

Legal restraints when doing business in Europe?

An assessment of competition legislation on vertical relations in
the European automotive supplier industry

Lund, May 2005

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Preface

This master thesis has been written in the period from March until May 2005 for my study “Master of European Affairs” at Lund University in Sweden. The choice for the specific topic is the result of a fusion of the knowledge fields of my previous studies in Technology Management and my current studies in European Business and Business Law, combined with my personal passion for the automotive industry.

It has been an enjoyable and interesting period that I look back at with pleasure. I wish to thank both my tutors Christer Kedström and Henrik Norinder for their input, as well as the people that were willing to devote time for interviews.

Lund, 19th of May 2005

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Abstract

- Title:** Legal restraints when doing business in Europe? An assessment of competition legislation on vertical relations in the European automotive supplier industry
- Author:** Walter van de Laar
- Tutors:** Christer Kedström, Henrik Norinder
- Problem:** How does EU competition legislation concerning vertical relations in industrial relations attribute to or – on the contrary – hinder business?
- Purpose:** The purpose of the investigation is to give an insight to how the EU legal environment in the field of vertical relationships influences the competitiveness of the 2nd tier of the automobile industry.
- Method:** This paper follows a deductive approach. Through desk research and interviews the relevant issues are investigated. Secondly, their impact is assessed through applying them to Porter's 5 forces framework. These findings are bundled and a judgement is done on the effect on the competitiveness of the 2nd tier of the automotive industry.
- Conclusion:** It follows that European legislation has succeeded in raising the competitiveness by breaking down the powers of the predominantly more powerful companies that the 2nd tier players do business with and by giving companies sufficient leeway to act. The comment must be made here that serious problems due to a power imbalance might still exist, yet are not uncovered. In the course of my research I have found a lack of issues in my subject field. These problems however would have a more structural and economical cause, dealing with these problems would fall outside the boundaries of the competence of European competition legislation.

Although criticism on the legislation does exist, it should be interpreted more as a balancing counterforce than as uncovering a sincere problem. Main point of relevant criticism is that the companies constantly have to remain aware of whether they still comply with legislation. The relatively high complexity and changing market shares lead to uncertainty and continuous legal costs.

The “innovator problem”, which addresses the issue of innovating firms gaining a too large market share according to European legislation can be concluded not be a practical issue, despite theoretical legal indications in that direction.

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1. Introduction

This chapter serves to give an introduction to the subject field, working towards the problem and the purpose of this investigation. The chapter will end with a description of the target audience and an outline to the rest of the paper.

This thesis will deal with vertical relationships of the 2nd tier automotive supplier (figure 1.1). It will discuss whether, and how, EU competition legislation influences business behaviour in this area.

As a case industry, the automotive industry is chosen, because of its relative importance for the European and global economy, the complexity, high series numbers and the availability of cases and case descriptions.¹ The 2nd tier of the automotive supply chain is introduced in section 1.1.2. Because it is a varied case group which can not be captured under one common denominator, examples and characteristics of the companies in this industry will be described when appropriate in other relevant paragraphs and in text boxes throughout the paper.

In the rest of this chapter, the reader will be introduced to both the business and the legal field of investigation.

1.1 The European automotive industry

In this paragraph, a first look will be taken at the European automotive industry. The importance of the industry for the European economy is pointed out. As the European Union states on its website: The EU is the largest automotive production region (34%) in the world and the industry comprises 7,5 % of the manufacturing sector in the Union. Direct employment by the automotive industry stands at about 2 million employees, while the total employment effect (direct and indirect) is estimated to be about 10

¹ Issues dealt with and conclusions drawn in this paper can be applied more generally to industrial supply chains where serial sourcing of technical modules takes place.

million². The European Commission states: While the car manufacturers themselves are not regarded as a high-tech industry, it is a major driver of new technologies and of the diffusion of innovations throughout the economy. Almost 20% of all R&D in manufacturing is undertaken by car manufacturers. Its close links with many other manufacturing sectors contribute to the rapid diffusion of new technologies. The industry is an important demand source for innovations from other industries, including high-tech sectors such as the IT³.

“... the major, long term contract will see Corus continue to supply its high quality precision tubes to specialist German hydroformer FAE. FAE in turn supplies hydroformed components to Chassis Systems Ltd (CSL), based in the UK, a joint venture business created by DANA and GKN to produce the chassis for Land Rover’s Discovery 3...”⁴

Box 1.1, example of complex relationships in the European automotive supplies market

1.1.1 The automotive supply chain: increasing importance

All industries supplying the automotive industry, be it high-tech or low-tech, be it specialised firms or firms that also supply outside the industry, can be perceived to be joint together through networks of companies or *supply chains*. Over the past decades, an increase of outsourcing at the same time as complexity of technology boosted has occurred. This development has enlarged the reach and the duration of subcontracting relationships in these networks, as I disseminate from the material read. Suppliers and supplier networks have more and more become a strategic issue for automobile manufacturers. In an early article from 1980 Ford⁵ points out the importance of relationships and the consequential mutual dependency in industrial markets like the automotive industry. Instead of the apparent competition between the automobile conglomerates, what we effectively see is the competition between whole supply chains of automotive suppliers⁶. This illustrates the importance for the automobile manufacturer of managing the supply chain with attention and care.⁷

² Figures are taken from the internet: EU, automotive section, 15th of May 2005:

<http://europa.eu.int/comm/enterprise/automotive/pagesbackground/sectoralanalysis/index.htm>

³ European Commission; European Competitiveness Report 2004; p.155

⁴ Internet: Corus website, www.corus.nl, 15th of April 2005

⁵ Ford 1980

⁶ Adapted from Mitchell 1999; p. 2

⁷ Dyer (1998) offers a counterbalance against too enthusiastic ideologies when it comes to outsourcing. He concludes that the benefits of outsourcing are not fully undisputed. Part of his foundation for this argument

Cobra is a successful 2nd tier supplier specialized in producing turned components for auto airbag igniters, supplying to the leading airbag suppliers in the industry. In a comparatively short period of time Cobra has grown to having approximately 100 employees and 60 CNC machine tools. Cobra's success is based on two pillars:
Firstly the company uses highly flexible machinery. Though these machines seem to elaborate and the costs per item seems to be too high at first sight, it guarantees maximum flexibility in both minor adjustments with regards to the design and major adjustments with regards to changing the product line.
Secondly, although advocating flexibility, the company has adapted to a rigid framework of ISO-procedures. Not a single change to machine settings can be made to the production process without approval from a quality circle. This guarantees consistency and thus quality and a constant output.⁸

Box 1.2, a typical 2nd tier supplier

1.1.2 Focus area: the 2nd tier of the automotive supply chain

Within these networks, the focus in this paper will be on the so-called “2nd tier”. Figure 1.1 is a depiction of the automotive industry, schematically showing the major players and the flow of goods and services. As depicted in this figure, and described in box 1.3, the 2nd tier is so to say the “supplier to the supplier” in the automotive industry.

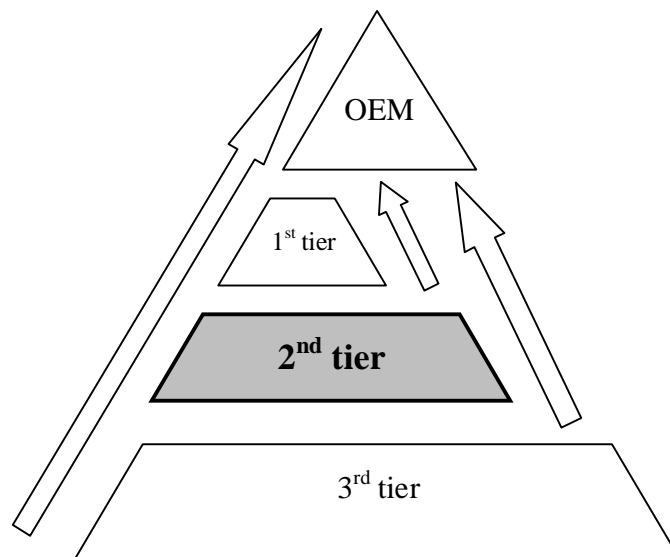


Figure 1.1, a schematic depiction of the automotive supply chain

is that different modes and methods of outsourcing can be distinguished in different regions of the world. In other words, different regions come to different, suboptimal (?), solutions (degrees of outsourcing). The question which method is to be preferred, and thus what we should think of the outsourcing “doctrine”, is not dealt with in this paper. It suffices here to point out that in the literature I have studied I have found factors like cultural issues, path dependency and also legal issues to play a role in these differences.

⁸ Vasilash 2000; p. 1-3

OEM: Original Equipment Manufacturer; a company that manufactures or assembles the final product, using the input from its suppliers. Examples from the automotive industry: DaimlerChrysler, Renault, Fiat.

1st tier supplier: AKA tier 1 supplier; a component manufacturer delivering directly to final vehicle assemblers. 1st tier suppliers work hand-in-hand with automobile manufacturers to design, manufacture and deliver complex automobile systems and modules, such as significant interior, exterior or drive train units.

2nd tier supplier: AKA tier 2 supplier; companies producing parts in the sub-assembly phase. 2nd tier suppliers buy from 3rd tier suppliers and deliver to 1st tier suppliers.

3rd tier supplier: AKA tier 3 supplier; a supplier of engineered materials and special services, such as sheet steels, bars and heat and surface treatments.

Down stream or lower tiers: the supply chain in the direction of the end consumer.

Up stream or upper tiers: the supply chain in the direction of the raw material.

Remarks:

- The definitions given in the following have been subject to generalization.
- As a rule of thumb, complexity of the products decreases when going upstream through the supply chain.

Definitions are taken from the European Competitiveness Report⁹

Box 1.3, definitions and examples of suppliers at different levels in the automotive supply chain

The European automotive industry is characterised by having few vehicle manufacturing firms (OEMs) and a substantial number of independent suppliers to which about 2/3 of the total production is outsourced¹⁰. When zooming in on the different levels that can be discerned within the group of these suppliers, it is found that the 2nd tier makes the majority of the parts in the modern automobile¹¹. Typically, 2nd tier suppliers at their turn source with crude material producers like steel manufacturers and chemical companies¹². Whereas the 1st tier produces predominantly for the car industry, it is not uncommon for a 2nd tier supplier to also supply industries outside the car industry¹³. The fact that these

⁹ European Commission; European Competitiveness Report 2004 ; p.159

¹⁰ Internet: EU, automotive section, 15th of May 2005.

¹¹ Piszczalski 2001; p.1

¹² European Commission; European Competitiveness Report 2004 ; p.160

¹³ Dejong 1999

companies often are the producer of relatively low-tech products¹⁴ makes it possible for them to serve multiple markets.

To conclude this section; Iskandar, Kurokawa, and LeBlanc¹⁵ found that the traditional view of a sharp distinction between 1st and 2nd tier should be adjusted; only 30% of the second tier suppliers in their survey delivered exclusively to first tier suppliers, the rest had either direct deliveries to the OEM as well, or the ambition to do that. This is illustrated in the example in box 1.4.

Haldex, the Swedish manufacturer of highly technological automotive parts such as 4wd systems and braking systems is predominantly a 2nd tier supplier. However, as the companies' product range and expertise is growing both with regards to its depth and its broadness, Haldex is seeking to establish the position of becoming the preferred 1st supplier for its products. An interesting idea for a strategy to achieve this is through establishing "Haldex Inside", similar to what microprocessor producer Intel did in the mid nineties.

Box 1.4, 2nd tier? 1st tier? Or both?

1.2 Central issue: The regulatory environment for the 2nd tier

Having identified the lower echelons of the automotive supply chain as the subject area object of investigation in this paper, in this section the reader will be introduced to the specific aspect of the 2nd tier of the automotive supply chain under investigation, competition legislation on vertical relationships.

The European Commission identifies the regulatory environment, of which competition legislation is a part, as one of the major determinants of competitiveness as a whole¹⁶. It can be derived from the argument that the legislation and its enforcement will have a significant impact on the well-being of the total automobile supply chain. As has been concluded earlier in this chapter, the suppliers upstream in this supply chain play an important role with regards to the total.

¹⁴ European Commission; European Competitiveness Report 2004 ; p.159

¹⁵ Iskandar, Kurokawa, and LeBlanc 2001; p.721

¹⁶ European Commission; European Competitiveness Report 2004; p.209

It is on basis of these arguments that the area of investigation is demarcated to the legal aspects and their implications of the 2nd tier of the supply chain. An eclectically chosen subset of these legal aspects in the field of competition legislation, that affect vertical relationships for the European automotive component supplier industry, will be investigated and their effect on the business climate will be assessed.

1.2.1 Relevance of the regulatory aspects of the upper tiers

After having identified the rough boundaries of the investigation and its theoretical importance, this section will now illustrate the importance that the EU attributes to the automotive industry as a whole and the relative lack of attention it gives to the legislative area subject of this report.

