NEWS

Automotive update

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EU

State aid for the automotive industry

The automotive industry is one of the hardest hit sectors of 'the real economy'. Since summer 2008 car sales have crashed all over Europe. This collapse in volume does not only affect the vehicle manufacturers but feeds down the supply chain and also affects dealerships. It has caused a significant cash burn. However, due to the tightness in the financial markets, companies in the automotive industry experience severe difficulties in getting money from private banks. The governments of various EU member states, as well as European institutions, have therefore taken measures to support the industry. On the one hand they aim to encourage demand for cars and on the other hand they grant state aid directly to the manufacturers and suppliers.

Incentives to consumers

Many European governments provide incentives to boost demand levels. Some countries – such as Austria, France, Germany, Italy, Portugal, Romania, Spain and Cyprus – have launched scrapping schemes. These schemes differ significantly. For example, the German government has put in place a bonus of €2,500 for car buyers trading in cars older than nine years for new, low-emission passenger vehicles. By contrast, the bonus in France amounts only to €1,000; in Italy bonuses between €1,500 and €4,000 can be applied for; and Spain provides interest-free loans of up to €10,000 for purchasing new cars. Moreover, some EU member states use general tax measures to incentivise the demand for new cars. For example, the UK has cut VAT on cars to 15 per cent from 17.5 per cent until 31 December 2009 and Germany exempts new cars registered for the first time between 5 November 2008 and 30 June 2009 for up to two years from the annual road tax.

The European Commission accepts such incentives if they are granted without discrimination with regard to the origin of the vehicles.

Financial assistance to vehicle manufacturers and suppliers

Governments and European institutions – eg the European Investment Bank (EIB) – have also put in place measures directly aiming to provide financial assistance to companies from the automotive sector.

National measures

Measures focusing on manufacturers and suppliers include loans, guarantees and subsidies.

For example, the French government, PSA and Renault have installed an investment fund to help suppliers with €300m. Moreover, the French public authorities will spend €400m during the next four years to help French vehicle manufacturers develop fuel-efficient vehicles. The French government also supports its domestic industry with loan guarantees – eg €1bn for the financing arms of PSA and Renault.

The German government provides via its public bank KfW loans of up to €300m to companies having difficulties getting capital on the financial market.

Furthermore, state guarantees have been facilitated and extended to enable companies to take up loans at favourable conditions in the short term. Finally, the German government is increasing its spending for innovation, inter alia by promoting research and development (R&D) projects in the framework of its central innovation programme for small and medium-sized enterprises (SMEs). These measures serve to support all industries, including the automotive sector.

Finally it should be noted that the financial branches of vehicle manufacturers may also qualify for aid under the schemes adopted by the EU member states and approved by the Commission for the banking sector.

Measures by European institutions

The EIB has in place a programme specifically aiming to support R&D projects in the automotive sector. Under this 'European clean transport facility', vehicle manufacturers and suppliers may benefit from loans at favourable conditions. Moreover, the EIB provides under its 'risk sharing finance facility' loans for risky R&D projects by companies in various industry sectors, including the automotive industry.

The Commission supports the car industry in its efforts to maintain investments into future technologies, in particular by developing 'green' vehicles, primarily through its seventh research framework programme.

Conclusions

There is a wide variety of state measures supporting vehicle manufacturers and suppliers. In particular, subsidised loans and guarantees may play an important role in meeting the automotive sector's financial needs and restructuring certain companies. Since the budgets are limited, applications for such loans and guarantees should be submitted as soon as possible.

EU

Revision of the European Globalisation Adjustment Regulation

The European Globalisation Adjustment Fund (EGF) aims to help keep European workers in employment or assist them in finding new jobs after redundancy due to changing global trade patterns or the downturn. It has an annual budget of €500m, much of which is spent on training, counselling and mobility allowances.

