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Completed acquisition by Inchcape plc of European Motor Holdings plc

The OFT's decision on reference under section 22(1) given on 26 March 2007. Full text of decision published 16 April 2007.

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**Please note that square brackets indicate figures or text which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.**

## **PARTIES**

1. **Inchcape plc (Inchcape)** is an international automotive services group, primarily active in the import, distribution and retail of new and used motor vehicles and the provision of financial services. In the UK, Inchcape is also active in the provision of fleet solutions, services and maintenance. It operates 117 franchises for a range of motor vehicle marques in the UK, including Toyota/Lexus, BMW, Mercedes-Benz, Volkswagen (VW), Jaguar and Land Rover.
2. **European Motor Holdings plc (EMH)** operates 52 motor vehicle retail franchises in the UK, representing a wide range of motor vehicle marques including Audi, BMW, VW, Bentley, Jaguar, Land Rover and Volvo. Dealerships offer sales of new and used cars, light commercial vehicles, parts, servicing and repairs.

## **TRANSACTION**

3. Inchcape acquired the entire issued share capital of EMH. The transaction completed on 29 January 2007. The 40 day administrative deadline expires on 26 March 2007. The 45 day statutory deadline expires on 30 March 2007.

## JURISDICTION

4. The aggregate Community-wide turnover of each of the parties exceeds €250 million and the parties combined aggregate worldwide turnover exceeds €5,000 million. While EMH achieves its entire turnover in the UK, Inchcape achieves 66.55 per cent of its Community-wide turnover (excluding Bulgaria and Romania<sup>1</sup>) in one Member State (the UK). Therefore, the undertakings concerned do not each achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State, as envisaged by Art. 1(2) of the EC Merger Regulation<sup>2</sup> (ECMR). The concentration therefore meets the requirements of a Community dimension pursuant to Art. 1 (2) ECMR.
5. On 21 December 2006, the parties notified this transaction requesting its referral to the UK pursuant to Art. 4(4) ECMR. On 26 January 2007 the Commission agreed to the Art. 4(4) request from which date the OFT assumed jurisdiction.
6. As a result of the transaction, the parties have ceased to be distinct. The UK turnover of EMH was approximately £755 million<sup>3</sup> for the financial year ending 30 February 2006. The turnover test pursuant to Section 23(1)(b) of the Enterprise Act 2002 ('the Act') is therefore satisfied. The OFT believes therefore that a relevant merger situation under Section 23(1) of the Act has been created.

## FRAME OF REFERENCE

7. The parties overlap in the i) retail distribution of passenger cars ii) retail distribution of light commercial vehicles (lcvs) and in the iii) supply of after-sales servicing and repairs for both passenger cars and lcvs.
8. In its analysis in *Pendragon/Reg Vardy*<sup>4</sup>, the OFT acknowledged that lcvs are to be considered separately from cars, since most customers would not consider the two as substitutes. It had, however, not been necessary to

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<sup>1</sup> Note that the concentration was notified on 21 December 2006, i.e. prior to the accession of Bulgaria and Romania on 1 January 2007.

<sup>2</sup> 139/2004/EC, OJ L24, 29.1.2004.

<sup>3</sup> Based on EMH figure of €1106.5m and 2005 ECB exchange rate (provided by the parties) of €1 = £0.68226

<sup>4</sup> *Completed Acquisition by Pendragon plc of Reg Vardy plc*, 4 August 2006.

conclude on this as the merger did not raise any competition concerns on the narrowest possible delineation, which also applies in this case.

## **The retail sale of new and used cars and lcvs**

### **Product scope**

9. Previously, the OFT found that customers did not consider costs of servicing as a significant factor when deciding which car to buy.<sup>5</sup> We have not received any evidence in this case to deviate from this analysis and the retail sale of new and used cars and lcvs will therefore be considered independently from servicing. The parties' combined share of supply of lcvs in the UK is less than 1 per cent and will therefore not be considered any further.
10. In its analysis in *Pendragon/Reg Vardy*<sup>6</sup>, the OFT concluded that used cars formed a distinct market from that for new cars and that the supply of used cars was more competitive than the supply of new cars. In talking to third parties in the present case, the OFT has found no evidence to suggest that it is necessary to deviate from that conclusion. We have therefore not considered the sale of used cars further.

