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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**Cancels & replaces the same document of 16 May 2017.**

**Competition Issues in Aftermarkets - Note from South Africa**

**21-23 June 2017**

*This document reproduces a written contribution from South Africa submitted for Item 4 of the 127th OECD Competition committee on 21-23 June 2017.*

*More documents related to this discussion can be found at  
[www.oecd.org/daf/competition/aftermarkets-competition-issues.htm](http://www.oecd.org/daf/competition/aftermarkets-competition-issues.htm)*

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## South Africa

### 1. Introduction

1. The Organisation for Economic Co-operation and Development (OECD) has invited contributions to its round table on “*Competition Issues in Aftermarkets*” that will be held in June 2017. This note is prepared to assist in these discussions, which are intended to:

1. discuss the economic and legal theories to support competition intervention in aftermarkets;
  2. identify enforcement challenges that competition authorities face in aftermarkets cases;
  3. take stock of experiences in competition cases involving aftermarkets; and
  4. understand the policy rationale for competition in aftermarkets.
2. In this note, the Competition Commission of South Africa (CCSA) draws from its experiences in the automotive aftermarket given the nature of concerns identified in this market as well as its recent interventions.

### 2. Background to the automotive aftermarket in South Africa

3. The CCSA is currently in the process of developing a code of conduct to regulate the conduct of original equipment manufacturers (OEMs) and other players in the automotive aftermarket. This process was triggered by concerns received from various independent players in the automotive aftermarket and members of the public who all raised concerns about anti-competitive practices and agreements that foreclose independents as well as pricing behaviour in the automotive aftermarket. The CCSA then conducted research, largely informed by how competition authorities in various jurisdictions such as the US, EU, Russia, India and others, have dealt with anti-competitive practices in the automotive aftermarket. This was followed by an industry workshop which communicated the need to regulate the industry to address the concerns identified.

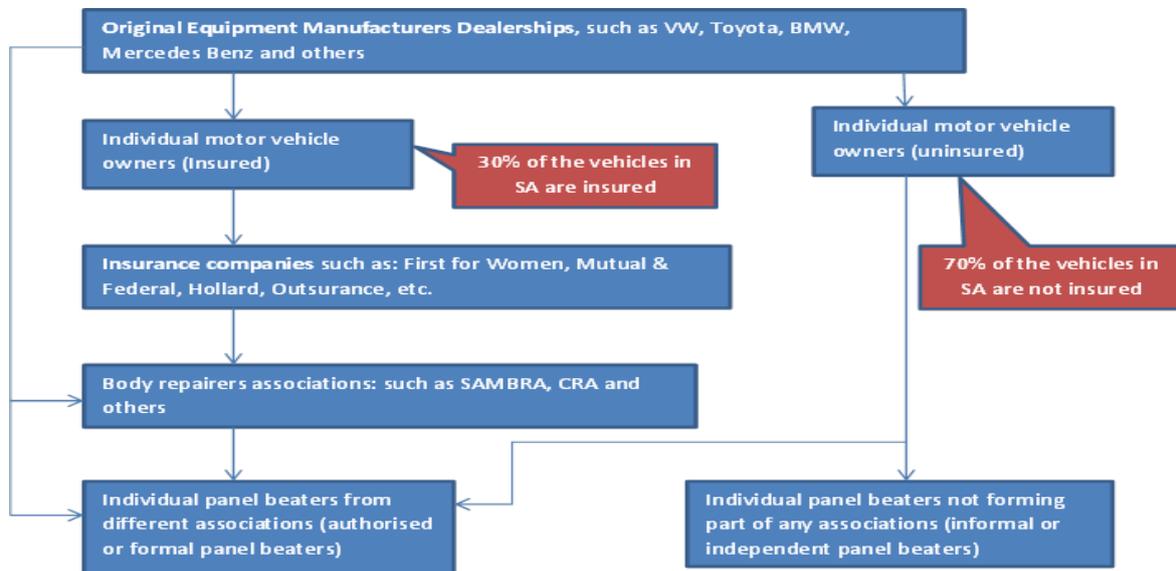
4. The automotive sector is one of South Africa’s most important sectors, with many major multinationals such as BMW, Volkswagen and Mercedes Benz, having established production plants and using South Africa to source components and assemble vehicles for the local market and exports to various countries. In January 2013, the automotive production and development programme (APDP) was introduced to increase the volume of cars and components manufactured in the country. The sector contributed 7.5% to GDP, more than 10% of total exports and employed more than 100 000 people in 2015. It is therefore a key growth sector in the economy.<sup>1</sup>

5. Various players in South Africa’s the automotive aftermarket are depicted in Figure 1 below and include OEMs, insurance companies and body repairers.

