the feasibility of a virtual retailer which might not have demonstrator cars and only telesales personnel.

8.316. The company thought it was reasonable for suppliers to price differentially between retailers, based on the economies of scale resulting from volume ordering, but not reasonable to base different prices on other factors, unless these factors were disclosed and available to all retailers. Suppliers should be required to publish their prices.

Separate sales and servicing operations

8.317. The company thought that one of the main faults with the current system in the UK was the continuing cross-subsidy between after-sales service and new car sales. This meant that few dealers clearly understood their cost structure and thus their most competitive pricing policy and fell prey to control by suppliers' new car volume incentives. By splitting new car sales from second-hand car sales and after-sales service, the cost structure would be clearer and this would encourage greater competition. Suppliers should not be able to insist that their cars were sold only by retailers who offered servicing and repair.

Servicing and repair operations

8.318. As a virtual retailer the company would not provide service and repair operations, but it needed to have access to approved dealers to perform warranty, service and repair work. It said that the suppliers had introduced the current approval system to ensure that minimum standards were maintained. The recent CA report on servicing and repair suggested that quality and value for money were still missing from this market. Provided they had appropriate equipment and trained staff, service and repair operators should not be prevented from gaining manufacturers' approval.

Solus dealerships

8.319. The company believed that solus dealerships were only advantageous for the supplier. It said that research suggested that almost 50 per cent of car buyers would prefer cross-brand choice from their retailer.

Full-range forcing

8.320. Full-range forcing was an example of the 'product push' mentality of suppliers that the company believed was against the customer's interests. The situation where retailers would not take the full range should encourage the supplier to refine its range more accurately to meet consumer demand.

Advertising and promotion

8.321. So long as advertising and promotion did not bring the brand name into disrepute and was not misleading, there should be no restrictions by suppliers, particularly on the prices at which cars could be advertised.

Other aspects of the Block Exemption

8.322. As the company did not have an existing role in the supply chain, it had no strong views on termination of agreements. It believed that customers would benefit from wider choice, keener prices, and greater convenience if they could select a retailer rather than having to deal with one within the supplier's artificial geographical allocation.

Other matters

8.323. Dealers wishing to buy new cars outright should be able to do so at the same terms offered to fleet customers buying the same volume. The company believed that this was an essential ingredient of a free market. Suppliers should not be able to discriminate between different contract hire companies on the basis of the percentage of business/private users. RRP's were helpful but should not be enforced by the suppliers. On the question of bundling, the company thought that dealers should be able to opt for an equivalent reduction in wholesale prices in place of bundled financial services and other benefits.

Supplementary Remedies

8.324. The company was in favour of any aid to transparency and therefore supported the suggested measures regarding pre-registration. It thought that dealers should be free to use the financial services provider offering the most competitive product for their customers. In addition the company suggested that dealers might be required to disclose the commissions or other remuneration earned on these financing and insurance transactions.

Consumers

Mr D R A Bott

8.325. Mr Bott, a consumer in south-west England, gave us copies of his correspondence with the Volkswagen AG group, the DTI and the European Commission about the difficulty he had experienced between April and July 1998 when attempting to purchase an RHD Volkswagen Golf from the Netherlands. He noted that in a letter of 17 April 1998 Volkswagen had told him that this version of the car was still being developed, although he had in fact already driven one in the UK. Later (in a letter dated 8 May) Volkswagen had said that he could order a car after 15 May 1998. Mr Bott said that when he had tried to do so from the importer's recommended agent, he was again frustrated at every attempt. Eventually after contacting over 50 Dutch dealers he had managed to order a car. He believed that the dealers did not want to sell cars to overseas buyers because of an implied threat of reprisals from Volkswagen or the importer. He said that, with the exception of alloy wheels (list price some £400), the car was a very similar specification to the UK model. Even after including his return transport costs to Holland, the car Mr Bott purchased had cost £5,500 less than the UK model. He believed the fact that the price in the UK was over 45 per cent more than the Dutch price was evidence of price fixing in the UK.

8.326. Mr Bott subsequently told us that when he ordered another Volkswagen Golf in August 1999 the process had been easier. However, the additional charge for an RHD car had doubled and the dealer had been unable to offer a discount because, it said, Volkswagen had threatened to take the dealership away if it discounted RHD cars. Despite this the car still cost approximately £4,000 less than the UK model (including all tax).

