Antitrust issues with shortening of supply and distribution chains

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Abstract

Recently, we have seen an increasing cost pressure on vehicle manufacturers, prompting them to internalize parts of a distribution chain. Accordingly, the push for electric vehicle makes certain automotive parts obsolete and the supply chain is shortened as the manufacturers source the parts directly from manufacturers. Finally, the online sales keep growing. All that may result in shortening the supply and distribution chain by the car manufacturers and excluding suppliers and distributors. In addition, there is a regulatory pressure from the EU to monitor supply chain compliance, such as the draft CSDDD. Therefore, we may expect the car brands to cut ties to some of the existing parts suppliers and distributors, which may be (partially) dependent on them. Antitrust laws respect contract freedom, but also impose special responsibility on dominant players. Will the car manufacturers break the law by refusing to supply distributors or refusing to deal with parts suppliers? Brands should be aware of the risks, while parts suppliers and distributors should realistically assess ways to defend themselves, such as filing complaints to competition authorities or going for a private enforcement.

Keywords: supply chain, distribution, refusal to deal, refusal to supply, antitrust

JEL Classification: K21, K41, K42

1. Introduction

The automotive industry is undisputedly undergoing a major change. First and foremost, the industry – and most particularly in Europe – has been and will be gradually shifting to production of primarily electric vehicles, or vehicles using alternative fuels in general. This truly essential change is regarded by many as concerning. The Czech Republic and Slovakia are very likely to be among the most affected countries in the world. The former two parts of Czechoslovakia lead the global ranking in most produced cars per capita (Hornak, Dudik, 2024).

However, the incoming production of mostly electric vehicles is not the only influential factor of the ongoing industry restructuring. Recent covid-19 pandemic greatly disrupted the relatively well-working supply chains starting in Asia and ending up in European manufacturers' factories. Combined with Asian electric vehicles continuous expansion in European markets, it led to concerns about security of supplies. Again, given the primary importance of the automotive industry in the Czech Republic and Slovakia, it is not only business-related, but also macro-economics and political issue.

Third, also in the aftermath of covid-19 pandemic, the automotive industry is affected by macroeconomy disbalances, inflation waves, drops in both demand and production (Koltay, Lorincz, Valletti, 2023; De Loecker, Eeckhout, Unger, 2020). It creates additional pressure to market participants to focus on effectiveness, cost cuts and general optimization of their business. Ongoing discussions and indications of cost cuts are omnipresent.

Fourth, the industry is moving from traditional sales methods to primarily online sales (AmOnline, 2021; Šmejkal, 2021; Bessen, 2020). It gives the manufacturers a much more direct access route to consumers and conversely, consumers have more direct access to information about vehicles from the manufacturer.

Finally, the manufacturers are under legislative pressure as well. German Supply Chain Due Diligence Act (*Lieferkettensorgfaltspflichtengesetz*; "LkSG") is effective from January 2023 and requires the concerned German companies to make extensive compliance efforts in their supply chains. The rules mean that not only the German producers, but also their direct and indirect suppliers may be concerned. The draft EU Corporate Supply Due Diligence Directive ("CSDDD") will eventually have even broader impact, likely directly subjecting the EU-based automotive players to strengthened rules on compliance efforts in the supply chain. Naturally, it may lead to tensions in existing supply chains not only in the automotive industry.

These factors result in most car brands reconsidering their business models and production. To ensure brand competitiveness, the manufacturers deploy strategies of optimization of production and distribution. As an example, Volkswagen Group recently announced that it aims to reach a milestone of 6.5% profitability in 2026. To achieve it, it will focus on decreasing material and product costs, reducing fixed and manufacturing costs (including labour costs and personnel cuts) and increasing revenues. As a part of its strategy, it wants to e.g. cut development times of new models, improve procurement services in which it plans to save over 320 million euros each year (Volkswagen [online], 2024). Another feature of the strategy is to reframe its distribution model. This is exemplified in Škoda Auto's current switch to more direct agent-based model in some of the European markets, instead of previously used regular dealer model. The estimated impact is that Škoda Auto will, for example, cut the number of dealerships in Germany by a third (from 330 to 220) (Charvát, 2024).

