Northwestern Journal of International Law & Business

Volume 28
Issue 1 *Fall*

Fall 2007

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I. INTRODUCTION

Recent reports from the European Commission on European Union price differentials for new motor vehicles reflect a steady narrowing of the differences in prices for motor vehicles across the 27 Member States.[1] Although the inclusion within the European Community in 2004 of ten new countries with relatively homogeneous pricing has evidently colored these findings,[2] price differentials among the EU-15 appear to be decreasing.[3] Price convergence has been welcomed by consumer associations[4] and

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[1] Since 1993, the Commission has regularly published biannual reports on car price differentials in May and November. *See* Europa, Car Price Reports Archive, http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/archive.html (last visited Nov. 25, 2007); *see also* Pinelopi Koujianou Goldberg & Frank Verboven, *EU Car Prices: Cross-Country Price Dispersion in the Euro Era: A Case Study of the European Car Market*, 2004 ECON. POL'Y 483.

[2] By "new members" reference is made to the ten countries which entered the European Union on May 1, 2004: Estonia, Latvia, Lithuania, Poland, Slovakia, Hungary, the Czech Republic, Slovenia, Malta, and Cyprus. In addition, Romania and Bulgaria joined on January 1, 2007.

[3] The latest Commission report on price differentials shows price convergence. European Comm'n, *Car Price Report: Annex* (2006), http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/2006_11_b.pdf.

[4] BEUC, the European Consumers' Organisation, has shown a particular concern for price differentials. BEUC is "representative . . . of 33 independent national consumer associations from countries of the EU, EEA, and elsewhere in Europe." Bureau Européen des Unions de Consommateurs (BEUC), *Position Paper: Reaction to Andersen Consulting Study on the Impact of Possible Future Legislative Scenarios for Motor Vehicle Distribution on all Parties Concerned*, 2 Doc. BEUC/X/008 (Jan. 31, 2002).

European institutions, which for many years fought arduously to force car manufacturers to reduce these differentials. The justification for their concerns was based on a logical argument. In the 1950s, European nations initiated a progressive process of integration which ripened over the years into a single market—the European Union's pride and primary objective.[5] Car price differentials questioned the very *raison d'être* of the emerging Community, as they served to re-enhance national borders, which were becoming progressively blurred by the steady elimination of barriers to trade. The blame was subsequently put on distribution restraints—those restrictions contained in distribution agreements between manufacturers and their dealers. Territorial or customer allocation could be used—and abused—to facilitate price discrimination as a consequence of the resulting "segmentation" of the market for the product. What is more, according to the Commission these restraints were being utilized to impede consumers from shopping for their cars across national borders and from benefiting from price differences. The Commission responded by penalizing those manufacturers considered to be preventing their dealers from selling to customers outside their allotted territories.[6]

The decrease in price differentials coincides with a difficult moment in the history of the European car industry. The long-established European car manufacturers have been caught in a period of decline which, coupled with

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[5] The general aims of the Treaty are set out in Article 2, and are "to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States." Consolidated Version of the Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C 325) 33, 40 [hereinafter EC Treaty], *available at* http://europa.eu.int/eur-lex/lex/en/treaties/dat/12002E/pdf/12002E_EN.pdf. For these purposes, Article 3 provides the means to achieve them. These include "(c) an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital." *Id.*

[6] Fines have been imposed, for instance, on Volkswagen, Opel, DaimlerChrysler, and more recently, Peugeot. Commission Decision 98/273, 1998 O.J. (L 124) 60 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/1998/l_124/l_12419980425en00600108.pdf; Commission Decision 2001/711, 2001 O.J. (L 262) 14 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_262/l_26220011002en00140037.pdf (overruled by Case T-208/01, Volkswagen AG v. Comm'n, 2003 E.C.R. II-05141, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62001A0208:EN:HTML); Commission Decision 2001/146, 2001 O.J. (L 59) 1 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_059/l_05920010228en00010042.pdf); Commission Decision 2002/758, 2002 O.J. (L 257) 1 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2002/l_257/l_25720020925en00010047.pdf; Press Release, European Union, Competition: Commission Imposes a €49.5 Million Fine on Peugeot for Obstructing New Car Exports from the Netherlands (Oct. 5, 2005), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/05/1227&guiLanguage=de.

stiff competition from non-EU newcomers, placed a large question mark on their ability to compete and survive. Despite the predicted growth of global car sales due to an increasingly motorized generation, particularly from among the "Asian dragons," analysts suggest that the emerging Chinese and Indian manufacturers will be the ones to benefit from the rising demand.[7] Recent studies suggest that European manufacturers' short-term solution—merging their way to giant status—has had an adverse impact on the firms' profitability.[8] This merging tendency has created a "bundling" effect, but without follow-up efficiency improvements through renovation and refurbishment. Added to these woes, the industry is faced with the difficult task of complying with detailed and complex EC competition rules, while the Commission continues in its monitoring and sanctioning role, as shown by its most recent actions: a EUR 49.5 million fine imposed on Peugeot in 2005 for obstructing car exports, and an investigation into BMW and General Motors' practices against the backdrop of Regulation 1400/2002, the block exemption for car distribution.[9]

This paper examines the task of the European legislator in the evolution of the car sector, and attempts to establish what role the now "modernized" EC competition law should play in light of the industry's gloomy road ahead.[10] Particular attention is paid to the application of

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[7] *Extinction of the Predator*, ECONOMIST, Sept. 10, 2005, at 63.

[8] *Id.*

[9] Commission Regulation 1400/2002 of 31 July 2002 on the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Sector, 2002 O.J. (L 203) 30–41 (EC) [hereinafter Regulation 1400/2002], *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2002/l_203/l_20320020801en00300041.pdf. This regulation replaced Commission Regulation 1475/95, 1995 O.J. (L 145) 25–34, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31995R1475:EN:HTML, itself a reform of Commission Regulation 123/85, 1985 O.J. (L 15) 16, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31985R0123:EN:HTML, the first ever block exemption for motor vehicle distribution in Europe.

[10] The regime affecting the distribution of motor vehicles changed with the introduction of Regulation 1400/2002, *supra* note 9, as a part of a major overhaul of EC competition law that has been taking place over the last decade. *See id.* Also relevant for our purposes are the changes in procedural rules introduced with Council Regulation 1/2003 of 16 Dec. 2002 on the Implementation of the Rules on Competition Laid Down in Articles 81 and 82 of the Treaty, 2002 O.J. (L1) 1–25 (EC), *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2003/l_001/l_00120030104en00010025.pdf, which provides for the decentralized application of Article 81 as a whole, as well as Article 82. The modernization package is comprised of this regulation and a whole set of binding and non-binding legislation that came into force on May 1, 2004 covering, *inter alia*, conduct of proceedings, cooperation within the network of competition authorities, cooperation with the courts of EU Member States, handling of complaints, informal guidance, effect on trade, and the application of Article 81(3) of the EC Treaty. *See* EUROPA, DG Competition, Antitrust, http://www.europa.eu.int/comm/competition/antitrust/legislation/#procedural_rules (last visited Nov. 25, 2007).

Article 81(1) of the EC Treaty ("Article 81(1) EC")[11] and the exemptions granted on the basis of Article 81(3) EC—currently via Regulation 1400/2002[12]—to distribution agreements in the car sector. Community regulation appears to have had a limited impact on the narrowing of price differentials across Europe, which has come about primarily as a result of other factors. To the detriment of economic efficiency, EC competition policy has been thus far affected by external concerns for integration and consumer protection (and the industry's interests in the case of the car sector). For this reason, the Commission's much criticized application of EC antitrust provisions may have exacerbated the difficulties already faced by a declining industry. It is clearly not the role of EC competition law to protect less efficient firms—even though the high degree of competition in the car market is likely to wipe out some established European car manufacturers.[13] However, what this paper explores is whether the existing competition rules are imposing additional and unnecessary burdens on manufacturers or if, on the contrary, efficiency arguments can serve to justify the current rules. Beyond pure economic efficiency,[14] justification can be found for pursuing other goals through antitrust doctrine. After all, as Komesar notes, Pareto optimal transactions can be truly unjust.[15] In the context of the car industry, manufacturers have long enjoyed an advantageous position *vis-à-vis* dealers and oftentimes consumers, and the Commission's policy has proven rather unsuccessful in re-establishing greater parity. Nonetheless, is the role of competition policy protecting dealers or consumers? The aim, in this context, is to assess how the new procedural and substantive rules for competition policy should be applied so as to provide for a sound application of the new rules and a coherent policy for future development of the car sector.

In order to determine the extent to which the application of EC antitrust provisions has affected the present situation of the European car sector, this study consists of four parts following this introduction. Part II explores price differentials and their justifications using relevant reports and studies available on the subject. Part III comprises a study of the possible causes for the decrease in the differences: the impact of the introduction of

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[11] EC Treaty, *supra* note 5, at 64.

[12] *See* Regulation 1400/2002, *supra* note 9.

[13] MASSIMO MOTTA, COMPETITION POLICY: THEORY AND PRACTICE 39 (Cambridge Univ. Press 2004).

[14] For a study of the concept of economic efficiency in the European context, see Damien Geradin, *Efficiency Claims in EC Competition Law and Sector-Specific Regulation* (European Univ. Inst., Florence, Working Paper Series 327, 2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=617922.

[15] NEIL KOMESAR, IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMIC AND PUBLIC POLICY 32 (Univ. of Chi. Press 1994); *see also* VILFREDO PARETO, MANUALE D'ECONOMIA POLITICA (Società Editrice Libraria, 1906).

the euro, the rise of the Internet, and the challenges faced by European car manufacturers in a transformed global market. In Part IV, the evolution of competition law in regulating the car industry is examined, as well as the relevant economic and legal theories to assess the existence of Regulation 1400/2002 on the one hand and the condemnation of price differentials on the other. The Part V attempts to evaluate the impact of this regulation on consumer welfare through a study of consumer preferences based on available data, personal interviews with consumers and a survey conducted by the author.

II. PRICE DIFFERENTIALS AND THEIR IMPLICATIONS FOR COMPETITION POLICY

A. General Remarks

When it comes to conceptualizing price differentials and price discrimination, it has been said on occasion that "[n]o definition exists to cover all real-world situations."[16] Indeed, it seems difficult to impose a single definition of price discrimination on so many business practices arising in the marketplace, and defining it has been described as a "thorny issue."[17] Generally, price discrimination implies higher prices for some consumers than for others as a consequence of the use of diverse distribution channels.[18] In economic terms, Kahana and Spiegel define price discrimination as "the existence of unequal arithmetic difference of price and marginal cost among consumers."[19] Other authors prefer to describe them as the existence of unequal ratios of price and marginal cost.[20] In any case, this research has proven a general lack of concern in the literature over the precise choice of definition, which some believe reflects the fact that most authors do not consider the choice to be very consequential.[21]

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[16] Stan J. Liebowitz, *Price Differentials and Price Discrimination: Reply and Extensions*, 26 ECON. INQUIRY 779, 779–83 (1988) [hereinafter Liebowitz, *Price Differentials*].

[17] MOTTA, *supra* note 13, at 491 n.105. In a similar way, for international price dispersion to exist, it must be profitable for firms and feasible to set different prices. Goldberg and Verboven, *supra* note 1, at 489.

[18] Peter C. Carstensen, *The Competitive Dynamics of Distribution Restraints: The Efficiency Hypothesis Versus the Rent-Seeking, Strategic Alternatives*, 69 ANTITRUST 569, 571 (2001).

[19] Nava Kahana & Uriel Spiegel, *On the Definition of Price Discrimination*, 26 ECON. INQUIRY 775, 775–77 (1988).

[20] Stan J. Liebowitz, *Tie-in Sales and Price Discrimination*, 21 ECON. INQUIRY 387, 387–99 (1983) [hereinafter Liebowitz, *Tie-in Sales*].

[21] Liebowitz, *Price Differentials*, *supra* note 16, at 783. For further explanations of price discrimination, see generally Hal R. Varian, *Price Discrimination, in* HANDBOOK OF INDUSTRIAL ORGANIZATION 597, 597–654 (Richard Schmalensee & Robert D. Willig eds.,

Regardless of the terminology used, price differentials are a common phenomenon. As Motta puts forward, "[P]rice discrimination is a persuasive phenomenon, of which examples from our daily life abound."[22] Relying on Pigou, for Motta there are two essential conditions for price differentiation to exist.[23] First, a firm must be able to differentiate between consumers so that it can charge different prices. Second, the absence of *arbitrage* is essential—that is, consumers are unable to re-sell the goods among each other.[24] For our purposes, this study focuses on territorial price discrimination—"a company's ability to charge different prices for the same product in different countries"[25]—which clearly meets Motta's two conditions: 1) the existence of national barriers makes it possible to distinguish between consumers in different countries and 2) agreements between manufacturers and their distributors usually contain exclusivity clauses by which only those appointed dealers, and not consumers, will be able to distribute the products in question within their allotted territory.[26]

Prices differ not only across national borders, but also across regions within any one nation, and even within a specific town.[27] Abundant studies confirm this reality,[28] but regardless of the evidence most consumers will

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1989); JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION (MIT Press 1988).

[22] MOTTA, *supra* note 13, at 491.

[23] *Id.* at 492–93 (relying on ARTHUR C. PIGOU, THE ECONOMICS OF WELFARE (MacMillan 1920)).

[24] A third requirement would be the existence of market power. Varian, *supra* note 21. Firms with limited market power will have a limited impact on prices through discriminatory prices, but most firms in the real world have some market power. MOTTA, *supra* note 13, at 492 n.107.

[25] Enrico Bachis & Claudio A. Piga, *Do Prices Grow More in Euroland? Evidence from the Airline Industry* 2,(Loughborough Univ. Dept. Econ., Working Paper No. WP 2006-8, 2006), *available at* http://www.lboro.ac.uk/departments/ec/RePEc/lbo/lbowps/bachis_piga_2.pdf. According to Motta, this constitutes third-degree discrimination (as opposed to first-degree discrimination, whereby a monopolist charges the maximum price consumers are willing to pay, or second-degree discrimination, whereby consumers choose one deal among several offered by a firm). MOTTA, *supra* note 13, at 492.

[26] *See* MOTTA, *supra* note 13, at 492–93. Even if these conditions now permit price differentiation, the Commission is fighting to make the practice more difficult by ensuring that parallel imports are not precluded. *See infra* Part IV.

[27] *See* Phillipp Maier, A Global Village without Borders? International Price Differentials at eBay 2 (Sept. 2005) (unnumbered working paper), *available at* http://webmail.econ.ohio-state.edu/john/jmcb-frb/eBay1.pdf.

[28] *See, e.g.*, Takaboshi Tabuchi, *On Interregional Price Differentials*, 52 JAPANESE ECON. REV. 104 (2001); David W.Yoskowitz, *Price Differentials in a Homogeneous Market: The Case of Water*, 7 INT'L ADVANCES IN ECON. RESEARCH 100 (2001); Fabio Canova & Evi Pappa, Price Differentials in Monetary Unions: the Role of Fiscal Shocks (June 2005) (unnumbered working paper), *available at* http://www.econ.upf.edu/docs/papers/downloads/923.pdf; Karen Clay & Choon Hong Tay, Cross-Country Price Differentials in the Online Textbook Market, (May 24, 2001) (unnumbered working paper), *available at* http://citeseer.ist.psu.edu/cache/papers/cs/23509/http:zSzzSzwww.heinz.cmu

have developed their own awareness. Let us consider three common examples of price differentials—local, interregional, and cross-border. The first type—those that occur within one region (often within a specific town or city) are the most easily identified by consumers. Everyday grocery costs, for instance, vary significantly across a range of local supermarkets, and are typically lower than those found in "open all hours" stores, which provide an arguably more flexible service.

