



## The Block Exemption review: exploring 'digital' competition

By Andrew Tongue, Research Director

As the process of reviewing and renewing the Block Exemption regulations that govern franchise distribution in the automotive and other sectors steps up a gear, the European Commission is busy soliciting views and data from interested stakeholders. At the same time, broader issues in the policy environment that may need to be reflected in the new regulations are coming more firmly into focus. Whilst it is too early in the process to talk about potential outcomes, we are now seeing the list of ingredients going into the melting pot. This Briefing gives a reminder of how the review processes will run, before going on to explore one of the major questions facing the regulators in updating the legal frameworks: how to handle the rapid growth of 'digital' competition, and the emergence of powerful online platforms connecting producers, retailers, and consumers.

### The timeline from now to 2023 ...

When talking about 'the Block Exemption', the European-level competition legislation defining how the franchise network format should operate in the automotive sector, it is important to remember that this refers not just to one, but to two different (but related) regulations:

- ◆ The General (or Vertical Restraints) Block Exemption (currently Regulation 330/2010) applies to franchise networks in all sectors of business, not simply the automotive sector. Most of its specific provisions are more relevant to new car sales franchises than they are to the authorised and independent aftermarket, but its general principles apply to both activities
- ◆ The Automotive Block Exemption (currently Regulation 461/2010) supplements the General Block Exemption with a small number of specific provisions applicable to the automotive sector, and relating to authorised and independent aftermarkets, and to spare parts distribution.

Details of how both frameworks work have been covered extensively in ICDP publications over the years, and are available on request from the Project Office.

The two regulations have slightly different timelines, with the GBE running to the end of May 2022, and the ABE to the end of May 2023. Whilst these deadlines might feel a long way off, the review process is a thorough one, stakeholder feedback exercises take time to complete, and then the new proposals need to be elaborated, launched, debated, and finally agreed through the European mechanism; stages which can be expected to consume the time available.



Thanks to the EU's 'Better Regulation' initiative (See [https://ec.europa.eu/commission/priorities/democratic-change/better-regulation\\_en](https://ec.europa.eu/commission/priorities/democratic-change/better-regulation_en) for more information), which aims to bring more consistency and transparency into the rule-making process, the details of how the Block Exemptions review and renewal exercise will run has been laid out much more clearly than used to be the case. 'Roadmaps' have been published for both regulations (For the GBE review Roadmap, see <https://ec.europa.eu/info/law/better-regulation/initiative/1936/>

On the GBE line, the initial feedback stakeholder submissions have been published by the European Commission, including a number from automotive sector operators. At the time of writing (July 2019), the submissions from the public consultation (which ran to the end of May) had not yet been published, although this was expected to happen imminently. These can be expected to give a wide range of views from a number of different sectors and different types of operator, and considerable 'raw material' for the



next stages in the process which will lead, via a public workshop, through to a European Commission Staff Working Document, which will give the first indications of possible policy options for the new regulation.

The ABE line lags a little way behind in terms of timing, but will follow a similar process. It also includes a formal Evaluation Report on the operation of the current rules, something that the European Commission undertook to produce when the current rules were introduced, to be published before the end of May 2021.

So, in Summer 2019, we are still some time away from any specific policy positions emerging from the European regulators; who are very much in 'listening mode' at this point.

## What will the European Commission be wanting to hear?

As mentioned above, a significant element of the evaluation process is the gathering of inputs from stakeholders of different types. Under the Better Regulation principles, the European Commission now asks for these inputs to be structured under a number of consistent headings:

- ◆ Effectiveness and efficiency
  - ◇ Have the objectives of the regulation under review been met, and at what cost?
  - ◇ In the case of the Block Exemptions, this would relate to 'vertical restraints' (so franchise agreements) operating effectively for both parties in the contractual relationship, and for affected third parties, whilst delivering a fair share of the benefits to end-consumers
- ◆ Relevance
  - ◇ This entails an analysis of new market developments since the regulation was adopted, and their impact on supply and distribution conditions
  - ◇ In both the automotive and other retail sectors, there will be a great deal to talk about here given the rapid pace of innovation and technology-driven change in how consumers acquire products and services, the new channels that have emerged over the past few years, etc.
- ◆ Coherence
  - ◇ This relates to the degree of fit between the outgoing regulation and the Commission's overall competition law enforcement policy and practice
  - ◇ This area is also expected to generate considerable debate from some non-automotive sectors in particular, not because the Block Exemptions have not been consistent with overall competition policy enforcement at the European level, but because there have been numerous instances of national-level interpretation and enforcement diverging from the 'EU-level view'
- ◆ Added value
  - ◇ This entails an analysis of the application of the rules and their accompanying guidelines; have they added value to the sectors concerned, and especially to consumers?
  - ◇ Here, in the automotive sector in particular, opinions will be divided, with the perspectives of those on

the 'giving' end, the manufacturers who set their franchise networks, very different in some aspects from those on the 'receiving' end, the dealers. Those who are not part of the franchise relationship, but who depend on the regulation to safeguard their rights of market access, such as independent aftermarket and spare parts players, will have their own perspectives too. Ultimately, the test of added-value for consumers is a difficult one to prove, given that the vast majority of new cars are sold via the franchise format laid down in the regulation, without there having been any large-scale alternatives that would offer a meaningful comparison. However, stakeholders will be able to discuss the role played by the range of online platforms which have become part of the car-buying journey, arming consumers with information and transparency, but sometimes testing the boundaries of the usual franchise relationship between manufacturer and dealer.

## What are the 'big picture' issues in the GBE review?

In the GBE arena in particular, there are a number of interrelated 'big picture' issues already firmly in play that apply across many sectors, and which all have automotive sector relevance too; we will be returning to them in detail as the reviews progress over the next few years.



Source: ICDP

- ◆ Digital competition
  - ◇ How does competition for products and services differ in the 'virtual world' from the traditional 'bricks and mortar' world? How should the notions of 'territories' and 'active and passive sales' be evolved to cope with markets that cross borders, and customers who are 'connected' to brands via technology? How to ensure that brands are not able to partition online markets in ways that would not be possible offline?
- ◆ Protecting physical retail
  - ◇ At a time when online shopping continues to grow, what should manufacturers/producers be able to do to protect the physical investments made by themselves and/or their retail partners in bricks and mortar outlets, which might still be performing an important function in representing the product or in supporting it post-sale? Should policy be more interventionist in supporting physical retail – the 'High Street' – for broader social purposes?
- ◆ Brands 'going direct' to consumers
  - ◇ Connectivity is enabling manufacturers to remain in contact with their products across their lifecycles, and also to maintain direct relationship with their customers. Together, these are fuelling a trend for brands in a number of sectors to sell 'direct' via their own online channels, or to add third party e-commerce platforms into their channel mix. Does policy need to do more to ensure that competition between direct and franchised channels is fair?

- ◆ Retail-level concentration
  - ◇ In a number of sectors, consolidation of retail-level players has led to the emergence of large retail chains, able to develop considerable market power across the geographies in which they operate. Does general competition policy, and merger assessment frameworks in particular, need to update its assessment of retail-level market power for both offline and online markets?
- ◆ Franchise requirements
  - ◇ In a number of sectors, including automotive, franchisees often feel that investment requirements and operational complexities are growing to the point where the economic viability of their franchises is being weakened. The result of this is them becoming ever more economically-dependent on their franchisor. Does policy need to establish a new understanding of 'fairness' in business-to-business franchise contracts?
- ◆ From 'products' to 'bundles'
  - ◇ In recent outputs, we have explored at length the ongoing growth of the 'monthly payment' over the outright purchase of a new car, and also how leases, subscriptions, and other formats increasingly 'bundle' a range of supporting services (such as maintenance plans, data packages, mobility service offers, etc.) around the core product. This trend towards 'subscription' is apparent in many other sectors too, from 'physical' products such as razors, to services such as Uber's plan to offer bundled access to its ride-hailing, food-delivery, and micro-mobility offers. But what are the competition implications of 'bundling' for end-consumers; does the 'tying together' of different services in one package limit their ability to choose from alternatives?
- ◆ Access to data
  - ◇ As is discussed in more detail below, data is now very much the 'fuel' that enables modern markets to function, with control over data potentially conferring huge market power for those who have it over those who do not. Does policy need to take a more nuanced view over how data is gathered, controlled, and shared in different sectors, to appreciate the potential impact that this has over competition?