Other consumers

8.327. A consumer in south-east England said that when attempting to negotiate the price of a Ford car with a dealer he had been offered extras (air conditioning etc) rather than a discount. Shortly after placing his order, Ford had advertised that it was giving the same extras free with new cars ordered during a specific period. When he pointed out to the dealer that he was now effectively paying the list

price for his vehicle the dealer agreed to approach Ford about a possible discount, but emphasized that Ford gave it little margin to negotiate.

8.328. A consumer in south-east England told us that he was experiencing difficulty in purchasing a British-made Honda in the Netherlands, where it was about 27 per cent cheaper. The car had been eventually available nearly nine months after being ordered and the Dutch importer had had continuous problems with Honda UK in obtaining responses to its questions or obtaining firm delivery dates. The consumer believed that the company was being difficult in order to prevent UK residents from buying their cars in the Netherlands.

8.329. A consumer living in Northern Ireland told us that several BMW and Mercedes-Benz dealers in the Republic of Ireland had refused to sell him a car for export to Northern Ireland. He alleged that a new Mercedes SLK purchased in the Republic cost £29,500 and that the same model of car (with similar extras) purchased in the UK cost £33,500. The consumer also believed that the UK importer had deliberately limited supply to keep prices high. The typical UK waiting time for delivery was 12 to 24 months compared with four months in the Republic of Ireland.

8.330. A couple in south-east England told us that an authorized Mitsubishi dealer had refused to carry out the first service on their imported vehicle although when the car had originally been purchased the dealer had agreed to do so. The dealer had later said that the Colt Car Company (importer of Mitsubishi brand cars) had told him not to service the car.

8.331. A consumer in south-west England had recently purchased an imported Mitsubishi and had had difficulty in finding a UK dealer to carry out repairs. A representative of the Colt Car Company had told him that the company instructed dealers not to deal with imported vehicles because the parts might be different.

8.332. A consumer in Northern Ireland complained that a dealer in the Republic of Ireland had told him that it would lose its franchise if it sold him a Land Rover. The price the dealer had quoted for the vehicle was £21,000 compared with the UK price of £28,000/£29,000.

8.333. A consumer in south-east England complained about the length of time he had to wait for delivery of a Volkswagen Golf ordered from a dealer in the Netherlands in December 1998. At the time of placing the order he had been warned that delivery could take from six to eight months. On enquiring in June 1999 he was told that delivery could take a further eight to twelve weeks. As there was no such delay in the UK he believed that Volkswagen were deliberately making it difficult to obtain RHD vehicles in mainland Europe.

8.334. A consumer in south-east England said that a dealer in France offered him a Rover to UK specification for £8,300 (plus 17.5 per cent VAT if the car was brought into the UK). Delivery was quoted as 20 to 24 weeks. A local UK dealer quoted £14,000 for an identical model to the same specification.

8.335. A consumer in south-east England had approached dealers in Belgium in order to buy a new Volkswagen. By purchasing in Belgium he would be able to choose which extras to have and there would be other advantages such as fixed price ordering (with a 30 per cent deposit) and rights if the written date of delivery was not met. A London dealer had told him that there was no guarantee that it would honour the order price if the list price changed. Even though the Belgian price included a supplement of about £750 for an RHD car, the price of the car he ordered was about £500 less than in the UK, even though it included £3,000 worth of extras. He noted, however, that the warranty in the UK was three years, whereas in Belgium it was only one.

8.336. A consumer complained that car prices in other EC countries included an RHD surcharge. Modern just-in-time manufacturing methods and the fact that most manufacturers already produced RHD cars led him to believe that manufacturers included the surcharge only to bring the price of cars nearer to UK price levels.

8.337. A consumer in south-east England told us that he had bought three new BMW cars from two local dealers during the last nine years. On each occasion both dealers had quoted exactly the same prices telling him repeatedly that BMW did not allow discounting. He had now ordered a new BMW from a dealer in the Netherlands and found that every item included in both the Dutch and UK specifications

was considerably more expensive in the UK. The consumer estimated that UK buyers were being charged between 10 and 30 per cent more for each item, excluding VAT, and that the overall saving on the UK price was 15 per cent.

8.338. A consumer in south-east England complained about Ford's marketing activities. He said that Ford was unfairly biasing the fleet market in its favour by offering large cash payments to companies which ordered Ford vehicles for their staff from contract hire companies. The end-user companies placed orders in the usual way and received the ordered car in return for monthly payments. The unfair element arose because after the order had been placed Ford paid the end-user company a sum of around 21 per cent of the retail value, subject to fleet size and hence annual reordering numbers.

