ANTITRUST REGULATION IN THE AUTOMOTIVE SECTOR: MANAGING RISKS IN THE BEV ERA

BY WENTING GE & HAZEL YIN[1]

1 Wenting Ge is an associate with the Antitrust, Competition & Trade group at Freshfields Beijing office. She focuses on all aspects of competition matters, often advising on the antitrust and regulatory aspects of cross-border mergers and acquisitions, compliance and investigations in China and throughout the Asia Pacific region. Hazel Yin is a Partner and Co-Head China Competition Practice at Freshfields Bruckhaus Deringer LLP, Beijing. The views expressed herein are those of the authors only and do not represent those of the entity that the authors are affiliated with.

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The auto sector has been under strict scrutiny by antitrust regulators across the globe including China. In 2020, the State Administration for Market Regulation ("SAMR") published the Anti-Monopoly Guidelines on the Automobile Sector (the "Auto Guidelines"), which provide guidance and outline SAMR's enforcement positions on key antitrust issues in the automotive industry. Over the past de-cade, SAMR and its predecessors have undertaken significant enforcement ac-tions along the entire auto supply chain, from auto parts supply and distribution of cars to aftersales servicing. Leveraging from the existing legislation and the authority's decisional practice, this article will discuss the main characteristics that define the new BEV era and attempt to analyze a series of antitrust issues automakers should take note when trying to gain an edge in the BEV market.

I. INTRODUCTION

China has been the top market in the world for battery electric vehicles ("BEVs"), with total BEV sales reaching nearly two million in 2020.[2] It is forecasted that the BEV sales in China will continue to grow rapidly for the foreseeable future. Three in five new cars go on China's roads may be powered by electricity instead of fossil fuel in 2030 according to UBS, while the China government's forecast is for a 20 percent penetration rate by 2025.[3] Key drivers of this growth include the extension of BEV state subsidies and the continued push for BEV adoption, both in corporate and leasing fleets and among Chinese private car buyers. For example, an increasing number of cities in China have mandated that ride-hailing cars must be BEVs, and some local governments specify that a certain number of new license plates must go to BEVs.

Adoption of BEVs has brought a profound impact on the automotive supply chain. Major systems that are essential to vehicles with internal combustion engines ("ICE") are absent from BEVs. Makers of exhaust systems, fuel systems, and transmissions face the prospect of disruption as BEVs become more mainstream. In the meantime, innovative technologies such as autonomous driving, connected cars are becoming crucial to remain competitive in the BEV market. The BEV market has also seen new distribution models emerge. An increasing number of BEV brands are beginning to sell cars directly to consumers. The days of consumers purchasing their cars exclusively through dealers are numbered. In terms of the aftersales market, the impact of electrification is less certain. Although BEVs tend to have fewer mechanical parts that break down, which leads to less maintenance and a lower demand for spare parts than internal combustion engine ("ICE") vehicles, servicing BEVs requires more specialized capabilities, as the tasks involved are more complex.

Automakers are faced with a host of new challenges as well as opportunities in this era. Taken together, these developments will result in an increasingly dynamic and competitive BEV market in which both traditional OEMs with a record of succeeding in the ICE market and BEV start-ups as newcomers will have to fight hard for market share. In such a dynamic market, antitrust regulation and enforcement will continue to play a crucial role to ensure the effective competition and sustainable development of the market.

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Over the past decade, SAMR and its predecessors have undertaken significant enforcement actions along the entire auto supply chain, from auto parts supply and distribution of cars to aftersales servicing. Leveraging from the existing legislation and the authority's decisional practice, this article will discuss the main characteristics that define the new BEV era and attempt to analyze a series of antitrust issues automakers should take note when trying to gain an edge in the BEV market.

II. ANTITRUST CHALLENGES ALONG THE VALUE CHAIN

A. Production of BEV Cars – Collaboration Has Become the Trend

The BEV era has redefined not just the automobile itself but the mobility ecosystem. Seizing the opportunities in the emerging market requires market players to innovate around autonomous, connected, electric and shared vehicles and technologies ("ACES"). Leading international automotive manufacturers typically spend as much as RMB 50 to 100 billion a year on research and development.[4] In the BEV era, much of this money, and more, will need to be redirected toward refining the ACES technologies. McKinsey research indicates that if an OEM wants to achieve significant success in all areas of ACES, it would have to invest approximately RMB 500 billion over 10 years.[5]

The considerable costs of keeping pace with these innovation trends are forcing consolidation and collaboration among market players, including collaboration between traditional OEMs and collaboration between OEMs and suppliers of auto parts or technologies. BMW and Mer-

2 McKinsey & Company, Winning the Chinese BEV market: How leading international OEMs compete, https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/winning-the-chinese-bev-market-how-leading-international-oems-compete.