These are all big issues, key to how markets operate both now and into the future. However, it is important to recognise from the outset that the Block Exemption rules are in place specifically to address competition-related issues, and not to implement any kind of European industrial or retail or sector-specific policy. In contrast to the ways franchise laws work in some other parts of the world, the European philosophy, for the moment at least, is that the rules are simply there with the objective of 'making the market work', rather than seeking any specific outcome, or favouring any particular type of player. Therefore, not all of these issues are directly 'regulated' in the current Block Exemption rules, nor will they be fully covered in the future rules, as they do not fit the definition of a 'competition issue'. Some of those who will lobby for changes in the interests of 'commercial fairness' will therefore be disappointed. Nevertheless, we can be sure that they will all feature strongly in the policy debate.

## Exploring 'digital' competition

As well as the direct inputs that have already and will continue to be made by interested stakeholders, the policy debate is also being fuelled by parallel enquiries and reports. Of particular relevance to the GBE debate are firstly the E-commerce Sector Inquiry completed by the European Commission in May 2017, and a more recent study, "Competition policy for the digital era", which was published this Spring. Both illuminate the particular challenges of digital competition, many of which will need to be reflected in the new Block Exemption regulations. We will focus on this second study in this Briefing.



Source: ICDP, European Commission

"Competition policy for the digital era" talks about three aspects of 'digital' in particular that are distinctive from 'traditional' competition, and which have readily-discernible impacts on competition.

## 1. Extreme scale benefits

When compared with traditional 'manufactured' products, digital services have a low cost of production but potentially massive and very rapid market reach if consumers find them attractive. This in turn can give a strong competitive advantage to the incumbent players who have developed these services against competition from new alternatives.

*"The cost of production of digital services is much less than proportional to the number of customers served. While this aspect is not novel as such (bigger factories or retailers are often more efficient than smaller ones), the digital world pushes it to the extreme and this can result in a significant competitive advantage for incumbents." ("Competition policy for the digital era", 2019, p2)*

Examples of these extreme scale benefits from other sectors could include Microsoft's dominance of the operating system market, Google's search engine, or the leading hotel booking portals such as Booking.com, etc., all of which have featured in EU-level competition enforcement in recent years.

Arguably, no digital services in the automotive sector have yet reached comparable levels of scale, although platforms such as AutoTrader or AutoScout24 do enjoy strong positions within their respective markets/groups of markets. Such a service does not yet exist, but one might imagine a parking booking service developing substantial scale benefits if it emerged as the platform of choice in multiple markets and cities, and for multiple brands.

## 2. Network externalities

This is the principle that the value of a digital service or platform to customers grows as more people start to use it. This value then serves as a defence against competition because, once a valued service or platform is established, it is not enough for a new entrant competitor simply to offer better quality or lower prices (or other features, as might be sufficient for a physical product), they also have to find a way of persuading a critical mass of users to switch to the alternative for it to achieve 'lift off'.

*"The convenience of using a technology or a service increases with the number of users that adopt it. Consequently, it is not enough for a new entrant to offer better quality and/or a lower price than the incumbent does; it also has to convince users of the incumbent to coordinate their migration to its own services. Network effects could thus prevent a superior platform from displacing an established incumbent. The size of this 'incumbency advantage' depends on a number of factors, including the possibility of multi-homing (the ability for users to use more than one network/platform/service), data portability, and data interoperability." ("Competition policy for the digital era", 2019, p2)*

Examples of network externalities are all around us in the social media space: Facebook, Twitter, WhatsApp, Instagram, etc., or alternatively crowd-sourcing platforms such as Google's Waze traffic information service.