8.339. The consumer believed that Ford's actions disadvantaged other manufacturers, kept retail car prices artificially high to cover these payments and, because not all manufacturers offered or were capable of offering such sums, restricted choice. Since the company car fleet segment formed a significant part of the UK market, Ford was reducing competition internally and thereby affecting the ability of European manufacturers to sell their vehicles in the UK.

8.340. A consumer supplied us with a breakdown of the differences between prices for the new BMW 323 and 328 Coupe in Germany and the UK taken from BMW UK and a dealer in Germany. A UK specification car bought in Germany cost around 13 to 17 per cent less (depending on the model) than the same car in the UK. In addition almost all the optional extras (that were not affected by the car being LHD or RHD) cost an average of 60 per cent more (pre-VAT) in the UK than in Germany. The consumer said that customers ordering a UK-specification Mercedes-Benz or Porsche from a dealer elsewhere in the EC were given delivery times of six to nine months longer than the UK delivery period to discourage them from ordering the car.

8.341. A consumer in Wales complained about the delivery time he had been quoted by a dealer in Germany for an RHD Volkswagen Golf. The contract, made in August 1999, had stated that the car would be delivered within 12 to 15 weeks, but the consumer was subsequently informed that delivery would take place during the first quarter of 2000 because of the high demand for diesel engines. He was told that he would experience the same problems if he ordered an RHD Golf in the UK. He then contacted a Volkswagen dealer in the UK and was told that delivery would take four to five weeks. The consumer considered that he had been discriminated against because he had ordered a vehicle in Germany and not in the UK.

8.342. A consumer in south-east England told us that a Volvo dealer in Germany had told her recently that Volvo did not allow it to sell RHD vehicles. If it did it could lose its franchise.

8.343. A consumer in south-east England complained that a Vauxhall dealer which was offering interest-free credit on new cars would not lower the price of a new Astra estate if he paid cash. He wrote to Vauxhall suggesting that there was no such thing as interest-free credit—the interest had just been rolled into the list price which was unfair on anyone not wishing to use hire purchase. Vauxhall replied that all manufacturer's costs were rolled into the list price irrespective of the method of purchase. The consumer said that this arrangement meant that consumers were pushed into using Vauxhall's in-house finance company and could not shop around to obtain better credit terms from other financial service providers. He thought that this was clearly anti-competitive. In addition he believed that the marketing overhead rolled into the list price must be very high, perhaps 20 to 30 per cent of the price, in order to cover the interest charges for the credit, and that this must be a major cause of higher prices in the UK. He disagreed with the manufacturers' argument that the price differential between the UK and mainland Europe could be attributed to the strong pound, believing that that should have had the opposite effect.

8.344. A consumer in north-west England said that when he had approached about 20 Subaru dealers with a view to negotiating the price of a new car, only one had offered a discount. One of the dealers he had contacted said that it was acting on the instructions of Subaru, which would take the franchise away from any dealer who discounted prices.

8.345. A consumer in south-west England said that whilst SED made it easier than it would otherwise have been for manufacturers to abuse their position, the main cause of the comparatively high UK prices was the high proportion of cars bought by company car buyers compared with other EC countries. Suppliers artificially inflated their prices by 20 to 25 per cent so that the purchasers believed they were obtaining a high discount. The consumer saw little point in a liberalization of the distribution

arrangements if the current company car tax subsidies were not removed to create a level playing field for car buyers.

8.346. A consumer in south-east England told us that by buying a new Volkswagen in the Netherlands he had saved 21 per cent of the UK price. He noted the minor inconveniences he had experienced. Because the specifications of the car were different to those in the UK the agent had insisted that he travelled to the Netherlands to order the car. Although an agent in the Hague had quoted a 12-month delivery period the agent in Amsterdam from whom he purchased the car had quoted five months which compared favourably with the delivery time in the UK (four months). He had been asked to sign a declaration that he would not sell the car in the UK and to confirm that he would not export it out of the EC. If he sold the car outside the EC the dealer would have to pay Dutch VAT on the sale. To protect the dealer's position he had paid a deposit equivalent to the amount of the VAT, refundable once he had proved that the car had been imported into the UK and UK VAT paid on it. The consumer had also had to pay a one-third deposit when ordering the car. Again this meant extra finance and this could be difficult for consumers who were using a bank to finance their purchase. The consumer also anticipated problems when registering the car in the UK because he would need to prove that UK VAT had been paid and provide an EC Certificate of Conformity.