### **Geographic scope**

11. The Competition Commission's (CC) 2000 report on the supply of new motor cars in the UK<sup>7</sup>, found the geographic scope for the supply of nearly new cars to be national. Whilst it appears that, since 2000, the extent of multiple-brand selling by car dealerships has generally increased, which may limit the chain of substitution across the UK and suggest a narrower geographic scope, there continues to be evidence to suggest that people are prepared to travel much further to buy a new car than they would to get their car serviced. It is, therefore, considered that the respective geographic scope for the retail sale of new cars is wider than that for the servicing and repair of cars (new or used). It is also considered, that the retail sale of any relevant individual car marque (such as, for example, VW) is constrained by other car marques. As a result no concerns arise on a national, regional or other reasonable local geographic scope. In addition,

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<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

<sup>7</sup> New Cars. A report on the supply of new motor cars within the UK, CC (2000).

no third party concerns were raised about new car sales. In the absence of any competition concerns, it has therefore not been necessary for the OFT to conclude on the geographic scope for the sale of new cars.

## **Supply of servicing and repair of nearly new and used cars and lcvs**

### **Product scope**

12. Previous OFT decisional practice<sup>8</sup> suggests that servicing cars which are less than three years old and still under warranty ('nearly new cars') should be in a separate product frame of reference to the servicing of cars that are more than three years old ('used cars').
13. The OFT's 2003 market study on new car warranties<sup>9</sup> identified restrictions in some warranties and found that authorised dealers accounted for about 90 per cent of servicing for nearly new cars. Under the Motor Vehicles Block Exemption<sup>10</sup> independent garages are able to service new motor vehicles which are covered by a new car warranty, providing consumers with greater choice. Despite a 2004 campaign by the OFT to inform customers that it was no longer necessary to have a nearly new car serviced at an authorised<sup>11</sup> dealership for the warranty to remain valid, many customer still prefer having their car serviced at an authorised car dealership.
14. From the demand side, responses from several third parties suggest that customer perception has largely remained unchanged. Some independent garages contacted by the OFT have also confirmed that they did not consider themselves as the parties' competitors with regard to servicing nearly new cars. Data from the 2006 Which? Car Survey suggests that 85 per cent of those owning a nearly new car use an authorised dealership for servicing. All competitors contacted thought that independent garages were not a good substitute for vehicles under three years old. While we received some evidence to suggest that independent garages may constrain authorised dealerships, this was not specific to the problematic overlap

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<sup>8</sup> *Pendragon/Reg Vardy*

<sup>9</sup> OFT, *New Car Warranties; Report of the market study*, December 2003.

<sup>10</sup> Commission Regulation (EC) No 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector.

<sup>11</sup> For the purpose of this assessment, we will be referring to authorised dealerships as including franchised dealerships.

areas dealt with below and the weight of third party comments still suggests that servicing of nearly new cars should be considered separately from used cars.

15. On the supply side, while it is easy for authorised dealerships to switch between providing servicing for nearly new cars and used cars, independents may not be able to switch to servicing nearly new cars due to the cost of purchasing specialised equipment and because they may not have a strong reputation in servicing nearly new cars.
16. In light of the above, the OFT considered the servicing of nearly new cars by authorised dealerships as a separate product scope for the purpose of this assessment. However, any competitive constraint that may be provided by independent garages in a particular area will also be considered.
17. With regard to the supply of servicing for used cars, it is considered that independent dealerships provide a sufficient constraint and these are therefore included in the relevant product scope. In *Pendragon/Reg Vardy* the OFT found that owners of used cars considered independent garages to constitute a substitute for authorised dealerships, with customers increasingly using independent garages as cars get older. We have not received any evidence to warrant deviation from this approach.