Once again, it could be argued that digital services in the automotive sector have not yet developed to the point of being 'essential' to customers, and network externalities are hindered by the fact that each OEM tends to develop its own range of digital services and apps which only appeal to owners of cars of the brand. However, as take-up of OEMs' integrated owner portals (such as Mercedes Me) connected into the dashboard screens in its cars continues to grow, one could see this 'snowball effect' taking place, at least on a brand by brand basis.

## 3. Role of data

As mentioned earlier, "Competition policy for the digital era" highlights how access to data is now a crucial input not just to the digital services built upon it, but the manufacturing and logistics processes of physical products. In this environment, it is not surprising that those operators who have collected data, typically but not exclusively from customers, have a strong incentive to retain it as best they can, although this does have implications for competition.

*"The evolution of technology has made it possible for companies to collect, store, and use large amounts of data. Data is not only one of the key ingredients of Artificial Intelligence but also a crucial input to many online services, production processes, and logistics. Therefore, the ability to use data to develop new, innovative services and products is a competitive parameter whose relevance will continue to increase." ("Competition policy for the digital era", 2019, p2)*

Again, we do not need to look very far to find examples of the power of data. Amazon, for example, is able to mine the vast quantities of data it collects on customers' shopping wishes, habits, and locations to determine which products to stock when, which ones to include in its Prime loyalty programme in what geographies, and so on. At the time of writing, Amazon is under investigation by the European Commission, who are questioning whether Amazon's policy of requiring its Marketplace sellers to share shopping journey-related data with the platform is then enabling it to compete unfairly against these sellers with its own products. (For more information, see [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_19\\_4291](https://ec.europa.eu/commission/presscorner/detail/en/ip_19_4291))

Once again, the automotive sector remains some considerable way behind platforms such as Amazon or Alibaba in its ability to work with data gathered from the marketplace. However, the area that is already raising competition concerns from a number of players is that of access to in-vehicle data, discussed extensively in other ICDP outputs, where the independent aftermarket and other groups fear that competition will be restricted, and their market access constrained, if the OEMs are able to exert control over the data modern cars are capable of generating as they drive.

## The goals of future competition policy

Following on from these three interlinked aspects, "*Competition policy for the digital era*" goes on to talk about four goals that future competition policy should aim at in encompassing digital competition.

### 1. Facilitate competition for the market – i.e. between competing platforms – by enabling switching

The principle here is that competition between different digital services or platforms can best be safeguarded by making it as easy as possible for customers to switch between them. Unnecessarily long and complex and/or opaque contracts that act to 'lock' customers in or make comparisons with alternative services needlessly difficult should be targets for simplification.

In the automotive sector, at least as far as the new car is concerned, customers do not 'switch' very frequently, often because they are tied into a lease agreement for a number of years, although the number of services offering the flexibility to swap cars (within the same brand) more easily is growing all of the time. However, it may be that customers will want to switch elements in the supporting package of services round the car more readily as their needs evolve, and questions may be asked as to how easy this will be if they were sold a 'car + services' bundle at the outset.

This also implies that, when customers do want to switch providers, that they are able to take their existing data etc. with them, just as is already provided for in the General Data Protection Regulation (GDPR). Again, one of most pertinent areas for this in the automotive sector may be existing in-vehicle data (such as trip histories, app preferences, infotainment playlists, etc.) that the customer may want to port across to their new car, even if it is of a different brand.

### 2. Dominant platforms which are in a position to 'set the rules' for others (e.g. app providers, or marketplace sellers) to be present on their platform should be responsible for ensuring that their actions are pro-competitive

The principle here is that, in the rapidly-evolving online sector, where a successful platform has the potential to build a strong market position extremely quickly, competition regulators will inevitably struggle to keep up with the pace of developments and the potential for harm, and so the onus should be on the operators themselves to demonstrate that what they are doing is in the best interests of overall competition.

The report considers that these first two goals, switching ability and the obligation to act pro-competitively can both be facilitated through interoperability, so the ability for different platforms/services to be able to connect to each other, and to be able to swap data in a mutually-recognised format.