The EU has devoted an elaborate section on its website to the automotive industry¹⁷ and the users of its products as a whole, and addresses the industry with a lot of regulations. In its annual report on European Competitiveness, a rough distinction is made between two types of measures¹⁸.

Firstly there are measures that attempt to affect the usage of vehicles, having a, generally speaking delayed, *indirect* effect. Examples are measures in the field of fuel taxation, charging for the use of infrastructure and on drivers' licenses. These types of legislation are not relevant for the purpose of this paper.

Secondly, there are measures that *directly* affect the business climate in which all the different players within the automotive industry operate. It can be learned that the focus of the EU is on regulating the downstream section of the industry (car dealers, spare parts, ...) and on regulating characteristics of the vehicles (emission, pedestrian safety, ...) as opposed to attempting to regulate the fabrication process towards the end product itself.

¹⁷ Internet; European Union, Automotive section.
<http://europa.eu.int/comm/enterprise/automotive/pagesbackground/sectoralanalysis/index.htm> 1st of May 2005.

¹⁸ European Commission; European Competitiveness Report 2004; p.209

1.3 Problematization

The findings in the foregoing paragraph lead to the question why the focus of the EU as concerning the automotive industry is not the subject area that is under discussion in this report. One explanation is that the industry at this phase in the supply chain does not have very specific characteristics as opposed to other, somewhat similar, industries like for instance electronics, so that the automotive industry is affected by both regulations that are specific to it and by regulations with a broader scope. This view is confirmed by the European Commission¹⁹. Other explanations however are that the problems are either non-existent, not identified on the EU level or, finally, identified but not tackled due to relative unimportance. The answer to this question will be dealt with throughout the course of this paper.

1.3.1 Problem

In this thesis the EU legal outsourcing climate in the market of (automotive) suppliers will be analyzed:

How does EU competition legislation concerning vertical relations in industrial relations attribute to or – on the contrary – hinder business?

1.3.2 Purpose

The purpose of the investigation is to give an insight to how the EU legal environment in the field of vertical relationships influences the competitiveness of the 2nd tier of the automobile industry.

1.3.3 The dilemma of competition legislation

The core of the paper consists of an investigation of competition law. It is a topic area that has been subject to change over the past years.

In his dissertation, Marcus Glader²⁰ teaches that competition law is a field of law that is heavily influenced by economic thinking. He states that primary, secondary and tertiary

¹⁹ *Ibid*; p.209

²⁰ Glader 2004, p.17

law in this area tend to follow the rational reasoning of economics. However, jurisdiction will and moreover should not always follow economic reasoning, for instance in cases where it would make legislation contradictory to principles of predictability or justice, he says. Secondly, as he argues, economical and business science as such has an exploratory, descriptive character as opposed to the more definite character of law. In other words, business and economics are not always as thorough as law, and don't catch all legal aspects. Hence, competition law is a field of law that has to serve non-corresponding interests, a situation which has as an inherent trait that it may cause suboptimal solutions. Levmore²¹ sees it somewhat differently; he argues that the role of law should be to guide the companies towards the business solutions that would normally materialize were there no laws at all, the law thus directing the companies towards the economical optimum. Al be these two opinions different, it can be discerned that both these authors agree that the analysis of the impact of the body of competition legislation is worthwhile.

In paragraph 2.5, "Regulatory Demarcation", explanation will be given on the delimitation towards the competition law area subject of investigation in this paper, legislation on vertical relations. Issues of law that will be covered involve exclusivity contracts and dominant behaviour. The results from this investigation will subsequently be mirrored with implications for the business field.

1.4 Target audience

This paper is primarily intended for an academic audience, consisting of both business and legal scholars. In order to make this paper readable for both parties and to improve usability beyond that group, text boxes are included throughout the paper with either an explanatory or an illustrating purpose. Moreover, a (non-exhaustive) list of terms is included at the end of the paper.

²¹ Levmore 1998; p.243

1.5 Outline of this document

In this document, the hierarchy is as follows: the main division is in *chapters*. Directly under that, *paragraphs* can be found. The final and lowest level, indicated with 3 numbers divided by points (e.g. 2.6.1) is referred to as *sections*.

In the next chapter, the methodology applied for this investigation will be presented. This will be followed by chapter 3, which describes the applied theoretical approach.

Subsequently, chapter 4 goes into detail on the characteristics of the 2nd tier of the automotive supply chain. In chapter 5 the relevant legal framework will be described. Chapter 4 and chapter 5 will converge in chapter 6, where the implications of the legal framework will be assessed through application of Porter's framework. The investigation will be concluded in chapter 7 where conclusions will be drawn and suggestions will be done for further research.

2. Methodology

This chapter serves to zoom in on, and comment on the applied methodology and on the legal subject area. It therefore covers, in logical order; the methodologies used for this investigation, a paragraph on the sources, the legal methodology, general demarcations, the demarcation of the legal area in more depth; and finally criticism on both the methodology and the sources.

In this research, two distinct subject areas are investigated; a research on law is done in support of a question on the competitiveness of the legal framework that applies to the suppliers of the automotive industry. The latter essentially is a question with its roots in business science. Both fields of science require different approaches, therefore this distinction can be found throughout this chapter. Firstly we will take a look at the general approach, in the next paragraph.

2.1 Methodological approach

In the field of methodology, a distinction is made between the “deductive” and the “inductive” approach. The deductive approach starts with a hypothesis, which is subsequently tested through observations. Upon these observations a conclusion is drawn. The opposite, the inductive approach, basically follows the other way round: based on observations of reality a pattern is discerned, conclusions are drawn and a theory is formulated.²²

This paper follows a deductive approach. Through desk research, both the business area subject of investigation, and the relevant legal issues are investigated. This is done by studying legislation, cases, journal articles and literature. Interviews are held to substantiate findings. Secondly, their impact is assessed through applying them to Porter’s framework, which is discussed in paragraph 3.1. Next, the findings are bundled and a judgement is done on the effect on the competitiveness of the automotive industry, therewith answering the problem that is subject of this paper²³.

²² Internet: <http://www.socialresearchmethods.net/kb/dedind.htm>; 19th of May 2005

²³ The “problem”, around which this paper has been written, can be seen as an alternative type of hypothesis.

Another classification for research methodologies is the “survey”, and its opposite, the “case study”²⁴. A pure survey forms a broad picture about the issue at hand, mostly through quantitative research. The case study, on the other hand, is used to obtain an in depth picture of the matter. Due to the characteristics of this paper; a relative wide delimitation of the business section – an industry segment – and a legal component; and due to the relative short time span, this paper holds the middle between a survey and a case study. A thorough survey on basis of the investigated legal framework would have been a more appropriate solution when more time would have been available. In the applied approach, a certain degree of broadness is pursued, however knowledge is gained through in depth, qualitative study; through cases and legal investigation. The next paragraph will zoom in on the method of data collection.

2.2 Data collection

The primary data²⁵ needed to substantiate findings from the desk research has been done through telephonic interviews with stakeholders in the industry. These interviews were held on the basis of open questions. A long list with the legal questions can be found in Appendix I. When possible, reference in the text is made to these interviews. However, as the interviews often also added to the general understanding of the subject as opposed to giving concrete knowledge, a complete overview of interviewees is included in the “Sources” section at the end of this paper. Some of interviews aimed at gathering info on business issues followed an open structure, no list with questions was used. An overview of the secondary data²⁶ and of the laws that were used can be found in the sources section at the end of this paper. The subsequent paragraphs will discuss in greater detail the legal and business approach.

2.3 Legal methodology

For the legal research, the ‘Traditional Legal Method’ is applied. Through the investigation of, subsequently, Treaty articles, regulations, directives, case law and

²⁴ Internet: <http://www.ukzn.ac.za/csds/Publications/Strategiesdoc.pdf>; 19th of May 2005. Other alternative approaches for research design can be found here as well.

²⁵ Empirical evidence

²⁶ Data collected from books, journal and magazine articles.

notices the appropriate legal framework is constructed²⁷. The approach to the delimitation of the regulatory field, which is part of the legal approach, is explained and applied in paragraph 2.5, “Regulatory demarcation”.

<u>Types of law</u>	
Treaty:	The Treaty establishing the European Community ²⁸
Regulation:	Legislation issued by the European Commission. Directly applicable in, and legally binding for, the member states.
Directive:	Legislation issued by the European Commission. Mode of implementation is free, the goals that the directives pursues however are binding on the member states.
Case law:	Explanatory or supporting legislation. Issued by the European Court of Justice (ECJ) or by the Court of First Instance (CFI). The latter is to be regarded as a secondary ECJ. Rulings are binding.
Notice:	Expression of the European Commission’s opinion. <i>See box 5.1</i>
<u>Hierarchy of law</u>	
Primary law:	The Treaty
Secondary law:	Regulations, directives, notices, guidelines
Tertiary law:	Case law

Box 2.1, legal definitions

2.4 General demarcations

The introductory first chapter served to give an outline to the subject field. In this document, a legal issue – competition law in industrial areas – is investigated for a more general, business purpose. The demarcation of the legal field of research, which can be seen separately, will be done in the following paragraph. Its level of assessment will be on European law. Enforcement issues will not be assessed in this document. The notion of legal relevance as used in this paper will be elaborated upon there as well.

The investigation will focus on the outsourcing of tangible products, thus leaving out the outsourcing of services and R&D. A neighbouring topic, whether vertical limitations would restrain innovation, has not been the focus of this paper. There will not be a delimitation in the field of type product or technology.

²⁷ Brokelind 2004

²⁸ EC Treaty; OJ 325 of 24th of December 2002.

2.5 Regulatory demarcation

This paragraph expands on the foregoing paragraph by zooming in on the regulatory environment. As identified before, the automotive industry is affected by both legislation that is specific to it and by legislation with a broader scope. With reference to the purpose of this paper, the major guidelines for the selection of topics to be covered are, in order of importance (legal relevance):

1. **Vertical.** Is the behaviour vertical? In other words, does the legislation concern transactions up or down the supply chain? The supply chain is schematically depicted in figure 1.1.
2. **Direct influence.** Does the legislation affect the horizontal relationship directly, by stating conditions on grounds of which certain agreements are deemed to be illegal, or, on the opposite, indirectly? The opposite; indirect influence is to be interpreted as influencing a neighbouring topic which in its turn influences the vertical relationship.

In the following table a comprehensive overview is given of regulatory issues that affect the relationship between 1st and 2nd tier suppliers and an assessment of their relative importance. Legislation that is classified “relevant” is subject of investigation within the framework of this thesis. These pieces of legislation will be explained in chapter 5.

All legislation that is part of the legal framework as identified in table 2.1 concerns measures that directly affect the vertical relationship, thus following the notion of legal relevance as it was constructed in this paragraph.

	Legislation	Explanation	Relevance
1.	Article 81 (EC); Notice on subcontracting	See chapter 5	Relevant
2.	Article 81 (EC); 2790/1999 on the application of 81(3) to vertical agreements	See chapter 5	Relevant
3.	Article 81 (EC); 772/2004 on technology transfer agreements	See chapter 5	Relevant
4.	Article 81 (EC): Notice on agreements of minor importance (De Minimis)	See chapter 5	Relevant
5.	Article 82 (EC)	See chapter 5	Relevant
6.	Regulation 139/04 on the Control of Concentrations between Undertakings	See chapter 5	Relevant albeit indirectly. This is discussed in chapter 5; regulation is not regarded to be part of the legal framework in this paper.
7.	REACH. Proposal for an EU Chemicals regulation.	Harmonizing regulatory framework on the treatment of chemicals throughout their whole life-cycle	No legal status at this point and the effect is – arguably – indirect.
8.	Industrial property: Commission proposal for more competition in car spare parts market	Proposes non protection on design of exterior parts for replacement market.	It involves physically the same products, yet the supply chain that is under investigation is different.
9.	Directive on the re-usability, recyclability and recoverability of motor vehicles (proposal).	Lays down rules for ‘re-usability’, ‘recyclability’ and ‘recoverability’.	Affecting characteristics of the car as opposed to the process, no legal status.
10.	Articles 31, 87-90 (EC) on State aid	Void any national legislation that distorts Trade between the Member states	Indirect effect
11.	Contract law	On validity of contracts and enforcement of laws in case of contract breach	This is an issue which will remain national for the time being ²⁹
12.	Article 81(3) EC: 2658/2000 in case of specialisation agreements	On horizontal relationships ³⁰	No customer-supplier relationship
13.	Article 81(3) EC: 2659/2000 in case of cooperative R&D	On horizontal relationships	No customer-supplier relationship
14.	Articles 28, 28 and 49 (EC) on Free Movement of Goods	These Treaty articles provide for the abolition of cross-boarder restrictions within the EU.	Partially direct effect; the legal aims are inarguably fulfilled.

