
Completed acquisition by Pendragon plc of CD Bramall plc

The OFT's decision on reference under section 22 given on 24 June 2004

PARTIES

Pendragon plc is active in the UK in the retail sale of new and used vehicles and associated servicing, repair and spare part supply. Prior to the acquisition, **CD Bramall** was also active in the same sectors in the UK. CD Bramall's UK turnover for the financial year ended 31 December 2002 was £1,388 million.

TRANSACTION

On 26 February 2004, Pendragon acquired the whole of the issued and to be issued share capital of CD Bramall for £231.45 million. Pendragon has cited two main reasons for the purchase of CD Bramall: the high quality of many of CD Bramall's dealerships and the complementary fit of the two companies. The transaction was notified to the OFT on 1 April 2004 and the administrative deadline expired on 11 June 2004. The statutory deadline expires on 25 June 2004.

JURISDICTION

As a result of this transaction Pendragon and CD Bramall have ceased to be distinct. The UK turnover of CD Bramall exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. A relevant merger situation under section 23(1) has therefore been created.

RELEVANT MARKET

The parties overlap in:

- a. the supply of new and used cars and light commercial vehicles (lcvs);
- b. the supply of spare parts to new and used cars and lcvs;
- c. the leasing of cars and lcvs; and

- d. the supply of servicing and repair to new and used cars and lcvs.

In the UK, new and used cars are distributed and sold through networks of dealers which in respect of new cars are selected by manufacturers to retail their own brand (selective distribution). In addition, manufacturers cannot refuse authorised repairer status to garages which meet certain objective criteria. All franchised distributors, and many independent dealers, also provide after sales service i.e. the servicing of vehicles and supply of spare parts.

The supply of new cars was investigated by the then Monopolies and Mergers Commission in 1992¹ and the Competition Commission subsequently revisited this in April 2000² (the CC report). The CC considered the relevant economic market to be the supply of new cars across the UK. Since then the EC has revisited the block exemption on the motor vehicle sector³ (the 'Motor Vehicles Block Exemption').

The supply of new cars and light commercial vehicles

On the demand side, cars could be divided into luxury, compact, people carrier, off-road and various other possible categories. In practice there appears to be considerable overlap between these categories.

In terms of new versus old cars, the CC concluded that these should be considered separately although it would be unlikely that either is completely immune to competition from the other. In this respect, given the lower barriers to entry and greater number of second hand car dealers, the OFT considers that the transaction does not give rise to concerns in respect of used cars if it does not give rise to concerns in respect of the sale of new cars which OFT believes, is the case in relation to this transaction. Used cars are therefore not considered further.

The CC considered that competition in the supply of new cars occurred across the UK, although one respondent in this case suggested that consumers tend not to travel further than 30 miles to purchase a model of car. The OFT does not find it necessary to review the CC's findings on the

¹ New Motor Cars: a report on the supply of new motor cars within the United Kingdom (Cm 1808/1992)

² Competition Commission, New cars: A report on the supply of new motor cars within the UK (Cm4660/2000).

³ 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.

geographic market as there is no need to reach a conclusion on this issue given that, even on a more restrictive basis, competition issues do not arise.

Servicing and supply of spare parts

The parties also overlap in the servicing, repair and supply of spare parts for new and second hand cars.

The OFT recently carried out a study on new car warranties⁴ (the 'Car Warranties Report') which found that franchised dealers account for about 90 per cent of servicing for 'nearly new' cars up to 3 years old. Previous surveys and a survey carried out as part of the OFT study found that consumers perceived that their warranties would be invalid if they did not service their car at an authorised dealership for that particular make of car. It appeared that as a consequence, franchised dealerships could charge a premium in comparison to independent garages. The reasons for this appeared partially related to consumer information issues (such as consumers believing their cars had to be serviced at franchised dealers) and partially due to the tying of dealership servicing to warranty validity by some car manufacturers. The OFT recently announced that conditions attached to warranties that require a car to be serviced at a garage in its manufacturer's network have been dropped by manufacturers of all major makes of new cars in the UK. This followed the OFT's Car Warranties Report which recommended that such ties were removed in order to improve consumer choice and aid the development of more effective competition in the car after-sales market. The voluntary lifting of the ties avoided the possibility of formal action by the OFT under EC competition law.

Given the evidence of consumer behaviour in this sector an appropriate frame for analysis is examining, by model of car, the servicing of 'nearly new' cars by authorised garages. In this case the parties overlaps by local area may be important in that it would seem unlikely that customers travel long distances for their car to be serviced. This is supported by the OFT study which found that the most important factor in deciding where to have a car serviced was a convenient location.