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<sup>1</sup> Automotive Industry Export Council (2016) - South African Automotive Export Manual

Figure 1. Industry players



Source: CCSA

6. In terms of the current arrangements between players in the automotive aftermarket, OEMs require consumers (vehicle owners) to use approved body repairers or spare parts distributors as a condition of the sale of a new car by a dealership in terms of warranty provisions. Insurance companies may also require that their customers (insured vehicle owners) use approved service providers who are usually the same service providers as those approved by the OEMs.

7. OEMs, through the assistance of various associations of body repairers, appoint certain body repairers (body repairers) into their network of approved service providers. The role of the association is, *among others*, to represent motor body repairers or body repairers and ensure that they meet quality requirements specified by the OEMs. Thus, OEMs will mostly consider service providers that are members of an industry association.

8. The approved body repairers or service centres are then included on a list of approved service providers who can repair or service the vehicles of that particular OEM's brand. OEMs also appoint a limited number of body repairers in every major city or area, using estimated demand within a particular geographic area as a basis.

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

10. Every new vehicle also comes with a warranty from the OEM. In order for the motor warranty to remain valid, all parts, maintenance and repair work must be done through the OEM-approved service provider/s. In the event that the vehicle under motor warranty and/or motor-plan is repaired or serviced by non-OEM approved service provider, the OEM is unlikely to honour the warranty provision. Furthermore, if a vehicle under warranty and/or service plan is fitted with any parts and components sourced from

independent parts supplier (not approved by the OEM) the warranty on the vehicle might be invalid.

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

### 3. Market definition in aftermarket cases

12. The approach adopted by the competition authorities in defining the relevant market in aftermarkets has not been consistent, but it seems to be predominantly based on the activities of firms at the different levels of the value chain. In this regard the markets have tended to be delineated into the following categories: manufacture and supply of vehicles/spare parts, the wholesale distribution of spare parts and the retail distribution of spare parts.<sup>2</sup>

13. The CCSA's approach in various automotive aftermarket cases has been to define the primary and the aftermarket as separate markets. The primary market (vehicles) has been dealt with in many cases and found to be a broad market including various OEMs and in most cases no competition concerns arise. On the other hand the market definition for the aftermarket tends to be narrower, and it has been found that a separate market for each manufacturer exists and that the geographic scope of that market is national. This is because from a demand side perspective, customers are unable to switch between parts of different manufacturers. For an example, only BMW spare parts and components will fit BMW vehicles.

14. In the merger involving **Imperial Holdings Limited and Alert Engine Parts (Pty) Ltd**<sup>3</sup> and **Imperial Group (Pty) Ltd and Midas Group (Pty) Ltd**<sup>4</sup> the Competition Tribunal ("Tribunal") also found that the OEM spare parts market and the non-OEM spare parts constitute separate and distinct markets as non-OEM suppliers do not pose a sufficient competitive constraint on OEM suppliers.

15. The Tribunal has also found that replacement/spare parts can be divided into branded products which are manufactured by OEMs (and on behalf of OEMs) and non-branded products, manufactured by non-original equipment manufacturers ("non-OEMs"). Original (OEM) spare parts are more expensive and target the higher income market as compared to non-branded spare parts which are cheaper and target the lower income market.<sup>5</sup>

16. The Tribunal also found that the two products cannot be considered as substitutes during the warranty period, suggesting that the market could even be narrowed further. This is because non-OEM (aftermarket) parts, are used where the manufacturer or supplier's warranty has expired and the customer is free to purchase a product from any supplier. The warranty guarantees that the manufacturer will replace and repair OEM

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<sup>2</sup> Comp/M.1825 Suzuki Motor/Suzuki, General Motors/Daewoo Motors, Ford Motor Company/Polar Motor Group Ltd and Comp/M.6718 Toyota Tsusho Corporation/CFAO at para 20.