As regards the second type, interregional differentials, most consumers will have travelled and identified variations. Tabuchi, for instance, uses the high price of a cup of coffee in a café located on the Avenue des Champs Élysées compared to what it would cost in other regions of France as an example.[29] This difference in price may result from higher costs such as rent, as well as the locational advantages of the former over the latter, which are factored in to the overall service price.[30] Other examples with which the reader may be familiar include variations in the cost of housing, land or even gas across regions even within one country.[31]

The third category, cross-border price differentials, is arguably the most difficult for everyday consumers to identify. Having said that, international travel is becoming ever more common. The creation of a single market in Europe has added to this phenomenon by facilitating travel within the European Community and encouraging the growth of low-cost airlines. As a consequence, Europeans have become ever more aware of cross-border variations in price for all sorts of goods, such as food, tobacco, or clothing.

Prima facie, such variations in price would not appear to be overly problematic. Yet, the Commission's concerns about car price differentials follow two principal trains of thought. First of all, in the context of the creation of a common market, an analysis of cross-border price divergence should reveal the scope and development of market integration. If the free movement of goods can be guaranteed within a truly single market, then consumers will be fully empowered to "shop around" the entire Union for their vehicles, leading eventually to price convergence. It is beyond the scope of this paper to examine the merits of this specific argument, however what emerges from this study is that price differentials across the European Union point to a lack of fully integrated markets. The second field where price differentials would play a role is competition policy. Both lines are

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[29] Tabuchi, *supra* note 28, at 104.

[30] *Id.*

[31] For a detailed study of price differentials in the oil market, see Robert Bacon & Silvana Tordo, *Crude Oil Price Differentials and Differences in Oil Qualities: A Statistical Analysis* (ESMAP Technical Paper No. 081, 2005), *available at* http://wbln0018.worldbank.org /esmap/site.nsf/files/081-05+Final+_for_Web.pdf/$FILE/081-05+Final+_for_Web.pdf.

somewhat intertwined, as integration has been explicitly recognized by the European institutions as a goal of competition policy.[32] In the words of Mario Monti, former Commissioner for competition, EC antitrust policy has played a fundamental role in the creation of the single market and increased economic dynamism.[33] The European courts have also recognized the importance of integration in antitrust. Since the ruling by the European Court of Justice ("ECJ") in *Consten Grundig*,[34] an agreement which may have the effect of dividing the market along national lines may be prohibited, even if its effects are not anti-competitive.[35]

From the perspective of competition policy, if different prices are charged for goods produced at the same cost in different locations this could be an indication of anti-competitive behavior. In a competitive market, two factors should contribute to price harmonization. From the point of view of the consumer, if there is price transparency and thus awareness of the differentials, it should act as encouragement for consumers to buy their products in the cheaper markets to benefit from price differentials. Besides, agents may be tempted to buy goods at cheaper locations and resell them at places where prices are high, which, according to the "law of one price," should naturally make prices converge.[36] If this is not the case, then price differentials could be interpreted as an indicator of the existence of agreements or practices that preclude this from happening. Therefore, price differentials are not in themselves necessarily harmful, but could hint at the existence of anti-competitive practices that could fall within the scope of Article 81(1) of the EC Treaty.

B. Peculiarities of Car Price Differentials in the European Union

One can find abundant literature on price differentials. The studies consulted refer to different kinds of goods—from housing to crude oil, water, books, cars, cosmetic products, or audiovisual equipment,[37] and provide an insight into the problems and causes of price divergence. With regard to cars, since the early 1980s, a considerable amount of research has been produced by consumer associations, competition agencies, and academics. They provide an evaluation of the presence of different prices and their underlying causes. In this part the aim is to focus on the main

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[32] Établissements Consten SARL & Grundig-Verkaufs-GmbH v. Comm'n of the Euro. Econ. Community, Joined Cases 56 and 58/64, [1966] C.M.L.R. 299.

[33] Mario Monti, *La Nueva Politica Europea de la Competencia*, *in* EL NUEVO DERECHO COMUNITARIO Y ESPAÑOL DE LA COMPETENCIA (José Maria Beneyto Pérez ed., 2002).

[34] [1966] C.M.L.R. at 342–43.

[35] *Id.*

[36] Maier, *supra* note 27, at 1.

[37] *See* studies cited *supra* notes 25, 27–28 & 31.

findings in these reports, the European Commission's secondary legislation—block exemption regulations and decisions—in this area, and other non-binding documents from the European institutions, such as Guidelines and Notices.

1. Essential Definitions

It is important to highlight, as Degryse and Verboven explain,[38] that there are two different types of price differentials. First of all, the authors use the term *international price dispersion* to refer to intra-EU price differentials that exist for individual models in the territory of the European Union. This would examine, for instance, the difference between the cost of a Ford Fiesta in the Netherlands and in France. Second, they refer to *systematic price differentials*, which estimate the average differences across countries—i.e., how much more expensive cars are in the Netherlands than in France. The European Consumers' Organization ("BEUC") definition of price differentials as "differences between recommended retail prices net of taxes" refers to the former.[39] International price dispersion indicators normally show much larger variations than systematic price differentials, as systematic price differentials are an average of the former, and averages smooth out variations. It should also be noted that most reports focus on pre-tax differentials, although some figures of post-tax prices are also available. In theory, according to the "law of one price" mentioned above, competition should drive post-tax driven differentials to zero. Currently, the European institutions do not have any power to introduce legislation harmonizing taxes in the different Member States, and therefore these differentials escape the control of the Commission.

It is equally important to discern how the European institutions draw the line between acceptable and unacceptable differentials. According to a rule established by the Commission in the Notice on Regulation 123/85,[40] recommended retail prices for a specific car model should not exceed 12 percent of the lowest price.[41] Exceptionally, the differential may exceed this percentage by 6 percent for a period of less than one year or for an insignificant percentage of motor vehicles. This means that a *de minimis* rule is established, by which differentials of between 12 and 18 percent are generally considered acceptable. However, price differentials have

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[38] Hans Degryse & Frank Verboven, Car Price Differentials in the European Union: An Economic Analysis (Nov. 2000) (unnumbered working paper), *available at* http://ec.europa.eu/comm/competition/sectors/motor_vehicles/documents/car_price_differentials.pdf.

[39] *See* Press Release, BEUC, Car Distribution: Time for Change at Long Last? (Sept. 29, 2005), *available at* http://docshare.beuc.org/Common/GetFile.asp?ID=18275&mfd=off&LogonName=Guesten.

[40] Commission Regulation 123/85, *supra* note 9.

[41] Commission Notice (EC) 85/C 17/03 of 18 Jan. 1985, art. II § 1(a).

traditionally exceeded 20 percent and could be as high as 65 percent.[42]

2. Main Findings

Since 1992, the Commission has published biyearly reports on car price differentials across the European Union.[43] An examination of these reports shows a steady decrease in these variations in price, particularly since 2004. Importantly, manufacturers had been claiming that prices were converging long before this date, and from as early as 2000 a number of independent studies confirmed their view. For instance, an independent survey by the Alliance and Leicester in 2000 found that the price of a new car in Britain—the most expensive market for cars in Europe—fell by more than 12 percent during that year.[44] Manufacturers also complained that the Commission normally referred to pre-tax prices, which are not always a fair reflection of the market price actually being paid by consumers. In Denmark, for instance, Value Added Tax ("VAT") can account for up to two-thirds of the total cost of a car, while in the United Kingdom, VAT typically accounts for a mere fifth of the total cost.

Studies undertaken by BEUC similarly serve as a useful source of information.[45] In their reports, a sample of popular car models was taken with comparable specifications across European countries.[46] For each model, pre-tax common currency prices in the various EU countries were computed and expressed relative to the price in a base country. These relative prices were then averaged across all models to obtain a measure for the general car price level in the Member States. Over the period 1981through 1993, BEUC found the pre-tax car price level to be the lowest in Denmark, followed by Greece and the Benelux countries. Higher car price levels occurred in Italy, Spain, and Sweden (in the 30–50 percent range), Ireland (in the 40–60 percent range, and the United Kingdom (in the

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[42] *See* Europa, Car Price Reports Archive, *supra* note 1.

[43] The first report was European Comm'n, *Intra-EC Car Price Differential Report* (1992). Denmark, Finland and Greece were not included until May 1, 1999 because of those nations' high taxes. *See* Europa, Car Price Reports Archive, *supra* note 1; Degryse & Verboven, *supra* note 38, at 4, 29, 30.

[44] BBC News, *EU: Cars Cost Most in the UK*, Jul. 23, 2001, http://news.bbc.co.uk/2/hi/business/1451560.stm.

[45] *See* BEUC, *Report on Car Prices and the Private Import of Cars in the EEC Countries*, BEUC/71/81 (1981); BEUC, *Report on Car Prices and the Private Import of Cars in the EEC Countries*, BEUC/105/82 (1982); BEUC, *Car Price Differences in the EEC*, BEUC/121/86 (1986); BEUC, *Car Report 1987: Survey on the Application of Regulation 123/85 Exempting the Selective Distribution System for Cars*, BEUC/200/87 (1988); BEUC, *EEC Study on Car Prices and Progress Towards 1992*, BEUC/10/89 (1989); BEUC, *Parallel Imports for Cars in the EC*, BEUC/222/92 (1992) (all reports on file with author).

[46] Twenty-five models in 1981 and 1982, thirty models in 1986, twenty-two models in 1987, twenty-four in 1989, and thirteen in 1992. *See supra* note 45.

50–80 percent range)). BEUC originally blamed the differentials on taxes, differences in the degree of competition, profit margins, and price controls. In subsequent studies, BEUC also highlighted that local price increases were the greatest in countries with high inflation rates and depreciating currencies.[47] These studies generated a lot of public policy attention, and were the seed that encouraged the Commission to carry out its own investigations.

The Commission's reports differ from the BEUC studies in terms of methodology and focus. They conduct a more detailed adjustment for specification differences across cars, and also attempt to account for discounts and financial benefits. The focus is placed on the magnitude of the price differentials for individual car models—what was defined above as international price dispersion.[48] The 1992 study found that specification-adjusted maximum car price differentials frequently exceeded the above-mentioned 12 and 18 percent margin.[49] According to the Notice on Regulation 123/85, the selective and exclusive distribution systems are compatible with European Commission law if, among other conditions, the maximum price differentials are no larger than 18 percent for a shorter period.[50]

In addition, the UK Competition Commission, formerly known as the Monopolies and Mergers Commission "MMC"), similarly investigated car price differentials in Europe, with a particular focus on the UK market.[51] The higher cost of motor vehicles in this country can be best explained with reference to the situation in 1992, when the pound devalued and Britain was forced to withdraw from the European Monetary System on September 16, 1992—the infamous Black Wednesday. As a consequence, the sterling pound experienced a drastic fall against other European currencies, with a consequential rise in prices. Regrettably for UK consumers, as the currency slowly recovered, prices remained constant. The effect was significant price divergence between the United Kingdom and much of continental Europe. The highly publicized "Rip-Off Britain" campaign sought to restore the balance. UK consumers sought to take matters into their own hands by endeavoring to shop outside the country for cheaper cars, and the United Kingdom also saw a growth in imports from Europe.[52] This

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[47] *See supra* note 45.

[48] *See* Europa, Car Price Reports Archive, *supra* note 1.

[49] BEUC/222/92, *supra* note 45.

[50] Commission Notice, *supra* note 41.

[51] *See* COMPETITION COMMISSION, NEW CARS: A REPORT ON THE SUPPLY OF NEW MOTOR CARS WITHIN THE UK (2000), *available at* http://www.competition-commission.org.uk /rep_pub/reports/2000/439cars.htm#full [hereinafter COMPETITION COMMISSION].

[52] For more details on this, *see, for example,* ECONOMIST INTELLIGENCE UNIT, GLOBALIZATION AND MANUFACTURING (2006) (commissioned by KPMG), *available at*

progression is evidenced in the MMC reports.[53] In an initial 1992 study, the MMC concluded that the UK market did not show excessive adjusted price differentials when compared with France and Germany, with those two markets revealing the greatest similarity to that of the United Kingdom.[54]

In its more recent 1999 report,[55] the MMC made use of the Commission's own figures, arguing that this data was a more reliable means of revealing actual price differentials. The main focus was on the measurement of the general car price level, but it also considered car price differentials for individual models to assess the full extent of arbitrage opportunities. The MMC reported that the general car price level in the United Kingdom was higher than in France, Germany, and Italy by a margin of between 3.5 and 7.1 percent over the period 1993–2000, and by a margin of 10.1 and 12.6 percent over the second half of that period. Considering hedonic price indices in 1999, the MMC reported that the majority of the models were at least 20 percent more expensive in the United Kingdom than in other countries with similar tax regimes.[56]

Over the years, economists, jurists, and political scientists have published numerous studies on the construction of hedonic price indices: Mertens and Ginsburgh (1985),[57] Ginsburgh and Vanhamme (1989),[58] Mertens (1990),[59] Goldberg and Verboven (1998),[60] or Degryse and Verboven (2000).[61] Several analyses considered a long time horizon to evaluate the persistence of car price differentials. Most studies found large differences in the general car price level between countries, broadly consistent with the results from the above policy reports. In addition, a sustained difference in price was recorded, despite a rather substantial year-to-year volatility for some countries. It seems that the volatility of price differentials is linked to exchange rate fluctuations. Importantly, studies do

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http://www.kpmg.co.uk/industries/a/pubs.cfm# (scroll down and click on "Globalization and Manuracturing"; then download PDF); Janet Gillen, *UK—Competition Commission Report on Supply of New Cars*, *in* COMPETITION COMMENT (Freshfields Bruckhaus Deringer, London, UK), June/July 2000; BBC News, *supra* note 44.

[53] COMPETITION COMMISSION, *supra* note 51.

[54] *See* Monopolies and Mergers Commission, *New Motor Cars—A Report on the Supply of New Motor Cars Within the United Kingdom*, Vols. 1 & 2, HMSO, London (1992).

[55] COMPETITION COMMISSION, *supra* note 51.

[56] *Id.* § 1.13.

[57] Yves Mertens & Victor Ginsburgh, *Product Differentiation and Price Discrimination in the European Community: The Case of Automobiles*, 34 J. INDUS. ECON. 151 (1985).

[58] Victor Ginsburgh & Geneviève Vanhamme, *Price Differences in the EC Car Market: Some Further Results,* 16/17 ANNALES D'ECONOMIE ET DE STATISTIQUE 137 (1989).

[59] YVES MERTENS, MODELLING PRICE BEHAVIOUR IN THE EUROPEAN CAR MARKET: 1970–1985 (1990) (on file with author).

[60] Pinelopi Koujianou Goldberg & Frank Verboven, *The Evolution of Price Dispersion in the European Car Market,* 68 REV. ECON. STUD. 811 (2001).

[61] Degryse & Verboven, *supra* note 38; *see also* Goldberg & Verboven, *supra* note 1.

show, for example, that in periods when the British pound was relatively weak, car price indices were low,[62] and that when the Italian lira strengthened, prices were high in Italy.[63]

A number of studies go one step further and explore the validity of those explanations offered by policy makers and industry insiders for price differentials. Consumers' preference for domestic produce was considered a reasonable explanation for international price differentials. The importance of several regulatory factors was also investigated. Exchange rate fluctuations, tax differentials, and trade restrictions—tariffs and quotas—create different cost conditions across European markets. The "Study on the Impact of Possible Future Legislative Scenarios for Motor Vehicle Distribution on All Parties Concerned" carried out by Andersen on behalf of the Commission (the "Andersen Study") found several justifications for price divergence across the European Union.[64] These included the existence of national tax regimes, the presence of domestic manufacturers who typically enjoy an "advantageous market position . . . with higher prices as a result," "a population density that allows for different coverage and behaviour," and "greater or lesser use of alternative channels."[65]

The Andersen Study has been harshly criticized by BEUC. The association complains particularly that the effect of taxes on pre-tax prices is that they tend to be lower. This proves, according to BEUC, that manufacturers squeeze more profit from those countries with lower taxes where they know that consumers are not affected by a high increase of a vehicle's cost by taxation. The Commission appears supportive of BEUC on this point. The chart below reveals car price differentials in the European Union according to a study commissioned by the institution in November 1999, and which appeared in the Report on the Evaluation of Regulation 1475/95.[66] It is the average price index (systematic price differentials) and

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[62] Periods 1980–1983 and 1997–2000. *See* Goldberg & Verboven, *supra* note 60, at 822; Goldberg & Verboven, *supra* note 1, at 498.