3 South China Morning Post, China's 2021 electric car sales soar, putting world's largest EV market on track to reach 20 percent penetration target ahead of schedule, https://www.scmp.com/business/china-business/article/3163005/electric-cars-account-over-20-cent-chinas-new-vehicle-sales.

4 McKinsey & Company, Winning the race: China's auto market shifts gears, https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/winning-the-race-chinas-auto-market-shifts-gears.

5 *Id.*

cedes-Benz, for instance, have forged a partnership focused on the next generation of mobility, which is an example of collaborations between traditional OEMs. The Renault-Nissan-Mitsubishi Alliance has partnered with Google's Android Automotive, in an example of a trend that OEMs collaborate with non-OEM partners such as tech companies.

When assessing collaborations between competitors, while the starting point for antitrust law is that competitors should act independently, competitors should be allowed to collaborate with each other when it is objectively necessary to do so in order to achieve a beneficial aim. Such collaborations can be pro-competitive and allowed under antitrust law on a case-by-case basis. The Anti-Monopoly Guidelines for the Intellectual Property Industry (the "IPR Guidelines") set forth SAMR's criteria for assessing joint R&D agreements, which assume that joint R&D agreements between competitors are permitted when the combined share of the parties in the relevant market is no more than 20 percent, to the extent that there is no hardcore restriction and absent evidence showing anti-competitive effects.[6] In addition, the Auto Guidelines specifically recognize that collaboration in the R&D and production of new energy cars can be pro-competitive because it allows market players to share costs, enhance efficiency and improve public welfare.[7]

However, companies should still be cautious of defining the boundaries of legitimate collaboration, as it will bite if the extent of the collaboration goes beyond what is needed to achieve pro-competitive benefits. For example, even if it is legitimate to collaborate on R&D, joint production, marketing or selling of the results of the R&D may not automatically be exempted and requires careful analysis on its legitimacy. Going further than what is absolutely necessary for achieving a legitimate goal may constitute coordination that results in prohibited cartel conduct (such as fixing prices, reduction of output, or sharing of customers or markets).

Also, while it is inevitable for competitors to communicate and contribute to each other's knowledge in the collaboration, information exchange risks may arise in such context. To avoid the risks, information of the competitors should generally be shared only when it is strictly necessary to achieve the collaboration. In addition, any sharing of competitively sensitive information that is necessary to plan or implement the cooperation should be subject to safeguards, such as "clean team" arrangements which usually require that information is disclosed on a "need to know" basis to a limited group of individuals who are subject to strict confidentiality obligations and will, where possible, refrain from a role in which they might make use of their rivals' competitively sensitive information.

While risks of cartel conduct may not arise in collaborations between an OEM and non-OEM suppliers, such collaborations are not exempt from antirust risks. In particular, SAMR will scrutinize if any vertical foreclosure effects may arise, especially when the collaboration concerns leading technologies and involves parties who are market leaders in the relevant markets. For example, in 2014, SAMR's predecessor MOFCOM found concerns and ultimately imposed remedies when reviewing a collaboration in the new energy car sector, the proposed joint venture among Hunan Corun New Energy Co., Ltd., Toyota Motor (China) Investment Co., Ltd. (Toyota China), Primearth EV Energy Co., Ltd. ("PEVE"), Changshu Xinzhongyuan Investment Co., Ltd. and Toyota Tsusho Corporation.[8]

The joint venture was established to produce nickel metal-hydride ("NMH") battery packs for another Toyota joint venture in hybrid cars. PEVE was the market leader in the NMH market with a 66.4 percent market share, and Tokyo held 80.3 percent market share in the hybrid car market. MOFCOM considered that the transaction would strengthen Toyota's controlling power on the value chain of the hybrid car industry, and other hybrid car companies in the China market may be restricted to access the NMH products supplied by the proposed joint venture. Specifically, MOFCOM found that the transaction agreement allowed Toyota to veto any proposals of the joint venture to sell products externally, and thereby may in fact lead to the joint venture supplying NMH products exclusively to Toyota and cause foreclosure impact on other hybrid car makers.

