



Background – automotive aftermarkets industry

Introduction

As part of the advocacy work undertaken by the Competition Commission (Commission) from time-to-time in sectors or markets that are of concern to the Commission but may not necessarily warrant investigatory intervention, the Commission seeks to hold a workshop for external stakeholders in the automotive sector and particularly in the aftermarkets. In doing so, the Commission has also considered the work being undertaken by other competition authorities in other jurisdictions, such as the Federal Antimonopoly Service of Russia (FAS).

The work of the Commission in the automotive aftermarket brought about a scoping study which was concluded in March 2015. The scoping study report highlighted how the automotive aftermarket functions as well as the competition issues that were identified at the end of the scoping study. The scoping study was as a result of multiple complaints received by the Commission in the preceding four years prior to engaging in the scoping study. In the period between 2011 and 2014, the Commission received approximately 19 complaints in relation to the automotive aftermarket.

Industry background

The South African automotive aftermarket is characterised by various agreements/arrangements between aftermarket service providers across the value chain including panel beaters, service centres, fitment centres, parts manufacturers, original equipment manufacturers (“OEMs”) and insurance companies. These agreements/arrangement vary in nature across the value chain and may encompass, in some instances, OEMs requiring customers (vehicle owners) to use approved panel beaters or spare parts distributors as condition of the sale of a new car by a dealership in terms of warranty provisions. Insurance companies may also require that their customers (insured vehicle owners) use approved service providers who are usually the same service providers as those approved by the OEMs.

Every new vehicle comes with a warranty from the OEM. A motor plan or a service plan can be purchased together with the vehicle to cover service related parts and components. Customers buy a motor plan/service when they purchase a new vehicle as some OEMs bundle motor plans with the sale of the vehicle. The customer pays the full amount upfront for a specified period or kilometres covered.

In order for the motor warranty to remain valid, all parts, maintenance and repair work must be acquired from the OEM-approved service provider. In the event that the vehicle under motor warranty and/or motor-plan is repaired or serviced by non-OEM approved service provider, the OEM is unlikely to honour the warranty provision. Furthermore, if a vehicle under warranty and/or service plan is fitted with any parts and components sourced from independent parts supplier (not approved by the OEM) the warranty on the vehicle might be invalid.

Short term vehicle insurers also operate in a much similar way and may rescind an insurance claim on the basis that the insured person undertook work by a non-approved service provider in relation to repairs.

OEMs through the assistance of various associations of body repairers appoint certain panel beaters (body repairers) as approved panel beaters. These OEM-approved panel beaters or service centres are on a list of approved service providers who can repair or service vehicles of that particular OEM's brand. Due to multiple reasons, OEMs appoint a certain number of panel beaters in every major city and this is determined by, amongst other things, demand factors within a particular geographic scope. In appointing service centres or panel beaters OEMs also rely on various motor body repairers' associations to assist in appointing the qualifying motor body repairer.

Thus the role of the association is, *among others*, to represent motor body repairers or panel beaters and ensure that they meet quality requirements specified by the OEMs. Thus, when the OEMs need to appoint certain panel beaters, they will go to those that are part of an industry association. However, being part of an association does not guarantee any panel beater work from the OEMs or that they will be approved by the OEMs. To be part of an association, panel beaters are required to pay a monthly fee which in some instances is an entry barrier for small independent panel beaters.

The above arrangement/agreements permeate through to the market for the manufacture and distribution of automotive aftermarket spare parts in that, an OEM will manufacture the parts or appoint certain manufacturers to manufacture parts and use the OEM's brand. Therefore new vehicles come with an OEM's warranty against defects that may arise. All maintenance and repair work on vehicles under warranty must be done by an authorised and qualified technician employed or approved by the OEM. All parts used during the maintenance and repair of vehicles under warranty must either be manufactured by the OEM or by the OEM-approved manufacturers.

Therefore, customers who own vehicles that are still under warranty and which are insured are precluded from purchasing parts from independent manufacturers (i.e. non-approved). Should such a customer buy or replace a part or a component in a vehicle with any other part or component bought from an independent distributor/manufacture that customer runs the risk of losing the warranty on their vehicle.