Table 2.1, Longlist of relevant law

²⁹ Blair e.a. 2004

³⁰ Explanation on this law; it covers the following situation: Company 1 produces product A., company 2 of a different nationality or region of the EU produces product B. Both agree not to produce the other's product and to sell each other's product in their respective region.

2.5.1 Selection of relevant case law

Where case law is used to elaborate or illustrate on the discussed primary legislation, the following criteria have been applied when selecting these:

1. relevance and resemblance from an industrial perspective,
2. relevance from a legal perspective.

2.6 Criticism on the sources

Availability of resources for empirical data has been a delimiting issue in this paper. When investigating a topic area that is not a real problem area, a low number of real-life cases and low awareness in the field is inherent. This resulted in a view that to a large extent been formed on the basis of scientific articles and indirect evidence.

Second point of critique, in describing Porter's 5 forces, the original book describing the model was not used. However, the spread and therewith the knowledge on this article is so big that the added value of obtaining the original source was assessed to be low.

2.7 Criticism and explanation on the methodology

The topics covered in this paragraph can be interpreted to be both criticism on the followed methods and as well as an insight to the author's reasoning. It is divided along the distinction drawn up earlier in this document between on the one hand business topics and on the other hand legal topics.

2.7.1 Business issues

The first part of this section is devoted to the models used in this paper. To begin with, an inconsistency occurs at the point where the models are described. Porter's model is discussed thoroughly there, whilst Kraljic' model can only be found in the paragraph where it is applied, paragraph 4.3, "A classification of the tier 2 suppliers". This difference is due to relative importance and to avoid redundancies, as will be addressed in the beginning of chapter 3, "Theory".

Secondly, the Porter model essentially does not fit with the research question because it takes a broader perspective than looking purely at vertical behaviour. However, in its application on forces other than the purely vertical, the legislation under discussion does concern vertical behaviour.

Final point on the models, in the description of the business methodology section the Porter model is already partially mirrored onto the focus area of the report. Although this can be debated from a scientific point of view, it adds to both the readability and the applicability of the report.

As is discussed before and will be discussed in chapter 4, the industry referred to as the “2nd tier of the automotive supply chain” is not a very distinct group of companies. Companies can be high-tech or low-tech, big or small, and can portray ambiguous behaviour as to what their exact place is in the supply chain. A broad target group as opposed to the alternative of – for instance – delimiting to a technological subgroup has been chosen in order best to serve the overarching goal of this paper, passing a judgement on the competitiveness of this industry. The drawback, however, is that reference is done in this paper to a generic, non-existing company, thus reducing applicability on the company level. A neighbouring issue is the fact that some of the examples and references given in the boxes do not completely fit within the definition of “the 2nd tier company”. This is done because the author finds it valuable to give a broader view to the market than what would have been obtained when interpreting the definition of 2nd tier narrowly.

2.7.2 Legal issues

Although the legal area of investigation is the law itself, the body of legislation on enforcement of the law and the enforcement itself normally have influence as well. They have however not been addressed in this paper because of the low applicability in this case and time restraints.

When in the course of this paper – for readability purposes – “the legislator” is mentioned, this refers to both the European Commission and the two European courts, these three institutes currently having legislative powers in the EU.

3. Theory

This chapter will specify the business models used in this paper and partially apply the core model, Porter's 5 Forces framework.

As there are no specific models that analyse legal issues in supply chains, generic models coming from business theory are applied in this paper. "Porter's 5 Forces" is used to describe impact of legislation on the overall power position of the 2nd tier suppliers as opposed to their relevant partner industries and (potential) competitors. The model will be explained upon in the following section of this paragraph.

A second model that has been – partially – applied is "Kraljic's Purchasing Portfolio Matrix". It hands a framework to classify suppliers according to firstly their financial and secondly their supply risk. Although it is a powerful model – see paragraph 7.1 "Suggestions for further research" – it is only used in this paper to illustrate on the 2nd tier of the automotive supply chain, applicability outside that chapter is low. Therefore it will not be described into further detail in this paragraph. Because of the approach chosen for this paper not to describe the model *sec*, but to apply it directly, a redundancy would have occurred when the model would have been described here as well.

3.1 Porter's 5 forces

The model is described by Michael E. Porter in 1980. Since then, it has become a frequently used tool for analyzing industry structures. In the model, Porter identifies five competitive forces that shape every single industry and market. These forces help to analyze the intensity of competition, the profitability and the attractiveness of an industry. Given the boundaries of this paper, the model will be used to classify and asses the impact of legislation on vertical relationships in the industry. The outcome of this analysis is hypothesised to be a good indicator for the effectiveness of this legislation. The following figure shows the different competitive forces.

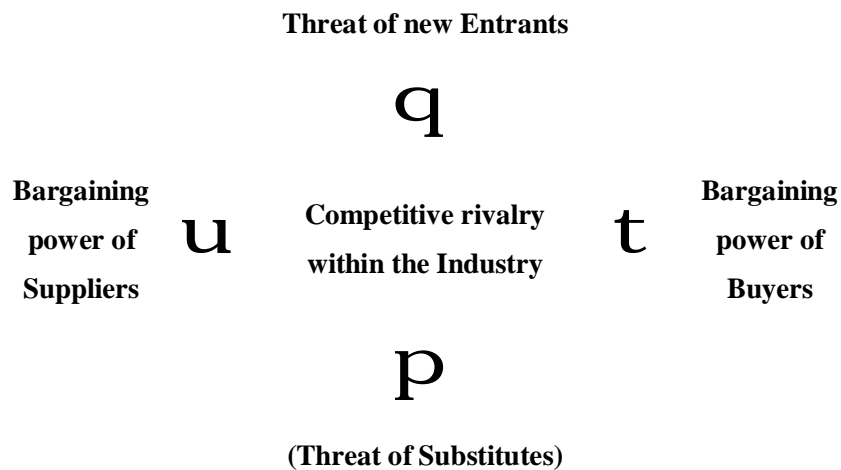


Figure 3.1, Porter's 5 Forces

In the following, the different forces as can be found in the above figure will be elaborated upon and provisionally mirrored on the legal framework and on the 2nd tier of the automotive supply chain.

Threat of new entrants - The easier it is for new companies to enter the industry, the heavier competition will be. In aiming for high competitiveness in the marketplace^{31, 32}, the legislator indirectly acknowledges that it should strive to eliminate any legal barriers to enter. Here we encounter one of the contradictions that the European Commission has to balance in drawing up legislation. If the legislator allows a high degree of interwovenness through lenient competition legislation it helps the industry raise barriers to enter. Closely connected is the point of availability of knowledge. Barriers raised by the legislator for the potential new entrant to source knowledge, for instance the impossibility to license from a (potential) competitor, will effectively raise the entry barriers.

³¹ Article 2 of the EC Treaty; OJ 325 of 24th of December 2002.

³² With regards to the aim of pursuing a high degree of competition; I have found in literature that some economic scholars question whether the resulting oligopolic market is the most efficient market form, delivering at the lowest total cost. These scholars debate the (virtual) loss of economies of scale to be greater than the gain through competitiveness.

Power of suppliers – The balance of power that the 2nd tier supplier has as opposed to its respective supplier is largely determined by the power the former has to make a large enough impact to affect the latter’s margins and volumes. With the 2nd tier supplier traditionally being the actual maker of the car parts, see chapter 1, his respective supplier being large steel companies, the intrinsic power of the 3rd tier supplier is high. Causes are not only a high relative turnover difference, but also few alternative sources of supply for the 2nd tier supplier and high dependency on the materials that the 3rd tier supplier provides for. The intervention of the legislator is important here, and in Europe it has succeeded in bringing this power balance to a somewhat more even level by prohibiting dominant behaviour such as discriminatory pricing and quotas, as will be described in chapter 5.

Power of buyers – Signifies the amount of pressure customers can place on a business. In its traditional role of the 2nd tier supplier as the metal shop producing both for the specialised 1st tier automotive supplier as well as for customers outside the automotive industry, independency is relatively high. However, changing roles in the supply chain demand higher intellectual involvement for the 2nd tier supplier, making investments necessary which may lead to a need for solely focussing on the automotive industry.³³ Challenge here for both the legislator and the 2nd tier companies is to avoid making the position too dependent. The companies can do this by building up specific and thus valuable know-how, thus lowering customers’ price sensitivity and raising substitution barriers. The legislator on his part can aid this process by monitoring potential dominant behaviour of the 1st tier player and for instance by creating licensing possibilities that give the opportunity for the 2nd tier supplier to exploit on its specific knowledge.

Availability of substitutes – As build-to-specs is common throughout the automotive supply chain, a narrow definition of “substitutes” would not suffice here. When broadening the definition, we are effectively looking at the next “force” in this section, “Competitive rivalry”. Another issue, the threat of substitution by other materials is a

³³ See paragraph 4.2, “Future developments of the role of tier 2 suppliers”.

very relevant issue³⁴, yet falls outside the scope of this paper due to the distinct nature of the subject area. It is therefore that this force will not be dealt with in this paper.

Competitive rivalry – The intensity of competition between existing firms within industries in Europe has increased in the past through the abolition of the barriers in the internal market. As this process has already largely been completed, this issue is not subject of investigation in this paper. However, intensity of competition is also positively influenced by posing tougher restrictions with regards to the possibilities for vertical agreements for companies that have large market shares and thus dominant positions. Moreover, competitiveness is facilitated by weak Intellectual Property Right protection and by weak contract law, these two effectively lowering switching costs³⁵. Contract law is not subject of investigation in this paper.

The 2nd tier supplier can roughly follow two strategies to outrun the competition. Firstly it can aim to create a unique and durable proposition for their customers. Legislation can help here for instance by allowing companies to develop and market products that are unique, thus covering (up to) 100% of their market niche, without the companies being afraid of being attacked by the law enforcer because of dominant behaviour. Secondly it can aim to become cost and/or quality leader in its market segment. Economies of scale necessary for this are to be allowed by the legislator in order for this second strategy to work effectively.³⁶

DuPont Automotive, division Paints and Coatings finds itself in a demand oriented market; the power is with the customer. The big players in the automotive coating industry compete each other on innovation and service. The level of innovation is high; however the pace with which this is copied as well. Nevertheless innovation is the key to success in this market. The second key factor in this market, offering premium service can be for instance be found being expressed through giving the automobile suppliers the chance to try new paints and coatings in house at the DuPont facilities. Large automobile manufactures limit every supplier's share to to 1/3th of their total need for paints and coatings, therewith reducing their dependency. Orientation for growth therefore currently is focussed on the far East and Asia.³⁷

Box 3.1, market situation for DuPont Automotive, Paints and Coatings Division

³⁴ For instance, a trend exists to make more parts of the car body from aluminium instead of from steel, thus saving weight.

³⁵ The costs a company has to make when switching, for instance, from supplier A to supplier B.

³⁶ Description on Porter's 5 forces have been adapted from the Internet:

<http://www.investopedia.com/features/industryhandbook/porter.asp>, 2nd May 2005

³⁷ Interview: B. Geboers, DuPont Automotive Wuppertal, Germany. 2nd of May 2005.

4. The 2nd tier of the automotive supply chain

In supplement to the boxes that describe example companies and to section 1.1.2, this chapter will give an in depth view to the current state of, and the future developments in the 2nd tier of the automotive supply chain. The chapter will end with a paragraph in which the industry segment is classified according to two types of risk, illustrating on the market characteristics. Examples of products are given here.

Suppliers for the automotive industry can be found in many different sectors, like chemicals, plastics and electronics. As has been addressed in the introduction of this paper, the looks and feels of the industry is subject to change. Reasons for this are external forces in the field of for instance technological advancement and more internal forces as a downstream initiated strive for cost reduction and efficiency. The latter is in its turn due to factors like increased competition and globalisation.

4.1 Position of the 2nd tier

The fact that 2nd tier suppliers often also supply to industries outside the car industry implies a relative low dependence on their 1st tier customers. An interesting view here on the role of 2nd tier suppliers is explained by Levmore³⁸. He indicates that for some products in the car, like the tires, the OEMs jointly bear the development costs, whilst for other parts; engines for instance, they are far less willing to. He continues to argue that a 2nd tier supplier is in a comparatively privileged position. The relative distance makes it less of an issue for the OEM to share development costs at that level with its direct rivals. This is an opportunity for the 2nd tier supplier, these companies often being the producer of relatively low-tech products, to decrease its relatively subordinate position to its contractors through upscaling their technological contribution. However, this would not solve the imbalance in power the generic 2nd tier player suffers from as opposed to its suppliers, those being the big raw material companies.