To address such concerns, MOFCOM placed remedies on the joint venture by requiring it to sell its products to third parties on fair, reasonable and non-discriminatory ("FRAND") manners, and required that the joint venture should generate external sales within the first three years of operation if there is market demand. The FRAND-type remedies in this as well as many other conditionally approved cases in China reflect the regulators' persistent concerns over vertical foreclosure effects, which may have to be solved by committing not to discriminate the Chinese customers and to supply to the China market on fair terms, especially in industries subject to close scrutiny, such as those markets along the value chain for BEV cars.

Antitrust concerns may arise not only in SAMR's merger review process, but also when assessing specific types of conduct in the context of collaborations between players at different levels along the supply chain. In the BEV era, OEMs teaming up with tech companies to

6 Article 13 of the IPR Guidelines.

7 Article 5 of the Auto Guidelines.

8 MOFCOM, Announcement of the Anti-Monopoly Review Decision to Conditionally Approve establishment of joint venture among Hunan Corun New Energy Co., Ltd, Toyota Motor (China) Investment Co., Ltd, Primearth EV Energy Co., Ltd, Changshu Xinzhongyuan Investment Co., Ltd., and Toyota Tsusho Corporation. Order No. 49, July 2, 2014.

develop ACES technologies has become the trend. When planning their partnership strategies, companies should carefully consider the antitrust implications, especially when the collaborations are carried out by market leading players. The IPR Guidelines put forward a 30 percent market share safe harbor for vertical agreements, where agreements between non-competitors in which each party's market share in any relevant market affected by the technology agreement satisfies the safe harbor will be presumed as lawful, to the extent that there is no hardcore restriction.[9]

In addition, no matter in collaborations between competitors or non-competitors, companies should be cautious for antitrust concerns raised by restrictive provisions in collaboration agreements. Such restrictive provisions may include, for example, requiring exclusivity by prohibiting the partner to develop the same kinds of technologies or technologies in fields not related to joint R&D with third parties or on its own, restrictions on carrying out follow-up R&D on the developed products, limiting the licensing or supply of the technologies or products to other market players.[10] The antitrust assessment for such restrictive agreements is not straightforward and typically requires an effects-based test taking into account the factual background covering a number of factors, including the parties' market share, the market conditions and potential efficiencies brought by the collaborations. Thinking about these issues up front will prevent unwittingly bringing antitrust risks.

B. Distribution of BEV Cars – Evolving Retail Models

In the early 2000s, given lack of authorized dealerships and aftersales channels, it was not easy to purchase a car from authorized channels and to obtain proper repairing services in China. To protect the consumers' interests and reinforce the management of the distribution channels, the Chinese government published the Administrative Measures for Automobile Brand Sales in 2005 (the "2005 Auto Sales Measures") which established dealerships authorized by OEMs as the only permissible channel for distributing cars in China.[11] Following the promulgation of the 2005 Auto Sales Measures, 4S stores (short for sales, service, spare parts and surveys) quickly began to set new standards in the purchasing market and had become "the norm" of the auto distribution model until recent years.

In the traditional 4S store resale model, dealers purchase vehicles and parts from OEMs and then resell the products to consumers. In such a resale model, an agreement between an OEM and a dealer to set or maintain the price at which the dealer will resell the products, known as resale price maintenance ("RPM"), carries high risks and is a prominent target for antitrust enforcement in the auto sector in China. In the Auto Guidelines and enforcement practice, SAMR and its predecessors have presumed that RPM is unlawful, with very limited and narrowly defined exceptions. RPM behavior in the auto sector is subject to strict scrutiny by the regulators, with 7 cases involving both international and domestic OEMs being penalized with fines exceeding RMB 1,200 million (approx. USD 188.65 million) in total over the past decade.

In contrast to the traditional 4S store model for distributing ICE cars, OEMs are starting to revolutionize the sales models of BEVs by switching to direct sales. As a general observation, there are typically two types of direct sales models adopted by the OEMs.[12] Some BEV OEMs open fully owned and directly managed stores to sell cars directly to consumers (the "Self-Owned Store Model"). In the Self-Owned Store Model, no vertical concerns including RPM risks would arise given that the OEMs themselves provide retail distribution services on their own, and have full freedom to decide sales strategies (including pricing).