In the automotive sector, again looking at in-vehicle data, it is not clear at this stage in their development how truly interoperable each of the OEMs' data ecosystems are going to be with each other and with third parties, but we are now seeing the emergence of a number of third party platforms, such as Otonomo and Caruso Dataplace, which are building the connections needed for data to flow. However, this particular issue is far from resolved in the sector, as the next goal illustrates.

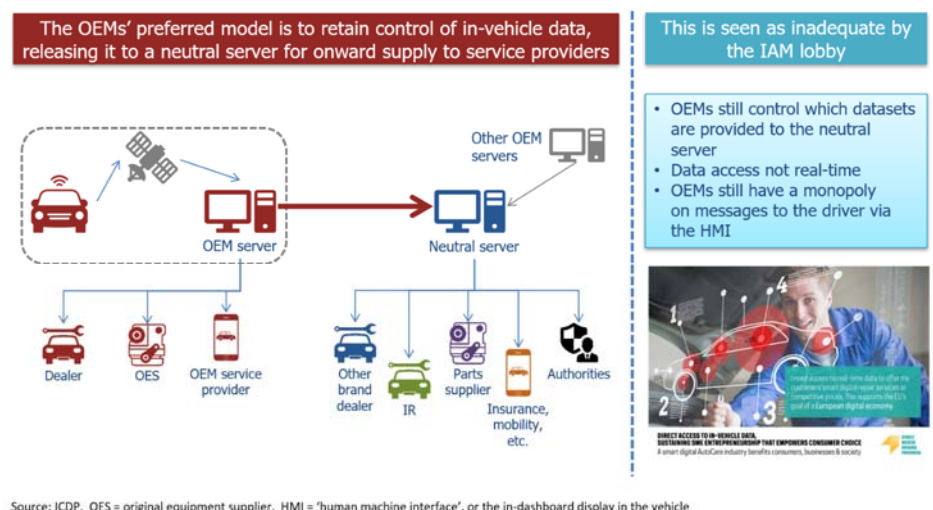
### 3. The significance of data access to a market needs to be assessed on a case by case basis, depending on the character of the market, the types of data involved, and how it is used

It has been suggested by some stakeholders that if one player is able to control access to data for another player to the extent that they cannot carry out their legitimate business, then this potentially represents an abuse of a dominant position under the provisions of Article 102 TFEU, which, if proven, opens the way to a range of sanctions.

"*Competition policy for the digital era*" does not go quite so far, suggesting instead that Article 102 should only be invoked when access to data is totally indispensable for other players, and in circumstances where they are totally unable to get it. For instances that fall short of this, and where a refusal to grant access to data concerns uses outside the market served by the dominant firm, then the best way for this to be addressed should be through sector-specific regulation.

This supports the widely-held view that some form of sector-specific regulation will be needed to resolve the issue of access to in-vehicle data, where the positions of the OEMs (wanting to preserve the security and integrity of complex vehicle systems) and the independent aftermarket (and others) lobby (wanting direct, real-time access to in-vehicle data plus the ability to communicate their services drawing on this data via the in-dashboard screen in the car) are increasingly entrenched.

The report also suggests that the competition rules could also give guidance on the conditions under which data pooling/sharing can be seen as pro-competitive, especially where data are aggregated, possibly through a specific Block Exemption on this topic. This, too, would be relevant for the automotive sector, where some elements of in-vehicle data sharing might be mandated for greater societal benefit, such as traffic flow management, truck 'platooning', accident avoidance, potentially even driver health monitoring, and so on.



As we have commented before, there is a danger of automotive sector-specific regulation in this area 'closing the stable door after the horse has bolted', given the pace of technological development and innovation in the uses to which data can be put, but the need for a resolution appears to be growing more pressing by the day.

### 4. Updating merger control methodologies

The final goal mentioned in the report relates to merger control, a complex area in its own right, and one that it is only appropriate to summarise here.