<sup>3</sup> Tribunal Case No. 59/LM/Jul06.

<sup>4</sup> Tribunal Case No. 31/LM/Mar09

<sup>5</sup> See Tribunal Case Nos 98/LM/Oct05, 59/LM/Jul06 and 31/LM/Mar09

parts for the duration of the contract with a customer. The failure to use OEM parts for a vehicle under warranty may lead to the termination of the manufacturer's contract.

17. OEM replacement parts are mostly used in the first four to five years of a vehicle's life when the vehicle is still under warranty and non-OEM replacement parts are generally used in cars older than five years and after warranty. There may be a short transitional period where motorists might use either OEM or non-OEM spare parts in cars older than four/five years before completely switching to non-OEM parts.

18. In the matter involving Imperial and Midas, the Tribunal also stated that potentially there may be sub-markets for spare parts which include engine and non-engine parts. This distinction is based on the argument that specialist knowledge is required to both purchase and sell engine parts while scheduled maintenance and general repair does not require specific expertise.

#### 4. Market power in the aftermarkets

19. The South African Competition Act no. 89 of 1998, as amended, defines market power as the power of a firm to control prices or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers.

20. As indicated above, the approach taken in defining the automotive aftermarket suggests that each manufacturer could be dominant in its own aftermarket. In other words, aftermarket products are unique and non-interchangeable with others where the consumers are not able to change between different brands. This applies particularly to OEM branded spare parts.

21. Because of the generally brand specific nature of the markets for repair and maintenance services and for the distribution of spare parts, competition in those markets is less intense. Market power in the automotive aftermarket would thus arise due to high switching costs and the ability of a supplier to lock-in consumers with the initial purchase of the primary product.

22. In various jurisdictions including South Africa, it has been found that the leveraging of dominant positions into other markets may constitute an abuse if success on the neighbouring market is not based on competition on the merits.

#### 5. Enforcement experiences and approaches

23. The CCSA has received more than 20 complaints and has reviewed various mergers in the automotive aftermarket. However, a large number of complaints received have not been prosecuted to-date. Similarly, there has been no merger that has been blocked on the basis that there is substantial lessening of competition in aftermarket. The CCSA is however pursuing possible cartel conduct among dealerships and body repairers.

24. The complaints under consideration currently are on hold pending advocacy and conclusion of the code of conduct. The complaints allege the following:

##### 1. spare parts

- Consumers are compelled to use costly spare parts (OEM branded parts); and
- Independent spare parts suppliers are excluded and the use of these independent suppliers during the warranty period may nullify the warranty.

##### 2. approved supplier network

- The process for approving service providers and the numbers in a specific area is not transparent (incl. insurers);
- Approved service providers are not allowed to source spare parts from independents – even if they are genuine parts;
- Service providers in a network are compelled by OEMs to only use identified service providers for related services e.g. auditing and surveys; and
- Independents are required to join associations to be appointed by OEMs and insurers, with no guarantee of work.

### **3. tying of goods/services**

- Customers are compelled to take up a motor plan with the sale of a new vehicle. The true value of the car without the motor plan is not transparent to consumers; and
- Once service plan lapses, cost of servicing and maintenance is inflated (labour and parts).

### **4. transformation**

- Lack of transformation in the automotive aftermarket restricts access to historically disadvantaged individuals.<sup>6</sup>

## **6. Exclusionary and exploitative behaviour**

25. The anticompetitive concerns identified by the Commission emanate from the vertical arrangements and/or agreements between OEMs and various automotive aftermarket industry participants. A majority of the issues emerge in body repairers and spare parts as discussed below:

### *i) Body repairers*

26. OEMs and insurance companies have entered into agreements with body repairers who are appointed as approved or preferred body repairers by each OEM or insurance company. In terms of these agreements, it appears that OEMs or insurance companies only appoint a few body repairers in a geographic area. These agreements restrict competition between approved body repairers and non-approved or independent body repairers, as independent body repairers are not allowed to repair vehicles that are insured and those that are still under warranty. OEM and insurance companies claim that the reason for not granting approval is because they have already appointed a body repairer in that area. This is done even if the body repairer meets all the quality service requirements. Lastly, approved body repairers are required to only buy spare parts from approved dealerships or parts suppliers and these are more expensive than parts supplied by non-OEM approved parts suppliers.