However, the Self-Owned Store Model requires considerable investment and costs by the OEMs to set up and operate the stores. To split the investment and costs, some other OEMs adopt an alternative direct sales model where they do not own sales stores but recruit third party agents to operate the so-called "brand flagship centers" to offer services such as display of car models and test-driving. In this model, the sales contracts with consumers are concluded between the end customers and OEMs, and the agents generate profits by commission fees paid by the OEMs (the "Agency Model").[13]

In addition, unlike traditional dealers under the 4S store model, the agents typically do not take ownership of the stock or assume contract default risks with end customers, although they may take certain commercial risks for operating the stores.[14] There remains to be ambiguity about the treatment of the Agency Model under Chinese antitrust laws and whether OEMs can enjoy exemptions of RPM to decide the retail price.

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9 Article 13 of the IPR Guidelines.

10 Article 7 of the IPR Guidelines.

11 In 2017, the 2005 Auto Sales Measures was revoked, and the *Administrative Measures for Automotive Sales* came into effect.

12 Strategy &, Direct sales or agency model: the road ahead of the sale of automobiles, https://www.pwccn.com/zh/automotive/direct-selling-or-agency-mar2021.pdf.

13 Thoughtworks, The change of OEM-led automobile sales model – the transformation from direct sales, https://insights.thoughtworks.cn/oem-automotive-retail-transformation/.

14 Accenture Study, Future automotive sales in China, https://www.accenture.com/_acnmedia/PDF-149/Accenture-Study-Future-Automotive-Sales-China.pdf.

Under the EU competition laws, a supplier is permitted to control the retail price where the dealer meets the criteria for a "genuine agent."[15] A genuine agent negotiates or transacts on behalf of a principal and does not bear or bears insignificant commercial or financial risks by itself. It is treated by the EU competition laws as forming part of the principal and the vertical relationship between the genuine agent and the principal is exempt from the EU competition laws. Nonetheless, the criteria for a "genuine agency" are very strict and are applied narrowly in EU competition law practice.

There is no explicit acknowledgement of the genuine agency exemption under existing China laws, but there is evidence implying that this may also be recognized in China. The genuine agency exemption was once incorporated in an earlier draft of the Auto Guidelines (the "2016 Draft"), although it was ultimately left out in the final version.[16] In particular, the 2016 Draft included some detailed guidance for assessing the genuine agency relationship, which was largely consistent with the test as provided in the EU competition laws. In fact, it is understood that EU competition rules played an important role in shaping the Auto Guidelines and the final version of the Auto Guidelines largely mirror the relevant rules covered in EU Motor Vehicle Block Exemption Regulation. This suggests that in practice, SAMR may adopt a similar assessment approach as the EU Commission and accept the genuine agency exemption.

While being silent on the genuine agency exemption, the Auto Guidelines provide a separate exemption of RPM when a dealer acts as an "intermediary" in the sales of cars.[17] In such a scenario, the sales price is directly negotiated and agreed upon between an OEM and specific end customers (e.g. an employee, key account or advertising sponsor) and the dealer only provides supporting services such as delivery, invoicing and payment collection. An additional exemption following the same logic may arise in the e-commerce context, whereby a dealer plays a similar "intermediary" role for OEMs' sales via an e-commerce platform. However, distinct from a genuine agent, an intermediary dealer may have obtained title to the automobiles which they are reselling since the intermediary dealer has already completed the wholesale purchase from OEMs and may undertake certain commercial risks during the transaction (such as the inventory or financial risks).

So far, there has been no precedent from past enforcement cases indicating that RPM in the auto sector was exempted based on the intermediary/e-commerce exemption or a genuine agency exemption. Companies need to carefully assess the functions and roles of a dealer in a specific transaction on a case-by-case basis to determine whether the dealer can qualify as an intermediary dealer or a genuine agent eligible for the exemption. As the distribution model continues to evolve in the BEV era, it would appear sensible to revisit the traditional approach towards RPM and adopt a more flexible test to adapt to the new business reality in the BEV era.