"*Competition policy for the digital era*" argues that the current turnover-based approach to merger control means that authorities are often unable to look at cases where the respective turnovers of the merging businesses might be minimal, but where they might have significant market positions or the potential for very rapid growth, which as we have discussed can be the case for digital platforms/services. A revised turnover test, more along the lines of the transaction value-based thresholds recently introduced in some markets (Germany and Austria for example) might then enable so-called 'killer acquisitions' to be blocked; these are instances where dominant firms acquire start-ups with growing user bases that might otherwise develop into important competitors.

This discussion is some way removed from the dealer group or, occasionally, OEM mergers that are a feature of the automotive sector, but could be a factor in cases where OEMs or large third party platforms buy start-up providers of digital or mobility services, in order to bring them within their branded ecosystem.

## Two core principles will feature strongly in the coming debate

We have devoted considerable space in this Briefing to this study of digital competition because we consider that the goals it sets reflect two core principles which are likely to run throughout both the GBE and ABE reviews.

Firstly, the key role played by data in enabling competition to function effectively.

- ◆ This reflects the principle also enshrined in the GDPR that consumers should have sovereignty over their data, and so it is vital that providers ensure interoperability between services to give consumers the ability to switch (moving their data with them).
- ◆ This also implies that, since dominant players should not be seeking to restrict competition, they should give equal treatment to rivals who use their platforms (this could apply to the example of Amazon and its Marketplace sellers, or to an automotive OEM offering their own and third party apps on the in-dashboard screen/owner portal). The belief here is that forcing dominant digital players to share data will be more effective in reducing their market power than pursuing other more 'structural' remedies such as seeking to break them up
- ◆ These two elements effectively represent a cross-over between the European privacy and competition rules, a significant development which is already in evidence, and which is giving European regulators more influence over the large online platforms than regulators in other parts of the world have been able to achieve (such as the European Commission's ruling that Facebook should not be permitted to mesh together its data with that of the Instagram and WhatsApp platforms that it also owns)

Secondly, that in an area where developments and market positions can evolve very fast, and where data can potentially be used to steer competition in ways that are difficult to detect, the risks of 'under-regulation' are greater than those of 'over-regulation'

- ◆ The "*Competition policy for the digital era*" study advises that policy should 'err on the side of disallowing potentially anti-competitive conduct'. Even where consumer harm cannot be precisely measured, strategies of dominant firms aimed at reducing the competitive pressure they face should be forbidden in the absence of clearly documented consumer welfare gains. In highly concentrated markets, incumbent firms should be required to show that their behaviour is pro-competitive
- ◆ In assessing whether firms hold market power, regulators should take account of insights from behavioural economics about consumer bias towards default options and short-term gain, and of ways incumbents can protect themselves by competition (e.g. by hanging on to large volumes of data not available to market entrants). In other words, competition concerns can arise even in supposedly fragmented markets
- ◆ This policy position, if adopted in the new regulations, would represent quite a reversal from that which underpinned the GBE/ABE renewal 10 years ago, where vertical restraints were more likely to be assumed to be benign unless hardcore restrictions were present, or evidence of harm found. It suggests that more detailed assessments will be appropriate in the future, especially where digital competition is concerned. And it also suggests that we might end up with more, rather than fewer, rules ...

This interplay between digital and physical competition, underpinned by the role of data, will be at the core of the sorts of issues the automotive sector will raise, and will be looking for answers to, in both the GBE and ABE reviews; issues that we will continue to explore in future outputs.



ICDP is an international research-based organisation focused on automotive distribution, including the supply and retailing of new and used vehicles, after sales, network structures and operations. Through our research activities, data services, education, events and consulting, we work with vehicle makers, dealers, suppliers, and related organisations to improve the quality and effectiveness of the distribution model. We believe that changing behaviours, new technologies and market pressures will combine to drive new ways of doing business. We welcome the opportunity to work with like-minded individuals and organisations in pursuit of this goal.

Project Office: Central Boulevard, Blythe Valley Business Park, Solihull, B90 8AG U.K.  
Tel.: + 44 (0) 1564 711224 E-mail: [projectoffice@icdp.net](mailto:projectoffice@icdp.net) Web: [www.icdp.net](http://www.icdp.net)

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