³⁸ Levmore 1998, p.220ff

Swedish Trelleborg AB is a global industrial group whose core competency lays in advanced polymer technology R&D and application. It develops high-performance solutions that damp, seal and protect in industrial environments. The group has annual sales of approximately 25 billion Euros, with about 22,000 employees in 40 countries. The company was founded in 1905. It supplies products and expertise to the automotive, mechanical, building and aviation industry. For the automotive industry, its wide product base consists of noise and vibration solutions, pneumatic suspension systems, thermoplastic boots for driveshafts, engine-cooling equipment, air-supply and acoustic-management systems, brake shims, boots, seals, gassprings, pedal assemblies and door seals. R&D and production is both done for 1st tier suppliers like Benteler (chassis, exhaust system, engine parts), ZF Sachs (drivelines and suspensions), Contitech (a.o. hoses, drive belts, sealing systems, conveyor belts) and Tenneco (a.o. shock absorbers, struts, springs, ride control systems, manifolds, mufflers, tubing, emissions systems, engine mounts) and for OEM manufacturers directly. Their products are found in cars of all major car manufacturers.³⁹ Trelleborg's diversified customer portfolio and high tech core competency makes them a relatively strong 2nd tier player that is likely not to change its current business model dramatically in the future.

Box 4.1, an example of a technology-driven 2nd tier supplier

4.2 Future developments of the role of the 2nd tier suppliers

One of the relevant aspects when doing an investigation in the field of business science is the state of constant flux that the business practice is subject to. Legislation by its very nature has a predominantly reactive position in relation to business. By taking into account future developments in this investigation, as an addition to the image on the current 2nd tier automotive supplier market formed in the previous paragraph and in the boxes, the investigation will gain applicability and relevance. Judgements can be done on the possible limits to the applicability of current legislation. These future developments will be described in this paragraph.

With relation to the purpose of this investigation, two major trends are discerned with regards to the lower ranks of the automotive supply chain; an increase of outsourcing upstream and continuing consolidation of the industry⁴⁰.

³⁹ Interviews: Mr. Werius, Corporate communications, Sweden and Ms. C. Aspinall, Assistant to the Sales & Marketing Director of Trelleborg; Automotive, Germany on the 29th of April 2005.
Internet: www.trelleborg.com, 29th of April 2005

⁴⁰ Corswant and Frederiksson 2002; p.753. These two trends come from a total of eight that were identified and investigated by the authors.

Corswant and Frederiksson⁴¹ elaborate on the finding on growing outsourcing. They find that although OEMs do not expect to further increase outsourcing, this is nevertheless expected for the 1st tier producers⁴². This increase of relative importance of the 2nd tier is underlined by the finding that a growing part of the development will be performed by the 2nd tier suppliers, with the 1st tier suppliers however increasing development efforts relatively more, both at the cost of the development efforts of the OEM⁴³. The increasing relative importance of the 2nd tier suppliers to the downstream firms will change their role, impelling them to innovate their product portfolio and broaden their competences.

Secondly, with regards to consolidation in the industry, the number of tier 1 suppliers worldwide is expected to decrease from 600 nowadays to 30 or 35 by 2010. The number of tier 2 suppliers will reduce from the current number of 9500 to around 800 over that same period⁴⁴. This finding is confirmed by Corswant and Frederiksson⁴⁵. One of the driving forces of this consolidation is a need for 2nd tier suppliers, particularly companies that supply commodities or “non-critical items”⁴⁶, to generate critical mass, cost savings, higher volumes and a broader geographic market coverage in order to meet the increasing demands of automakers⁴⁷.

⁴¹ *Ibid*; p.745

⁴² de Banville e.a.(1991 ; p.211) hypothesise hesitations to further increase outsourcing to be due to the fear of having to make high costs when the process needs to be reversed in the future. Levmore (1998 ; p.225ff) attributes the issue to firm pride.

⁴³ Corswant and Frederiksson 2002; p.751

⁴⁴ Internet: Michael Burwell, automotive industry partner with PriceWaterhouseCoopers Transaction Group. 28th of April 2005; http://www.hlh.com/main.asp?p=CFR_PRSearch&pr=116

⁴⁵ Corswant and Frederiksson 2002; p.745

⁴⁶ “Non-critical items” is a notion taken from Kraljic’ theory. For an elaboration on the definition, see paragraph 4.3, “A classification of the tier 2 suppliers”.

⁴⁷ Internet: Michael Burwell, automotive industry partner with PriceWaterhouseCoopers Transaction Group. 28th of April 2005; <http://www.babcox.com/editorial/ar/eb60305.htm>

At DaimlerChrysler's new minivan plant an automobile is built through assembling 13 basic modules. Examples of these modules are instrument panel, rear suspension system, headliner and the seats. All these modules are fitted into the car body on an automated assembly line.

The increasing complexity, mutual dependency and shift of responsibility upstream are illustrated with the example of the headliner, which has variations that include for instance a hole for a sunroof or a control panel. The suppliers design and adapt within given boundaries and come up with solutions⁴⁸.

Postscript: Although a strive for modularity is identified as a trend throughout the whole automobile industry, in reality most OEMs do not (yet) achieve the extreme level of modularity as described in this example, as I have found in my investigation.

Box 4.2, the OEM assembles, the 1st tier produces the module.

These developments will cause a rising dependency throughout the supply chain both due to a decrease of potential partners and the diffusion of knowledge upstream, which in its turn will favour the position of the 2nd tier suppliers. Park and Hartley⁴⁹ give an insight at how the relationship should be shaped in the future: "...the performance of second-tier suppliers is improved when first-tier suppliers place a greater emphasis on managing second-tier suppliers by building long-term relationships, reducing the supply base and focussing on quality when selecting suppliers". They suggest that 1st tier suppliers should adapt a more outward, upstream focus when it comes to quality and delivery performance, as it has become standard practise for OEMs towards *their* suppliers. OEMs on their part could play an active role here, screening and suggesting potential 2nd tier partners. In other words, they suggest close collaboration to be the best approach.

4.3 A classification of the 2nd tier suppliers

The chapter will be concluded with an elaborate description of types of companies found in the 2nd tier of the automotive supply chain. For that purpose, "Kraljic framework" will be used. In 1983 he suggested a portfolio framework for sourcing strategies. In this paper, the description of this model is based on van Weele⁵⁰. The framework classifies suppliers

⁴⁸ Dejong 1999

⁴⁹ Park and Hartley 2002

⁵⁰ van Weele 2002; p.145ff

according to firstly their financial and secondly their supply risk^{51,52}. In this paper it will be used to give the reader an insight to the characteristics of the companies in the 2nd tier of the automotive supply chain. Classification according to dimensions of “risk” are believed by the author to be useful in the context of this paper, because risk from a buyer’s perspective is a major determinant for power from a seller’s perspective. Subsequently, power or “force” is what in Porter’s model is assumed to be a major determinant for an industry’s competitiveness. Hence, a high risk profile infers strength in the Porter reasoning.

Basics of the model are that a company’s procurement strategy with regards to a supplier is dependent on two variables. The first variable is the impact that the supplier has on the profit, measured on basis of criteria such as cost of materials, total costs, product quality, performance and business growth; “profit risk”. The second variable is the “supply risk”. It comprises availability, number of potential suppliers, competitive structures in supply markets, make-or-buy opportunities and substitution possibilities. When supply risk is low, the market is depicted as a buyers’ market.

In a first application of the model on basis of the findings in the foregoing paragraph, the lock-in created through increased outsourcing in the upstream direction will increase the future supply risk for the 1st tier companies, thus favouring the position of the 2nd tier companies.

⁵¹ The qualitative and simplifying character of the model is criticized by Gelderman and van Weele (2003) as reducing applicability of the model. This however is not a problem in the context of the application in this paragraph.

⁵² Although the framework is more powerful than that, offering possibilities for thorough sector and – on a company level – strategy analysis, application for the matter of this paper will be limited to having it give the reader an insight to the 2nd tier of the automotive supply chain. For further application of the framework, see paragraph 7.1 “Future research”.

Profit impact	High	Leverage Items	Strategic Items
	Low	Non-critical Items	Bottleneck Items
		Low	High

Supply risk

Figure 4.1, Kraljic' Portfolio

In the following, all four quadrants of the matrix will be discussed and applied to the industry, with an emphasis on the 2nd tier of the supply chain.

Non-critical items – These products produce few technical or commercial problems from a purchasing point of view. Value per item is generally low and there are many alternative suppliers. Within the boundaries of the 2nd tier of the automotive supply chain, examples in this area are becoming increasingly rare due to increasing demands in the field of performance, weight and specific dimensions. Traditionally, items like nuts, bolts and electric wiring can be classified in this corner. Suppliers will have a dependent position when situated in this quadrant of the framework.

Leverage items – Products in this quadrant can be obtained from various suppliers, with low switching costs. Because price effects are high, aggressive sourcing strategies are used. The input the 2nd tier typically uses like steel and chemicals can be classified in this category. Examples of 2nd tier companies that can be classified as supplying “leverage items” to their 1st tier customers are manufacturers of minor parts of the body of the car or of some parts of the engine.

Bottleneck items – Products in this quadrant are highly complex and difficult to substitute, especially in the short run, yet the price is relatively low as compared to the price of the entire car. Many products manufactured by 1st tier automotive in the industry can be categorized in this quadrant, as well as an increasing amount of products coming

from 2nd tier suppliers. The companies in this quadrant are often technology leaders. Examples are suspensions, exhaust systems and engine mounts. Buying parties should aim for standardization, securing supply, considering “in-sourcing”⁵³ and actively searching for alternative sources of supply.

Strategic items – Products falling in this category are customer-specified and form a significant part of the automobile. Development typically is a joint effort, communication and dependency is high for both the buyer and the supplier. Still, even in this quadrant many of these partnerships in the automobile industry are found to be dominated by the buyer, as van Weele⁵⁴ states. Examples in the 1st tier can be found in car-bodies, drive trains and engines. 2nd tier suppliers that can be classified in this quadrant will often have a strong technology position. Trelleborg AB (box 4.1) is an example company here.

Applying the knowledge gained from paragraph 4.2, “Future developments of the role of 2nd tier suppliers” to the matrix, the future will show an increase in general risk for the customers in the 1st tier of the supply chain as the 2nd tier consolidates and gains know-how, moving “up” in the framework.. Under the assumption of increasing modularization⁵⁵ throughout the industry, this move will predominantly go through “leverage items” to the “strategic items”. For these upper left and upper right quadrants, van Weele⁵⁶ finds a strategy based on close partnership to be most appropriate and effective. However, as was hinted in the foregoing, this might interfere with legislation on vertical relations. In the following chapter 5, the relevant legislation will be discussed.

⁵³ The opposite of outsourcing

⁵⁴ van Weele 2002; p.148. He finds that the automotive supply chain in general is a buyer’s market.

⁵⁵ Noori and Lee; p.309

⁵⁶ van Weele 2002; p.149

5. Legal aspects of vertical relationships

Aim of this chapter is to give a comprehensive overview to the relevant legislation, without the intention of covering the whole subject area in depth. It starts with giving an explanation on why companies choose to limit partner companies' behaviour and on the legal status of Intellectual Property Rights. These paragraphs will be followed by an assessment of the legislation that is identified to be applicable to the subject area, including the relevant exceptions and case law. The chapter will be concluded by an overview of the presented legislation.

When zooming in on the regulatory environment, the impact of individual pieces of legislation on competitiveness is far from straightforward. They can have a positive impact if they lead to strengthened competition and thus lower costs, or to innovations that the market wants, or negative if they misdirect innovation to unprofitable areas. Besides that, as the European Commission says itself⁵⁷, new regulations are, in the short run, associated with additional costs. It is therefore relevant to critically assess the legislative of the EU actions and their impact. The EU does not lack self-criticism, and puts effort in making legislation compliant with economical needs and developments. This is confirmed by commentators from business; “The European Commission nowadays more and more recognizes the necessity of close ties within supply chains, therewith stepping away from the view that any agreements are harmful to competition”⁵⁸.

In order to be able to put the European legislation in a broader context, it is first necessary to understand why the European Commission is interested in companies' behaviour in the legal field subject of investigation.

European economic legislation in general aims to improve the competitiveness within the European market place and to improve the competitiveness of the European industry in the global economy. When, for some reason, the incentive to conduct business efficiently and to innovate is taken away, this will go contrary to these aims. However, the answer to

⁵⁷ European Commission; European Competitiveness Report 2004, p.209

⁵⁸ Business Europe 1998; mentioned as a comment on the draft version of the now regulation now known as regulation 2790/99 on Vertical Agreements and Concerted Practices, see section 5.3.3.

the question whether certain behaviour or actions will be contra-competitive or not is far from straightforward.

Limitations imposed by a certain party on other parties' behaviour are termed as "restraints" in legislative circles. Restraints on vertical behaviour are termed "vertical restraints". In the subsequent paragraph, the concerns of both businesses and the legislator in the area of vertical restraints are investigated.