Recent revisions to the EGF, intended to improve its effectiveness, include:

- lowering the eligibility threshold for EGF applications from 1,000 to 500 redundant workers in a sector, region or undertaking (which will allow more redundancy cases to be eligible and, therefore, more workers to be helped back into employment); and
- extending the duration of EGF support to 24 months (from the current 12 months, which will ensure that the affected workers can be assisted with the most appropriate measures and not merely short-term ones).

INTERNATIONAL

Supply and R&D co-operation in the automotive sector

The pressures of the automotive industry will increasingly lead to innovative structures for production, distribution and R&D. The scope of manufacturer's vertical integration continues to decrease and co-operation and outsourcing will be the best instruments to save costs and to gain further synergies in difficult times. This relates to both co-operation among suppliers and between suppliers and original equipment manufacturers (OEMs).

Co-operation agreements

Long-term and high-volume supply and service contracts are at the heart of these co-operation projects and receiving specialist legal advice on these structures is key to their success. Particular contractual mechanisms are available to address the challenging demands, including:

- term and termination provisions, which ensure predictable long-term costs and provide a strong incentive for the suppliers to keep to delivery dates and quality requirements;
- the right balance between the security of dual sourcing and the upsides of exclusive supplier relations;
- change-management procedures, which keep costs foreseeable and ensure state-of-the-art technology;
- open book clauses and benchmarking mechanisms to keep long-term co-operation in line with market prices;
- 'design to cost' as a steering tool of modern R&D co-operations; and

- the right mix of flexible offtake processes and minimum commitments.

Carve-outs
Other hot topics are the sale of production plants and joint ventures with OEMs. As production plants do not usually operate as self-contained entities, the most important pre-requisite for these projects is the separation from the manufacturer's group. Given the multiple ties between the plant and the group, this carve-out is a rather complex exercise. To avoid the risk that efficiency decreases instead of increases as a result of the carve-out, it is crucial to carefully unwind the closely knit production facilities system. Notably, the new company will remain linked to the manufacturer by means of a production-and-supply agreement, which must be designed more cost efficiently and flexibly than the former intra-group supply arrangement.

The key issues relating to carve-outs are:
- how to ensure access of the new company to the manufacturer's intellectual property rights (in particular, patents and knowhow) and at the same time to protect the manufacturer's proprietary technology;
- how to preserve economies of scale for the new company in purchasing materials and components; and
- how to balance reliability and flexibility in the new company's supply agreement with the manufacturer.

Co-operation, outsourcing and carve-outs in the automotive industry are subject to complex contractual arrangements that require an early involvement of legal advisors with relevant deal expertise.

INTERNATIONAL

Managing the risk of industrial disputes in the downturn

The severity and reach of the downturn is prompting many unions and employee representatives to react strongly against business decisions that threaten adverse effects for workers. The consequences can be extremely uncomfortable, particularly for a sector such as the automotive one, whose output depends on a motivated, hardworking workforce. They may include:
- industrial action, wildcat strikes and even physical intimidation (including instances of workers holding managers hostage for short periods of time). Local politicians sometimes back some of these actions, adding to the political dimension and the 'newsworthiness' of the event and possibly making it more difficult to resolve;
- possible litigation by employee bodies, such as local works councils and European works councils, with the aim of delaying restructuring processes with claims that the employer did not comply with the requisite information and consultation processes;
- unions and employee representative bodies growing in power as a collective 'voice' for employees and seeking more formal recognition rights than might have been pursued in the past; and
- difficult public relations implications because even if an employer's actions are not motivated by the nationality of its workforce some elements of that workforce may see it differently in the current climate.

Managing the risks carefully and effectively is crucial.
- Compliance: ensure your compliance policy is up to date and effectively enforced.
- Co-ordination: ensure your in-house legal team is close enough to key business lines and works effectively with human resources. Check that you know about all relevant existing key agreements, both collective and individual.
- Communication: this means both internally with employees and their representatives and externally with unions, regulatory/local authorities and the press.
- Funding: ensure that any public funding obtained does not interfere with planned measures, which would be the case if, for example, there was a commitment to maintain a minimum workforce.
- Redundancies: be careful with selection procedures and carry out consultation properly.