[63] Period 1981–1991. *See* Goldberg & Verboven, *supra* note 60, at 822; Goldberg & Verboven, *supra* note 1, at 498.

[64] European Commission, Director General Competition [DG COMP], *Study on the Impact of Possible Future Legislative Scenarios for Motor Vehicle Distribution on All Parties Concerned*, at 48 (Mar. 3, 2001) (published by Andersen) [hereinafter *Andersen Study*], *available at* http://ec.europa.eu/comm/competition/sectors/motor_vehicles/documents/distribution.html.

[65] *Id.*

[66] *Commission Report on the Evaluation of Regulation (EC) No. 1475/95 on the Application of Article 85(3) of the Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements*, at 100, COM (2000) 743 final (Nov. 15, 2000) [hereinafter *Evaluation of Regulation No. 1475/95*], *available at* http://eur-lex.europa.eu/LexUriServ/site/en/com/2000/com2000_0743en01.pdf.

reflects the impact of taxes.

In Figure 1.1, the Commission seeks to highlight how pre-tax prices are normally lower in those countries where taxes are higher. This is especially obvious if one considers the cases of Denmark and Finland. It is also noteworthy that the most significant differentials—with the exception of the United Kingdom—occur when taxes are factored in; post-tax prices are, in some cases (particularly in Denmark), almost twice as high as the cost of vehicles in other EU Member States (such as Spain, Belgium, Italy, or Luxembourg). Indeed, this could be an indication that manufacturers do try to increase their profits in those countries where taxes are lower. However, practice and microeconomic theory reflect that these differences can be justified and can have beneficial effects, as seen below.[67]

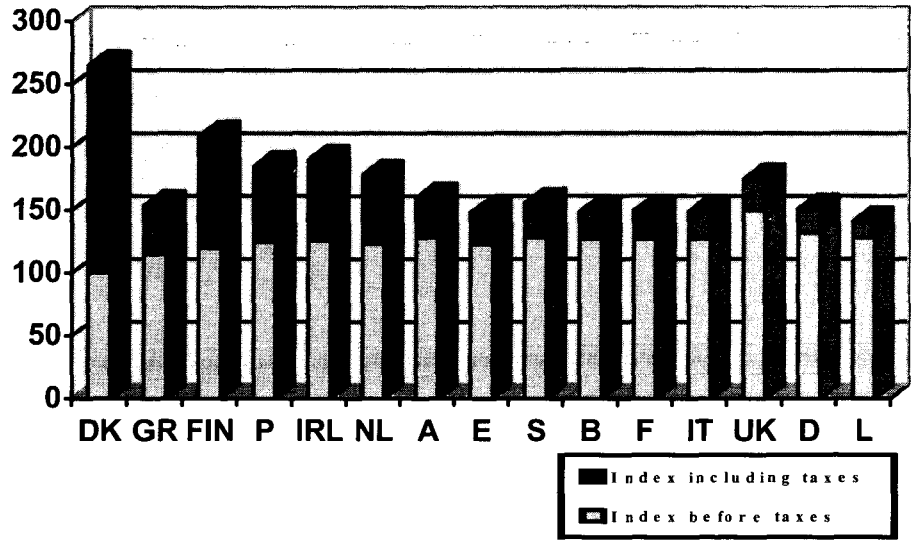

Figure 1. Car Price Differentials Net of Taxes and Including Taxes (1/11/99)

3. Brief Reference to Price Differentials in the United States

To fully emphasize the peculiarities of price differentials in the European Union, it is worth referring to how price discrimination is viewed in the United States. Although the United States is a politically and economically integrated country, price differentials also occur between the different states, even if they are much less noticeable than in Europe. In the car sector, besides territorial price differences, manufacturers and their dealers seem to employ other ways of implementing price discrimination, a

[67] *See infra* Part IV.D.

particularly frequent practice in recent years.[68] These differentials are introduced by having two different purchase alternatives for consumers. The first of these includes "cash back" rebate offers, while the second comprises a low interest rate on financing.

One author has highlighted that, with this choice of incentives, manufacturers can potentially differentiate between households with different levels of willingness and ability to purchase a car. On the one hand, a high price for the vehicle and a low finance rate might appeal to households who value the vehicle highly, but cannot pay for it immediately. On the other hand, a low price for the vehicle with a high interest rate should be more attractive for those who can pay for the vehicle at the time of purchase.

Nevertheless, as opposed to the European Union, antitrust authorities have not shown a concern for these practices. Despite the prohibition of price discrimination contained in the 1936 Robinson-Patman Act ("RP Act"),[69] which is still in force, the statute has not only been staunchly criticized, it has also been decreasingly applied in the last forty years.[70] Thus, in U.S. antitrust law, firms currently have a high degree of freedom to set prices when they manage to avoid dominance and price-fixing agreements. This is mainly a consequence of the fact that U.S. policy makers act on a belief that pricing should be left to the market. If that is the case, then any excessive prices will be corrected (i.e. if firm A is charging too much for its products, then there will be an incentive for other competing firms to lower their prices and increase their sales; firm A will eventually have to reduce its prices if it wants to remain in that market).

C. Explanations for the Differentials

1. Taxes

Different tax systems account for a large part of the differentials in post-tax prices,[71] and this is not exclusive to the European car sector.[72]

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[68] *See* Steven Berry, James Levinsohn & Ariel Pakes, *Differentiated Products Demand Systems from a Combination of Micro and Macro Data: The New Car Market*, 112 J. POL. ECON. 68 (2004).

[69] Robinson-Patman Act, 15 U.S.C. § 13(a) (2007).

[70] *See* William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J., 377, 410 (2003); *see also* Terry Calvani & Gilde Breidenbach, *An Introduction to the Robinson-Patman Act and Its Enforcement by the Government*, 59 ANTITRUST L.J. 765 (1991).

[71] Differences of 5–10 percent still exist in value-added taxes. Goldberg & Verboven, *supra* note 1, at 490.

[72] *See* Laurence J. DeFranco, William Lilley III & John R. Dunham, *The Case of the Transient Taxpayer: How Tax-Driven Price Differentials for Commodity Goods Can Create*

Maier, for instance, carries out a study of differentials within the common market in various products sold on the Internet, particularly on eBay.[73] He refers to differences in taxation as one of the principal causes of price differentials.[74] In the car sector, taxes can account for over 50 percent of the purchase price in some countries.[75] Studies also reflect that pre-tax prices tend to be lower in those countries with high taxation, such as Denmark, Finland, and the Netherlands.[76] This leads Degryse and Verboven to conclude that "price dispersion would be reduced if a harmonisation of car purchase taxation took place."[77] Therefore, from the point of view of end consumers it is likely that harmonizing taxes across Europe would be a much more efficient way of reducing the differentials. However, the founding Treaties give the Commission no power to act in the field of tax harmonization. Moreover, given the major political sensitivities involved in relation to the concept of the welfare state, which varies across Member States, it is an area that has remained in the hands of the national governments. A discussion on the adequacy of harmonizing taxes is beyond the scope of this paper.[78] It needs to be noted however that, in contrast to most other goods, car taxes are paid by consumers in the country of use and not where the car is purchased. As Goldberg and Verboven posit, "*Pre*-tax prices are the ones relevant to arbitrageurs, so if markets were fully integrated, pre-tax car prices should be equalized across countries, leaving post-tax car prices to differ only due to local car taxes."[79] Therefore, it is still necessary to find justifications for pre-tax differentials, which for our purposes are of particular relevance.

2. Exchange Rate Fluctuations and Divergent Fiscal Policies

According to Degryse and Verboven, in systematic price differentials, exchange rates play an important role in explaining short-term fluctuations, whereas taxes are important determinants of long term, persisting systematic price differentials. They refer to an "incomplete pass-through of

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Improbable Markets, BUS. ECON. July 1998, at 43.

[73] *See* Maier, *supra* note 27.

[74] *Id.* at 3.

[75] Goldberg & Verboven, *supra* note 1, at 490.

[76] *See supra* Part II.B.2.

[77] Degryse & Verboven, *supra* note 38, at 13.

[78] On the subject of EU tax harmonization, see generally JAMES BARR & MATTHEW ELLIOT, MOVING ON UP: EU TAX HARMONISATION PLANS (The European Foundation) (1998), *available at* http://www.europeanfoundation.org/docs/moving.pdf; STEVE BOND ET AL., CORPORATE TAX HARMONISATION IN EUROPE: A GUIDE TO THE DEBATE (The Institute for Fiscal Studies) (2000), *available at* http://www.ifs.org.uk/publications.php?publication_id=1881; Kitty Ussher, *The Myth of Tax Harmonisation*, CENTRE FOR EUROPEAN REFORM BULLETIN, Feb. 1999, *available at* http://www.cer.org.uk/articles/n_4_4.html.

[79] Goldberg & Verboven, *supra* note 1, at 490–91.

taxes, tariffs and exchange rates."[80] It takes place when undertakings do not fully pass through a change in a cost variable to consumer prices, thus resulting in differences in pre-tax prices.[81] Therefore, currency exchange fluctuations account for part of the differentials. For instance, the depreciation of the Italian lira in the early 1990s led to temporary low distribution costs in Italy, and the depreciation of the British pound in the same decade and its subsequent appreciation led to large fluctuations in the local costs.[82] The introduction of the euro has naturally eliminated this problem within the twelve Member States that have adopted the single currency,[83] but thirteen other members of the European Union have to date not entered into the Economic and Monetary Union ("EMU"), including the United Kingdom—the most expensive market. Canova and Pappa, in their study of price differentials and monetary shocks, also consider differences in the fiscal policies of countries as a cause for price differentials.[84] The effects of differences in national fiscal policies in price differentials have also been reduced with the creation of the EMU, as there is now one policy for the twelve Member States involved.

3. Local Costs and Shipping Expenses

An important explanation highlighted by Maier—sometimes under-emphasized by the Commission—would be the consequence of certain local costs,[85] such as divergent rents for supermarkets and stores, or wages for employers in the Member States.[86] Wages and rents differ across countries, as well as advertising, marketing and servicing costs, and this can have an impact on the final price of the products. In the European car sector, it is estimated that local costs can account for up to 40 percent of the price of a car.[87] Shipping costs could also be included here, as the total price paid by the consumer increases when a product is produced in a Member State

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[80] Degryse & Verboven, *supra* note 38, at 45 (emphasis in original).

[81] *See id.* at 45–46.

[82] *See* Goldberg & Verboven, *supra* note 1, at 491.

[83] *See supra* Part III.B.1; *see also* Michael R. Baye et al., *Did the Euro Foster On-Line Price Competition? Evidence from an International Price Comparison Site,* 44 ECON. INQUIRY 265, 265–79 (2006).

[84] *See* Canova & Pappa, *supra* note 28.

[85] Degryse and Verboven refer to "differences in local costs" as an explanation for the differences. Degryse & Verboven, *supra* note 38, at 45.

[86] *See id.* at 45; *see also* Shelby D. Gerking & William N. Weirick, *Compensating Differences and Interregional Wage Differentials*, 65 REV. ECON. & STATISTICS 483 (1983); J. Vernon Henderson, *Evaluating Consumer Amenities and Interregional Welfare Differences*, 11 J. URBAN ECON. 32 (1982); Jennifer Roback, *Wages, Rents, and the Quality of Life*,. 90 J. POL. ECON. 1257 (1982).

[87] Goldberg & Verboven, *supra* note 1, at 489; *see also* Goldberg & Verboven, *supra* note 60.

different from that of the purchase. For instance, Maier estimated that shipping costs for products sold on the Internet could explain up to 60 percent of the price differentials for regressions between different countries that have adopted the euro.[88] These extra costs partially justify the different prices charged at different locations, and limit the freedom manufacturers have to set prices, given that in some locations manufacturers incur additional costs, which necessarily have an impact on the final price.

4. Divergences in National Product Regulations

Differences in product regulation across Europe are generally regarded as a cause for price differentials.[89] However, the impact of this phenomenon has been limited over the years as the process of integration taking place in Europe has advanced and a sea of directives harmonizing product standards has been adopted by the European institutions. Nowadays, the path towards the free movement of goods has meant that product regulation across Europe has become increasingly uniform, and most of the differences that still remain are a consequence of exceptions granted to some countries on the basis of Article 30 EC[90] or the Cassis de Dijon "mandatory requirements."[91] The abolishment of import duties as for intra-EU trade has also contributed to the progressive disappearance of this cause.

5. Demand Elasticity

Goldberg and Verboven note that firms tend to have an incentive to charge higher prices in those markets where consumers are the least price sensitive.[92] Although this factor is overlooked by Maier and some of the leading studies, evidence in the car market suggests that consumers are less influenced by price when it comes to national brands, whereas price sensitivity increases for foreign brands. Our consumer survey[93] also reflected this, particularly in Germany, as 67 percent of the people questioned stated an unconditional preference for German cars regardless of price. At the same time, when asked under what circumstances they would consider buying a different brand, price was second in importance, after brand reputation. However, of those consumers who owned a car from another Member State, almost 78 percent said they would consider

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[88] Maier, *supra* note 27, at 20.

[89] *See id.* at 4.

[90] EC Treaty, *supra* note 5, art. 30.

[91] Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltun für Branntwein, 1979 E.C.R. 649.

[92] *See* Goldberg & Verboven, *supra* note 1, at 491.

[93] *See infra* Part V.

purchasing a vehicle from a different manufacturer if the price was adequate.

6. The Remainder—Possible Explanations

After taking into consideration the justifications traditionally given for price differentials, still more than half of the price differential range remains apparently unexplained.[94] The differences are more acute when considering international price dispersion versus systematic price differentials, since the latter is an average of the former and averages tend to smooth out differences. In the words of Verboven and Degryse, "the systematic price differentials can be fairly well explained by observed structural factors such as taxes and exchange rates. In contrast, the price differentials for individual car models . . . can only be explained to a partial extent by these factors."[95] Outside of such factors, the Commission and consumer organizations seem to believe that pricing policy is, to a great extent, decided by manufacturers. However, the situation of European car manufacturers places a question mark on the power that they have to set prices, as will be analyzed in the next part.

In addition, some authors believe that the mere existence of national borders between countries—the so-called "border effect"—is sufficient to create frictions in international trade which cause significant price differentials.[96] This idea is supported by empirical studies of different products,[97] and could also account for differences in the car industry. In this sense, despite a growing share of product regulations being decided upon in Brussels, it seems that national borders still create sufficient friction to cause prices to differ significantly within the European Union. If European markets were fully integrated, fewer opportunities to segment markets and to change different prices would exist. Bluntly put, there is still insufficient market integration, and the existence of price differentials would be an indication of this, rather than a cause. For instance, in the online market, shipping goods within a country takes about two days, whereas shipping goods from one European country to another takes about a week. By way of example, Maier notes that it is faster to ship goods within Germany from Munich to Hamburg (about 450 miles) than between two closer cities located in two different countries, such as Amsterdam and Brussels (less than 100 miles).[98] This situation is not peculiar to Europe; in

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[94] The residual price differential range resulting from the first measure of price dispersion is 20.7 percent on average, compared to the initial 38.8 percent.

[95] Degryse & Verboven, *supra* note 38, at 16–17.

[96] *See generally* Maier, *supra* note 27; Carolyn L. Evans, *The Economic Significance of National Border Effects*, 93 AM. ECON. REV. 1291 (2000).

[97] *See* BEUC/222/92, *supra* note 45.

[98] Maier, *supra* note 27.

the United States, the situation seems to be similar: trade within the States is about seven times higher than trade between the States. This would justify the Commission's position and could mean that it is precisely the lack of integration that is cause for concern.