5.1 Rationale for the use and the rejection of vertical restraints

What are vertical restraints, why does a manufacturer use them and why is the legislator interested in them? This question will be addressed in this paragraph.

When assessing vertical relationships from the perspective of competition law, a distinction is made between (vertical) "...agreements between undertakings, decisions by associations of undertakings and concerted practices..."⁵⁹ on one hand, and unilateral vertical behaviour on the other. The first group is assessed under article 81 (EC); potentially illegal dominant *unilateral* behaviour, be it either by the firm in question itself or the partner upstream or downstream, is assessed under article 82 (EC). The term "vertical restraint" is commonly used when investigating "vertical" cases under 81 (EC), however its rationale has a broader application area than that. Explanation of the concept at this stage of the report adds to the general understanding of the reader of the companies' motives.

In order to benefit from economies of scale or to spread risk, a company ("contractor") may wish to have products made by a supplier instead of producing them itself. This possibly involves the transfer of patented or secret technology (Intellectual Property Rights) to the supplier. The contractor may request the supplier to use this technology exclusively for him, thus preventing competitors to freeride on his investment. Moreover, the subcontractor as well as the contractor may wish to protect specific investment in additional R&D, machinery or human capital through an exclusivity agreement. For

⁵⁹ Article 81(1) of the EC Treaty; OJ 325 of 24th of December 2002.

instance, as Moellgaard e.a. argue, the subcontractor might want to have a guaranteed number of orders in order to cover for investment costs⁶⁰.

A company can be both recipient and supplier of technology at the same time. In other words, vertical restraints can exist throughout the entire supply chain⁶¹.

The legislator, on his part, observes these agreements with vigilance, because it believes that agreements cause inertia in the supply chains. Market lock up will raise thresholds for potential competitors to a level possibly too high to make it interesting to enter the market. Lack of external pressure causes incentives for innovation to be taken away from the industry, lowering resultant competitiveness of for instance product quality and price.

The legislator has to strike a fine balance between on the one hand ensuring a healthy environment in terms of innovation and product development, and on the other hand retaining competitiveness within the industry. The legislation on vertical restraints that is subject of investigation in this paper can be said to be the resultant of this deliberation.

Grossman and Hart⁶² investigate what happens if the legislator makes these laws too strict, thus giving companies not much leeway to enter into agreements with their partners. They conclude that if it is too costly or, in general terms, impossible for a party to obtain the rights it desires through a contract, which would be the case if the legislator would not be sufficiently lenient when it comes to vertical restraints, this party may decide to purchase the company, as not to be hampered by legislation. The authors show that this might not always be the most efficient solution. Benefits derived from focussed management incentives that are inherent to a small company and economies of scale through potentially larger market are (partially) lost⁶³. The authors thus argue in favour of lenient legislation on vertical agreements.

⁶⁰ Moellgaard e.a. 2004

⁶¹ And they do, as Moellgaard e.a. (2002) find for the Eastern European car industry.

⁶² Grossman and Hart 1986

⁶³ With regard to the last argument; if a company merges with, for instance, one of its customers, his other customers, who are *competitors* of the acquiring company, will be inclined to go look for another supplier.

5.2 Intellectual Property Rights; the doctrine of exhaustion

In the previous paragraph, the relevance of Intellectual Property Rights (IPR) has been debated in the context of vertical restraints. Subsequent to that, it is now necessary to take a look at the legal status of IPR in the European context. It is worth noting at this point that the relevance of the exhaustion of IPR is low in the context of this paper, because of the high speed of technological developments in the automotive industry. Because of that, the theory presented in this paragraph will not be used in the rest of this paper. However, for reason of completeness the subject is covered here.

Although efforts are made to harmonize legislation, IPR remains a predominantly national matter for now. However, the differing national legislations in this subject field have had their effect on European issues. It is therefore that IPR has been dealt with in the European context. The body of legislation and case law that deals with IPR on European level is referred to as the “Doctrine of Exhaustion” of IPR. Although the doctrine as a whole is somewhat inconsistent, the main approach this doctrine describes towards IPR in the European context is that whenever the holder of an IPR has exercised (licensed) this IPR in a certain member state, the national regulations for IPR will apply on that product *in that member state*.⁶⁴

5.3 Article 81 (EC) on the prohibition of collusion that affects trade

After the explanation on the subject field in the foregoing paragraphs, the coming paragraphs will focus on the law at issue. Firstly, article 81 (EC). Article 81(1+2) of the EC Treaty restricts and automatically voids any agreements⁶⁵ between undertakings that affect competition⁶⁶. However, article 81(3) provides for exemptions, which are further elaborated upon in secondary legislation and in case law. As a rule of thumb, agreements

⁶⁴ A product may therefore be patented in one member state whilst the patent has expired in the other. However, it is not allowed to rely on an expired IPR in country B when exporting to country A where the copyright still exists. Secondly, *selling* the IPR exhausts the rights throughout the whole common market.

⁶⁵ The body of case law on the question what an agreement is shows that the ECJ adopts a broad view on this matter. For further reading see Korah (1994; p.40ff)

⁶⁶ Simplified. For the complete text of Article 81(EC), see Appendix II.

serving a general interest⁶⁷, agreements between small companies and innovation-driven agreements might be exempt from this regulation. In the following sections, elaboration will be given on the various exemptions.

5.3.1 The Commission explains article 81(EC) in the context of outsourcing: The 1978 subcontracting notice

In a 1978 notice, which is referred to as “The subcontracting notice”, the commission states that when a subcontractor working for a contractor uses the latter’s technology or equipment, which is necessary to enable the subcontractor to do his job, the contractor is allowed to restrict the subcontractor from making available to third parties the technology or work resulting⁶⁸. The notice thus applies to *upstream* licensing. This is allowed under the conditions that the supplied assets are not easily accessible on the market through other channels and that they are necessary for the supplier to make goods or services that differ from those available on the market.

A **notice**, being so-called soft law, cannot be used to derive any rights upon in a court case, but merely expresses the commission’s opinion. Notices are used by the commission to give interpretation of any provision of the treaty or previous legislation. It is not a piece of enforceable legislation itself. It depends on another law and is used only together with the text it interprets, as in the case of the 1978 subcontracting notice, article 81(1) EC. Due to the fact that it is used as a standard interpretation of a provision it can be said to be legally binding. Knowing that it is no surprise that no reference is found in the ECJ case law database to the 1978 subcontracting notice.

Box 5.1, the legal validity of a notice

The 1978 subcontracting notice does not explicitly exclude agreements drawn up by two competitors, therewith giving the European industry a flexible possibility to adapt their businesses to core competencies and to seek for efficiency gains through economies of scale. This can be done by licensing out to competitors that have better means of producing than the owner of the particular IPR.

⁶⁷ More precisely: “...which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit...” (Article 81(3) of the EC Treaty; OJ 325 of 24th of December 2002.)

⁶⁸ Commission notice of 18 December 1978 concerning its assessment of certain subcontracting agreements in relation to Article 85 (1) of the EEC Treaty; OJ C 001 of 3rd of January 1979. *Article 85 (EEC) is the same as article 81(EC). It has been renumbered to article 81 (EC) by the Treaty of Amsterdam of 1997.*

Efficiency gains are recognized by the legal scholars as being the effect of this notice. As Korah⁶⁹ argues, if this provision would not exist, the contracting party would be more inclined to manufacture the part himself, and the result might be less competitive. The wording of the notice is characterized by an understanding and soft approach to the subject matter, as Korah⁷⁰ continues to argue: “the official who drafted it listened very carefully to comments from the industry and it is not too tightly circumscribed to be of use.”⁷¹

Interesting about the notice is that it refers back to 81(1), therewith providing for a general exception under that article. The effect is that the general applicability of the notice is higher than the derogations under 81(3) and the subsequent elaborations upon these derogations⁷², which are, by their very nature, to be interpreted narrowly. The theoretical end result is more leeway for the companies.

5.3.2 Exemptions 81; IPR: Regulation 772/04 on Technology Transfer

In contrast to the Notice on Subcontracting that was subject of discussion in the previous section, the relatively new regulation 772/04⁷³ is an exemption under 81(3)⁷⁴. The regulation is the successor to, and effectively a modernisation of, the previous regulation on Technology Transfer⁷⁵. It aims to support diffusion of technology by giving licensors the possibility to limit usage of technology provided by them only for the production of products that are made for their own benefit⁷⁶. Exempt from prohibition under article 81(EC) are “...technology transfer agreements entered into between two undertakings

⁶⁹ Korah 2004; p.334

⁷⁰ *Ibid*; p.335

⁷¹ The author observes this behaviour by the European Commission as rare (Korah 2004; p.335).

⁷² For instance “Commission Notice - Guidelines on the application of 81(3)”; OJ C101 of 27th of April 2004

⁷³ Commission Regulation (EC) 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements. OJ L123 of 27 April 2004 p 11-17

⁷⁴ In legal literature the Regulation falls under a class of exemptions which is commonly referred to as “Group exemptions”.

⁷⁵ Commission Regulation (EC) 240/96 of 31 January 1996 on the application of Article 81(3) of the Treaty to certain categories of Technology Transfer. OJ L31 of 31 January 1996 p 2-13

⁷⁶ “A license merely permits the licensee to do something that would otherwise be unlawful, so clearly does not infringe Article 81(1) unless it is coupled with other obligations that have the object of restricting competition in some way.” (Korah 2004, p316)

permitting the production of contracted products...⁷⁷, under the conditions of staying under a market share threshold and the agreement not being a so-called hardcore restraint⁷⁸. For a large part, the regulation covers the same topic areas as the Subcontracting Notice does, extending it in several areas. The regulation can for instance also be used for reciprocal licenses⁷⁹ by the original licensee.

The Commission holds the right to withdraw the benefit of this regulation on a case-by-case basis where it finds in any particular case that a technology transfer agreement to which the exemption applies nevertheless has effects which are incompatible with Article 81(3) of the Treaty.

Comments

For the benefit of assessing the impact of the regulation, it is commented upon in this section. Korah⁸⁰ argues: “The simplicity is only apparent”, therewith referring to the simplified measuring methods introduced in this regulation. She observes the demarcations to be though restrictions on paper. The market share percentages are for instance relatively low⁸¹ and the definitions complex. In some cases, the new regulation is said to be tougher than the previous Regulation 240/96⁸².

Both the unpredictable nature of the relevant market and the difficulty to earn back R&D investments given the low market share thresholds worry Korah⁸³. With regards to the latter argument, a serious problem might arise according to Korah when an innovator

⁷⁷ The exemption applies only to pure patent, know-how or copyright software licenses and to mixed licenses, not to traditional copyright or trade mark licenses, unless these are ancillary to the previously mentioned types of licenses.

⁷⁸ These hardcore restraints primarily consist of price-fixing, territorial restraints and on restraints concerning conditions after termination of the contract.

⁷⁹ Licenses issued *by* the licensee *to* the licensor that ‘build’ on the original license.

⁸⁰ Korah 2004; p.331

⁸¹ Where the undertakings party to the agreement are competing undertakings, the combined market share should not exceed 20% ‘on the affected relevant technology and product market’. In the case the parties are non-competing, this market share threshold is raised to 30% per company.

⁸² For instance, there is no longer any provision according to which the exemption provided could also apply to agreements containing obligations restrictive of competition which are not covered by the exemption on condition that the agreements in question are notified to the Commission and that the Commission does not oppose such exemption within a period of four months.

⁸³ Korah 2004; p.324

owns the sole solution for a problem on the market. This problem is referred to as “The innovator problem”, and is elaborated upon in the coming paragraph 5.3.5. Although this problem is not new, the new regulation does give the European Commission and the European Court of Justice comparatively more powers to intervene in this situation. Korah⁸⁴ even argues that “...under this regulation it can become worthwhile to do R&D outside Europe and export the product to Europe.... Where R&D is expensive, markets tend to be concentrated. There may be no one to license to in order to qualify under the ceilings.”

The Commission notice “Guidelines on the application of Article 81 of the EC Treaty to Technology Transfer Agreements”⁸⁵, seems to somewhat take the edge of this regulation, albeit in soft terms, acknowledging that the incentive to remain innovating should not be taken away. Due to the recent apparition of the regulation, and the resulting lack of case law, it is not clear at this point how the European courts will deal with the new regulation in practice. However, as can be concluded from paragraph 5.3.5 on the innovator problem, Korah’s criticism presented in this section might prove to be somewhat exaggerated.

5.3.3 Exemptions 81: Regulation 2790/99 on Vertical Agreements and Concerted Practices

Commission Regulation 2790/99 on Vertical Agreements and Concerted Practices (The Block Exemption Regulation)⁸⁶ complements the Technology Transfer regulation and the Subcontracting Notice, as both discussed in the previous paragraphs. Generally speaking, an agreement will be legal if it stays under the market threshold⁸⁷ and when the hardcore restraints, which are comparable to those of regulation 772/04 on technology transfer, are not violated⁸⁸. Furthermore, agreements are not allowed to last longer than 5 years.