27. The effect of these agreements between OEMs and approved body repairers is to make entry into the panel beating market difficult for emerging or small body repairers and restricts competition between independent body repairers and approved body repairers.

### *ii) Spare parts suppliers*

28. Similarly to body repairers above, OEMs have entered into various agreements with spare parts suppliers in terms of which certain spare parts suppliers are appointed as

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<sup>6</sup>This is an important consideration for South Africa because of its apartheid past

approved spare parts suppliers. Further, OEMs have agreements with approved body repairers and in terms of the said agreements, body repairers are required to source all their spare parts requirements from OEM approved spare parts suppliers. Concerns resulting from the relationship or agreements between spare parts suppliers and OEMs or Insurance Companies are as a result of approved spare parts suppliers not being allowed to sell OEM parts to independent body repairers.

29. Insurance companies also refuse to pay claims where a body repairer uses spare parts bought from any other parts supplier other than the approved spare parts supplier. However, prices attached to branded spare parts from approved suppliers are much higher compared to non-branded spare parts of the same/similar quality. These agreements restrict competition between approved parts suppliers and non-approved or independent spare parts suppliers.

*iii) Service Centres*

30. OEMs generally enter into dealership agreements with independent dealers. In terms of the dealership agreements, OEMs appoint dealers as approved OEM dealers and as approved service centres. These agreements have an effect of restricting competition between approved service centres and independent service centres as OEMs and approved service centres use warranty provisions and service plans to exclude independent service centres from the market for the servicing of cars. Warranty conditions are used by OEMs to require or induce customers to not deal with competitors (independent service centres/mechanics), which seems to restrict competition between independent mechanics/technicians and approved mechanics/technicians.

31. Requiring an independent service centre to also own a dealership before they can be appointed as an approved service centre also creates high entry barriers in that potential entrants must enter two markets, the servicing market and the dealership market. Therefore these agreements restrict independent service centres from entering into the vehicle servicing market and from competing effectively in the market. It also limits customer choices in as far as servicing of vehicles is concerned.

32. The effect of all these arrangements and/or agreements is as follows:

- The exclusion or foreclosure of independent body repairers in the market for repairing insured vehicles and/or vehicles that are still under warranty;
- The exclusion/foreclosure of independent service centres from servicing insured vehicles or vehicles that are still under warranty;
- The exclusion/foreclosure of part distributors from distributing OEM branded parts to body repairers;
- Higher prices charged by OEM part manufacturers to individual customers or body repairers;
- Higher prices charged by authorised body repairers for panel beating vehicle that are still under warrant and those that are still ensured.

33. The CCSA is therefore of the view that OEMs conduct themselves in a manner which is not only exclusionary but also exploitative.

34. However, it should also be mentioned that it is not always clear that there is substantial foreclosure resulting from all the agreements listed above. For example, there are numerous other customers that do not own vehicles which are under warranty and/or which are insured (approximately 65% to 70%). Therefore, independent body repairers can and do serve this market but this market is less lucrative.

## 7. Efficiency gains and other objective justifications

35. One of the common justifications raised by the OEMs is that their intellectual property rights could be compromised in the case where spare parts are sold in the open market and such arguments are not unique to South Africa. OEMs have invested in the development of their vehicles and brands. However, again the CCSA has found that some OEMs are willing to work around the blanket imposition of warranty provisions in relation to parts that should not, in the ordinary course, be under warranty provisions, provided that such work is undertaken properly without affecting warranty-related parts.