As a conclusion to this part of the paper, which has studied the existence of car price differentials and their causes, it seems that price differentials are not a phenomenon peculiar to the automobile industry, and are usually generated by causes similar to those of other sectors of the economy.[99] It is a fact that consumers pay different prices for similar goods, despite the price transparency provided by the Internet.[100] This even occurs within the United States, and in online purchases. Therefore, it remains interesting that so much effort has been invested to fight against differentials in this sector, and in particular on the part of the Commission. It is even more curious if one examines the figures provided by the European Automobiles Manufacturers Association ("ACEA"), which reflect that the car industry actually maintains relatively small differentials when compared to other consumer goods.[101] No evidence is provided in the available studies that these differentials are actually caused by the manufacturers, which raises the question of how much power manufacturers really have in setting high prices in such a competitive industry.

III. REASONS BEHIND PRICE CONVERGENCE AND IMPLICATIONS FOR THE FUTURE

Recent Commission reports reflect a narrowing of car price differentials.[102] This seems to be partly because prices in the ten Member States which joined the European Union in May 2004 are included, and prices tend to be relatively homogeneous between them. However, the decrease is also noticeable among the former members, even if the United Kingdom remains the most expensive market. This part attempts to find explanations behind this new tendency. It seems that one of the principal

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[99] *See, e.g.*, Stephanie Giaume & Sarah Guillou, *Price Discrimination and Concentration in European Airline Markets*, 10 J. AIR TRANSPORT & MGMT. 305 (2004). Maier's study of price differentials on products sold on the Internet also reflects important differences in the prices of goods ranging from lipstick to books to audiovisuals and bras. Maier, *supra* note 27.

[100] Maier, *supra* note 27, at 2; *see also* Glenn Ellison & Sara Fisher Ellison, *Lessons About Markets from the Internet*, 19 J. ECON. PERSP. 139, 148–55 (2005) (discussing frictionless commerce and product differentiation).

[101] *See, e.g.*, Press Release, Eur. Auto. Mfr. Ass'n, Price Differences for Cars are Smaller than for Other Consumer Goods, (July 23, 2001), http://www.acea.be/files/23072001.pdf.

[102] European Comm'n, *Car Price Report: Main Highlights: Car Price Differentials Across EU Remain at Low Level* (May 2007), http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/2007_05_a.pdf; *see also* Europa, Car Price Reports Archive, *supra* note 1 (demonstrating this trend in years 2003 to 2007).

causes is the enhancement of the integration of markets across Europe, which has almost eliminated two of the principal causes for the differentials—exchange rate fluctuations (and divergent fiscal policies), and differences in national product regulations. More specifically, this part focuses on what the author believes to be the two main culprits of price convergence: 1) the increase in price transparency brought about principally by the introduction of the single currency, and the boost of new communication technologies such as the Internet on the one hand, and 2) the position of European car manufacturers in the market as a result of enhanced foreign competition on the other.

A. The Impact of Price Transparency

"The increasing significance of the Internet in recent years, as well as the introduction of the euro, have made prices considerably more transparent throughout Europe."[103] These two factors highlighted by DaimlerChrysler have indeed facilitated consumers' access to information regarding prices across Europe. In today's economic transactions, consumers can observe and compare prices across different locations and countries with relative ease. In the European context, the single currency and the boost of the Internet are arguably the two principal conditions which have contributed to the increase in price transparency.

1. The Single Currency

In January 2002, twelve of the then fifteen Member States of the European Union entered into the third phase of the EMU and the euro replaced national currencies in their territories.[104] The new currency accounts for 25 percent of world GDP and 40 percent of world trade.[105] *A priori*, the existence of a common currency would suggest greater price transparency and lower transaction costs, and it was therefore expected that this would somehow force upon manufacturers a duty to reduce price differentials across the European Union. It would also eliminate exchange rate volatility, which generally leads to differentials.[106] Major changes were not reflected in figures gathered initially. In November 2001 the Commission published the first report on car price differentials reflecting

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[103] DaimlerChrysler News, Mercedes-Benz P. Cars, Mercedes-Benz Leads the Way in Harmonizing Prices Throughout Europe (Feb. 25, 2002), http://www.daimlerchrysler.com /dccom/0-5-7153-1-9358-1-0-0-0-0-0-10748-7145-0-0-0-0-0-0-1.html.

[104] Press Release, Eur. Cent. Bank, The Euro Cash Changeover Is Progressing Smoothly in All Euro Area Countries (Jan. 2, 2002), http://www.ecb.eu/press/pr/date/2002/html /pr020102.en.html. The euro became legal tender on January 1, 2002 in twelve of the fifteen Member States that formed the European Union.

[105] Goldberg & Verboven, *supra* note 1, at 485.

[106] *Id.* at 489.

prices in the new single currency.[107] Germany and Austria remained the most expensive markets, whereas Spain, Greece, and Finland were still the cheapest.[108] Outside Euroland, the United Kingdom maintained its position as the most expensive.[109]

While the latest reports reflect smaller price differentials, the *de minimis* rule is still violated in some cases—among the ninety car models examined, twenty-five still have differences exceeding 20 percent.[110] Furthermore, our investigations have not been able to show a direct correlation between the existence of a single currency and the decrease in the differentials. It is questionable that such correlation exists. For instance Denmark, a non-member of the Euro zone, traditionally has the lowest pre-tax prices, whereas Germany and Austria, who have adopted the single currency, are among the highest.[111] Even more worrying is the evidence that seems to point towards a noticeable increase in the price level since the introduction of the euro.[112] In this sense, the car sector is somehow an exception, as studies point towards a decrease in price differentials in other sectors in Euroland since 2002.

2. New Technologies

The technological revolution posed by the Internet is the second factor to account for the increase in price transparency.[113] The Internet features "low search costs, low barriers to entry and easier price comparability."[114] Consumers no longer need to go cross-border to find out about prices in

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[107] Press Release, Eur. Union, Car Price Differentials in the European Union Remain High, Especially in the Mass Market Segments (Feb. 25, 2002), http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/305&format=HTML&aged=0&language=EN&guiLanguage=en; *see also* Europa, Car Price Reports Archive, *supra* note 1 (bi-annual publication of studies, on May 1 and Nov. 1, since 1992).

[108] *Introduction of Euro Has Not Caused Car Prices to Converge, and Differences Remain Great Between One State and the Next*, BULLETIN QUOTIDIEN EUROPE (Agence Europe, Brussels), Feb. 25–26, 2002, at 10; *see also* Press Release, Eur. Union, *supra* note 108.

[109] *Id.* (reporting greater differences in the prices of mini-cars and family models than for luxury and monospace cars); DG COMP, *Car Price Differentials Within the European Union on 1 Nov. 2001*, http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/2001_11.pdf.

[110] *See European Commission—Car Price Report at 1.05.2007*, http://ec.europa.eu/comm/competition/sectors/motor_vehicles/prices/2007_05_rep_main_table.pdf.

[111] *See, e.g.*, Press Release, Eur. Union, *supra* note 107.

[112] *See* Baye et al., *supra* note 84, at 265 (finding that average and minimum prices increased, respectively, by 3 and 7 percent in their study of the online market for electronic goods).

[113] *See* Michael R. Baye & John Morgan *Information Gatekeepers on the Internet and the Competitiveness of Homogeneous Product Markets*, 91 AM. ECON. REV. 454, 454 (2001).

[114] Bachis & Piga, *supra* note 25, at 2.

other countries. A simple search on the web will suffice to provide the necessary information.[115] There are search engines which can find the cheapest store to buy a specific item, and which even compare prices across countries—Kelkoo or Froogle are two good examples.[116] It is also possible to browse for items on auction sites such as eBay. Online auctions have been described as the closest one could reasonably get to perfect competition, given the fragmentation of buyers and sellers with limited market power.[117] According to eBay's 2003 annual report, 95 million users from more than 150 countries listed 970 million items on eBay that year. The total value of goods for that year nearly reached $24 billion.[118]

Car manufacturers have progressively adapted to the new technologies and most of them now allow consumers to buy their cars through their websites.[119] Consumers can "pick and choose" by selecting the car model and potency of the engine and then adding any extras they may wish to have. Detailed information regarding price is provided, even if consumers need to be familiar with technicalities beforehand as no technical explanations are generally provided on these sites.[120] Despite the accessibility of the information, a survey conducted by the author on European consumer preferences still reflected a certain reluctance to actually purchase cars on the Internet, particularly among people aged thirty and above.[121] Future generations, for whom internet sales are common, could well change this tendency, and thus possibly change the way cars are distributed forever. If internet sales rise, dealers' territorial exclusivity may be put at risk. In such a scenario, there will be little incentive for them to enter into dealership contracts, as they will not be rewarded for the investments they are required to make if others can sell the same cars on the web, presumably at more competitive prices.

B. The Position of the European Car Industry in the Global Market

When examining the effective power of car manufacturers over price, the competitiveness of the European carmakers is a crucial factor.[122] In

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[115] *But see* Ellison & Ellison, *supra* note 100.

[116] Kelkoo.com, http://www.kelkoo.com (last visited Nov. 25, 2007); Google Product Search, http://www.google.com/products (last visited Nov. 25, 2007).

[117] Maier, *supra* note 27, at 6.

[118] *Id.*

[119] The author has been regularly checking the car manufacturers' websites since 2001. In the last few years, they seem to work much better whereas originally many technical problems occurred which made it virtually impossible to compare prices online.

[120] Very little information is provided, for instance, on what the characteristics of each of the different models are and how they differ from each other.

[121] See *infra* Part V.

[122] A competitive market would be one which allocates resources to its best use.

order to be able to raise prices with the sole purpose of increasing benefits, a manufacturer ought to have an advantageous position within a defined market.[123] Otherwise, a price increment in his products will lead consumers to buy their cars from his competitors. In any case, Motta suggests that, in the real world, nearly all firms will have enough market power to act as an incentive to discriminate.[124] The car market is arguably one of the most competitive markets in the European Union, yet for the past three years the automobile industry has been ranked among the three "most troubled industries" in a poll conducted by the Turnaround Management Association.[125] To anyone familiar with the history of the industry, this decline would remind them of that suffered by the U.S. carmakers in the 1960s. Similarly to what is happening now in Europe, the convergence of factors such as macroeconomic instability, changes in consumer preferences, a rise in the price of oil, an increase in foreign competition, and intense governmental regulatory activity became a significant burden on the industry, and led to mergers which transformed the structure of the market.[126] By the 1960s the so-called "big three" U.S. assemblers—GM,[127] Ford, and Chrysler—held the market largely to themselves. Most of the smaller independent manufacturers such as Kaiser, Willys, Studebaker, and American Motors were forced to merge or close down, leaving the industry in the hands of the Big Three.

At the moment, all the indicators suggest that the European car industry is also experiencing similarly difficult times, and as a consequence it is likely that its structure will be irrevocably transformed within the next decade or so. Its position in the midst of pressure from firms in other parts of the world has, in the author's view, also contributed to the decrease in car price differentials across Europe, as foreign competitors have forced Europe's established brands to adjust their prices to remain in the picture. Given its importance, this part examines the competitiveness of the European Union's car manufacturers in order to predict how they will subsist in the years to come, and if there is a role for the European legislator in sustaining them.

Resource allocation efficiency is highlighted, for instance. *See generally* KARL E. CASE ET AL., ECONOMICS: EUROPEAN EDITION 24 (1999); Joan Bodoff, *Competition Policies of the U.S. and the EEC: An Overview*, 1984 ECLR 51, 52.

[123] MOTTA, *supra* note 13, at 492 n.107.

[124] *Id.*

[125] *See No Change Predicted in Top 3 Struggling Industries for 2005*, BUS. CREDIT, Feb. 1, 2005, at 56, *available at* http://www.allbusiness.com/sales/335682-1.html.

[126] Lane Kenworthy, Stewart Macaulay & Joel Rogers (1996), *"The More Things Change. . .": Business Litigation and Governance in the American Automobile Industry*, 21 L. & SOC. INQUIRY 631 (1996).

[127] GM was the result of a merger between 200 garage-sized firms. *See* GM History—A Brief History, http://media.gm.com/corpcom/history/intro.htm (last visited Nov. 25, 2007).

1. Competition in the European Car Market

Competitiveness is usually defined as the ability to gain or defend market share on the international market by relying on price and/or the quality of goods produced. The car market is, in this sense, a highly competitive market, and according to the European Parliament, this might cause trouble for car manufacturers in Europe.[128] Most of these problems are derived from the pressure of the Japanese, and to a lesser extent the American, car industries,[129] at a time when European car makers have less financial power than their competitors from abroad and when a rise in the number of new manufacturers in Asia with important export potential is developing.[130] In global terms, an expansion for the automobile industry is expected over the next decade, in particular with the motorization of China and India. It is predicted that more cars will be made in the next twenty years than in the entire history of the industry.[131] However, in the last few years concerns about the future of the European car industry have emerged. In its 2004 Competitiveness Report, the European Commission warned about the delay in developing green technologies already mastered by Japanese makers.[132] The competitiveness of the European car industry is dependent upon factors such as production costs, technological and organizational innovation, regulatory framework, and macroeconomic conditions, which, according to the report, place a large question mark on the future of the sector.[133]

The EU car market is relatively competitive, without one single manufacturer holding a clear dominant position.[134] Kenworthy, Macaulay, and Rogers have highlighted the effects of competition on firms' behavior: "Competition . . . increases firms' attention to short-run bottom line concerns. Firms can less easily afford to forego opportunities for

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[128] *See* European Parliament Fact Sheets—The Automobile Industry, http://www.europarl.europa.eu/facts/4_7_4_en.htm (last visited Nov. 25, 2007).

[129] Nissan, Japan's second largest carmaker, recorded a 15 percent increase in revenue last year, which meant that net profit rose by 1.7 percent. Honda's net profit for the same year rose by 4.7 percent. Both companies were helped by strong sales in America and a growing position in Europe. *World this Week*, ECONOMIST, Apr. 30, 2005, at 9. In contrast, General Motors lost $1.1 billion in its worst quarterly loss since 1992. Ford Motors said quarterly net income fell by 38 percent to $1.21 billion. *World this Week,* ECONOMIST, Apr. 23, 2005, at 7.

[130] *See* European Parliament Fact Sheets, *supra* note 128.

[131] *Extinction of the Predator*, *supra* note 7, at 71.

[132] *EU Car Sector Successful but Not "Green" Enough*, EURACTIV, Dec. 1, 2004, *available at* http://www.euractiv.com/Article?tcmuri=tcm:29-132985-16&type=News.

[133] *Id.*

[134] It would be more adequate to talk about "car markets" as there are different relevant (product) markets that can be distinguished. For a detailed classification see Commission Decision 2002/758, Mercedes-Benz, 2002 O.J. (L 257) 1 (EC).

immediate gain, and their room for maneuver, and ability to sustain the costs of constructing and applying alternative sanctions, are reduced. Competition also raises the relative stakes in individual transactions by reducing margins of permissible error."[135] There are many competitors in the game, and this, according to 19th Century Neoclassical economics, would in itself reflect the existence of competition. However, if there are market imperfections, then the level of competition of that market may be limited, despite the presence of many actors. For instance, if manufacturers are exchanging information and fixing prices between them, then they will be creating monopoly-like effects. In the case of the car sector, there have been numerous mergers over the years, and horizontal cooperation is frequent. Nonetheless, it is questionable that these mergers have restricted the competitiveness of the market or harmed competition, particularly since Europe's firms face fierce competition from manufacturers all around the world and thus would be unlikely to survive if they decided to artificially raise prices.

According to Garel Rhys, director of the Centre for Automotive Industry Research at Cardiff University, "[T]oday's car plants will need [to be] renewed, retooled, refurbished and replaced to remain competitive."[136] This is quite a challenge for European carmakers, in particular given the peculiar structure of the sector. Many of the established producers have merged over the years as a short-term solution to confront competition, but are still dragging their operating difficulties, much to the benefit of new entrants.

2. Difficulties Faced by European Car Manufacturers

Horizontal cooperation[137] and mergers in the car industry are frequent. Even so, they may go by unnoticed for some as many brand names still remain—fifty-eight brands survive among the ten largest manufacturers. The five largest company alliances account for 75 percent of the global market. Adding the next five, it rises to 90 percent. In Europe, alliances between firms are said to have "bundled" brands. For instance, British Leyland was the resulting brand of the merger of virtually all the British car industry, while in France Citroen was swallowed by Peugeot (despite its survival as a brand). Volkswagen used its acquisitions of Seat and Skoda to expand geographically towards Spain and Eastern Europe. The takeover of

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[135] Kenworthy, Macaulay, & Rogers, *supra* note 126, at 633.