### **Geographic scope**

18. The parties submit and third parties agree that customers are generally unwilling to travel long distances to get their cars serviced. Third party estimates ranged from 20-30 minutes travel time and a likely radius from five to 20 miles.
19. In line with the OFT's approach in *Pendragon/Reg Vardy* the OFT was supplied with post code data for overlap dealerships. The local market of a given dealership was represented using a circle with a radius of the distance from which at least 80 per cent of its customers travelled rounded up to the nearest five miles. We have not received any evidence in this case to suggest a different approach. Due to the small number of overlaps, the OFT was able to consider each local market on an individual basis.

## **HORIZONTAL ISSUES**

### **The retail sale of new cars**

20. The most significant overlap between the parties is in the sale of luxury saloon vehicles, where the parties have a combined share of supply of [0-10] per cent, (increment [0-5] per cent). Across all new vehicles their combined share of supply is [0-5] per cent (increment [0-5] per cent).
21. One competitor raised concerns that the parties would have a combined share of supply of 12 to 13 per cent for the retail distribution of new VWs, which they may be able to leverage to negotiate better deals with VW. Another third party suggested that the parties' share of the total national VW network would give Inchcape increased market power, particularly on the basis that the next largest dealership chain's share is, at just below 3 per cent, considerably lower. However, the OFT believes that the parties' share of supply is still relatively low, there remain plenty of other suppliers post-merger and that sales of new VWs are constrained by other makes of car. Therefore, it is not considered that the merger will result in the realistic prospect of a substantial lessening of competition in the supply of new cars in the UK.
22. On a local basis the most significant overlaps are in the Northern Welsh Marches and Gloucestershire and Wiltshire (as discussed in more detail below). As the geographic scope is likely to be wider than for servicing and as VW is in competition with other marques for new car sales, it is not considered that the merger will result in a realistic prospect of a substantial lessening of competition in the retail sale of new cars.

### **Supply of servicing and repair of nearly new cars and lcvs**

23. Application of the above principles on the geographic scope identified two<sup>12</sup> potentially problematic areas for the servicing of nearly new cars. In doing so, the OFT considered the number of competing authorised dealerships fascia, how close the parties' garages were and whether independents were regarded as a competitive constraint in that area by

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<sup>12</sup> Note that while the EMH Chiswick and Inchcape Romford dealerships were also within 25 miles of each other, these catchments do in fact not overlap, as they are geographically located on either side of London. Therefore, travel times are considerably longer than a distance of 25 miles would otherwise suggest.

third parties. In both cases the overlap related specifically to the servicing of VWs. As discussed above (see paragraph 19), the appropriate radii were calculated on the basis that 80 per cent of a particular dealership's customers are located within the relevant isochrone.

#### Northern Welsh Marches

24. The parties provided postcode data for each overlap dealership, which shows that 80 per cent of all customers for each dealership in this area travel less than 20 miles. Within a 20 mile radius of the EMH Wrexham dealership there is the EMH Chester dealership and the Inchcape Oswestry dealership, but no other authorised repairers. The merger therefore results in a reduction in fascia from two to one.
25. Within a 20 mile radius of the Inchcape Oswestry dealership the only other authorised repairer is the EMH Wrexham dealership. Therefore the merger again results in a reduction in fascia in the 20 mile catchment area around Inchcape Oswestry of two to one. EMH Wrexham is the closest competitor of Inchcape Oswestry. No evidence was provided to suggest that any independent garages in the area would particularly constrain either of the parties. Nor, as set out below, does the prospect of timely, likely and sufficient entry, or buyer power, alleviate the concerns that derive from the above analysis.
26. The OFT therefore believes that the merger raises the realistic prospect of a substantial lessening of competition in the servicing of nearly new cars in the Northern Welsh Marches area.