⁸⁴ *Ibid*; p.331

⁸⁵ OJ 2004 C101 p 2

⁸⁶ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices. OJ L336 of 29th of December 1999 p 21-25

⁸⁷ A general delimitation of n upper market share of 30% applies for the supplier.

⁸⁸ Korah 2004; p.288

Main intent for this regulation is application in the field of distribution agreements⁸⁹, hence generally speaking more downstream than the area subject of investigation in this paper. However, article 2(3) of the regulation *is* relevant here. It states that if an exclusive license is demanded downstream⁹⁰, an agreement falls under the regulation to the extent that “...those provisions do not constitute the primary object of such agreements...” Herewith the Commission safeguards licensing possibilities in the direction opposite of that of the 1978 Notice on Subcontracting⁹¹.

Agreements drawn up by two competitors can be exempted under this regulation as well, be it under an extra turnover condition and when the goods involved are not manufactured by *both* parties.

Background

The development of this regulation is characterized by the changing view of the European Commission on vertical agreements, partially infused by developments in business and technology⁹². The Commission therewith follows the lenient approach that the ECJ already adopted towards vertical restraints⁹³, changing its approach from a legal-form of analysis towards more use of economic analysis⁹⁴.

⁸⁹ “a contract governing the marketing of an item of merchandise” (Internet: Google Definitions, 15th of May 2005: <http://www.google.com/search?num=100&hl=en&lr=&newwindow=1&oi=defmore&q=define:distribution+agreement>)

⁹⁰ Hence, when the supplier licenses out IPR to the buyer. This demarcation of 2790/99 is only made in case of licensing IPR, otherwise the Regulation applies both up- and downstream.

⁹¹ Interesting here is that the Commission has stated that the Regulation does not apply to vertical technology licensing agreements, but mainly to various kinds of distribution (Korah 2004; p.279).

⁹² Two examples to illustrate this point: Firstly; developments in the IT creates possibilities in which the supply chain can become and thus becomes more intertwined for reasons of efficiency gain. Besides, shorter development and delivery times create necessity to intensify use of these new communication means. Secondly, an explanation from the field of R&D; as there is more and more capital involved in R&D, the ability to share the risk throughout the supply chain becomes both a necessity and a competitive advantage.

⁹³ Business Europe 1998

⁹⁴ Lorentzen e.a. 2002; p.2

Comments

Business Europe⁹⁵ concludes that this regulation has had a positive impact both in wording and through its explanation by the legal authorities because of the huge simplification it was in comparison the previous set of regulations and the higher easiness to comply.

However, not all comments are positive: in another opinion article, Business Europe⁹⁶ states that the interpretation whether an agreement is a hardcore restraint or not is not very straightforward⁹⁷. In a position paper, Orgalime⁹⁸ addresses the innovator problem once again, by arguing that companies that are highly specialized (as many suppliers have to be these days in order to stay competitive) will easily exceed the 30% market share limit⁹⁹. In another position paper, Orgalime¹⁰⁰ objects to the maximum duration of an agreement of 5 years. It is highly common for technical collaborations to exceed this time span¹⁰¹.

5.3.4 Exemptions 81: Notice on agreements of minor importance (De Minimis)

Complementing to the regulations aforementioned, the Commission has issued a notice called the “De Minimis” notice¹⁰². It exempts agreements concerning small market

⁹⁵ Business Europe 1999

⁹⁶ Business Europe 2001

⁹⁷ “Actions having the indirect effect of influencing the price” also fall under the hardcore restraints. It is a wide definition that is difficult for lawyers to interpret.

⁹⁸ Orgalime 1999 #1, p. 2. Orgalime is “The European Engineering Industries Association”, looking after the interests of European electro technical engineering, metalworking and mechanical engineering companies.

⁹⁹ This statement is supported by the results coming from a consultation amongst its members; companies active in either the mechanical, electrical, electronic and metalworking industry, stating that 82% of the respondents oppose market share thresholds in general.

¹⁰⁰ Orgalime 1999 #2, p. 1

¹⁰¹ In the automotive industry it becomes more common to jointly develop a car and sell it under several brand names with light modifications to the exterior and the accessories. A recent example is the new Toyota Aygo / Citroen C1 & Peugeot 107, the both latter companies belonging to the French PSA group. Both development and production of the cars have been a joint effort by the two conglomerates. Total time span of the period of development and production for this collaboration will easily exceed 5 years.

¹⁰² Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (de minimis) OJ C 68 of 22nd of December 2001 p 13-15

shares¹⁰³ as long as they do not fall under any hardcore restraints. The legal issue was addressed for the first time in 1969, where the ECJ pointed out in *Völk v. Ets Vervaecke Sprl*¹⁰⁴, that where very small market shares are involved there can be no appreciable anti-competitive effect¹⁰⁵. As the 2nd tier suppliers in the automobile industry are often SMEs, this regulation is relevant to mention here. As it concerns a notice, the Commission and the courts have some leeway in its application.

Lorentzen e.a. (2002 p.9) provide for an example on application of the De Minimis regulation where a Hungarian producer of braking hoses, a straightforward and easily copied product is requested by its buyer, a Danish trading company, not to sell this product outside Hungary to 3rd parties. Although this agreement is deemed to be illegal under article 81 and cannot be exempted under either one of the legislation discussed before, the annual turnover of the Hungarian firm of 500.000 US\$ makes it that De Minimis applies in this case.

Box 5.2, example of an agreement falling under 'De Minimis'

5.3.5 The innovator problem

The innovator problem has been addressed several times in the foregoing. This section will discuss the issue in depth. Marcus Glader talks extensively about the problem in his dissertation. He argues that in assessing a potential R&D project, a company will need to be able to expect a higher return on its investment than just marginal costs in order for the decision to invest to be positive. The risk involved with the project, as well as relatively long earn-back times and the need to build a financial buffer for future investments will make it hard, not to say impossible and thus unjust from a regulatory perspective to assess, by the legislators, the legitimacy of pricing methods that go beyond charging cost-price + a 'normal' margin¹⁰⁶. Although Glader takes in an extreme position in his argumentation here, his point is clear; the authorities are simply not in the position to be knowledgeable enough to decide on whether for instance pricing exceeds what can be called reasonable.

Glader¹⁰⁷ continues to argue that authorities need not interfere anyways. Pricing as done by the innovator will have to adapt to a certain degree of market conformity anyways,

¹⁰³ Between 5% and 15%, dependent on the situation.

¹⁰⁴ Case 5/69 of 9 July 1969; *Völk v. Ets Vervaecke Sprl*

¹⁰⁵ Business Europe 1999

¹⁰⁶ Glader 2004, p.24

¹⁰⁷ *Ibid.*

thanks to competing “outdated” products which will be priced comparatively low and thanks to new technological developments which provoke new opportunities to attack monopolistic positions. Thus, Glader takes the somewhat theoretical point of view that products or technologies at different stages in their life cycle are competing with each other for the same market. He reasons that innovation will remain necessary in order to be competitive in tomorrow’s market. This view is largely confirmed yet somewhat weakened by Reimann¹⁰⁸. In his paper, Reimann disputes the applicability of the method of measuring market power by means of the market share, seeing competition in high tech markets as being competition *for* instead of competition *on* markets. Summarizing, both authors disagree with the current methods of applying market share thresholds as are found in the legislation that is under discussion in this paper.

Glader¹⁰⁹ also observes the problem in practice. He finds that the European Commission and the ECJ show in their actions that they agree with the above reasoning. In the context of regulation 772/04 on technology transfer, Glader concludes that the EU legislation assesses technology transfer in a positive manner, seeing it as an “...essential and dynamic component of an open and competitive market economy...” It does not become clear from this source why the EU doesn’t address this problem the same in hard law as it does in its case law. In paragraph 6.2, “Explanations on the market situation”, it is suggested that the real reason for this is political. Further elaboration on this point can be found there, for now it suffices to observe that the commentators that were cited in the previous paragraphs seemingly exaggerated the problem.

5.3.6 Issues dealt with under article 81

As a conclusion of this paragraph 5.3, a short look will be taken on the application of article 81(EC) in the upper tiers of the automotive industry in practice. Two sources of information are available here; the first one is case law. The conclusion is drawn quickly; no relevant case law exists.

¹⁰⁸ Reimann 2004, p. 2

¹⁰⁹ Glader 2004, p. 91

Second source of information is an article by Lorentzen e.a.¹¹⁰. They find in their survey on subcontracting relationships in the Eastern European automobile industry that approximately half of the vertical relationships that they identified involved technology transfer agreements that would be exempt under either one of the regulations mentioned in the foregoing paragraph. The other agreements would for instance fall under De Minimis or would be deemed illegal under EU legislation.¹¹¹

Another finding by these authors worth mentioning in this respect is that they find no significant correlation between the existence of technology transfer and the use of exclusivity agreements¹¹². In other words, technology transfer does not automatically imply the use of exclusivity agreements. The authors leave the finding untouched in the rest of their article, it would therefore be merely a guess whether we already see early effects here of implementation of the European legislation or the effects of equivalent national laws, either one of these forcing the companies to abstain from making agreements. Another possible explanation would be that exclusivity agreements are simply not always a necessity for doing proper business in this industry segment.

5.4 Article 82 (EC) on the abuse of a dominant position

The other Treaty article covered in this paper, article 82 (EC)¹¹³ prohibits abuse of a dominant position. As opposed to assessment under article 81 (EC), there need not be an agreement of any kind to be caught under this article, it assesses unilateral behaviour¹¹⁴. When falling under this article, there are no exemptions.

In contrast with article 81(EC), article 82(EC) depends more on case law than on secondary law for interpretation. It is for that reason that in this paragraph several cases will be discussed, to illustrate on the reach and the application of the article.

¹¹⁰ Lorentzen e.a. 2002; p.10ff.

¹¹¹ The countries under investigation are those that either got access to the EU as of May 2004 or are still in the course of accession talks. The investigation was carried out some years earlier.

¹¹² *Ibid*; p.7

¹¹³ EC Treaty; OJ 325 of 24th of December 2002

¹¹⁴ However, the existence of an agreement does not preclude from falling under article 82.

5.4.1 Dominance without abuse of this position is legitimate

The company Cigarette Component Ltd held nearly the whole market for cigarette filter rods in the UK, enjoying significant profits. Although the license was freely available for other companies, no competitors emerged in the market for decades. This is attributed to the fact that the company held its price at competitive levels, thus making it not interesting for other companies to enter the market as Korah¹¹⁵ observes. This early interpretation of article 82 (EC)¹¹⁶ has attributed to paving the way for, amongst others, companies holding a technological monopoly, not to automatically be held liable of abusing their dominant position.

5.4.2 Test of Dominant position - United Brands

Market shares higher than 30% are considered to be falling within the concept “dominant”. Companies exceeding these market shares are “...bearing a special responsibility...”¹¹⁷ In the ‘United Brands case’¹¹⁸, the European Court of Justice introduced the “Test of dominant position”;

“Economic strength enjoyed by an undertaking which enables it to prevent effective competition on the relevant market by giving him power to behave independently of its competitors, customers & consumers”.

However, as Korah¹¹⁹ states, “...both the Commission and Community courts have failed to make many clearly and cogently reasoned decisions.” In other words, whether or not a company falls under the notion of being in a “dominant position” is far from straightforward. This increases both uncertainty and legal costs.

¹¹⁵ Korah 2004; p.109

¹¹⁶ The description of the case dates from 1969.

¹¹⁷ Case 219/99 of 17 December 2003; British Airways vs. Commission

¹¹⁸ Case 27/76 of 14 February 1978. United Brands Company and United Brands Continentaal BV v Commission of the European Communities. “*Chiquita Bananas*”

¹¹⁹ Korah 2004; p.93

Unilateral behaviour does not necessarily have to be conducted by one company. In one of the rare cases coming from the automotive supplier industry, the Court of First Instance stated in joined cases T68/89, T77/89 and T78/89¹²⁰, that two or more undertakings may hold a dominant position within the meaning of Article 86 (EEC) (now 82 (EC)) of the Treaty where two or more independent economic entities are, on a specific market, united by such economic links and, by virtue of that fact, together hold a dominant position vis-à-vis the other operators on that market¹²¹.

Box 5.3, unilateral behaviour conducted by more than one economic entity.

5.4.3 Dominant behaviour by groups of firms – Italian Glass

The, generally speaking, scattered character of the 2nd tier in the automotive supply chain does not preclude possible infringement of article 82, as is illustrated in box 5.3. In this case, the Court of First Instance interpreted the aforementioned “Test of dominant position” as that “independent behaviour” was perceived to be superior to the legal constitution (in this case: more than one entity) *by which* it was done.