[136] *Extinction of the Predator*, *supra* note 7, at 71–73.

[137] As regards horizontal cooperation, see, for example, the *Ford/Volkswagen* Commission Decision, 93/49, 1993 O.J. (L 20) 14, 15–16, which exempted a joint venture agreement between those manufacturers on integration grounds and an attempt to create new jobs and promote a "harmonious development of the Community and the reduction of regional disparities."

Chrysler by Daimler-Benz in 1998 and the alliance of Renault and Nissan in 1999 are the most recent changes and the two biggest consolidation deals in the industry.

It seems the strategy of consolidating behind the brands has not been entirely successful, as recent studies prove an inverse correlation between the number of brands a firm possesses and profitability.[138] In fact, the most recent facts reflect that brands are now more cautious before entering into mergers or other types of horizontal cooperation.[139] Mergers changed the privileged position European car manufacturers had enjoyed for many years. According to the Commission's above-mentioned Competitiveness Report,[140] Europe still has the largest single market for passenger cars in the world and is well positioned to leverage economies of scale and scope with 42 percent of global production coming from the European Union in 2002. So far, the fact that many consumers have remained loyal to European brands has shielded the European Union from excessive international competition. As a result, European firms remain dominant in many relevant product markets (particularly luxury cars) and are rather well positioned in emerging markets such as China. Qualified affordable labor is abundant thanks to the European Union's recent expansions towards Central and Eastern Europe.[141]

However, in terms of labor productivity, employees are generally more costly and less flexible in the European Union than in other regions. Growth in the European Union is slow compared to other major world regions and is further hindered by a relative fragmentation of the European Union's single market, especially relative to differing vehicle taxation in the Member States. One major challenge to growth lies in the advantage Japanese car makers have gained in developing environmentally friendly technologies. Another challenge to the industry is the rise of mighty superstore chains, which have eroded the disproportionate power carmakers once had over their dealiers.[142] It seems that a shift in power is taking place

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[138] *Extinction of the Predator*, *supra* note 7, at 71–73.

[139] The possible merger between MAN and Scania has been delayed on several occasions, and no interest in the takeover of Fiat has been expressed, despite the company's troubles. Fiat nevertheless entered into a joint venture with India's Tata Motors in late 2006. *See Industry News*, UK AUTO INDUSTRY, Jan. 12, 2007, *available at* http://www.autoindustry.co.uk/news/day-12_1_2007#12-01-07_13.

[140] *EU Car Sector Successful but Not "Green" Enough*, *supra* note 132.

[141] Ten new members entered the European Union on May 1, 2004: Estonia, Latvia, Lithuania, Poland, Slovenia, Hungary, the Czech Republic, Slovakia, Malta, and Cyprus. Romania and Bulgaria joined on January 1, 2007.

[142] For instance, see Jules Stuyck & Ton Van Dyck, *EC Competition Rules on Vertical Restrictions and the Realities of a Changing Retail Sector* (2002), *reprinted in* 5 PRIVATE LAW IN EUROPEAN CONTEXT SERIES, THE FORTHCOMING EC DIRECTIVE ON UNFAIR COMMERCIAL PRACTICES 131–32 (Martijn Hesselink et al. eds., 2004). Nevertheless, the

in the relationship between retailers and manufacturers, with the power is being put into the hands of these large retailers, facilitated by technological innovation and the information technology revolution. The car sector has remained, for the most part, an exception to this tendency. The relationship between manufacturers and dealers in this sector has been referred to as a "relation of adhesion,"[143] for it is the manufacturer who defines the general clauses and the specific contractual obligations and has the unilateral right to change the conditions. But this appears to be gradually changing. In the United States, it is now common to see huge car retailers that sell more than one brand and have many branches, and in the European Union the new regulatory framework provided by Regulation 1400/2002 should open up similar possibilities for European car dealers.[144] In this sense, the new changes address the creation of a new type of dealer with as much bargaining power as the manufacturer when enacting dealership contracts. Pressure on EU carmakers is therefore mounting, and even more so considering the fines that since the late 1990s have been imposed on manufacturers—the latest being the EUR 49.5 million fine on French manufacturer Peugeot for barring dealers in the Netherlands from selling their products to consumers in other EU countries.

Ivan Hodac, Secretary General of the ACEA, claims that product regulations imposed by the European Union are worrying for carmakers.[145] Some of the rules even seem contradictory, as they demand both greater fuel efficiency and safety enhancements, which make cars heavier and require more power. He suggests that the European Commission institutions should concentrate on ensuring better quality regulation by carrying out integrated impact assessments, particularly given the newly enlarged Union. He proposes a series of solutions: "The rapid completion of the internal market in the automotive sector, including fiscal harmonisation of vehicle and fuel taxes, alongside further development of efficient road infrastructure is essential. . . . Lastly, more flexible labour conditions to boost competitiveness should be considered."[146] It seems therefore that the abundant product regulation harmonizing standards across the European Union is proving a heavy burden on the manufacturers.

Despite these claims, recent data seem to indicate a less worrying

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authors conclude that the power of manufacturers over their retailers is much greater. *Id.* at 168.

[143] Christian Joerges, *Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Principles in the Assessment of Contract Relations Between Automobile Manufacturers and their Dealers in Germany*, 1985 WIS. L. REV. 581, 584 (1985) (citing Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691, 770–71 (1974)).

[144] *See infra* Part IV.C.2.

[145] *See EU Car Sector Successful but Not "Green" Enough*, *supra* note 133.

[146] *Id.*

picture for the industry. A survey by AC Nielsen[147]—a company dedicated to providing worldwide marketing information—recently reflected that the demand for brand-new cars in Europe is increasing, and that European brands are still the favorite among European consumers.[148]

3. Proposed Solutions

Goldberg and Verboven believe that the remaining differentials call for structural interventions.[149] In the same line, regulation seems to be the best way for the Commission to tackle the difficulties envisaged by this crucial European industry. The Commission recommends putting in place the appropriate regulation to anticipate technology trends, such as tax policies to provide customers with the incentives to buy advanced technologies and further align the Member States' vehicle tax system. Recently, ministers meeting at the EU Competitiveness Council on November 25, 2006 welcomed the conclusions of a separate report, saying that future regulatory proposals in the European Union's automotive sectors "should undergo comprehensive impact assessments taking into account the cumulative burden of the existing regulatory framework for the automotive industry."[150] They supported the Commission setting up a high level group to address issues of importance to the automotive industry's competitiveness.

CARS 21, a high level group to address key issues for the competitiveness of the automotive industry, was set up by Commissioner Verheugen in January 2005.[151] It intends to improve the regulatory framework of the car industry and prepare it for the competitive challenges of the next decade. The group is composed of three commissioners, five ministers from Member States, two MEPs, five CEOs from the automobile

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[147] The study consisted of a worldwide online consumer survey, polling over 14,000 people through the Internet in twenty-eight countries across the Asia Pacific, Europe, and the United States.

[148] *See* Press Release, ACNielsen, New Survey Names Volkswagen as Leading Car Brand in Europe (Apr. 4, 2005), *available at* http://www2.acnielsen.com/news/20050404_eu.shtml.

[149] *See* Goldberg & Verboven, *supra* note 1, at 516–18.

[150] *See EU Car Sector Successful But Not "Green" Enough*, *supra* note 132.

[151] Opinions on CARS 21 have been issued by the different representatives of the stakeholders. *See, e.g.*, Press Release, BEUC, *supra* note 39; Press Release, European Automobile Manufacturers' Association, EU Commission Launches CARS 21 Initiative: A Positive Step Towards Better Competitiveness and Sustainability in Europe (Jan. 13, 2005), *available at* http://www.acea.be/files/20050066.pdf; Press Release, International Federation of Automotive Aftermarket Distributors, "CARS 21" Is Endangering Consumer Choice in the Aftermarket-Repair and Service Sector (Oct. 5, 2005), *available at* http://www.euractiv.com/29/images/FIGIEFA%20Press%20Release%20on%20CARS%2021%20-%2005%2010%202005%20(3)_tcm29-145373.doc.

industry and one from the petroleum industry, one automotive supplier, one trade union, one motorist organization, and one environmental think-tank. At this point, it is still too early to evaluate the outcome of its work, but it has already received some criticism from consumer organizations and other industry sectors connected to the automotive sector for being tailor-made to fit EU manufacturers' interests.[152] The group has, however, adopted a ten-year plan of action to simplify EU automotive regulation, as well as to improve safety and reduce pollution.[153] To adequately evaluate the recent line of action of the Commission, it is necessary to place it in the broader context of the European regulation of the car sector, which is examined below.

IV. IS THERE A ROLE FOR INTERVENTION?

When the car distribution regime was being revised in the early 2000s, former Commissioner Monti insisted that car price differentials and possible obstacles to parallel trade remain a high priority for the Commission. Car price differentials seem to have given the Commission wings to take action in this sector of the economy. EU law has traditionally looked upon price discrimination between Member States with mistrust.[154] Indeed, some practices to prevent the flow of parallel imports are believed to be among the most harmful offenses to competition, and are therefore practically treated as a *per se* prohibition. At its most basic, EU law in the car sector has, mainly through competition provisions, focused mainly on limiting car price differentials by protecting parallel imports—whereby retailers (and consumers) to buy the products in the cheaper markets and then resell them in the most expensive countries at lower prices than the official retailers in that territory. The Commission acts in a belief that if parallel trade is upheld, then it will be unfeasible for manufacturers to price discriminate,[155] and the segmentation of markets will disappear. The European antitrust rules also appear to aim at protecting dealers and consumers from the power of manufacturers, and this is particularly clear in

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[152] *See* EurActiv.com, *EU Carmakers Square Up to Critics in Parliament*, Oct. 5, 2005, http://www.euractiv.com/en/transport/eu-carmakers-square-critics-parliament/article-145384.

[153] For full text of the 10-year plan, see European Commission, Enterprise and Industry Directorate-General, *CARS 21: A Competitive Automotive Regulatory System for the 21st Century* 43–58 (2006), *available at* http://ec.europa.eu/enterprise/automotive/pagesbackground/competitiveness/cars21finalreport.pdf. *See also* BEUC, *The Automotive Regulatory Framework of the Next 10 Years—BEUC Comments*, BEUC/169/2005 (2005), *available at* http://ec.europa.eu/enterprise/automotive/pagesbackground/competitiveness/stakeholder_consultation/beuc.pdf.

[154] MOTTA, *supra* note 13, at 495.

[155] Pigou's second essential condition, the absence of arbitrage, would not be met. *See supra* Part II.A; *see also* PIGOU, *supra* note 23.

the secondary legislation that comes mainly in the form of regulations. Antitrust rules governing this sector coexist with the many directives that aim at harmonizing product requirements across the European Union in order to grant the free movement of goods within the European Community.[156]

In the context of antitrust law, EC competition provisions relating to the car industry clearly seem to be addressed at promoting market integration, which has generally been recognized as one of the main objectives of EC competition policy.[157] It is more questionable however that they are pursuing economic welfare and efficiency, which are arguably the main goals of antitrust policy. Economic efficiency should be understood as the highest possible level of economic welfare, the sum of consumer and producer welfare. In this sense, leaving aside integration pursuits, the actions of the Commission indeed appear to be addressed at maximizing consumer welfare and protecting car dealers in the dealer-manufacturer relationship. However, we might ask ourselves what happens with *producer* welfare.

Given the somewhat uncomfortable position European manufacturers are currently experiencing, strict competition rules that do not factor in their interests might impose a burden that makes it impossible for them to survive. It is not the task of the European competition legislator to protect inefficient firms;[158] this would encourage the inefficient allocation of resources and lead to high prices in the long run. However, the Commission has been particularly harsh on territorial restrictions in car distribution agreements, differing in this aspect from the standard U.S. Chicago School approach that vertical restraints only become an issue when there is horizontal market power. To adequately assess the European competition rules, they must be analyzed in the context of economic and legal theory and critically examined for their impact on economic welfare.

A. The European Union's Action in the Car Sector

EU law has addressed the issue of price discrimination in the European sector via two principal lines of action: integration and competition. For the *integration* of markets, a number of Commission directives intending to harmonize essential product requirements across the European Union were set out in the 1970s and eventually replaced national product regulation.[159]

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[156] According to EC Treaty art. 249, a directive is only binding as to the result to be achieved, and leaves it up to the Member States to choose the means to achieve that result (within a specific period of time).

[157] *See* MOTTA, *supra* note 13, at 23–24.

[158] *See* Brunswick Corp. v. Pueblo Bowl-O-Mat, 429 U.S. 477 (1977).

[159] In 1993, the directives fully replaced national systems. *See* Goldberg & Verboven, *supra* note 1, at 492.

In this way, divergent national standards, which could lead to higher prices in some Member States and serve as an obstacle to the free movement of goods, are now harmonized for the most part. As concerns *competition*, browsing through the European Union's website[160] for this policy can give an idea of what the line of action of the Directorate General for Competition of the Commission ("DG COMP") reflects regarding the car sector. Besides the many reports and press releases previously analyzed, there is abundant information on fines that have been imposed on manufacturers for not complying with Regulation 1400/2002, in particular for trying to impede cross-border sales.[161]

In its policy, the Commission seems to be inspired by the "law of one price,"[162] which establishes that if different prices are charged for similar goods at different locations, someone will be tempted to buy products at cheap locations and then resell them at places where prices are higher. In the long run, this would force prices to converge. According to this premise, unjustified car price differentials should tend to disappear much faster than what has in fact happened. There could be two possible explanations for this. First, the lack of price convergence could lead to thinking that manufacturers were somehow impeding this tendency. Second, the "border effect" referred to earlier on could in itself prevent convergence.[163] The reader must note that empirical evidence seems to suggest that the law of one price does not always reflect what happens in reality, as prices tend to remain heterogeneous.[164]

The Commission seems to act on a belief that price discrimination is wrong, and that it is manufacturers who block price convergence, utilizing their distribution agreements to do so. Not every territorial or customer allocation is intended to facilitate price discrimination, but everyone has that potential by segmenting the market for the product. As Joerges explains, "orderly marketing plans have often utilized arrangements

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[160] EUROPA, Activities of the European Union—Competition, http://europa.eu/pol/comp/index_en.htm (last visited Oct. 12, 2007).

[161] According to EC press releases, an investigation was launched into BMW and GM to find out if they have been allowing their dealers to deal with other brands and therefore lead to multi-branding, as Commission Regulation 1400/2002 establishes. Press Release, European Comm'n, Competition: Commission Welcomes Changes to BMW's Distribution and Servicing Agreements (Mar. 13, 2006), IP/06/302, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/302&format=PDF&aged=1&language=EN&guiLanguage=en; Press Release, European Comm'n, Competition: Commission Welcomes Changes to General Motors' Distribution and Servicing Agreements (Mar. 13, 2006), IP/06/303, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/303&format=PDF&aged=1&language=EN&guiLanguage=en.

[162] *See* Maier, *supra* note 27, at 1.

[163] *See supra* Part II.C.6.

[164] *See* Maier, *supra* note 27, at 1; *see also* MOTTA, *supra* note 13.

whereby dealers agree to sell the product only within specified territories and to solicit business only from specified classes of customers."[165] These restrictions, which are imposed on the buyer, facilitate price discrimination. A producer or wholesaler that is able to compel the retailer to take its product at a higher price than the same products sold to nearby retailers increases profits to the supplier by segmenting the geographic market into small territories with unique prices. In a context of building up a single market and trying to achieve integration, the reasons for concern are obvious.