The parties believe that independent garages do exert a competitive constraint on servicing. The parties also argue that drive times are most appropriate for assessing catchment areas, not least because of the difference between rural and urban areas. They believe that for 'volume' brands customers are willing to travel up to 15 miles whilst for 'specialist'

⁴ Office of Fair Trading, 'New Car Warranties: Report of the market study', December 2003.

brands this could be as far as 100 miles for servicing. The parties' have also informed the Office that each dealership can vary its prices to reflect local conditions. Information provided on the parties' Mercedes dealerships in the Bolton – Huddersfield and surrounding area show quite large variations in servicing charges (from an average of between [£140 to £240⁵] per service).

As noted under Horizontal Issues below, the OFT has taken the view that the relevant catchment area of the dealers concerned is at a maximum of 25 miles in those cases given detailed consideration in this decision. This has been based upon a survey of the parties' dealerships in the areas concerned which show that approximately 95 per cent of customers are located within a 25 mile radius.

In terms of the supply of spare parts, the parties distribute spare parts to other repairers as well as to their own dealerships. However spare parts are also available direct from the original equipment manufacturer. Given the parties' shares of supply are reported to be under 10 per cent and no complaints were received this is not considered further.

Leasing of cars

CD Bramall has a 37.5 per cent shareholding in Thrifty Car Rental which offers short-term car rentals and Pendragon is marginally involved in this business. As the increment to CD Bramall's market share is limited and no complaints were received, this sector is not considered further.

HORIZONTAL ISSUES

Market shares

At the national level, the parties have estimated that they do not represent more than 5 per cent of supply in any category of car sale (whether new or second hand), servicing, repair or spare part supply in the UK.

Sale of new cars and lcvs

Given that the prime concern of the CC report was the muting of competition due to the weak position of dealers in relation to car manufacturers, this merger could be seen as beneficial. It will create the largest dealership group in the UK, although on the basis of the estimated UK shares in any sector being below 5 per cent, the OFT considers that no competition concerns will arise at a national level. The CC report found that the market for the sale of

⁵ Exact figures replaced by range at request of parties

new cars is a national one and that conclusion has not been challenged as a result of our analysis. In addition, the comments of several third parties are that the industry overall is highly fragmented at the dealer level. Many third parties also recognised that the merger may be pro-competitive in as much as the strengthened Pendragon group may gain improved bargaining power with the car manufacturers which may be expected to be passed on to the end consumers. Even examining the supply of new cars at a local level, the only area where shares exceed 25 per cent is within the City of Manchester (at approximately 40 per cent representing 2 out of 5 authorised dealers of all marques). Here many other dealerships exist in the surrounding area outside of the City of Manchester and consequently this does not appear to raise competition issues.

Servicing of cars

As discussed under the Relevant Market, the OFT considers that examining the effect of the merger on a local basis by marque is appropriate for the servicing of nearly new cars. Here there are regions of the country where the parties both operate dealerships of a specific marque. Two areas where this effect potentially appears most significant are considered below:

The Bolton – Huddersfield area for Mercedes

For Mercedes dealerships in this area and its surrounds, information provided by the parties in terms of their dealers' catchment areas shows that an average of 76.5 per cent⁶ of customers are drawn from within 10 miles of each dealer (an average of 99 per cent of customers within 25 miles). If the catchment area is considered to be 25 miles (at its widest) then the overlap catchment area is the area between Bolton (C D Bramall) and Huddersfield (Pendragon) (there is no overlap between the parties based on a 10 mile catchment area). In this particular area there are three other dealerships which are located between the parties' dealerships and would appear to be viable alternatives. These are all dealerships owned by Daimler Chrysler, the owner of the Mercedes brand. In addition, there are two other independently owned Mercedes dealerships within 25 miles of the C D Bramhall dealership in Bolton.

For the Mercedes dealerships, the parties have been able to provide average service charges for their dealerships within this local area. As noted at paragraph 13 above these show wide variation which suggests that not all dealerships within a catchment area are able to act as an equal constraint upon each other. However, in one instance the parties have noted that one

⁶ correction – should state 84.2 per cent

(C D Bramall) dealership reduced service prices to compete with a new local rival dealer that opened close by. This would suggest that local competition has some effect on pricing. In this regard, it is relevant that the merger will not result in the loss of the closest rival of each party's dealership in the area.