One may assume that the brands' business models recalibrations will result in ceasing partnership with some of the existing direct or indirect suppliers and independent distributors. Electric vehicles generally require much less parts to be produced. With this logic, the parts will become on average more expensive, making transportation costs relatively less significant compared to the specific part's costs. There might be parts suppliers going out of the market simply because their parts will no longer be needed. The brands could also prefer less supply relationships to cut down transactional and operational costs and may focus on larger parts producers, if not internalizing the production entirely.

The end of often long-term partnerships will have various consequences including the ones in the field of antitrust law. These are the subject of this paper and are discussed below. The geographical focus is primarily on EU competition law, which would

be likely applicable to the conduct in question, while the conclusions can be easily transposed also to a conduct without an EU angle.

The paper is structured as follows. First, the main relevant features of antitrust are described. It includes the prohibition of an abuse of a dominant position and the law against anticompetitive agreements. Second, it discusses the takeaways from the first part for various stakeholders. Third, the paper concludes with a brief summary of recommendations for the car brands and their partners.

2. Relevant antitrust rules

Below, the main relevant features of antitrust law for situations in which the car brands will cease purchasing from its direct or indirect suppliers and/or use independent distributors are identified. Such a conduct could be viewed through two different lenses. First, the authorities may consider whether it represents an abuse of dominance. Second, as the conduct occurs in the vertical relationships of supply and distribution chain, it shall be considered if there are anticompetitive vertical agreements.

Assessments of both types of conduct have common ground in two aspects. First, proper application of the rules requires a correct definition of the relevant undertakings (single economic units). Second, the relevant markets must be defined. Therefore, this part begins with a description of concepts of an undertaking and a relevant market and continues with rules on abuse of dominance and vertical agreements. Finally, it shall be noted that the possibility of internalization of production of some parts by the car brands could also be relevant from the perspective of merger control. Therefore, the final subsection is briefly devoted to merger control rules.

2.1 Concept of undertaking

Competition law is specific in that it is not a corporate entity (a firm) which is relevant to its application, but an undertaking or an economic unit. In that the rules aim to capture the fact that they are not concerned primarily with corporate structure, but with a group of entities tied together with factual economic, organizational and legal links, as explained by EU Advocate General in *Sumal* (case C-882/19, para. 24). First and foremost, it means that entities which are ultimately controlled by the same holding entity, are most often to be regarded as belonging under the same undertaking. As an example, all Stellantis brands would probably seen as members of a large Stellantis undertaking.

Second and perhaps equally important in our case, it might be that some distributors, although not formally owned by car brands, are under such a level of *de facto* control by the car brand, that they would also be considered to form a part of one undertaking with the brand. The required level of control could be established e.g. by specific contractual arrangements such as exclusivity clauses [see to that end Advocate General's opinion and Court of Justice of the EU ("CJ") judgment in case C-680/20, *Unilever*].

It has two implications for the assessment of antitrust assessment of automotive supply and distribution chains shortening. First, market power of some of the car brands could possibly be much higher than how it is seen by the regular public (in isolation, not taking into account other brands belonging to the same holding group). Second, there

could be instances of distributors and possibly also suppliers, which are already in so close relationship with a car brand, that they would belong to the same undertaking. In such cases, these distributors or suppliers cannot claim, from the antitrust perspective, to be harmed by a conduct of the cooperating car brand.

2.2 *Relevant market*

Another central concept is the one of a relevant market. A relevant market is a fictional idea of a market including all products, that are seen as interchangeable or substitutable by the consumer. We differentiate between product and geographical aspects of the definition.

In the past (see e.g. a decision in case M.9360 – *Daimler / Geely / JV*, para. 15), the European Commission ("EC") has defined separate product markets for passenger cars by their size (mini, small, medium, large, executive, luxury, sport, SUVs and multipurpose). These markets were delimited as national (see EC's decision in case M.9730 – *FCA / PSA*, para. 159 and 1104). For spare parts, the EC e.g. seemed to assume that there is one EEA or worldwide market for battery cells and modules for the automotive sector (EC's decision in case M.10524 – *Mercedes Benz / TotalEnergies / Stellantis / ACC*, paras. 24-27).