36. The OEMs also list safety as one of the main rationale for their conduct as they have the responsibility to manage brand reputation in case of accidents, and they can only do so if they have control over the quality and over the life cycle of their product. They are not in a position to assure the safety of their brand once handled by independents. By extension, they can only be liable for their approved products and approved network of suppliers throughout the value chain.

37. OEMs also submit that they require a limited network of service providers in order to guarantee standards due to requirements imposed within their approved networks. However, some OEMs indicated that they are amenable to changing their conduct in relation to the appointment of preferred repair shops through the standardisation and formalisation of standards which will be monitored by an association.

38. Some OEMs informed the CCSA that the preferred use of approved dealerships linked to an approved service centre for cars still under warranty and a service plan/motor plan are as a result of the fact that customers who purchase vehicles with a service plan, waive their right to service the vehicles with independent non-approved service centres. OEMs argue that this conduct is unlikely to have an exclusionary effect given that independent, non-approved service centres are not foreclosed from servicing vehicles that do not have motor plan/service plan. Moreover, approved service centres need to be specialised and are under the requirement to invest in acquiring OEM-customised equipment and training. Therefore the authorised dealerships and service centres must get a return on their investment which is provided through the arrangements with OEMs.

39. The CCSA has not dealt in any detail with any of these justifications but will take these into consideration in developing the code of conduct and will also adopt the approach followed in other jurisdictions to address these issues.

## 8. Remedies and other policy considerations

40. In order to address anti-competitive effects in the automotive aftermarket, the CCSA has decided to follow the approach of various competition authorities in other jurisdictions and to regulate the conduct of OEMs through a code of conduct to be developed with industry players.

41. In this regard, the CCSA conducted a scoping study which was completed in 2015. The scoping study highlighted how the automotive aftermarket functions and identified various competition issues to be addressed. The scoping study was as a result of multiple (19) complaints received by the CCSA between 2011 and 2014, in relation to the automotive aftermarket.

42. The CCSA has found that the competition issues identified are not unique to South Africa. However, many jurisdictions including the EU, US, Russia, India, and others have intervened in the automotive aftermarket and changed competition dynamics.

The interventions by other jurisdictions can be characterised as either interventions which have led to the promulgation of regulations, voluntary codes of conduct or enforcement. Notable changes in the automotive aftermarket in other countries as a result of these interventions include:

- Independent repairers competing with authorized repairers
- Vehicle owners have the right to use any repair shop for non-warranty during warranty period without losing warranty
- Use of matching quality parts
- Access to technical information

43. The CCSA has since held an Automotive Aftermarket Workshop on 17 March 2017, which was hosted with the Federal Antimonopoly Service of Russia. Various stakeholders were invited to participate and deliberate on the concerns identified by the CCSA as well as resolution of these issues through the development of a code of conduct.

44. Although the code of conduct is still to be developed and canvassed with the industry, it is expected that the code of conduct will cover various remedies, including the following:

*1. Remedies relating to the spare parts*

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

*2. Remedies relating to warranty provisions*

46. Vehicle owners should have the right to use any repair shop for non-warranty work even during the warranty period. Any defects originating from the factory fault must be corrected by the vehicle manufacturer and not authorised repairers.

47. OEMs may not make the warranty conditional on the repair and servicing of the vehicle within their network or on the use of their branded spare parts. Authorised and independent repairers or service centres should be allowed to use non-OEM branded parts in repairing or servicing vehicles under warranty as long as the parts are matching quality parts.

48. However, one of the main challenges likely to face the CCSA in implementation of the code of conduct is the use of matching quality parts. This will be applicable to locally produced parts and imported spare parts. Other jurisdictions relied on other regulatory bodies to assess the equal quality part and it is not apparent that South Africa has this capacity currently.

*3. Access to technical information*

49. OEMs should make available their technical information, training, tools to independent service centres, at a cost.

## 9. Conclusion

50. The CCSA's view is that the best outcome for the industry can be achieved through advocacy and the development of a code of conduct. These interventions in the automotive aftermarket are likely to have far reaching benefits, in terms of opening it up to more competition and thus benefit end consumers. However, if the code of conduct does not address the concerns identified, the CCSA still intends to pursue anti-competitive conduct through enforcement.