Other complaints

8.347. In addition to the above complaints and those listed in Appendix 8.1, we received complaints about new car pricing generally from 25 members of the public. Seven of them commented on the high UK retail prices compared with prices in the rest of Europe. One said that when sterling was strong against other currencies there should be a downward adjustment of prices for foreign-produced cars but this was not happening. Three said that price differences between the UK and Australia were more relevant than differences between the UK and other EC member states. Two of these said that this was because Australia had similar wage rates to the UK, but new car prices in Australia were about one-third lower than in the UK: manufacturers claimed that UK specifications were higher than those overseas but generally the reverse was true.

8.348. Seven of the 25 members of the public complained about high discounts suppliers gave to fleet operators compared with discounts given to individuals. One commented that the new car market was driven by company vehicle purchases and other corporate purchase schemes. Another of the seven noted that the UK had a higher proportion of company-owned vehicles than other EC member states.

8.349. Five of the members of the general public complained about fixed retail prices and two about dealers' inability to negotiate prices. One claimed that a manufacturer had threatened to discontinue supplying a dealer which offered discounts. One member of the public said that a manufacturer was rationalizing its dealer network in order to exert control over the prices of its products. One other believed that abolition of the SED system, which was used by manufacturers as a barrier to parallel imports, would result in lower prices. However, he was concerned about the effect this would have on residual values.

Others

Corporation of London, Trading Standards Office

8.350. The Corporation of London, Trading Standards Office (TSO), responded to the Remedies Statement (Appendix 2.3). It made the following comments.

The Block Exemption

8.351. Although the current system seemed unlikely to continue after 2002 the TSO questioned why it currently operated to such consumer disadvantage in the UK compared with most other EC member states.

Selectivity vis-à-vis new car retailers

8.352. The TSO said that it was difficult to see significant justification for the restrictions we had identified. The suppliers' understandable wish to require showroom appearance and display space which would show their products in as positive a light as possible was only valid where exclusive territories existed. It would be useful to have a restriction preventing suppliers from using differential pricing effectively to perpetuate the territories of favoured retailers, as was already the case with other goods.

Separate sales and servicing operations

8.353. There was on the face of it no reason not to permit the separation of sales and service. Cars were, however, not entirely like other consumer goods. In practice every retailer would probably need to be able to undertake PDIs and also any rectification under the terms of the Sale of Goods Act. If separation were to be permitted the situation of warranty and the crucial safety issue of recalls needed careful consideration.

Servicing and repair operations

8.354. It would seem reasonable to permit the supplier to require minimum standards but this should not be misused and become a method of forcing a customer into an artificially priced servicing regime. There was no obvious reason for servicing territories and size was immaterial so long as the abilities and equipment were adequate. In the interests of safety, technical information should be available to all although it was reasonable not to supply specialized tools, diagnostic equipment and training to non-approved service operators.

Solus dealerships

8.355. There was no reason to permit restrictions on the makes of cars sold from particular premises. However, a supplier that had invested heavily in a site's facilities would clearly not wish for other cars to overshadow its own. A satisfactory resolution needed to be found for this difficulty.

Full-range forcing

8.356. Retailers should be free to sell the models they wished. This would be particularly relevant once the exclusive territories were removed.

Advertising

8.357. There was no obvious justification for suppliers controlling retailers' advertising.

Other aspects of the Block Exemption

8.358. All the remedies we had suggested might help to ameliorate the difficulties under the Block Exemption but the big issue of price would need to be addressed.

Other matters

8.359. The TSO believed that effectively fleet customers should be charged the wholesale rate available to dealers and that suppliers should be prohibited from discriminating in the terms offered to contract hire companies depending on the end-users. The prohibition of RRPs might not be appropriate because in some ways they were useful to customers. Perhaps general prices should be quoted as they were with other goods. Dealers were in danger of committing criminal offences if free insurance, cheap

credit etc were only available when the retail price was higher than it was without these benefits. If the proposed remedy were implemented each dealer should have to choose one or the other of the offers.

Mr P Groves

8.360. Mr Groves, a solicitor with considerable experience of the motor industry, gave us his views. He believed that the issue of price differentials had masked a number of other important issues in the area of dealer agreements, particularly relating to the balance between the economic interests of the supplier and the dealer. He thought that the non-renewal of the Block Exemption would be undesirable and would not necessarily tackle the underlying price issue. There had been little change in the balance of multi-franchising since the introduction of the current regulation. Most suppliers took advantage of the restrictions permitted by the Block Exemption and insisted that dealers had separate premises and management, and distinct legal entities for additional franchises, although these terms were rarely justified in terms of avoiding confusion between makes.