The EC also discussed market definitions with respect to components for automotive industry and concluded that the markets should be defined separately for each component (see EC's decision in case COMP/M.7401 – *Blackstone / Alliance BV / Alliance automotive group*) and on EEA-wide basis (EC's decision in case M.7796 – *Linamar / Montupet*). With respect to spare parts, the EC differentiates both between wholesale and retail level and between original-equipment ("OE") and non-OE spare parts. Such markets are brand-specific, meaning that there are separate markets for e.g. VW-branded OE spare parts (EC's decision in case M.9839 – *VGRD / Auto Wichert assets*).

In terms of distribution, the relevant markets are likely to be divided by the distribution level (wholesale and retail) (see EC's decision in case M.8449 – *Peugeot / Opel*). It was not decided if the markets should be geographically defined as national or local (EC's decision in case M.9839 – *VGRD / Auto Wichert assets*).

2.3 *Abuse of dominant position*

Finding an abuse of dominant position requires two elements – finding of a dominant position and finding of an abusive conduct. An undertaking is in a dominant position if it can behave to a certain extent independently on its competitors, customers and consumers (CJ's judgment in case 27/76, *United Brands*). It is generally presumed that an undertaking is not in a dominant position if it covers less than 40% of the relevant market. Being in a dominant position is not problematic in itself, but the dominant player has a special responsibility not to harm competition (European Court of Justice's judgment in case 322/81, *Michelin I*).

The jurisprudence backed by case law of the CJ has evolved into the position which makes a difference between cases in which the dominant player would have to be mandated to deal or provide access to parties which it has not been cooperating with before, and cases in which the parties already cooperate but the dominant player

deploys an exclusionary strategy. In the first line of cases, labelled as an 'outright' refusal to deal, emphasize the freedom of contract and the right to property (CJ's judgment in cases C-152/19 P and C-165/19 P, *Slovak Telekom*, para. 46). In order to be able to mandate the dominant competitor to deal with third parties, the authorities must prove that the conduct in question meets strict requirements. First, the product or ability to supply the dominant player must be indispensable. Second, the refusal to deal would have to eliminate all competition in the market (CJ's judgment in case C-7/97, *Bronner*).

On the contrary, once the business partner already cooperates with a dominant undertaking, these elements are not required for finding an abuse. It suffices if it can be proven that an equally efficient rival would or could be excluded from the market due to the conduct of the dominant player. Finally, all conduct leading to a ceasing of business relations with partners by a dominant player may always be justified on the basis on legitimate and objective reasons (see again CJ's judgment in case C-7/97, *Bronner*).

2.4 *Vertical agreements*

Rules on vertical agreements are generally lenient as long as the parties do not reach the threshold of 30% market share, because they are block exempted by Regulation (EU) 2022/720 and Regulation (EU) 461/2010 with a few exceptions. The exceptions concern resale price maintenance, restrictions on passive sales and reselling. On the contrary, Regulation (EU) 2022/770 also applies to the relationship between the parties in so-called dual distribution situations, when the manufacturer uses distributors but also functions as a distributor itself (usually via online sales).

When the market shares exceed 30%, the agreement in question is not automatically anticompetitive, but must be assessed on a case-by-case basis. With a great simplification, the assessment is similar to the assessment of an abuse of dominance.

2.5 *Merger control*

The recalibration of business models of car brands also implies that some of the brands will internalize a part of the supply and distribution chain. It can be done in two ways. First, the brands may cut ties with the existing suppliers or distributors and build their capacities internally. Second, the internalization may occur via acquisitions of the existing independent suppliers and distributors. For example, a brand that has been relying on research and development, and later also on a production of batteries by a third party, may decide to combine the forces and acquire the battery producer. It may then become a reportable transaction to the antitrust authorities.