This ruling complicated the possibility for groups of firms, operating within a particular link in the supply chain, where they were faced with few competitors, to exercise dominant powers, thus resulting in a more evenly balanced spread of the powers throughout the supply chain. In a more speculative mode, it can be argued as well that this ruling would favour horizontal consolidation of firms within their link in the supply chain, because it took away an important reason *not* to merge.

5.4.4 Dominant behaviour over linked sectors – Tetra Pak II

Another reduction of the possibilities for firms to exercise market dominance was realised by Commission decision on the Tetra Pak II case¹²². Here, the Court of First Instance (CFI) condemned abuse of a dominant position over horizontally linked sectors.

¹²⁰ Cases T-68, 77 and 78/89 of 10 March 1992. *Societa Italiana Vetro SpA v. Commission. “Italian Flat Glass”*

¹²¹ This point made by the CFI was only part of the ultimate ruling in this case however. It concerned an appeal case here on a prior decision of the European Commission. After having made this point, the CFI eventually quashes the fines earlier imposed by the Commission on basis of new evidence.

¹²² Commission Decision (92/163/EEC) *Elopak Italia Srl v Tetra Pak*. On appeal; Case T-83/91 of 6 October 1994. *Tetra Pak International SA v Commission of the European Communities. “Tetra Pak II”*.

The case concerned the connection between firstly the market for the supply of cartons for keeping beverages and secondly the market for machinery for filling these cartons. Tetra Pak observed these two markets to be an “integrated packaging-systems market”¹²³, the CFI found otherwise and condemned tying the sales for both products in any way. The possible application of this ruling goes further than merely cases where it would concern parts and machines to produce this part. An example is given in box 5.4.

An example of a company where the “Tetra Pak II” ruling might be applicable as well is the Dutch “Van Doornes Transmissie”, a subsidiary of Bosch GmbH. This company develops and produces both a *tangible* product for automatic transmissions and the accompanying operating intelligence software.

Box 5.4, hypothetical issue as a result of the Tetra Pak II ruling.

5.4.5 Predatory pricing by dominant players – AKZO

In the appeal case AKZO Chemie BV v Commission¹²⁴ the ECJ condemned AKZO for applying predatory pricing in the market for organic peroxides which are used to make plastics. AKZO, enjoying a dominant position in this market, offered considerable discounts to competitors’ customers whilst maintaining normal price levels for its own customers. As with the other cases discussed in this paragraph, this ruling has a positive effect on competitiveness throughout the automotive supply chain. Moreover, the positive effects of this ruling will be enjoyed relatively much by the 2nd tier suppliers, these companies being the typical buyers of primary products like the products AKZO makes, as identified in the foregoing chapter. Effectively, the ruling breaks part of the power of the often big multinational raw material suppliers that they enjoyed vis-à-vis the smaller 2nd tier automotive suppliers.

¹²³ Case T-83/91 of 6 October 1994. Tetra Pak International SA v Commission of the European Communities. “*Tetra Pak II*”. par 79.

¹²⁴ Case 62/86 of 3 July 1991. Akzo Chemie BV v Commission.

5.5 Special case: the Merger regulation

This paragraph is devoted to article 139/04¹²⁵, also known as “The Merger Regulation”. It is not regarded to be part of the legal framework under investigation in this paper, however because of its indirect relevance it will be discussed in this section.

First of all, relevant here is to point out that falling within the Merger regulation criteria excludes the need to comply with the articles 81 and 82 (EC). Main criterions are that the “cooperating” companies give up power and a duration of the cooperation of at least 5 years.

The regulation has been called into force by the Commission as an extra safeguard to ensure competition within the EU, alongside articles 81 and 82 (EC). The commission argued it to be necessary as it considered the powers that it was given under these latter articles not sufficient to prevent mergers that *created* dominant positions in the market place¹²⁶. Applying articles 81(EC) and 82 (EC) here would limit the EU powers too much, according to their point of view¹²⁷.

Within the framework of this analysis, vertical co-operations that prove to be so tight that they fall under the Merger Regulation will be excluded, despite obvious relevance: hindering competition laws trigger creative companies to find different solutions; a closer cooperation, a joint venture or even a merger, solutions that obviously go beyond a simple agreement between the two vertical partners, is one of them. It has been found in case law that licenses granted within one corporate group are no agreements between two undertakings, therefore they do not need to be assessed under article 81 (EC)¹²⁸. Thus, if merging is a relatively easily achieved option then companies would be inclined to chose for this option, therewith leaving the regulations on vertical agreements for what they

¹²⁵ Regulation 139/2004 on the control of concentrations between undertakings of 20 January 2004; OJ L24/1 of 29th of January 2004

¹²⁶ In *Continental can* (Case 6/72 21 February 1973. *Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities*), the ECJ is only able to prevent a merger under article 82 because one of the parties *already has* a dominant position on the market.

¹²⁷ Regulation 139/2004 on the control of concentrations between undertakings of 20 January 2004; OJ L24/1 of 29th of January 2004; preamble no. 7

¹²⁸ Case T-102/92 of 12 January 1995. *Viho v. Commission*

are.¹²⁹ Although the merger regulation is said to be less harsh than the legislation under article 81 and 82 (EC)¹³⁰, the ECJ effectively does have an extra means with this regulation to act against anti-competitive behaviour.

Bayer AG and GE Plastics have completed plans to form a joint venture to produce polycarbonate car windows. The new company, Exatec LLC, will be headquartered in Wixom, Michigan, with European headquarters at Cologne, Germany. The 50-50 joint venture will invest \$40 million in research, and is building a 100,000 square foot technical center. The Wixom facility initially will employ 30 workers. Bayer is based in Leverkusen, Germany, and GE Plastics is headquartered in Pittsfield, Mass.¹³¹

Box 5.5, a joint venture in the car industry

5.6 An overview of the legal framework

Table 5.1 provides for a simplified overview on the application of the legislation on articles 81 (EC) and 82 (EC) as it has been reviewed in the previous paragraphs.

Prohibiting: Exemptions:	Article 81			Article 82
	De Minimis Notice	Subcontracting notice	Regulation 772/2004	
IPR upstream	x	x	x	x
IPR downstream	x		x	x
Other agreements or behaviour	x			(x) x

Table 5.1, overview on the application of the legislation on articles 81 and 82

A possible infringement will be assessed under both articles 81 and 82 (EC). A situation that might be legal under the one article might be illegal under the other. When the issues are questioned to be illegal under article 81 (EC), the both notices mentioned will offer guidance for all parties on the question of its (il)legality, without giving absolute legal certainty¹³². The two regulations *will* give absolute assurance. When applying these

¹²⁹ One can consequently debate whether the subsequent effect of large, vertically integrated companies is beneficial for the economy, or not.

¹³⁰ Korah 2004; p.338

¹³¹ Internet: Automotive News; www.autonews.com. 17th of April, 2005.

¹³² The Subcontracting notice gives a lot more leeway in wording than the both regulations.

regulations, in case an agreement may not qualify for exemption under the one regulation, it may still be exempt under the other, *safe when it is prohibited by this first regulation*. This is the opposite of how articles 81 and 82 (EC) interact.

The differences between both regulations are found in the details. Firstly, the “technology”¹³³ that regulation 772/2004 on technology transfer exempts, is defined broader than the “IPR” that 2790/1999 (on vertical agreements and ...) exempts. Secondly, in case of licensing between competing undertakings, both regulations apply different standards, with regulation 772/2004 focussing on the combined market share whereas 2790/1999 mainly uses turnover criteria.

¹³³ “Technology” under regulation 772/2004 on technology transfer covers, *inter alia*, patents, know-how, copyright and designs. Commission Regulation (EC) 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements. OJ L123 of 27 April 2004; article 1(b).

6. Effects on the competitiveness of the industry

In this chapter, the legal framework and the findings on the 2nd tier of the automotive supply chain will be combined with Porter's 5 forces, as introduced in chapter 3. Aim is to give insight to the competitiveness of the industry. The first part of the chapter is set up along these forces. The item on "substitution" will not be addressed, see paragraph 3.1. Subsequently, a conclusion on basis of "Porter" will be drawn and its implication assessed.

6.1 Application of Porter's 5 forces

Following the deductive approach as described in paragraph 2.1, "Methodological approach", the findings on the industry from chapter 4 and the legal framework from chapter 5 will come together in Porter's framework in the following sections.

6.1.1 The threat of new entrants

Generally speaking, the legislation under both articles 81 and 82 (EC) favours new entrants. Market share thresholds and disapproval of dominant behaviour give newcomers more leeway to draw up vertical agreements when necessary, therewith placing them at a comparative advantage as opposed to the big incumbent 2nd tier firms in the case of 1st tier companies seeking to do business with 2nd tier players. The risk involved with infringing legislation in case the newcomer quickly grabs large market shares thanks to an innovative product or technology seems to be low, as was concluded in section 5.3.5 on the "innovator problem". However, the raise in interdependency throughout the supply chain that was observed before does complicate market entry for newcomers. Initial investments in knowledge and machinery may pose an insurmountable barrier, as was the matter in the case of the cigarette filter rods discussed in section 5.4.1.

6.1.2 The power of suppliers

Past rulings under article 82(EC) have broken down parts of the potential power of big suppliers in the 3rd tier, as was noted earlier and described by the AKZO case in section 5.4.5. However, it can be argued that the cases that come before the ECJ will be the extreme cases, the figuratively speaking "tip of the iceberg". The relative turnover

difference between both industries logically results in downstream independence for the 3rd tier player; the power is in their hands. Consolidation in the 2nd tier will possibly bring some minor changes to the power misbalance. Yet, it will take a big part of the automotive industry to act in unison against these 3rd tier suppliers to get to an even power balance.¹³⁴

6.1.3 The power of buyers

In chapter 4 it was noted that the automotive supply chain in general is a buyers' market. This goes despite the fact that *excessive* dominant behaviour is broken down by European law under article 82 (EC). Here we can expect the consolidation to significantly reduce the relative difference in size and thus the misbalance in power, the ongoing specialization of the 2nd tier however will increase dependency on the buyer. Box 1.2 gives an interesting description here on how a company can avoid a too large dependency in the field of its tangible assets.

Referring back to the conclusion drawn at the end of paragraph 4.3 that the future of the automotive supply chain might see more and closer partnerships emerging; on basis of the findings about the legal framework it can be concluded that these partnerships will not be hindered by European legislation. The main issue in this respect, the “innovator problem”, is addressed by the ECJ in a – for the companies – positive manner. Secondly, the possibility under regulation 772/04 on technology transfer to draw up reciprocal licenses gives the 2nd tier supplier the possibility to harvest from investments in knowledge. The European Commission therewith paves the way for the 2nd tier player to work towards an equal kind of partnership.

¹³⁴ The global steel industry for instance is estimated to have an annual turnover of somewhere between US\$ 200bn and US\$ 300bn (Internet; Steel Business Briefing; 17th of May 2005; <http://www.steelbb.com/?pid=37&spid=22>); the *total* car industry is estimated a yearly turnover of US\$ 1600bn (Internet; Organisation Internationale des Constructeurs d'Automobiles; 17th of May 2005; http://www.oica.net/htdocs/press/releases/Press%20Release_2%20Nov04.pdf)

6.1.4 Competitive rivalry

The subject of competitiveness within the industry segment has been touched upon throughout the course of this paper. The European Commission sees it as one of its primary aims to ensure competitiveness¹³⁵.

An aspect that positively influences competitiveness, the possibility for competitors to mutually license on an exclusive basis, is permitted. The delimitations as set out in regulation 772/04 on technology transfer basically follow the logic by Levmore¹³⁶ by allowing essentially anything except for unilaterally imposed prices, quantities or markets. It also ensures the possibility to pool R&D, therewith giving the industry the possibility to reap the benefits of economies of scale without the legislator having to give up his objective of avoiding consolidation.

6.1.5 Conclusion on Porter's 5 forces

Although buyer and supplier power are relatively high, which can to a large extent be attributed to market powers that go beyond the reach of the powers of the European Union, the European legislation does succeed in creating a competitive playing field through well-balanced interference, as can be concluded from the foregoing sections. This is substantiated by a resulting lack of issues in this field that I have found when addressing relevant literature and interviewing people working in the industry¹³⁷ and working for interest groups¹³⁸.

6.2 Explanations on the market situation

Despite the positive sounds in the previous paragraph, it is still found that the legal framework investigated hinders companies in their behaviour, for the sake of competitiveness in the market place. Although this affects profitability from the

¹³⁵ Article 2 of the EC Treaty; OJ 325 of 24th of December 2002.

¹³⁶ Levmore 1998; p.243. Discussed in paragraph 1.3, "The dilemma of competition legislation"

¹³⁷ Interviews with Mr. Sven Åke Berglie, Haldex AB, also Managing Director Scandinavian Automotive Suppliers, Januari 2005; Ms. C. Aspinall, Assistant to the Sales & Marketing Director of Trelleborg Automotive, Germany, 29th of April 2005.