B. Distribution Agreements Under EC Competition Policy and U.S. Antitrust

The distribution of brand new motor vehicles in Europe and America is traditionally arranged through franchising agreements between manufacturers and their dealers.[166] In fact, it was precisely in the context of the distribution of motor vehicles that franchises emerged as a way of distributing commercial goods in the United States.[167] Sullivan defines these contracts as "license[s] granting the right to trade under the mark and name, provided that the licensor's standards for the business are maintained."[168] The distinctive feature of these agreements is that customers perceive an identification between franchisor and franchisee.[169] They create a network of selected retailers in each community (in the case of the European Union, each Member State) who are in charge of ensuring that these products efficiently reach the end consumer. In Europe, selective and exclusive distribution ("SED") systems exist for the channeling of new cars. Exclusivity implies that the manufacturer only appoints one retailer who can sell his brand within an allotted territory, and the retailer in turn agrees to sell only the manufacturer's products. Selective distribution allows a certain type of retailer, who meets the conditions laid out by the

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[165] *See* Joerges, *supra* note 143, at 584, 594; *see also* White Motor Co. v. United Status, 372 U.S. 253, 255 (1963).

[166] *See, e.g.*, United States v. General Motors Corp., 384 U.S. 127, 130 (1966) ("Chevrolets are ordinarily distributed by dealers operating under a franchise from General Motors"); *see also The Automobile Dealers Act*, Note, 9 STAN. L.R. 760, 760 (1957).

[167] ENRIQUE CARLOS DÍEZ DE CATRO, ANTONIO NAVANO GARCÍA & FRANCISCO JAVIER RONDÁN CATALUÑA, EL SISTEMA DE FRANQUICIA: FUNDAMENTOS TEÓRICOS Y PRÁCTICOS (Ediciones Pirámide 2005).

[168] LAWRENCE ANTHONY SULLIVAN, ANTITRUST 401 (W. Publ'g Co. 1977).

[169] *Id.* at 400. The degree of identification may vary. Sullivan distinguishes three types of franchise agreements: The ones where the relationship is merely that of a buyer-seller, those where the retailer is a non-exclusive authorized retailer that operates under the manufacturer's guidance but does not look to be one entity in the eyes of the consumer, and finally where most would assume that the manufacturer operates the outlet (the most frequent type).

manufacturer, to distribute his goods.[170] Industry representatives have long claimed that there are multiple reasons that justify the use of franchising in the distribution of cars. Through a franchise contract, for instance, the manufacturer can exert considerable control over the process of distribution. Beyond that, a limited number of dealers is usually the most efficient means of entering a market and servicing the product. Also, franchised dealers are usually given the capacity to build and maintain a strong retail organization. According to manufacturers, the nature of the relationship is of mutual dependence, as each party has a substantial interest in the other's conduct.[171] They also argue that in this game the consumer benefits, since if the products are delivered in the most efficient way, prices should be lower and the service ought to be better.

As is usually the case, reality can differ from theory. In order to understand what the *de facto* situation is, it is necessary to look further back into the origins of franchises in the auto industry. Independent dealerships arose as a consequence of mass automobile production.[172] The dealer assumed increasing responsibilities and performed successively greater functions, but he did not become an independent merchant. The manufacturers wanted them as "exclusive agents."[173] Eventually, manufacturers were compelled to pay increasing attention to retailing problems. They learned that the dealer is a "principal competitive weapon," because upon the sales of the dealer "rests the success or failure of the whole manufacturing process," and since automobile sales usually require considerable service, demonstration, and the post-sale service, manufacturers check the performance of these tasks.[174] This "idyllic" situation of mutual dependence is not so even in the real world, and manufacturers have traditionally held an overly strong position in relation to their dealers.

Franchises have long been criticized for their one-sidedness. They have often been defined as *de facto* contracts of adhesion enacted overwhelmingly in favor of manufacturers.[175] Carmakers have used franchising as a means to gain maximum control over the management of the dealers' business. Yet the importance of dealers is immense and the

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[170] On this distinction, see MOTTA, *supra* note 13, at 304.

[171] Paul Davis, *Retrieving Corporate Policy: Managing Minority Dissent*, 5 CORP. GOVERNANCE: INT'L J. BUS. IN SOC'Y 64 (2005).

[172] *See* Kenworthy, Macaulay & Rogers, *supra* note 126, at 657.

[173] The dealer has been referred to as an exclusive agent since the early days of franchising. *See* Illsley v. Peerless Motor Car Co., 195 Ill. App. 572 (1915); Garfield v. Peerless Motor Car Co., 75 N.E. 695 (1905).

[174] JOSEPH CORNWALL PALAMOUNTAIN, JR., THE POLITICS OF DISTRIBUTION 108 (Harvard Univ. Press, 1955).

[175] For a criticism of this abusive character of franchises, see Joerges, *supra* note 143.

success of a certain brand in an allotted territory depends very much on how the dealer performs his functions, as we as consumers normally associate the manufacturer with the person we have direct contact with when purchasing the vehicles. Even though he might not legally be considered an agent, he is normally regarded by the general public as the manufacturer's representative.[176] In this context, the new EC competition rules for car distribution reflect a concern for the middle man.[177] The Commission therefore indirectly appears to question economic efficiency as the only goal for competition policy. As Komesar expresses, Pareto's efficient transactions can be truly unjust.[178] For instance, slavery might be considered efficient in some respects, yet given its unfair connotations it is forbidden in today's society. There are arguments other than economic efficiency present in regulation which should be considered. In the automobile industry, the situation of unfairness that affects the dealer could in this sense invalidate the efficiency argument.

Apart from these issues, an issue arises in the sphere of competition policy, and which is related to the maintenance of price discrimination. The contracts between manufacturers and their dealers have traditionally established exclusive rights for both sides. Since the manufacturer generally requested the dealers to sell only his products, the dealer also wished to have the privilege of being the only person authorized to sell the manufacturer's brand in the allotted territory. While the former problem could be solved to a certain extent using contract law, the latter is more complicated as there is a conflict of interests. On one hand, the dealer's weak position could be compensated by rewarding him with territorial exclusivity and protection from free-riders who might be able to offer the same product at a lower price by taking advantage of the dealer's investments and efforts. On the other, this exclusivity tends to divide the territory of the European Union along national lines and allows manufacturers to price discriminate. This protection of the dealer, as Kessler points out, could happen at the consumer's expense.[179]

In the United States, these matters are seen under a different light. The preoccupation about the unbalanced manufacturer-dealer relationship was reflected in early U.S. antitrust jurisprudence in the prevailing "free trader doctrine."[180] Until the 1960s, rigid legal rules against vertical restraints,

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[176] U.S. Senate Subcommittee on Automobile Marketing Practices of the Committee on Interstate and Foreign Commerce, *Automobile Marketing Practices* (84th Cong., 2d sess., Sen. Res. 13 continued by Sen. Res. 163, Washington, D.C., 1956).

[177] *See supra* Part IV.C.

[178] KOMESAR, *supra* note 15, at 33.

[179] Friedrich Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L.J. 1135, 1189 (1957).

[180] *See* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

which applied to distribution agreements in the car sector, were observed, intended to preserve the freedom and autonomy of distributors.[181] Retailers were seen as people without power in relation to manufacturers. However, as world competition became robust and the quest for efficiency and competitiveness took center stage, U.S. law and policy changed. The free-rider doctrine was overruled by the U.S. Supreme Court in the *Sylvania* case.[182] The Court observed that when a single producer chooses to impose a vertical restraint, the restraint is nearly always efficient, increasing output , and good for consumers, and that government restraints (i.e., antitrust rules) against the freedom of firms to choose how to distribute their own product are nearly always inefficient, output decreasing, and harmful to consumers.[183] As for the possibility of manufacturers to price discriminate via the appointment of exclusive and selected dealers, there is no prohibition of excessive pricing in U.S. antitrust law, not even by monopolists or dominant firms. The American view is that pricing and its excesses should be left to the market. Excessive pricing usually attracts new players to enter the market, and therefore eventually this imperfection will correct itself. Only when that is not the case is there a role for regulation, but the general rule is that freedom of pricing works better for the public than antitrust intervention, which is likely to reduce incentives to create and compete, upsetting the balance of risk and reward.[184]

C. The Application of EC Competition Law to Car Distribution Contracts

1. Overview of the Regime

As a consequence of the potential threat posed by exclusive and selective distribution systems to the single market and competition, the Commission is usually suspicious of car manufacturer-dealer agreements, and this has affected the manner in which the EC Treaty's competition law provisions have been applied, and how the specific regulation has developed. As regards the former, Article 81(1) contains a general prohibition of agreements which affect more than one EU Member State which may have the "object or effect" of distorting competition in any

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[181] Eleanor M. Fox, *Parallel Imports, the Intrabrand/Interbrand Competition Paradigm, and the Hidden Gap Between Intellectual Property Law and Antitrust*, 25 FORDHAM INT'L L.J. 982, 983 (2001–2002).

[182] Cont'l T.V., Inc., v. GTE Sylvania Inc., 433 U.S. 36, 55–59 (1977). *But see* Toys"R"Us, Inc. v FTC, 221 F.3d 928, 937–38 (7th Cir. 2000) (where the Court established that the free-rider rationale for vertical restraints loses its force when dealers are being compensated for providing customer services).

[183] *See* Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 725 (1988).

[184] Fox, *supra* note 181, at 984 (relying on Berkey Photo Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979)).

way.[185] Obviously, any agreement, by its nature, restricts, and this prohibition has consistently been broadly interpreted to catch most agreements between firms. Article 81(2) provides the sanction for those agreements which are considered to fall within the scope of the prohibition: they will be null.[186]

Agreements can nonetheless escape this sanction on the basis of Article 81(3) EC, which provides an exemption for those agreements that may serve to improve "the production or distribution of goods or to promot[e] technical or economic progress," when they benefit consumers and provided they do not impose unreasonable restrictions[187] or give the firms involved the capability to eliminate competition. The current system allows the Commission, national competition authorities, and courts to grant an exemption. In addition, a number of block exemptions exist which, provided the requirements laid out in them are met, automatically exempt certain types of agreements. Regulation 1400/2002 is the current block exemption regulation for motor vehicle distribution agreements.[188] Its key points are summarized below.

2. Key Elements of Regulation 1400/2002

On July 31st 2002, the Commission adopted a new block exemption regulation for the distribution of motor vehicles, Regulation 1400/2002.[189] This exemption replaced Regulation 1475/95—itself a reform of Regulation 123/85, the first ever block exemption for the car sector.[190] The new sectoral regulation follows to some extent the U.S. "new economics," which reflects a debilitation of the ban of vertical competition restraints, in line with other Commission reforms regarding vertical agreements.[191] "Flexibility for distribution" is probably the best way to describe the rationale of Regulation 1400/2002, as it provides an attempt to liberalize distribution with a view to minimizing the existence of price differentials.

Until 1985, there was no specific regulation of the car sector in

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[185] EC Treaty, art. 81(1), *supra* note 5.

[186] *Id.* art. 81(2).

[187] *Id.* art. 81(3). The text of the provision refers to "restrictions which are not indispensable to the attainment of [the objectives laid out in Article 81(3)]." *Id.* This would put one in mind of those restrictions that the U.S. courts have named "naked restraints," which are those which serve no other purpose other than restricting competition, and are considered *per se* illegal. Bus. Elecs. Corp., 485 U.S. at 729; *see also* United States v. Addyston Pipe & Steel Co., 85 F. 271 (6th Cir. 1898).

[188] Regulation 1400/2002, *supra* note 9.

[189] *Id.*

[190] *See Evaluation of Regulation 1475/95, supra* note 66; *see also* Commission Regulation 1475/95, *supra* note 9.

[191] *See* Klaus Tonner, Book Review, 10 J. CONSUMER POL'Y 223 (1987).

Europe. It was common practice that manufacturers and suppliers would forbid their dealers from reselling their cars, especially if those cars would then be exported by the reseller. Apart from this, a series of additional measures ensured that parallel imports were virtually impossible: high deposits had to be paid, deliveries were delayed, and after-sales would not be provided to imported cars.[192] Commission Regulation 123/85 exempted some of these practices, as it permitted a system of selective and exclusive distribution for motor vehicles, which meant that the dealers could not engage in cross-border arbitrage activities to exploit international price differentials.[193] In theory, European consumers were free to purchase their cars anywhere in the European Union and benefit from price differentials, but in practice cross-border sales were made very difficult by these measures. In 1995, Regulation 1475/95 provided a renewal of the system, which did not include radical changes due to strong pressure exerted by the car manufacturers' lobby.[194] Since the 1990s however, efforts were made to guarantee that the EC competition law provisions were adequately enforced, and fines were imposed on those manufacturers who impeded their dealers from selling to consumers from other Member States.[195]

Regulation 1400/2002, the block exemption currently in force, finally introduced some important changes. For instance, the link between sales and after-sales is finally broken, and dealers must be allowed to subcontract to authorized repairers. Previously, dealers were obliged to provide after-sales services. This creates at least the theoretical possibility for sales to be made by supermarkets and Internet operators, who would otherwise be incapable of carrying out such repair and maintenance. Besides, dealers are now allowed to sell more than one brand of cars. Multi-branding—dealers selling more than one brand of cars—was not permitted under the previous Regulation.[196] This is yet another attempt to balance the relationship between manufacturers and dealers.[197] Also, market power is now crucial when determining the validity of a distribution agreement. It is assumed that most restrictions are unlikely to cause any substantial harm to competition unless the supplier[198] has a market share exceeding 30 percent

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[192] Goldberg & Verboven, *supra* note 1.

[193] *Id.*

[194] Commission Regulation 1475/95, *supra* note 9.

[195] *See supra* note 6 and accompanying text.

[196] Commission Regulation 1475/95, *supra* note 9.

[197] In the U.S., "supermarket" sales and multi-branding have been common practices for many years. Examples can be found as early as in the 1950s. For instance, Chevrolet dealers resold new cars to discount houses, which provided a wide range of goods and services in a manner very similar to department stores. They also sold a variety of makes and models from different manufacturers. *See* United States v. Gen. Motors Corp., 384 U.S. 127 (1966).

[198] In the case of exclusive supply obligations, it will be the buyer's market share that is

within the specific relevant market.[199] Therefore, those agreements below that threshold will be able to benefit from the exemption if they meet the other requirements. Moreover, the market share can be up to 40 percent for quantitative selective distribution,[200] and there will be no threshold for qualitative selective distribution.[201] That is, these distribution systems will be able to benefit from the exemption regardless of the market power of the manufacturer—the *per se* validity of such agreements is thus recognized.[202]

Regarding SED systems in general, both selective and exclusive distribution are still permitted. In the former, when dealers are chosen following qualitative criteria, manufacturers cannot place a ceiling on the number of dealers. Despite criticisms of SED systems,[203] the Commission argues that they are considered adequate for "expensive and exclusive goods such as motor vehicles."[204] The lobbying of the industry, which had for so long prevented any evolutions in the policy, could not be completely ignored. The current block exemption implies an attempt to bring the specific rules for the motor vehicle sector in line with the Commission's general rules on vertical agreements that apply to all other sectors. However, the car sector is still crucial in the European economy, and the strong lobbying on the part of industry representatives, dealer associations, and consumers managed to keep a slightly stricter regime.

To sum up, the new rules reflect concerns not only for price differentials, but also for market integration and the protection of the middleman. Regulation 1400/2002 has introduced some crucial changes, and opened up the door for progress and evolution in car distribution. From the point of view of economic efficiency, the changes imply a more balanced consideration of consumer-producer-dealer welfare than the previous regime. However, the system still departs from the assumption that these dealership contracts are caught by the prohibition contained in Article 81(1) EC. The question that pops into one's mind is whether it would have been better to opt for a narrower interpretation of the prohibition, whereby *a priori* these agreements would *not* be considered to breach this provision and thus do not need to be exempted at all. The existence of a general regime for vertical agreements—Commission

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considered. *See* Regulation 1400/2002, *supra* note 9, art. 3(2); *infra* Part V.

[199] *See* Regulation 1400/2002, *supra* note 9, art. 3(2), para. 2.

[200] *Id.*

[201] *Id.* para. 3.

[202] An exception is those agreements that contain a hardcore restriction. *See id.* at art. 4.

[203] *See* Gillen, *supra* note 52 ("[T]he adoption of the SED system coupled with [the suppliers'] reluctance to compete with each other when setting the level of their recommended retail prices and their lack of price transparency operated against the public interest.").