Merger control rules are exercised upfront. Hence, the authorities look at the transaction and whether it realistically could, in the future, harm competition. The standard widely used in the EU for intervention is whether the transaction would significantly impede effective competition (so-called SIEC test), in particular as a result of the creation or strengthening of a dominant position.

Vertical mergers, i.e. mergers between and acquisitions of non-competitors, used to be regarded as largely unproblematic, but the pendulum has recently moved to far stricter enforcement. Nowadays, vertical acquisitions, if performed by players with

market power, are closely scrutinized. It is probably correct to estimate that there are no truly dominant players among car brands on most relevant market(s). However, it may be different for suppliers or distributors in their relevant markets, which are likely to be defined in narrower sense (confined to a specific car part or even specific brand – see above). Should a car brand acquire a supplier or a distributor being dominant in its market, the car brand would have to explain that it will not lead to an exclusion of rivals and would not harm existing competition in the supplier's or distributor's market.

It needs to be emphasized that only rather large transactions (in terms of the parties' size) are subject to mandatory notifications to the authorities. Nevertheless, it must be pointed out that some of the competition authorities – most prominently the European Commission – has recently paved ways to investigate mergers and acquisitions that do not meet the regulatory thresholds, if they give an impression of potential harm to competition. Speaking of the European Commission, it uses a creative interpretation of Art. 22 of the Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings ("EUMR"). Under this provision, EU members states may ask the Commission to examine a transaction that meets neither national nor EU thresholds.

3. Takeaways

3.1 Abuse of dominance

Car manufacturers may employ various strategies how to achieve the desired new business model in which they will be closer to manufacturing of the car parts on one end, and to final consumers on the other hand. Depending on their contractual arrangements with the partners, they may simply stop the cooperation once needed and allowed in the contract. They may also use the situation to push the suppliers to lower prices (and lower margins) and the distributors to either increase prices or lower their commissions by increasing the wholesale car prices. With respect to distributors, the manufacturers may also want to impose the highest possible retail prices.

First of all, it is necessary to establish whether there are relevant markets with dominant car brands. When taking the example of car sales in the Czech Republic (E15.cz, 2023), it seems that in most sales segments, no brand exceeds 40% market share, setting a presumption of no dominance. However, there could be specific segments in certain countries in which such brands exist – especially if there is a strong domestic brand (Hashmi, Van Biesebroeck, 2016). Second, the components markets are defined for each type of component separately. When looking at the purchasing side of the markets (i.e. at the car brands), it would probably be difficult to find a brand that is dominant in purchasing a specific kind of component. Arguably, there can be exceptions. On the contrary, the spare parts markets concerning OE parts are relatively likely to feature a dominant player, given they are brand-specific. Finally, looking at the distribution chain, there is a potential of a market with a dominant player in countries where some (usually domestic) brand is particularly strong and it is also present as a distributor.

Taking the above into account, abusive conduct may appear particularly with respect to spare parts. To a lesser extent but still possible, car brands may be dominant in markets where they are particularly strong (in terms of a segment and a country). If

this is the case, they need to consider whether their recalibration of a business model is aligned with their special responsibility not to distort competition.

Importantly, in all recalibration scenarios we focus on situations where the parties have already been cooperating. It means that the case would not require mandating a duty to deal on the dominant undertaking *de novo*. Therefore, the requirements set in *Bronner* case law should not be required and car brands conduct should be assessed simply in the lenses of potential or actual exclusionary effects. The guiding principle is whether a competitor as efficient in the activity as the dominant car brand could profitably coexist on the market.

In this regard, any changes of business models by a brand in a dominant position on the market, which make it more difficult for the existing partners to stay present on their market, could be problematic. This would be the case of outright ceasing the cooperation, but also of renegotiated prices decreasing the partners' margins. The key assessment will be whether the act of the dominant brand can be objectively justified.