With respect to the approved or authorised channels, panel beaters, fitment centers, and workshops are required to (whenever they need to replace parts or fit new part in an insured vehicle or vehicle under

warranty) procure such parts from the vehicle manufacturer or from the approved manufacturer or distributor.

With respect to the independent spare parts market, informal panel beaters, fitment centers, and workshops are free to procure spare parts from either approved manufacturers or independent parts manufacturers. However, it appears from the advocacy work undertaken thus far and from the cases reviewed that parts sold by approved manufacturers or vehicle manufacturers are generally more expensive than parts manufactured by independent manufacturers. Moreover, the Commission also found that part manufacturers are restricted from manufacturing parts similar to parts manufactured by OEMs, even if the part is not branded with the OEM's logo.

Market participants

Through investigations, the Commission found that there are more than 1800 service providers in the markets for motor body repairers and service centres. This should also be read with the statistical fact that in South Africa, about 30% of the cars are insured and/or still under warranty and 70% of the cars are not insured and/or no longer under warranty. This therefore implies that small and unauthorized panel beaters can still compete to service the balance of 70% which comprise of cars that are not insured and that are not under warrant. However, the Commission also understands that this 30% is a lucrative part of the market and so notwithstanding the contestability of the remaining 70%, the conduct identified further below is of significance to the growth and expansion of small and non-approved service providers.

The competition concerns

The competition concerns identified by the Commission emanate from vertical agreements entered into between OEMs and automotive aftermarket participants such as service centres and panel beaters. These anticompetitive concerns can be further categorised in terms of industry participants across the automotive aftermarkets industry and are set out below.

Panel Beaters

The Commission has found that OEMs and/or insurance companies enter into various agreements with panel beaters who are appointed as approved or preferred panel beaters by each OEM and/or insurance company. In terms of these agreements, OEMs and/or insurance companies will therefore only appoint a few panel beaters in a defined geographic area to the exclusion of others. Consequently, these agreements restrict competition between approved panel beaters and non-approved or independent panel beaters, as the independent panel beaters are prevented from repairing vehicles that are still under warranty and/or insured.

Moreover, the Commission has also found that linked to the above arrangement, OEMs also restrict the network of approved panel beaters from purchasing spare parts from anywhere else apart from equally approved dealerships or parts suppliers thereby creating another closed network for service providers.

The above arrangements between OEMs and/or insurance companies and approved panel beaters make entry into the panel beating market difficult, particularly for emerging and/or small panel beaters. In particular, OEMs and insurance companies limit the number and criteria of panel beaters they approve to operate in their network whilst the vehicle is still under warranty and/or still insured. The consequence of this is that prices within the approved network during the warranty period and/or insured vehicle are markedly higher than when a vehicle is being serviced outside the warranty period and/or outside the insurance period. This is because consumers are likely to shop around and compare quotes when they have to pay out of pocket rather than through the insurer or during the period of warranty.

Essentially, the outcome of the use of warranty conditions by OEMs and/or insurance companies requires customers to not deal with independent panel beaters for repairs in their vehicles. This leads to a restriction and lessening of competition between independent panel beaters and approved panel beaters. The same applies in relation to insurance companies who may refuse to pay claims where a customer repairs his/her vehicle from a panel beater that is not approved by the insurance company and/or OEM within the warranty period.

Moreover, given that approved panel beaters are required to source spare parts from approved spare parts suppliers, this makes the cost of the spare parts more expensive than parts supplied by non-OEM approved parts suppliers.

Spare parts suppliers

OEMs have entered into various agreements with spare part suppliers in terms of which certain spare parts suppliers are appointed as approved parts suppliers. These agreements are simultaneous and analogous in effect to the ones referred to above in relation to panel beaters. Panel beaters are required to source all their spare parts requirements from OEM-approved spare parts suppliers. These agreements restrict competition between approved parts suppliers and non-approved or independent spare parts suppliers as the latter are not allowed to sell spare parts to approved panel beaters.