[204] Regulation 1400/2002, *supra* note 9, at para. 12 (explanatory note).

Regulation 2700/1999[205]—places a further question mark on the necessity of the sector-specific regime: why are car distribution contracts unable to benefit from this general exemption for similar contracts for the distribution of other consumer goods?

D. Benefits and Costs of Sectoral Regulation as a Corrector of Market Imperfections

The Commission, when arguing in favor of a differentiated treatment for distribution agreements, uses justifications related to the special nature of the products being delivered. It claims that there are certain characteristics which make the car sector unique and hence arises the need for differentiated treatment. These peculiarities appear on the Report on the Evaluation of Regulation 1475/95,[206] and have been re-emphasized in Regulation 1400/2002.[207] Indeed, cars are obviously technologically complex products, and need to be dealt with by experts both at the time of purchase and when providing any after-sales service. Besides, the price of a motor vehicle is high, and during the life of a car it is estimated that one spends as much money on repairs and spare parts as the original price of the product. Safety standards are also essential, since vehicles should guarantee security on the road to the maximum extent possible. Finally, brand image needs protection, therefore it is justifiable to a certain extent that the manufacturer only chooses to sell his or her products through appointed dealers.

In Regulation 1400/2002, the Commission insists on the need for stricter rules for the sector, especially given the fact that traditionally selective and exclusive distribution systems are used, and therefore it is necessary to prevent the possible abuses that these practices may imply.[208] Despite these characteristics,[209] it is still questionable that they are enough to justify the existence of a specific regime for these consumer goods. If one takes a look at other consumer goods, some other products have very similar features—in particular those which have emerged with the boost of

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[205] Council Regulation 2700/1999, 1999 O.J. (L 327) 1 (EC).

[206] *Evaluation of Regulation No. 1475/95*, *supra* note 66.

[207] Regulation 1400/2002, *supra* note 9 recital 21. Other peculiarities and explanations can be found scattered around the rest of the recitals. For instance, how stricter rules are required for this sector (recital 2), that dealers have a particularly disadvantageous position in the dealer-manufacturer relationship (recital 9) or how expert after-sales and servicing of these products is of particular importance in this sector (recital 22).

[208] This idea is highlighted in the third recital of the draft. Regulation 1400/2002, *supra* note 9 recital 3.

[209] *See* Regulation 1400/2002, *supra* note 9 recital 21 ("[M]otor vehicles are expensive and technically complex mobile goods which require repair and maintenance at regular and irregular intervals.").

technology—and yet they do not benefit from such a regulation.[210] Also, it is only the distribution of new cars that is affected by these rules, while used cars are not within the scope of the block exemption.[211] The reason for this, quite clearly, is that SED systems are only used for the sale of brand new vehicles, and independent resellers can indeed engage in cross-border arbitrage in the second-hand market. Therefore, the inherent negative effects of these SED systems do not present themselves in the sales of used vehicles.

Justifications for the existence of sectoral regulation and government intervention in markets can be found in the field of microeconomic theory. The "Theory of Second Best" ("TSB"),[212] for instance, can be used by the legislator to establish how much regulation is needed when a market failure presents itself—i.e. when a constraint "prevents the attainment of one of the Paretian conditions' for Pareto's optimum to be achieved."[213] The TSB establishes that, where market imperfections occur in any market, the equilibrium conditions could be subject to change in all markets.[214] In such a scenario, imperfections could be eliminated with intervention via regulation. The TSB thus justifies regulatory intervention, for it could restore the lost equilibrium in a specific market. In the case of the European Union's regulatory framework for the distribution of cars, price differentials reflect the existence of market imperfections, and the TSB would justify the existence of the specific regulation.

In practice, some flaws can be detected in this theory. The main problem appears to be how to define with precision what the perfect level of regulatory intervention should be in all markets. In this sense, this theory alone does not seem to serve as a sufficient explanation for the existence of Regulation 1400/2002. Furthermore, modern regulatory theory reaches somewhat different conclusions on the role and necessity of sectoral regulation, based on approximation and general presumption.[215] This involves the "cost-benefit" ranking of regulatory policies based on their potential for realising Kaldor-Hicks ("KH") efficiency improvements, on which modern law and economics in the U.S. is entirely based.[216] The

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[210] This argument is stressed in *Car Retailing: Driving a Hard Bargain*, ECONOMIST, Jan. 26, 2002.

[211] *Id.*

[212] Although originally formulated by Meade, *see* JAMES E. MEADE, TRADE AND WELFARE (1955), the general definition of the TSB can be found in Richard G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 R. ECON. STUD. 11, 11 (1956).

[213] Lipsey & Lancaster, *supra* note 21.

[214] *See* PAUL R. KRUGMAN & MAURICE OBSFELD, INTERNATIONAL ECONOMICS: THEORY AND POLICY 234–35 (1994).

[215] *See, e.g.*, Richard S. Markovits, *The Case for "Business as Usual" in Law-and-Economics Land: A Critical Comment*, 78 IOWA L.R. 387 (1993).

[216] Edward Stringham, *Kaldor-Hicks Efficiency and the Problem of Central Planning*, 4

Kaldor-Hicks criterion has long been the standard for cost-benefit analysis,[217] and American judges—including Judge Posner of the Seventh Circuit—believe in using it to reach a decision on the cases presented before them.[218]

A KH improvement is defined as a change that is either a Pareto improvement—that is, where at least one participant would be better off as a result of a change and no participant would be worse off—or "such that the 'winners' from the change would be able to compensate the 'losers' and still be better off, and the 'losers' could not afford to bribe the 'winners' to prevent the change."[219] This would lead to a state of the world in which no new allocation of resources could be made whereby those made better-off could hypothetically fully compensate those made worse-off, and still be better-off. In such a context, the potential welfare costs of inefficient sectoral regulation are clear. If regulators attempt to correct market failures via a particular form of regulation, but fail to do so or in fact create greater market failures in other markets, regulatory intervention may be suboptimal and may cause more harm than it intends to correct. The TSB suggests that the scope for suboptimal intervention is very considerable, given that any intervention in one market will typically affect the equilibrium conditions in a wide array of other markets.

Any regulatory system, for example, has both administrative costs and error costs. Administrative costs occur when industry participants seek to influence regulatory intervention in their favor, for instance by lobbying or pursuing litigation. Error costs, on the other hand, are the result of incorrect regulatory decisions, and could imply either allowing an anti-competitive conduct or prohibiting a pro-competitive one. According to KH, an optimal regulatory system would be a system that minimizes such costs while promoting transparency and accountability, thus reducing the ability for governments to misuse regulation to favor particular firms and industries for their political self-interest. In competition policy, the optimal regulatory system should also minimize the possibility for regulatory error by complementing the competitive process rather than hindering it. These factors would raise doubts about the car sector regulation. First, the outstanding influence of the industry's lobby could be the cause for the stricter conditions in place which are beneficial mostly to manufacturers.

Q.J. AUSTRIAN ECON. 41 (2001).

[217] Nicholas Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939); *see also* John R. Hicks, *The Valuation of the Social Income*, 7 ECONOMICA 105 (1940).

[218] Richard A. Posner, *Cost-Benefit Analysis: Definition, Justification, and Comment on Conference Papers*, 29 J. LEGAL STUD. 1153 (2000).

[219] Reckon Open, Pareto Improvements and Kaldor-Hicks Efficiency Criterion, http://www.reckon.co.uk/open/Pareto_improvements_and_Kaldor-Hicks_efficiency_criterion (last visited Nov. 25, 2007).

The last regulation has somewhat restored that balance, but the influence of the industry is still palpable. Second, as regards error costs, it is likely that, by establishing market share thresholds which apply almost regardless of the specific circumstances of each case,[220] it is likely that some potentially beneficial distribution agreements are being struck down, while other more harmful accords could qualify for an exemption. The *per se* illegality of certain types of clauses, enumerated in Article 4 of Regulation 1400/2002,[221] could bear the same effect.

The KH test, however, remains inconclusive for our purposes, and in recent times its validity as a comprehensive guide to policy development has been questioned.[222] In particular, it seems to forget the importance of other considerations beyond efficiency, such as equity, and seems only well-defined in terms of the "local optimum" and not for larger changes.[223] Therefore, direct regulation is still perceived by some as the best way to reduce error costs and diminish administrative costs.[224] Modern theory of industrial organization suggests therefore that as a general presumption, the more competitive a market, the more efficient that market will be. This presumption suggests a positive correlation between competition and market efficiency and indicates a role for governments in directly promoting competition to offset market failures associated with imperfect competition. Accordingly, such theories and general presumptions collectively establish the theoretical justification of modern competition law and its objective of promoting competition to increase economic efficiency.

In the case of regulation affecting the car sector, the KH test poses serious questions about its efficiency. However, it is not the only criterion relevant and one must not forget any other implications. It is necessary to explore further to see if there are any other justifications that may serve to sustain the need for specific regulation. For that, the next part looks at economic theory to find justifications and criticisms of car price differentials.[225]

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[220] However, this is with the exception of those agreements which contain one of the black clauses contained in Article 4 of the Regulation. Regulation 1400/2002, *supra* note 9.

[221] *Id.*

[222] *See, e.g.*, Stringham, *supra* note 216; KOMESAR, *supra* note 15.

[223] Reckon Open, *supra* note 219.

[224] *See, e.g.*, Jagdish Bhagwati, *The Generalized Theory of Distortions and Welfare, in* TRADE, BALANCE OF PAYMENTS AND GROWTH (Jagdish Bhagwati et al. eds., 1971); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1 (1969).

[225] For a detailed look of the regulation/competition dichotomy in the sector of telecommunications, see Paul Nihoul, *Convergence in European Telecommunications: A Case Study on the Relationship Between Regulation and Competition (Law)*, 2 INT'L J. COMM. L. & POL'Y 1 (1998–99).

E. Economic Justifications for the Condemnation of Price Differentials

Economic analysis also needs to be considered in order to evaluate just how much of a concern price differentials are from the perspective of competition policy. Motta illustrates the potential problems for competition with an example:

> Suppose that a monopolist (but the same arguments can be made to any firm enjoying some market power) sells the same product in two different countries, say Germany and Portugal; assume also that transportation costs are nil, for simplicity. In Germany there exists a higher intensity of demand for the good than in Portugal, which can be thought of as reflecting the higher German incomes. If the monopolist is allowed to price discriminate, it will set a higher price in Germany, say p^D, than in Portugal, say p^P. (Of course, it will be able to enforce this price difference only if it can prevent consumers and intermediaries from exploiting arbitrage opportunities. For instance, if it forbids Portuguese buyers to re-sell outside their home country.)
>
> Suppose instead that price discrimination is prohibited by law. One would then expect the new uniform price, p^U, to be located somewhere in between p^D and p^P, if the firm wants to serve both markets. What is the effect on welfare of imposing the same price across countries? *A priori*, it is ambiguous: profits decrease (as the firm is not able to exploit the different intensities in demand), Germans would gain (since they buy at a price p^U lower than p^D) and Portuguese would lose (the new price p^U is higher than p^P).
>
> Nevertheless, . . . aggregating losses and gains, overall welfare increases when banning price discrimination *if* both markets are served under both regimes.[226]

This would, in principle, support the Commission's concerns about car price differentials. However, there are other factors that need to be taken into consideration. F or instance, it raises some equity concerns, since, as Motta points out, higher income consumers are better off and lower income consumers are worse off from the prohibition of price discrimination.[227] Also, it could be that the firm in question, if it cannot price discriminate, might find it more profitable to stop serving the Portuguese market, or to set the higher price p^D for both markets even if it loses its sales in Portugal. That might be the case if the demand in Portugal is limited compared to that

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[226] MOTTA, *supra* note 13, at 495–96.

[227] *Id.* at 496.

in Germany, or if the market in the former is much smaller than in the latter.[228] In such a case, "banning price discrimination is clearly detrimental: it reduces the profits of the firm, reduces Portuguese consumer surplus. and leaves the German consumer surplus unchanged."[229] Using the scenario of the pharmaceutical industry's supply of drugs to the South African market, Fox provides us with another example that further clarifies the problems associated with banning price differentials:

> We might enthusiastically applaud the commitment of Bristol-Myers Squibb, Merck, GlaxoSmithKline, Hoffmann-La-Roche, and Boehringer Ingelheim to provide South Africa with their anti-AIDS drugs at lowest rates available anywhere in the world. (I do). But if distributors in South Africa can ship those drugs to the United States, the United Kingdom, and Germany, undermining the market that pays back total costs, there will be no low-priced drugs for South Africa after the very short term.[230]

The economic analysis raises further doubts about the adequacy of prohibiting manufacturers from price differentiating. Theory would suggest that it would be economically beneficial for consumers. However, in practice this is not always the case. This is further emphasized by the fact that price discrimination can have longer term dynamic effects on welfare, as it can act as an incentive to invest. Again, Motta's work provides an illustrative scenario:

> Suppose that a firm has to decide whether to introduce a new product in the EU or not, and that the cost of developing and launching the product is independent of output . . . . Since price discrimination allows the firm to have higher profits, if the fixed cost falls between the price discrimination and the uniform pricing profits, then the product will be introduced if the firm expects to be able to prevent parallel imports, but will not be introduced if price discrimination practices were outlawed. More generally, price discrimination can affect the marginal profits from investing or innovating, creating more incentives to engage in such activities.[231]

The European case law proves this tendency, in particular relating to the pharmaceutical sector. A number of companies have been fined by the

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[228] *Id.*

[229] *Id.*; *see also* Case 30/78, Distillers Co. v. Comm'n, 1980 E.C.R. 2229 (where the whisky manufacturer Johnny Walker stopped selling outside the United Kingdom as a result of the prohibition imposed by both the Commission and the ECJ to price discriminate between the United Kingdom and the continental market—the latter being cheaper).

[230] Fox, *supra* note 181, at 986.

[231] MOTTA, *supra* note 13, at 496–97.

Commission for preventing their representatives in cheaper Member State from selling the product in those countries with higher prices. The *Bayer* and *Glaxo/Wellcome* cases are good examples.[232] In 1996, Bayer was fined for reducing supplies of a drug to French and Spanish wholesalers that had been re-exporting to the United Kingdom, where the price for the drug was higher. The Advocate General of the case did however express the view that forbidding parallel trade need not necessarily be *per se* anti-competitive, as had been upheld until then. The decision was later annulled by the CFI for a formality—the Court found no agreement where Bayer merely allocated the supply of its product to its distributors in a unilateral effort to prevent arbitrage.[233] This seems to reflect certain tolerance towards the manufacturer's practice of forbidding parallel trade. Nevertheless, five years later, in *Glaxo/Wellcome*, a dual pricing system was considered to fall within the scope of the 81(1) EC prohibition.[234] By virtue of the scheme set up by Glaxo/Wellcome, Spanish wholesalers were charged a higher price for supplies which were to be re-sold abroad than those aimed at the local market, since it was proven that this practice had effectively impeded parallel trade.[235]

In this scenario, the majority seems to believe, as the author, that price discrimination and the ability of a producer to segment its own markets can indeed be the means to increase output and sell more products, rather than to restrain trade. Indeed, if a firm is not able to price discriminate, the firm may not be able or interested to serve the lowest priced market.[236] This leads Fox to conclude that

> [T]he problem is not about freeing trade, but controlling or subsidizing price. The EC rules on internal-market exhaustion on parallel imports are ad hoc tools, dependent upon fortuities, by which government can sometimes put a lid on price without calling the intervention price control. The EC exhaustion and competition rules would import into all of the EU the price regulation of the Member State that suppresses the price the most. But, of course, one hundred percent success would mean one hundred percent failure: the market

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[232] Case T-41/96, Bayer AG v. Comm'n, 2000 E.C.R. II-.3383; Commission Decision 2001/791, 2001 O.J. (L 302) 1 (EC) (relating to a proceeding pursuant to Article 81 of the EC Treaty, including *Glaxo Wellcome* and others).