Speaking of the manufacturers' supply chain, the changes invoked by a move to electric vehicles and related redundancy of some components could very likely represent such an objective justification. Therefore, even if the car brand was dominant in the given market and stop working with a supplier or imposing new conditions with a result of the supplier (potentially) leaving the market, these steps would be unlikely to be seen as abusive in most cases. However, specific situations may arise where the move to electric vehicles is used as a shield, concealing a different underlying reason for dismissing the supplier – such as internalizing the production and absorbing the supplier's margins. In these cases, the validity of justification would be uncertain.

On the distribution end, an existence of a possible justification is less imminent. While the authorities may accept the right of the undertaking to internalize distribution (see EC's case *Filtrona/Tabacalera*), the dominant undertaking should be capable of proving cost efficiencies stemming from the internalization. If a car brand is dominant in a particular market and decides to distribute its new vehicles (on wholesale or even retail level) alone, it cannot do so simply because it wants to attract and control the existing distribution margins.

3.2 Vertical agreements

With respect to the applicability of vertical block exemptions, it is sufficient to say that the probability of the parties exceeding 30% market share threshold is vaguely similar to what we said above about the threshold of a dominant position. Hence, most arrangements between car brands and partners would be block exempted due to the low market share, including any forms of exclusivity setups etc. It also applies to often present dual distribution scenarios, when the manufacturer also competes on a downstream market via its own online sales. Although the parties are competitors, their manufacturer-distributor relationship is still exempted, provided that exchange of information between the parties is directly related to the implementation of their agreement and necessary to improve car production or distribution.

Among the remaining cases, most would be approached similarly to the case of abuse of dominance, as described above. However, there is one type of conduct that stands

out. In the run for higher margins, the brands could try imposing retail prices on its independent distributors. Unless the brand takes the business risk on itself and transform the distributors to 'simple' agents, they cannot direct retail prices.

3.3 Merger control

In a usual acquisition scenario that can be expected in the course of car brands business model recalibrations, the acquirer will be a car brand, or more specifically, its business group. It is almost given that the filing threshold on the acquirer's side would be met. What is more important is whether the target – a supplier or a distributor will also exceed the turnover threshold. Hence, the size of the target will be the decisive factor for the obligation to notify the transaction and, thus, whether the transaction will be even assessed by the competition authorities.

However, the authorities may also use techniques to examine below-threshold transactions, as pointed out above. In fact, the European Commission has already chosen a transaction related to the automotive industry for review. In August 2023, it announced that it will assess the proposed acquisition of Autotalks by Qualcomm. Qualcomm is a global semiconductor manufacturer also serving the automotive sector with chipsets for vehicles-to-everything ("V2X") communications. Autotalks is specialized in such V2X semiconductors. Given the prospective importance of V2X technology, the European Commission found it necessary to review the transaction, albeit it did not meet the notification thresholds (European Commission [online], 2023).

Given the example above, which is one of a few below-threshold transactions being called in by the European Commission for a review, the risk of more automotive sector acquisitions below thresholds being scrutinized is material.

4. Conclusion

Car brands have to reassess their business models and some changes are clearly inevitable. When focusing on getting back on profitable track in the new period of automotive industry, they should stay vigilant with respect to the antitrust angle of their decisions. Arguably not in many, but still some relevant markets, the brands can have such market power to give rise to a special responsibility not to distort competition. In these cases, proper preparation and evidence of objective reasons to recalibrate the business model will be necessary. Furthermore, changes in distribution models must be performed with caution. It may be that under some setups, it will not be entirely clear whether the distributors remain independent or not, while this division is crucial for the ability of the brands to control distributors' behaviour in the retail market. Finally, the brands should be aware of the fact that vertical concentrations (such as internalizing distribution by taking over the previously independent distributors) may be closely scrutinized by merger control authorities.

On the other hand, suppliers and distributors should be aware of the antitrust element in brands' behaviour towards them. In cases identified above as problematic, they shall consider a complaint to a competition authority. It will require a very good documentation of facts, in particular the evolution of a relationship with the brand, and

the state of the relevant market. While it is also possible to directly enforce the claim in front of courts, it would be quite difficult without a backing of a competition authority.

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