Moreover, insurance companies may refuse to pay claims where a panel beater used spare parts bought from any other parts suppliers other than the approved spare parts supplier, this raises prices for customers as branded spare parts from approved suppliers are more costly than non-branded spare parts of the same quality.

Service Centres

OEMs generally enter into dealership agreements with independent dealers. In terms of the dealership agreements, OEMs appoint dealers as approved OEM dealers and as approved service centres. These approved service centres are the subject of OEM warranty provisions and service plans which have the effect of excluding independent, non-approved, service centres from servicing vehicles which are still under service plans and warranty.

In line with the findings above, the Commission has found that these agreements have the effect of restricting competition between approved service centres and independent service centres and limit customer-choice in relation to the number of service providers for vehicles during the service plan and warranty period, as well as the cost of the service.

Essentially the arrangements between OEMs and service centres require or induce customers to not deal with competitors (independent service centres/mechanics), thereby restricting competition between independent mechanics/technicians and approved mechanics/technicians. Moreover, the use of long term service plans/motor plans also serve to restrict competition between independent mechanics/technicians and approved/authorised mechanics/technicians by again inducing customers to not deal with independent, non-approved service centres, due to conditions attached to the plans which may void service plans should a customer use the services of an independent, non-approved, service provider. OEMs also “lock-in” independent dealers into their network by requiring that they run and own a dealership alongside running an approved service centre which raises barriers to entry in that potential entrants must enter two markets, the servicing market and the dealership market in order to become part to the OEM network of approved service providers.

Summary of anticompetitive concerns identified by the Commission following the scoping study and advocacy

The exclusion or foreclosure of independent panel beaters in the market for repairing insured vehicles and/or vehicles that are still under warranty.

The exclusion or foreclosure of independent service centres from servicing insured vehicles or vehicles that are still under warranty.

The exclusion or foreclosure of parts distributors from distributing OEM-branded parts to panel beaters.

The above exclusionary conduct leads to higher prices charged by OEM-part manufacturers to individual customers or panel beaters as compared to prices charged by service providers of non-OEM branded parts. The Commission has ample anecdotal evidence relating to this pricing difference from consumers and service providers. The Commission has found similar pricing outcomes in relation to prices charged by authorised panel beaters for vehicles still under warranty and/or vehicles which are still insured, in relation to prices charged by independent panel beaters.

The Commission therefore has found that overall the arrangements between OEMs and their approved network of service providers during the period of warranty and/or insurance in relation to insurance companies, raise the cost of services for consumers during this period along with restricting competition between authorized aftermarket service providers and independent service providers by raising barriers to entry for small and independent services providers who are unable to expand in the market.

Lastly, this exclusionary conduct is also extended to associations of approved service providers who impose strict requirements for membership and approval, which again raise barriers to entry for small and independent service providers including cumbersome financial requirements without the guarantee of that work will be diverted to them once they become approved service providers.

As part of its advocacy and investigative work, the Commission engaged with some OEMs in order to understand the rationale for the conduct referred to above. Below is the summary of the Commission's understanding of the views of the OEMs:

- A limited network of service providers is preferable in order to guarantee standards due to requirements imposed within approved networks.
- The need to protect intellectual property and know-how relating to parts and technologies which the OEMs have invested in, in the development of vehicles.
- It is preferable to use approved dealerships linked to an approved service centre for cars still under warranty. Moreover, the acquisition of a service plan/motor plan inherently means that customers who purchase vehicles with a service plan, waive the right to service the vehicles with independent non-approved service centres.

Comparative work

The Commission has found that the conduct described above is not unique to South Africa. The Commission looked at other jurisdictions to ascertain how they have intervened in this market. The interventions by other jurisdictions can be characterised as either interventions which have led to the promulgation of regulations or voluntary codes of conduct.

Regulations/binding legal instruments

European Union

The European Union has specific block exemption regulations which define a category of vertical agreements which are exempt from specific competition law scrutiny within the provisions of Article 101(3) of the Treaty of the European Union. Commission Regulation No. 330/2010 of 20 April 2010 is "*limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 101(3) of the Treaty*".