#### Gloucestershire and Wiltshire

27. In Gloucestershire and Wiltshire, the OFT found that the size of catchment areas covering 80 per cent of customers was significantly more mixed than in the Welsh Marches. In the case of EMH Cirencester 80 per cent of customers travelled less than 20 miles. For Inchcape Swindon, the 80 per cent catchment area was over 40 miles and for Inchcape Cheltenham, 25 miles. Each of these areas will be dealt with below.
28. Within a 20 mile radius of the EMH Cirencester dealership, there are two Inchcape dealerships (Cheltenham and Swindon) and three other authorised VW dealerships run by competitors. Therefore the merger results in a fascia

reduction of five to four. However, it should be noted that around 80 per cent ([ ] per cent) of EMH Cirencester's customers would be captured within a 15 mile radius. On a 15 mile basis, the merger would result in a fascia reduction from two to one. Nevertheless, for the following reasons related to this specific area, no competition concerns arise. Firstly, the overlap is between two dealerships around 15 miles apart, and two of the competitor authorised dealerships are themselves located just outside the 15 mile radius and are located on direct main routes out of Cirencester (A429 and A417 respectively). In other words, the parties are not substantially closer geographically relative to one another than to third party fascia in the radial overlap area. Secondly, a significant proportion ([30-40] per cent) of customers are located between 5 and 10 miles from EMH Cirencester. These customers are more likely to be marginal (that is, willing to have their nearly new car serviced at the competing dealerships on the 15 mile radius) than customers located in closer proximity (0-5 miles). The even distribution of competitors in this area suggests all customers located within this band, a large proportion of which are likely to be marginal, would have, even post-merger, another authorised dealership within a similar distance than the EMH Cirencester dealership. As such customers can switch to another authorised dealer if EMH Cirencester were to offer less value for money post-merger, the OFT considers the competitive threat posed by these other dealerships as sufficient discipline on the merged firm in this radial area.

29. Within a 25 mile radius of Inchcape Cheltenham is the EMH Cirencester dealership and three other authorised dealerships operated by competitors. The merger therefore results in a fascia reduction of five to four.
30. Within 40 miles of Inchcape Swindon there is one other Inchcape dealership and the EMH Cirencester dealership. There are also several other authorised dealerships (six fascia) resulting in a reduction in fascia post merger from eight to seven.
31. On the basis of the above, the OFT does not believe that the transaction raises the realistic prospect of a substantial lessening of competition in the servicing of nearly new cars in Gloucestershire and Wiltshire.

## Supply of servicing and repair of used cars and lcvs

32. The isochrone analysis with regard to Gloucestershire and Wiltshire discussed above did not give rise to any potential competition concerns in this area and segment and only one local area dealt with below warranted closer scrutiny.

### Northern Welsh Marches

33. According to data provided from the parties, 80 per cent of all customers of the Inchcape Oswestry dealership travel less than 20 miles. In this catchment area, the transaction results in a fascia reduction from three to two for the supply of after-sales services for used cars. The one independent garage within the Oswestry catchment focuses on the servicing of older vehicles. Given that over a third of the number of services conducted by the overlap garages relate to cars over three years old, it is conceivable that the transaction raises competition concerns, subject to the prospects of timely and likely entry in the specific area. However, there is no need to decide this issue in this case, due to the concerns raised in respect of servicing nearly new cars and the divestment remedy proposed to resolve them (below).

## Barriers to entry and expansion

34. While opening a new authorised dealership is not subject to any quantitative criteria, an appropriate location must be found and the high qualitative standards of the car manufacturer must be met. Respondents estimated the cost of new entry at between £750,000 and £3.5 million and thought it would require three to eight months. In *Pendragon/Reg Vardy* the OFT found that it was not very attractive for an independent garage to become an authorised repairer, as the work is relatively low margin for having to invest to reach high standards. We have not received any evidence in this case that would warrant a different view. Third party responses suggest that in the last five years, entry into the areas in question has been limited, despite already limited competition in some areas. The OFT, therefore, does not believe that it could rely on timely entry on a sufficient scale into the provision of servicing to nearly new cars to mitigate the anticompetitive effect of the transaction in the local area identified above.