The Manchester area for Jaguar

For Jaguar in the Manchester area both parties have a dealership in the south of the city and Pendragon has a second to the north west near Bolton. Information as regards the location of these dealerships' customers indicates again that they have a reasonably restrictive catchment area of no more than 25 miles from each dealer (an average of 76 per cent of customers are drawn from within 10 miles of each dealer and 86 per cent⁷ within 25 miles). Within the overlap area of ten miles in the south of the city consisting of one existing and one acquired dealership, there is one alternative privately owned dealer at Wilmslow. At 25 miles, there are two other Jaguar dealerships - the privately owned one and another which is part of a competing dealer group.

Barriers to entry

Under the new Motor Vehicles Block Exemption manufacturers are allowed to authorise other garages (outside of franchised dealerships of that model of car) to service and repair such cars. In practice it is believed that this has not occurred to any great extent, as yet, although it is understood that applications are currently being processed. Added to this is the expectation that the removal of tying restrictions on new car warranties to dealerships may indeed strengthen the constraint offered by independent service garages. At this stage it is difficult to be definitive about how effective a constraint this will represent. However, it is the Office's expectation that this will enhance the ability of independent garages and dealerships of rival marques to attract business from the existing marque dealerships. In relation to the parts of the country identified above, it is noted that there are a number of authorised dealerships of all marques which are not owned by the parties (for instance, 70 such dealerships exist across Manchester, Bolton and Preston) in addition to a large number of independent garages⁸.

⁷ correction – should state 94.2 per cent

⁸ The Car Warranties report states that there are 16,000 such garages in the UK (para 4.18)

Buyer power

Servicing is largely provided to individual consumers and is an area that the OFT has identified where consumer information problems exist. Consequently it is unlikely that buyer power exists.

THIRD PARTY VIEWS

Some third parties have raised concerns that the merged entity will represent the single largest supplier of certain marques (*text removed for reasons of commercial confidentiality*). In this respect concerns were raised that the merged entity might receive preferential treatment in the supply of scarce cars (such as during the launch of a new model) and may be able to influence the second hand valuation of these cars upwards. It has also been suggested that Pendragon may 'predate' against other adjacent dealerships it does not control.

However, given Pendragon still represents only approximately (*text removed for reasons of commercial confidentiality*), it appears unlikely Pendragon will gain bargaining power over (*text removed for reasons of commercial confidentiality*) to any significant degree. However, to the extent that it might do, the OFT considers this would not entail a detriment to final consumers provided there remains sufficient inter-brand and intra-brand competition at the local level. The analysis concerning the sale of new cars would suggest such competition will remain. In respect of priority in the supply of new 'scarce' cars, consumers will still be able to choose from a variety of models from different manufacturers. In respect of the cost of second hand cars increasing, competition in second hand cars appears particularly intense due to low barriers to entry and so purchasers of second hand cars will still have a wide variety of different models to choose from.

In terms of predation, OFT does not consider that this is a strategy that Pendragon acting rationally would or could pursue. It requires a period of loss in order to force the exit of competitors so that the ability to charge higher prices only comes in the longer term. However, franchises are time limited. Furthermore, a large proportion of car dealers' turnover derives from the sale of new cars which, most evidence suggests, is a national market. Both factors would tend to limit the long term feasibility of any such predation strategy.

Additionally, some third parties raised general concerns about the prospect of consolidation in the sector. Corporate customers were unconcerned. Concerns were also raised in relation to the servicing of cars.

VERTICAL ISSUES

No significant vertical concerns are raised as a consequence of this merger.

ASSESSMENT

The parties overlap in the sale, servicing, and supply of spare parts for new and used cars and lcvs. These are characterised as dealerships which typically embody all of the aspects mentioned above. At the national level, the industry is still highly fragmented and, in relation to the sale of new and used cars and the supply of spare parts, it is not expected that this merger will result in a substantial lessening of competition. The only potential concern arises at the local level and relates to servicing of nearly new cars of particular makes where consumers appear to be prepared to pay a premium for servicing at a local franchised dealership. Where the merger brings together two franchised dealerships of a particular marque within the same catchment area, then consumer choice may be reduced.

There appear to be only two areas in the UK where the merger might lead to a reduction in choice at the local level. However, the OFT believes that in both these areas the presence of existing alternatives dealers, together with the recent removal of servicing ties from new car warranties - which is expected to increase the likelihood of potential new entry and enable independent garages to be a stronger constraint than they have been in the past – will be a sufficient competitive constraint upon the merged group.

Consequently, the OFT does not believe 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.

DECISION

This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.