In 2010, the European Commission introduced a framework for the automotive aftermarket industry, setting out rules which are encompassed in various legal instructions including the block exemptions referred to above. The rules cover the “*trade in spare parts for and the repair and maintenance*” of motor vehicles as well as agreement between independent aftermarket service providers. In particular, the rules state, *among others*, the following:

- Authorised repairers/panel beaters are obliged to not only use original parts, but also matching quality parts.
- Vehicle manufacturers may not hinder their original parts or component suppliers from also supplying their products as spare parts to independent distributors or directly to independent or authorised distributors.
- Authorised repairers are free to procure original parts or parts of matching quality from parts suppliers or independent parts distributors.
- Independent repairers should have access to the vehicle manufacturers’ captive parts to allow independent repairers/panel beaters to properly maintain and repair vehicles and compete with the authorized repairers.
- Vehicle manufacturers are prohibited from making warranties conditional on the repair and servicing of a vehicle within the approved network or on the use of OEM branded spare parts.
- Vehicle owners have the right to use any repair shop for non-warranty work, during the warranty period.
- Within the warranty period, any defect originating from the factory fault must be corrected by the vehicle manufacturer and not authorized repairers.

Access to technical information, tools and training remains a prerequisite for effective competition in the automotive aftermarket. Lack of access to technical information by independent repairers might result in the loss of competitive strength to the advantage of competitors within the approved network leading to consumer harm.

Notwithstanding the above rules, the regulation also acknowledges that OEMs are free to choose members of its network of repairers, subject to market share thresholds in relation to the network of authorised repairers.

Federal Trade Commission

The Magnuson-Moss Warranty Act prohibits vehicle manufacturers from refusing to honour warranty mainly because a vehicle owner used parts manufactured/distributed by an independent distributor or repair work was done by an independent non-approved repairer/panel beater. The Magnuson-Moss Act rather places an obligation on manufacturer to demonstrate or prove that the damage was caused by the improper work done by the panel beater/repairer rather than other defects that caused the damage to the engine. According to the FTC the damage caused by the improper work done by the unauthorized

repairers/panel beater relating to one particular part does not necessary mean that the warranty relating to other parts should be void as well.

China

On September 2014, the National Development and Reform Commission (“NDRC”), Ministry of Commerce (“MOFCOM”), State Administration for Industry and Commerce (“SAIC”) and other relevant government authorities jointly issued the *Guiding Principles on Promotion of Transformation and Upgrading of Automobile Maintenance and Repair Industry* (“Guiding Principles”). The Guiding Principles introduced the concept of “same quality spare parts” in order to mitigate against discrimination in the market for spare parts not manufactured by the OEM or approved spare parts supplier.

The Guiding Principles also state that OEMs and their approved network service providers cannot abuse warranty provisions in order to restrict consumers from choosing repairers or repair services.

The Guiding Principles also states that starting from January 2015, OEMs will be required to publicise auto maintenance and repair technical information of newly launched vehicles to both the approved dealers and independent repair operators without any discrimination.

Voluntary codes of conduct

French Competition Authority (FCA)

Following a sector inquiry into spare parts, maintenance and repair services in October 2012, the FCA published and made various recommendations for the sector. These included the amended of legislation to introduce a “repair clause” in order to remove the protection in respect of spare parts. The FCA also recommended a case-by-case analysis of contractual restrictions between OEM and OEM-approved part manufacturers that restrict the sale of spare parts to independent repairers. The FCA also recommended legislative amendment to in order that OEM-approved parts manufacturers producing parts on behalf of an OEM is not prevented from removing an OEM’s branding from the parts without breaching intellectual property law, thereby encouraging the sale of spare parts directly to the aftermarket by the OEM.

FAS

The FAS, alongside industry players, adopted a Code of Conduct with members of the Automobile Manufacturers Committee of the Association of European Business with the aim of establishing good business practice in the Russian automotive sector. In terms of the Code of Conduct, members of the Automotive Manufacturers Committee have undertaken to adhere to, *among others*, the following good business principles:

Spare parts of matching quality for maintenance and non-warranty repairs

Members of the Automobile Manufacturers Committee should not prevent official dealers from using spare parts of matching quality for maintenance and non-warranty repairs after the expiration of the warranty period.