35. Given that the standards to operate as an independent garage are lower than those specified by car manufacturers for authorised dealerships, the OFT would expect barriers to entry into the servicing of used cars to be lower. However, the only local area that raises the realistic prospect of a significant lessening of competition for the servicing of used cars is around Inchcape Oswestry. In this area the transaction also gives rise to a facia reduction from two to one for the servicing of nearly new cars, for which barriers to entry are not considered to be low enough to alleviate the competition concerns. For the purpose of this assessment, it has therefore not been necessary to conclude on barriers to entry into the market for independent garages.

### **Buyer power**

36. While certain fleet customers may have some degree of buyer power, most customers are individuals who do not have any negotiating strength.

### **THIRD PARTY VIEWS**

37. Customers who responded were generally in agreement that independent garages did not effectively constrain authorised dealerships for the servicing of cars under the three-year warranty. The concern that the transaction would give Inchcape a national share in authorised VW dealerships of 12 to 13 per cent, is dealt with above. It has also been put to the OFT that Inchcape would, post-merger, hold a strong position in authorised VW dealerships in the North West of England. This area is covered by the local isochrone analysis under horizontal issues.

### **ASSESSMENT**

38. The parties overlap in the sale, servicing and repair of new, nearly new and used cars and lcvs in the UK. However, the OFT believes that competition concerns only arise in respect of the supply of servicing for nearly new and used cars and lcvs at a local level.
39. In line with the OFT's findings in *Pendragon/Reg Vardy* the OFT believes that for the servicing and repair of nearly new cars (that is within the three-year warranty) independent garages do not generally provide an effective

constraint on competition in the local overlap areas identified above and has therefore not included independents in the product scope.

40. On that basis, local areas were identified by a circle around each dealership with a radius representing the area from which approximately 80 per cent of customers from that dealership travelled for servicing. These were subject to the specific local overlap analysis set out in more detail above. The OFT has established a duty to refer in respect of the catchment area around Inchcape Oswestry and EMH Wrexham, as this area gives rise to a two to one facia reduction in the supply of servicing and repair of nearly new cars. In light of this duty, and the remedy proposed to resolve concerns, discussed below, it is not necessary in these circumstances to reach a view on any issues raised in respect of servicing of used cars in this area.
41. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.
42. However, as explained below, on the information currently available, the OFT has decided to exercise its discretion under section 73(2) of the Act to negotiate undertakings in lieu of reference.

## **UNDERTAKINGS IN LIEU**

43. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.
44. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's *Mergers Substantive Assessment Guidance* states that, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to

address them are clear cut, and those remedies are capable of ready implementation.' (para 8.3).

45. Inchcape has offered an undertaking with a view to remedying the realistic prospect of a substantial lessening of competition identified as a result of the merger in the reduction of fascia from two to one within the relevant 20 mile catchment area around the Inchcape Oswestry dealership for the supply of servicing and repair of nearly new cars and lcvs. In order to solve competition concerns in this area, Inchcape has offered to divest the authorised VW dealership of either Inchcape Oswestry or EMH Wrexham.
46. The OFT believes that the undertaking offered is capable of clearly addressing the competition concerns arising in the local area identified above, as it covers divestment of one of the dealerships that the OFT considers necessary to fully address the adverse effect on competition arising from the merger.
47. Accordingly, on the information currently available, the OFT has decided to exercise its discretion under section 73(2) of the Act to negotiate undertakings in lieu of reference.

## **DECISION**

48. The OFT's duty to refer the completed acquisition by Inchcape of EMH to the Competition Commission pursuant to section 22 of the Act is suspended because the OFT is considering whether to accept undertakings in lieu of reference under section 73 of the Act. However, pursuant to section 34A(3) of the Act this decision does not prevent the OFT from making a reference in the event that no such undertakings are offered or accepted.