C. Aftersales of BEV cars – The Impact of Electrification Remains Uncertain

A primary focus of the antitrust enforcement in the automobile sector has been the aftermarkets. In the ICE era, competition in the maintenance and repair markets occurs between authorized repairers that belong to the OEMs' official networks and independent workshops. For several reasons, competition on these markets is not particularly strong. For one thing, the OEMs' authorized networks have high market shares – often exceeding 50 percent.[18] For another, OEMs have a stranglehold over two of the inputs necessary to compete effectively – technical repair information and certain spare parts, known as captive parts, which can only be obtained from the vehicle manufacturers. This is an important market for automobile consumers, since car ownership is a major part of overall expenditure, and repair and maintenance costs currently account for a large part of the cost of owning a car.

Antitrust authorities have been concerned that this gives an OEM market power within its own ecosystem, resulting in lack of effective competition in the auto aftermarket. Specifically, the Auto Guidelines recognize that the aftermarket may have a brand-specific feature. OEMs that do not hold a dominant market position in the automobile manufacturing market may nevertheless possess market power (and therefore be deemed dominant) in aftermarkets for parts and services for their vehicles due to so-called "lock-in effects." Accordingly, OEMs face more limitations in terms of imposing restrictions on their counterparts in the aftersales market in order to avoid behavior that may constitute an abuse of dominant position.

The impact of electrification on auto aftermarkets is less certain. Compared with ICE cars, BEVs experience lower wear and tear per mile travelled, typically resulting in lower maintenance costs. However, even though BEVs typically require less maintenance work than ICE vehicles, with less frequent service touchpoints, servicing BEVs requires specialized capabilities, as the tasks involved are more complex. Therefore, be-

15 Commission Guidelines on Vertical Restraints (OJ 2010 C131/01, 19.5.2010).

16 Hua Su, Study on Antitrust Regulation of Automobile Market – a Comparison of China, EU and U.S. (2017), page 317, China University of Political Science and Law Press.

17 Article 6(2) of the Auto Guidelines.

18 Autohome, Aftersales service is critical: maintaining customers is key to 4S stores, https://www.autohome.com.cn/news/202007/1013571.html.

cause of commercial reasons and technical barriers, the independent aftermarket has not developed a strong competing repair and maintenance offer for BEVs.

In the short term, BEV owners tend to be more loyal to the aftermarket network authorized by OEMs, largely due to the fact that the owners – often concerned by the complexity of BEV cars – are looking for the "peace of mind" that remains at the OEM-authorized network. However, in the mid-to-long term, once BEVs become the mainstream in the auto market, independent repair shops may start to enter into aftermarkets and antitrust authorities may want to ensure that there is sufficient competition between authorized and non-authorized repair shops. Similar to what happened in the ICE era, SAMR may become particularly concerned about the barriers for independent repair shops to enter BEV aftermarkets by that time.

The Auto Guidelines have specifically identified some restrictions by OEMs that can amount to an abuse of dominance because these restrictions create barriers for independent repairs to enter into the aftersales markets. These restrictions include, *inter alia*: (i) preventing dealers or repairers from purchasing aftermarket spare parts, particularly compatible parts or original parts obtained through channels other than the OEMs; (ii) preventing parts suppliers, dealers and repairers from selling parts among themselves or to end-users; and (iii) withholding access to technology information, testing equipment and tools necessary for repairers.[19] Although technically there is some room for an OEM to prove that it does not have a dominant market position in parts and services aftermarkets for its own brand, SAMR appears to take an aggressive approach by *de facto* prohibiting the above conduct and presuming market power in those aftermarkets.

III. CONCLUSION

China has been the top market in the world for BEVs. Many international automotive OEMs and suppliers have not started large-scale launches of BEVs in EU, U.S., and other countries until recently, while in China, a rapidly growing BEV market and ecosystem have already emerged. The Chinese automotive market has been essential for the business of international OEMs and suppliers for more than a decade – and will be even more indispensable in the post-COVID BEV era.

In the transition to the BEV era, many market players have developed new business models to thrive, such as collaborations with other market players and forming partnerships and developing new distribution models. While the exiting legislation and regulation is well positioned to address most of the issues arising in the BEV era, there are still issues that are yet to be clarified. As China moves into the lead in global electric mobility, the China antirust authority could be a pilot to examine these issues.

Given SAMR's strict scrutiny in the auto sector, companies must develop a precise understanding of the China antitrust laws and should be aware of its unique features. Even if certain forms of conduct or transactions do not raise concerns under antitrust laws in the EU, U.S., or other jurisdictions, companies should consider carrying out another round of review from the China antitrust law perspective.

19 Articles 8 and 9 of the Auto Guidelines.

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