¹³⁸ Interviews with Mr. Roland Gillebeert, Senior Manager Technical Department of CLEPA, 19th of April 2005; Anonymous, working at DG Competition of the European Union, April 2005; Mr. Ziljko Pazin, Adviser at Orgalime ("The European Engineering Industries Association"), April 2005.

companies' point of view, it is not clear whether these hindrances negatively affect the industry as a whole, as Levmore¹³⁹ indirectly argues.

The investigation in the foregoing chapters inevitably leads back to the questions posed in paragraph 1.3 whether issues exist and, if so, why these issues are not uncovered. Is the industry just running smoothly or are the issues overshadowed by bigger problems?

In a speculative mode, reasons for this lack of issues are firstly found in the earlier discussed dependency of the suppliers on the buyers. 2nd tier suppliers that compete on price, quality and supplying performance rather than on a rare technological specialisation are dependent on a relative small base of buyers within the automotive industry. Given such market situation, having a clean and reliable reputation is highly important for the supplier, and companies will not harm this reputation by questioning in front of the legal authorities the behaviour of their customers. This reason amongst others can make mutual agreements, although (partially) illegal according to the European law, to be effectively beneficial for both parties which will make them therefore be kept a secret. In this given market situation, 3rd parties, more specifically competitors of the supplier, will hesitate as well to take an issue to the legal authorities as it can seriously damage their position in the industry. The oligopolistic market situation, as they are found in many of the upper tier markets within the automobile suppliers industry, aggravates this situation. Because everybody knows each other, an agreement to keep something silent is easily made.

Moreover, the smaller the companies are, the lower the general legal awareness and financial leeway for legal dealings. Given the fact that many SMEs are found in the 2nd tier of the automobile industry, that is also a likely reason why not all potential cases come before court.

Looking at the issue from the political angle, it is found that the legislator not only serves economic goals, it also takes into consideration legal issues, as discussed before, and

¹³⁹ Levmore 1998; p.243. See section 1.3.3.

political considerations. A notable example here is the debate between industry stakeholders and DG Competition¹⁴⁰ that was held on the (rigid) market share thresholds in the regulations that were discussed earlier in the context of article 81 (EC). Although the DG Competition unofficially agreed that there were better alternatives, the solution as it currently stands was still pushed through, being imposed from higher up in the organisation. A possible explanation, highly speculative though, would be the pursuit of the European Commission for global alikeness in competition law.

¹⁴⁰ “Directorat General” Competition; the EU competition department.

7. Conclusion

This concluding chapter analyses and brings together the main points of this investigation. Recommendations for future research will be done at the end of the chapter.

At the end of paragraph 5.3.6 that looked at the application of article 81 (EC) in practice, it was indirectly suggested that exclusivity agreements might not be necessary to run proper business. Both the rationale for these agreements as presented in paragraph 5.1 and the oppositions from industry interest groups and industry watchers against the current regulations¹⁴¹ however contradict this theorem.

Assuming the rationale of the European Commission to safeguard competitiveness in the market place to be valid as well, the necessity of the existence of a legal framework is acknowledged. Therewith we arrive once again at the central question as stated in the Problematization paragraph, 1.3: How does EU competition legislation concerning vertical relations in industrial relations attribute to or – on the contrary – hinder business? Based on the generic characteristics of the 2nd tier players as they were formulated in chapter 1, the typical company being relatively small, it can be concluded that European legislation to a large extent helps the companies by breaking down the powers of the bigger companies they do business with¹⁴² and by giving companies sufficient leeway to act themselves. However, as Korah¹⁴³ identifies, the legislation under article 81 (EC) will still hinder the “generic” 2nd tier company in the margin it has when seeking to license technology. The relatively high complexity and changing market shares lead to uncertainty and continuous high legal costs¹⁴⁴. Legal costs also have to be made by the firms in order to assess whether the company is or is not in a dominant position under article 82 (EC), see section 5.4.2. This financial burden is more easily borne by large companies. Bigger firms also have the advantage of being able to more easily find ways to exploit an invention in-house.

¹⁴¹ Amongst others: Korah 2004, p.331; Business Europe 2001; Orgalime 1999 #1, p. 2

¹⁴² “The legislation under article 82 (EC) obviously favours SMEs at the expense of the more efficient larger firms” (Korah 2004; p.174).

¹⁴³ Korah 2004; p.333

¹⁴⁴ Business Europe 1998

Putting the issue in a broader, not purely legal perspective, with reference to the speculative paragraph 6.2, “Explanations on the market situation”, the oligopolic market situations found in many of these markets thus still leaves these 2nd tier companies in a dependent position, through powers that go beyond those of the European Community.

With regards to companies in the 2nd tier that are relatively strong through their technology base, the “innovator problem” can be concluded not to be an issue in practice, despite theoretical legal indications in that direction. An issue might however still arise when this company shows such abusive dominant behaviour, misusing its strong technology position, that it would qualify for condemnation under article 82 (EC).

Herewith the only major possible weak point that I identify in the legislation is touched upon. It is the emphasis the European Commission puts on competitiveness in the market place at the cost of companies being able to conquer and subsequently exploit a big market share. It can be said that the legislator therewith takes away a significant incentive to innovate and that companies will not be able in this way to achieve the economies of scale needed to compete in the global market place. In this paper, it is however assumed that the Commission’s reasoning in this matter is correct. The theoretical problem that underlies this issue goes beyond the scope of investigation of this paper.

The foregoing leads to the conclusion that the European legislative framework that has been subject of investigation in this paper copes with the issues in a predominantly efficient and economically oriented manner. The economic forces that were suggested to be at work in paragraph 6.2, “Explanations on the market situation”, largely go beyond what the legislator can influence. The European Commission and the European courts have succeeded in listening closely to the needs of the business and adapting the legislation accordingly. European legislation in this field can be said to be driven by business, instead of the opposite. Although criticism on the legislation does exist, it should be interpreted more as a balancing counterforce than as uncovering a sincere

problem. This is underlined by the lack of issues in this field, as I found to be case in the course of my research.

7.1 Future research

In connection with the last but one passage in the previous section, my first suggestion for further research would be to investigate the issue of market share caps under article 81 (EC) and, closely connected, the question under what circumstances a dominant firm should not be condemned under article 82 (EC), despite showing abusive dominant behaviour. This would add to the understanding of the legal framework and to the reasoning to the matter that has been left unanswered in the that passage.

Second suggestion would be a thorough assessment on the legal framework as a whole as it is discussed in this paper, more specifically how the effects of legislative framework is in practice. The legal framework presented would significantly gain depth therewith.

Next, taking a global perspective, another interesting aspect omitted in this paper would be the comparison of the effectiveness of the EU legal system with legal systems in other relevant regions of the world. A useful angle here would be for instance a historical analysis of the rise of the successful Japanese automotive industry from a legal perspective, their automotive industry since decades being characterized by close relationships.

Final suggestion is to do further investigation on the future role of the 2nd tier suppliers, as already mentioned in the theory section, chapter 3. Kraljic' matrix that has been used in chapter 4 can be applied to form a picture on industry level on how the trends in the industry change the playing field. On the basis of that, an assessment can be done about future legal issues. The article by Gelderman and van Weele¹⁴⁵ can serve as a starting point here. Besides identifying and describing strategic directions, they give an extensive overview of criticism and therewith on elaborations of Kraljic' model. These references can be used when seeking to apply this "next level" perspective.

¹⁴⁵ Gelderman and van Weele 2003

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Haldex AB

Januari 2005: Mr. Sven Åke Berglie, also Managing Director
Scandinavian Automotive Suppliers

Trelleborg AB

29th of April 2005: Mr. Werius, Corporate communications, Sweden
29th of April 2005: Ms. C. Aspinall, Assistant to the Sales & Marketing
Director of Trelleborg Automotive, Germany

Organisations

CLEPA -

14th, 19th of April 2005: **European Association of Automotive Suppliers**
Mr. R. Gillebeert, Senior Manager Technical Department

DG Competition European Union

April 2005: *Anonymous*

Orgalime -

15th of April 2005: **The European Engineering Industries Association**
April 2005: Ms. Stephanie Uny, Adviser
Mr. Ziljko Pazin, Adviser

Definitions & abbreviations

Legal

CFI	=	Court of First Instance, the 2 nd highest court in the EU legal hierarchy. Appeal to a ruling, at the ECJ, is possible under certain conditions.
ECJ	=	European Court of Justice, the highest court in the European legal hierarchy. Decisions are final and non-appealable.
Court of First Instance	=	The 2 nd highest court in the European legal hierarchy. Appeal to a ruling, at the ECJ, is possible under certain conditions.
European Court of Justice	=	The highest court in the European legal hierarchy. Decisions are final.
Primary legislation	=	The Treaty establishing the European Community
Secondary legislation	=	Regulations, directives, notices, decisions, guidelines

Miscellaneous

OEM	=	Original Equipment Manufacturer; a company that manufactures or assembles the final product (EC 2004).
1 st tier supplier	=	AKA tier 1 supplier; a component manufacturer delivering directly to final vehicle assemblers (EC 2004).
2 nd tier supplier	=	AKA tier 2 supplier; companies producing parts in the sub-assembly phase (EC 2004).
3 rd tier supplier	=	AKA tier 3 supplier; a supplier of engineered materials and special services (EC 2004).
Contractor	=	the buyer
Subcontractor	=	the supplier
IPR	=	Intellectual Property Rights

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Appendix I, Longlist of legal questions

In the following the long list with legal questions is presented. This version has been adapted to CLEPA, my major source for information. Because of the size of the questionnaire, a prioritization is given to the questions.

Question no.	Subject area	Question	Priority (1-3); 1 = highest
1		Can I conclude from the fact that CLEPA is not so much involved with legal issues in outsourcing relationships that things are running smoothly in that subject area?	1
2	General	Do you know of any law firms that are specialized in my legal issues in outsourcing relationships?	1
3	General	General question; is it your believe that the demands of the business environment form the European legal framework or do companies in Europe have to adapt to EU rules? How does CLEPA experience the flexibility of the EU?	1
4	General	Would it be possible to send me documentation like opinion letters or reports that your organisation has made on the subject, also to get an idea what your organisation is occupied with in this field?	1
5	General	Did CLEPA or any other organisation that you know of ever compare the legal circumstances in my subject area with those of the main rivalling car-building regions in the world, the USA, Japan, perhaps South Korea and China?	1
6	Interregional	Regarding the recently introduced group exemption for technology transfer 772/04; is it your experience that the ceilings of market share as defined in article 3 of this regulation are too low? Is this regulation regarded as too strict, hindering R&D, as some authors observe?	1
7	Regulation 772/04 on article 81	Do you experience the interpretation of this regulation to be strict, in practice? Is it a nuisance in practice that two competing undertakings having an agreement can not benefit from this regulation?	1
	Regulation 2790 /99 on article 81		1

8		Is it your experience in general that investments in R&D are chilled due to uncertainty in EU regulations, like for instance the definition of the relevant market?	2
9	General	What is and has been the influence of the 1979 Notice on subcontracting which amends article 81(1) of the EU Treaty? Do you regard it as still being up to date? Which amendments do you suggest? Why would you say it has been formulated as an amendment to 81(1) instead of as an explanation of the derogations to 81(1) as formulated in 81(3)?	2
10	78 Notice on Subcontracting	What is the relevance of this article for suppliers to the automotive industry? Is it often referred to?	2
11	Article 82	How do you assess the difference between the 78 notice on subcontracting for upstream technology transfer and the possibilities under 2790/99 for downstream technology transfer?	2
12	General	What is, generally speaking, the relevance of the European laws in this area? More specifically, is the focus on European or on national law? Does this differ from country to country? Are there perhaps examples that can be given?	3
13	General	Is it possible to change 'the looks' of agreements to have them fall under a different regulation or notice (Notice on Subcontracting, 772/04, 2790/99)? Do you have examples?	3
14	General 78 Notice on Subcontracting	Is it noticeable in practice that this is a notice, having officially less legal status than hard law?	3
15	2790 /99 on article 81	With regards to Block exemption regulation 2790/99, how is the annual turnover maximum of 50 million and 100 million for the supplier resp. buyer experienced? And the upper limit of 30% market share? Are these a nuisance in practice?	3
16	De Minimis	How is this regulation regarded? Are there any improvements that you might think of?	3

Appendix II, Articles 81 EC and 82 EC

Art. 81 (EC)

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them in a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 81 (EC) on collusions that restrict competition¹⁴⁶

Art. 82 (EC)

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Article 82 (EC) on the abuse of a dominant position¹⁴⁷

¹⁴⁶ EC Treaty; OJ 325 of 24th of December 2002

¹⁴⁷ *Ibid.*