[233] *See* Valentine Korah, *"Consent" in Relation to Curbs of Parallel Trade in Europe*, 25 FORDHAM INT'L L.J. 972, 974–78 (2001–2002).

[234] Commission Decision 2001/791, *supra* note 232, at 978.

[235] *Id.*

[236] *See* Michel Waelbroeck, *Price Discrimination and Rebate Policies Under EU Competition Law*, 1995 FORDHAM CORP. L. INST. 147 (1996); *see also* Distillers Co. v. Comm'n, 1980 E.C.R 2229.

would disappear.[237]

Summing up, the economics of price discrimination seem to question the *per se* prohibition of forbidding parallel imports under competition law that the Commission defends. Evidence suggests that low income consumers could end up paying more if prices were harmonized, and there is a danger that some markets will cease being served unless manufacturers are not allowed to price discriminate and forbid parallel imports. In the car sector, there does not seem to be an initiative for firms to stop serving the cheaper national markets. Manufacturers have frequently put into practice systems to prevent the flow of parallel imports and to avoid cross-border sales. In the future, this practice might encourage manufacturers to stop serving those markets where their cars are less popular and are sold at cheaper prices if they cannot prevent their dealers in these territories from selling in other more expensive countries. In such a context, the overwhelming concern for price differentials in the car sector can be questioned, as can the existence of specific sectoral regulation for distribution in the automobile industry.

V. THE EUROPEAN CONSUMER'S PERSPECTIVE

This study would not be complete without taking into consideration consumer preferences when it comes to purchasing a brand new vehicle. In order to accurately estimate the potential impact of price transparency and regulation on price, it is necessary to know just how important it is for consumers to pay less for their vehicles, and how aware they are of the possibilities EC competition law gives them. With this purpose, an examination of the data available in some of the studies and surveys available has been carefully developed. Moreover, the author felt the need to investigate deeper by conducting a survey in three Member States, as well as one-on-one interviews in various EU countries.

An optimum point of departure for our purposes is provided by the study carried out by AC Nielsen referred to earlier.[238] It reflected that one in every four European drivers was considering changing automobile within a year.[239] This implies that there is a high demand for cars within the European Union, where the survey shows that consumers tend to prefer local (European) brands. Although Toyota is the worldwide bestseller, Volkswagen and Peugeot are the favorites among consumers in the European Union. More specifically, the study reflects that nationals from those Member States with leading national carmakers (in particular

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[237] Fox, *supra* note 181, at 986.

[238] ACNielsen, *supra* note 148.

[239] *Id.* (34% of Italians are thinking of changing cars, while 32% of the French and 30% of the Spanish are expected to do the same.)

Germany, Italy, and France) have a preference for their national product.[240] This study therefore seems to suggest that European consumers are still loyal to the big European carmakers, which should *a priori* imply a better prospectus for the industry than would be expected given the problems it currently has to face.[241] However, the survey also provided information on the factors that impact the European consumer when choosing a motor vehicle. Safety and design were among the top priorities, but the most influential factor across the globe was price.[242] Therefore, if European manufacturers maintain their advantageous position in Europe and wish to do well in the rest of the world, they need to keep their prices low. This evidently exerts a lot of pressure on the manufacturers, and even more so considering that Asian newcomers to the industry are predicted to enter the market with highly competitive prices.

The information provided by this survey proves useful for our purposes, but unanswered gaps remain. For instance, we still ignore the question of whether or not consumers actually have information about price differentials, and if so, to what extent those consumers in the most expensive Member States are willing to go across the border to purchase their vehicles. By investigating in this direction, it will be possible to determine the practical consequences of the Commission's fight against car price differentials and the protection of parallel imports. In addition, information regarding consumer preferences pertaining to distribution channels, sales, and after-sales services is essential. To this end, we use data gathered from two principal sources: a study undertaken by Dr. Lademann & Partner in 1996 on behalf of the Commission on consumer preferences in automobile distribution (the "Lademann Study"),[243] and the results of my own investigations, materialized in a survey carried out in three Member States in early 2006, and a series of interviews with randomly selected consumers across the European Union.

Given the five year gap between the two surveys, any possible changes in consumer preferences over this period should be reflected. Most importantly, the impact of Regulation 1400/2002 should also show in our findings, as they provide us with reliable data of the situation before and after its entry into force.

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[240] *Id.* (Volkswagen was a leading brand in Austria, Belgium, Germany, Portugal, and Sweden, while Fiat was a clear market leader in Italy, and Citroen and Peugeot in France.)

[241] *Id.*; *see also supra* Part III.B.

[242] *Id.* (In the United States and Asia, performance was also among the top priorities.)

[243] European Commission, DG COMP, *Customer Preferences for Existing and Potential Sales and Servicing Alternatives in Automotive Distribution*, (Dec. 20, 2001) [hereinafter *Lademann Study*] (*prepared by* Rainer P. Lademann), http://ec.europa.eu/comm/competition/car_sector/distribution/eval_reg_1475_95/studies/customer_preferences.pdf.

A. Consumer Preferences When Purchasing a New Motor Vehicle

With the purpose of estimating consumers' acceptance of different sales and servicing alternatives,[244] the Lademann Study surveyed around 100 consumers randomly in Germany, France, the Netherlands, Spain, and the United Kingdom. The choice of countries responds to an attempt to find a balance with respect to geography and size of these Member States. For similar reasons, the survey carried out by the author focused on three of these countries: Germany, Spain, and the United Kingdom. Germany was chosen for being one of the most expensive Euroland markets for new cars, and it was complaints from German customers who were refused by Italian dealers when trying to purchase their cars cross-border which started the Commission's investigation leading to the infamous *Volkswagen* case.[245] As regards Spain, it is traditionally one of the markets where prices are lower, and it has also adopted the single currency. Finally, the United Kingdom has the highest car prices in Europe and has remained outside the EMU. Three hundred questionnaires were handed out to people in these countries ensuring that people with different cultural and economic backgrounds, as well as from different regions of each of the selected Member States were adequately represented. The response was overwhelming: nearly 85 percent of the questionnaires handed out in Spain were returned, over 70 percent of the ones carried out in the United Kingdom and nearly 65 percent for Germany. On the basis of these replies, some conclusions can be drawn about consumer preferences.

Our study shows that people in the United Kingdom tend to change cars more often, while Spanish people normally hang on to their vehicles for five to ten years (and even more than that in 20 percent of cases!). The results for Germany suggest that in this Member State people change cars more often, as 55 percent said they changed cars in less than five years. It seems that in the United Kingdom, people tend to purchase new cars—just under 72 percent of consumers had bought brand new vehicles—whereas in Spain almost 48 percent of the people surveyed declared owning a second-hand car or were thinking of buying one. More particularly, our survey shows that about 12 percent of Spanish consumers go across the border to buy second-hand cars, Germany being the preferred country of purchase. The reason for this seems to be that in Spain people use their vehicles for over ten years, whereas the Germans usually resell them within five years. The long use the Spanish give their vehicles means that second-hand cars in Spain tend to be very old, and therefore those wishing to buy a second hand car go to Germany, where cars are resold in a better condition and at competitive prices. Going cross-border is not as common for brand new

[244] *Id.* at 5.
[245] Commission Decision 2001/711, *supra* note 6.

cars, as only 2 percent had considered buying their new vehicles abroad. This can be easily understood since Spain is one of the cheapest markets in the European Union, with some of the lowest pre-tax prices. As for Germany, over 75 percent of consumers opt for new vehicles.

Up to 20 percent of British consumers proved to be willing to buy their cars abroad, which shows a certain awareness of the high level of prices in that Member State. Still, only about 5 percent had actually done so. However, according to the Lademann Study, it seems that about 10 percent of UK drivers buy their cars from a re-importer.[246] Hence, parallel imports seem to be relatively frequent, particularly compared to other Member States. Re-importers are virtually nonexistent in Spain given the low price level, and about 95 percent of cars are bought through authorized dealers.[247] Our survey further showed that about 65 percent of consumers purchased their cars from their nearest concessionary, while 30 percent went to cheaper national regions where prices were lower.[248] In Germany, authorized dealers are the most popular choice, with over 90 percent of sales. Re-imports do exist, and about 5 percent of consumers buy their cars from a re-importer. The Lademann Study also reflects that, curiously, it is in France where most cars are sold by distribution chains other than branches of the manufacturer and authorized dealers. Almost 20 percent of sales are carried out by re-importers and, most importantly, retail chains.[249]

Internet sales of cars are still uncommon, especially when compared to online sales of other products.[250] In the United Kingdom, 80 percent of consumers seem to shop around for the best price and as many as 75 percent check online prices before the final purchase. In Spain, the Internet is used less frequently, and the main purpose of using it is to obtain information about the characteristics of the car they are thinking of purchasing, rather than price (only 11 percent have done that) or even less with the purpose of actually purchasing their cars online (4 percent had contemplated the possibility). Only two people in Germany had actually purchased a car online, and expressed satisfaction with the purchase. When asked if, in the future, they would consider purchasing their cars online, only 15 percent of Spanish consumers said they might do so, while 16 percent of Germans and 23 percent of British consumers were willing to do so. Most of those consumers were among the youngest interviewed.

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[246] *Lademann Study*, *supra* note 243, at 32. Our own results also reflected such a preference, as 97 percent of the consumers surveyed had purchased their cars in a concessionary.

[247] *Id.* The remainder are sold in the manufacturers' branches.

[248] *Id.* This was the case mainly for those consumers interviewed who resided in Madrid but were originally from other areas of Spain.

[249] *Id.*

[250] *See* Maier, *supra* note 27.

Therefore, it is likely that, within the next ten years or so, Internet sales will become more and more common, particularly once younger generations whose lifetime coincides with the Internet era begin to drive.

As far as loyalty to European brands is concerned, our study showed that, for the time being, European brands are indeed the favorites, particularly in Germany and Spain. Up to 55 percent of the people surveyed in this country chose European manufacturers—mainly Volkswagen, Audi, and Peugeot. Even so, when asked if they would consider switching to extra-Communitarian cars, up to 40 percent said they would consider on the basis of price and quality. In the United Kingdom, over 18 percent already have a car that is not European. Toyota, Honda, and Nissan are the main rivals of European manufacturers in this market. Again, price and quality were highlighted as crucial when choosing which car to buy. In Germany, the favorite manufacturer is the Volkswagen-Audi group.[251] It is mainly those who have just bought their first vehicle who go for Japanese cars, and those who already own a European car tend to remain faithful. Luxury cars, such as Mercedes and top Audi models, show the largest loyalty rates. These results therefore are very similar to those of the ACNielsen survey.[252]

To further illustrate how consumers prefer to purchase their vehicles, twenty-five personal interviews were conducted across the European Union with consumers based mainly in Spain, Germany, the United Kingdom, France, Belgium, and Poland. These interviews reflect that it is mainly the Germans and the British who think of buying their cars abroad. Italy is the main choice for the German consumers, while Belgium and Denmark are the United Kingdom's favorite. Two of the people interviewed in the United Kingdom had actually purchased their cars in Belgium. One of them had experienced a problem in doing so, as the dealer originally seemed to be reluctant to sell to UK consumers. The consumer threatened to take the case to the Commission, and eventually he was able to purchase his car. In this sense, the threat of the possibility of going to the Commission seemed to have an effect on the dealer. Even so, this case was the only one we came across, and most consumers were happy to avoid the hassles of buying abroad even if it meant paying higher prices. A general interest in buying cars online in the future was expressed, but only five reflected a thorough knowledge of the websites where it is possible to do so.

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[251] The VW group comprises some of the leading firms such as Volkswagen, Audi, Skoda, Bentley, Lamborghini, and SEAT. *See* Volkswagen, Other Companies, http://www.volkswagenag.com/vwag/vwcorp/content/en/brands_and_companies/other_companies.html (last visited Nov. 25, 2007).

[252] *See* ACNielsen, *supra* note 148.

B. Estimations

On the basis of these findings, a series of deductions can be made. The Commission's action can be held partially responsible for opening up cross-border sales. It seems that manufacturers are reluctant to allow consumers to shop in Member States other than their country of residence for their cars, and the threat of facing a big fine has proven effective in some cases. Even so, only a small proportion of consumers show an awareness of this possibility, and even less expressed an interest in going to another Member State to benefit from lower prices. Price convergence, as reflected by recent figures, is possibly driven to a greater extent by the high degree of competition in the market, and in particular the pressure posed by Japanese carmakers, who look set to increase their sales in the European Union among first-time buyers, if they maintain their very competitive prices. The Internet has also played a crucial role and will continue to do so in future years. Currently, the Web is providing consumers with accurate price information and the possibility to check and compare prices across territories of one country and the entire European Union. Within the next decade, Internet sales could gradually become more frequent among the new generations of drivers who have a high degree of confidence in online shopping. This should, in principle, lessen the effect of national borders in price differentials, even if studies of the prices on the Internet for different products still reflect cross-border differences. It will also exert a lot of pressure on car manufacturers and may, in the long run, alter the structure of the European car market and the way cars are distributed across Europe.

VI. CONCLUSIONS

The steady decrease in price differentials in the car sector is a consequence of a convergence of circumstances. The progressive process of integration taking place in the European Union is principally responsible, as the elimination of barriers to trade in the path towards the implementation of the free movement of goods is eventually unifying markets across the EC territory. Even so, and while prices can be expected to converge further, complete integration will most likely never be achieved given the existence of linguistic and geographical differences that make it almost impossible. While these differences remain (more than likely forever), price differentials are likely to exist. This "border effect" affects not only the car sector but also other products and even those sold on the Internet.

Other factors, however, are also pushing greater price convergence. The improved price transparency, achieved mainly by the Internet and to a lesser extent by the euro, is having an impact on prices. Consumers seem to rely on the Web for comparing prices, and given its boost as a shopping forum and the results of our survey Internet sales of cars are set to become

increasingly popular, even if for the time being authorized dealers are still preferred and will be unlikely to disappear. This technological revolution is joined by a difficult situation for European car manufacturers that imposes a duty on them to remain competitive if they do not want to lose their position to foreign carmakers from the United States and particularly from Asia. This pressure is likely to lead to a restructuring of the European car market, as currently European car manufacturers are too many to survive in a competitive worldwide market. Hence, the author's predictions for the future are a proliferation of Internet sales in the long term, which may well lead to a revolution in automobile distribution, and a restructuring of the car market similar to that of the United States in the 1960s which led to the consolidation of the "big three" as the only national manufacturers.

On the one hand, the regulatory changes introduced by the Commission in 2002 have provided an adequate legal context for the vital change and innovation in distribution, which the previous regime hampered. Doubts arise, however, about whether the renewal of the block exemption was the most favorable way of achieving these changes. The KH efficiency test shows some costs which may question the efficiency of this specific and stricter regime for car distribution. On the other hand, the Commission's concerns about protecting parallel imports and the freedom to buy anywhere else have had some beneficial results for consumers, as some of them have indeed been able to buy their cars from dealers in other Member States. The Commission's hostile view of price discrimination and its consequential *de facto* prohibition of the phenomenon by defending parallel imports have, in this regard, undoubtedly pushed price convergence. However, our analysis has proved that important mid- to long-term problems can be derived from parallel trade which cannot be overlooked. In the long run, prices could end up being higher in countries where consumers are worse off, or certain markets could stop being served altogether. Besides, the Commission's action and regulatory activity increases the burden on manufacturers, who not only have to comply with regulation regarding safety standards, environment and product requirements, but also with sector-specific competition rules for their franchising agreements with their dealers. It is therefore far from clear that the law can provide an adequate means of controlling these differentials, and even more dubious is the fact that it should. An analysis of economic theory behind price discrimination raises serious doubts about its *per se* illegality, and urge for a reconsideration.

The author would like to leave the reader with a quote from Fox that sums up the dilemma. "One need not conclude . . . that granting freedom to producers who act unilaterally is the prescription that serves the interests of the world. If one cares about the distribution of resources (as opposed merely to efficient allocation), it is not. However, the above analysis might cause us to rethink whether the unilateral use of vertical restraints is the

problem and whether government proscription of vertical restraints is the cure."[253] Food for thought.

[253] Fox, *supra* note 181, at 986.