8.361. Mr Groves believed that prohibiting the SED system in order to level prices would be an unnecessarily harsh measure. The system had advantages which most consumers would regret losing in order to solve pricing problems. Evidence showed that when a local dealer no longer held a particular franchise, consumers were more likely to transfer their loyalty to a new franchise held by the dealer than to travel to an unknown dealer in another town. It would be inappropriate to replace dedicated dealers with non-specialized garages because although cars were more reliable and service intervals longer, cars were more sophisticated and needed specialist maintenance. Although suppliers' use of warranty terms to preserve the servicing of cars of up to three years old was justified for difficult repairs, it was unnecessary for regular servicing which any garage could undertake. Mr Groves said that not all consumers were concerned about price differentials and most would prefer to pay a premium (though smaller than at present) to secure the current levels of service.

8.362. Mr Groves believed that action should be taken to prevent abusive conduct by suppliers, such as their refusal to grant volume discounts to dealers. If the Block Exemption were removed, suppliers' reaction might be to integrate their operations vertically. This would allow them to take complete control of the distribution of their products and remove intra-brand competition. The same effect could be observed in the move to larger territories for dealers and in the appointment of regional dealers.

8.363. Mr Groves said that legislation on the lines of the US model would give dealers protection against arbitrary and unfair treatment from suppliers and help to redress the balance of power in their relationships. A major cause of the industry's problems was the suppliers' ability to terminate dealers' agreements on only two years' notice after dealers had made considerable investments in the dealerships. He believed that the Competition Act 1998 would enable the OFT effectively to address abuses of market power and restrictive agreements.

Lord Jacobs

8.364. Lord Jacobs, Chairman of the British School of Motoring from 1973 to 1990, said that price comparisons carried out during the last two years had shown that, for virtually every model of car, UK prices were higher (on average about 15 per cent) than in any other country in western Europe (both inside and outside the EC).

8.365. Lord Jacobs said that, as a proportion of total sales, UK sales of cars to fleet buyers were higher than in any other country in the world, accounting for an average of 60 per cent of new cars. He believed that the high discounts given to fleet buyers were a major cause of the high retail prices. Because suppliers' sales through dealers could not easily be increased, the best way for suppliers to raise their market shares quickly was by increasing their fleet sales. Their attempts to do so had resulted in a severe price war in this sector over the last few years. Fleet prices were so low that the margins available to suppliers were inadequate and to protect their overall margins they kept retail prices as high as possible.

8.366. Lord Jacobs attributed the large number of fleet sales to fiscal policy in the 1970s when, under prices and income restraint, employers had not been able to reward employees with increases in pay. In an effort to get round this restraint they had provided company cars. The practice had become

widespread and the benefit to the employees at that time was considerable. Employees did not have to pay any tax for the use of the car, or pay for fuel, repairs or insurance. At the same time all these costs, including full depreciation, were deductible by the employer against his profits. In the last ten years or so the Treasury had begun to tax the private benefit of a company car at increasing rates year by year. Nevertheless it was still more beneficial for employees to have cars provided by their companies than to buy and run their own.

8.367. Lord Jacobs said the evidence suggested that manufacturers would welcome an opportunity to reduce discounts to fleet buyers. He believed that to resolve the issue of high retail prices it might be necessary for the Government to negotiate with manufacturers to limit fleet discounts to an agreed level in exchange for which the manufacturers would cut retail prices by, say, 15 per cent. This would also be likely to reduce the demand for company cars. Legislation might be necessary. Lord Jacobs believed that the situation in the German market was relevant to our inquiry. There, discounts to fleet buyers were modest, despite the fact that the fleet sector was now, in his understanding, not far behind the UK as a percentage of the total market.

Motor trade journalists

8.368. We held a hearing with journalists from *Autocar*, *Auto Express*, *Automotive Management*, *Fleet News* and *What Car?* during the early stages of our inquiry. The main reason for inviting them to give evidence was to obtain background information on the car industry. The issues discussed included the Block Exemption, UK price levels, the market and consumer behaviour. Some journalists gave us copies of relevant articles from their publications. Some of them later attended the open hearing (see Appendix 1.1). We refer elsewhere in this report specifically to information collected by *What Car?* (see paragraphs 7.18 and 7.167).