Members of the Automobile Manufacturers Committee have the right to demand that their official dealers use only original parts and/or identical spare parts for maintenance and non-warranty repairs during the warranty period if the prices for such original and/or identical parts are the same as matching quality parts.

In instances where a dealer wishes to offer spare parts of matching quality for maintenance and repairs as well as selling them to customers, the dealer is required to provide sufficient proof that such spare parts are of matching quality which have been officially imported into Russia with the requisite customs clearance in accordance with the legislation; and to offer such parts only as alternatives to original and/or identical parts.

The dealer has the responsibility to inform customers in writing before selling them the matching quality spare parts and before using the part for maintenance and repair that the OEM does not bear any liability for the quality of such parts and for the possible consequences arising from installation in the vehicle.

Warranty repairs

Warranty repairs and other repairs paid by the OEM should be undertaken by the official dealers. The OEM may require using only original and/or identical spare parts for warranty repairs paid by the OEM.

Sale of original and identical spare parts to independent repairers

Members of the Automobile Manufacturers Committee should not prohibit their official dealers or parts distributors from selling original parts and/or identical spare parts to independent repairers for maintenance and repair purposes. This provision also relates to security-related parts and features of the vehicle.

Authorization of service dealers

Members of the Automobile Manufacturers Committee should envisage a possibility to authorize official service dealers (without sales). This is required in those regions where there is a need for services but no sufficient demand for an additional sale point.

OEMs which do not have a quantitative selection systems for official service dealers, should publish plans of their official service dealers network expansion based on the realistic evaluation of the market potential.

Training

Each OEM should make independent decisions on providing technical training either to official dealers only or to other parties as well, especially independent repairers.

Summary of common interventions adopted by various competition authorities

As indicated above, whether through binding legal instruments or whether through voluntary codes of conduct, competition authorities in various jurisdictions have intervened in the automotive aftermarket industry. The underlying concerns relate to omnipotence of the vertical arrangements/agreements between OEMs and/or insurance firm in relation to related markets such as the spare parts market and the market for service providers such as panel beaters. Therefore the intervention of most competition authorities, either by way of binding legal instruments or voluntary codes of conduct have been to either address the conduct of OEMs in relation to spare parts, the use of warranty provisions, and access to technical information relating to the servicing of a vehicle.

Outcome of the workshop

The workshop forms part of the advocacy work undertaken by the Commission thus far in the automotive aftermarket. Therefore in bringing together relevant stakeholders including but not limited to, OEMs, automotive spare parts manufacturers across various industries including commercial vehicles, mining, construction etc., dealerships, motor body repairers, independent services centres, insurance firms, standards regulators, relevant government departments, complainants who approached the Commission and repair and maintenance service providers, the Commission will have an open platform to engage these stakeholders and to enable the parties to discuss the state of competition in the industry along with likely recommendations or interventions in order to address those competition concerns. The Commission has considered potential interventions which include:

Spare parts

Original spare parts should be made available to independent repairers and service centres. OEMs should not restrict the distribution of their spare parts to authorised repairers and dealerships.

Regulations into equal quality parts or matching quality parts are concerned are necessary and can be monitored by organisations such as the National Regulator for Compulsory Specification.

Warranty provisions

OEMs should be restricted from misusing the warranty provisions but making the terms and conditions clear and allow for a consumer to use the services of an independent repairer without losing the benefit of the warranty. Vehicle owners should have the right to use any repair shop for non-warranty work even during the warranty period. And any defects originating from the factory fault must be corrected by the vehicle manufacturer and not authorised repairers.

OEMs may not make warranty conditional on the repair and servicing of a vehicle within their network or on the use of their branded spare parts. Authorised and independent repairers or service centres should

be allowed to use non-OEM branded parts in repairing or servicing vehicles under warranty as long as the parts are matching quality parts.

Access to technical information

OEMs should make available their technical information, training, and tools to independent service centres.

Appointment of repairers/Panel Beaters

OEMs should disclose and make public the quality criteria in their appointment of service providers.