EU

Commission announces its proposals for the future of motor vehicle distribution after May 2010

On 22 July the European Commission published its long-awaited proposal for the regulatory framework of motor vehicle, service and spare parts distribution after the expiry of the current Motor Vehicle Block Exemption 1400/2002 (MV-BER) at the end of May 2010.

In short, the Commission proposes that the competition rules for the automotive sector be aligned to those of the general block exemption regime for distribution contracts – ie the successor to the current Block Exemption Regulation for Vertical Agreements 2790/99 (Vertical-BER). Its draft for the successor regulation to the Vertical-BER is expected to be published for consultation before the Commission's summer break. The proposed changes to the current Vertical-BER are believed not to affect the issues virulent in the automotive sector. To allow the automotive sector, which has been particularly hit by the financial crisis, a smooth transition, the Commission furthermore suggests a transitory period of three years – in which the current rules will continue to apply – for motor vehicle distribution contracts but not for service and spare parts contracts. The latter will be subject to the new regulatory framework from June 2010.

Major changes in the framework for motor vehicle distribution under the proposed regime of the successor Vertical-BER will be:

- a maximum market share for exemption under the BER of only 30 per cent (compared with a maximum of up to 40 per cent for quantitative selective distribution systems and none for qualitative selective distribution systems under the MV-BER);
- the possibility of imposing stricter single branding requirements on dealers than under the MV-BER;
- the possibility of preventing dealers from opening additional sales outlets;
- the possibility of requiring dealers also to operate a repair shop; and
- contractual protection for dealers will no longer be a prerequisite for exemption.

The Commission has furthermore announced that it will issue sector-specific guidelines on the issues of single-branding (indicating very close monitoring of the new freedom, including the possibility of withdrawing the exemption in cases of abuse), for market shares above 30 per cent, for the imposition of price discipline by manufacturers and for potential barriers to cross-border trade (comparable to the 'availability clause' in the MV-BER).

In the repair and spare parts sector, we should expect a major shift in the regulatory framework. Applying the Commission's current position on market definition, most repairer networks will have a market share above 30 per cent and so will fall outside the scope of the Vertical-BER. This means that any restriction on competition in contracts that fall within the scope of article 81(1) of the EC Treaty in the future will have to meet the criteria of an individual exemption (and hence require an individual assessment).

However, the Commission has indicated in its proposal that – in most cases – a strictly qualitative selective system would fall outside the scope of article 81(1) of the EC Treaty. To increase transparency and legal certainty it intends to publish either sector-specific guidelines that outline specific situations in which a qualitative selective distribution system may nevertheless come within the scope of article 81(1) of the EC Treaty or to enact a sector-specific BER focused on the motor vehicle aftermarket only. The guidelines and/or the Aftermarket-BER will address in particular the following issues:

- refusal to grant access to the authorised repairer network;
- refusal to grant access to technical information to independent repairers;
- direct or indirect restrictions for the use and distribution of competing spare parts and for sourcing such parts directly from the spare parts manufacturer;
- misuse of (extended) warranties preventing competition from the independent repairer sector; and
- specific conditions under which a combination of service and sales may exceptionally be justified.

The Commission has invited interested parties to comment by 25 September 2009 and will then proceed with the necessary legislative steps to enact the proposed – or modified – rules in due time.

TURKEY

The automotive sector in Turkey

The history of the automotive sector in Turkey goes back to the mid-1950s. The first vehicle assembly plant in Turkey was established in 1954 for jeep manufacturing. Trucks have been produced since 1955 and buses since 1963. In the late 1950s, Vehbi Koç, the founder of one of the important family-owned Turkish business conglomerates, set up the Otosan joint venture with Ford for the production of passenger cars. Further joint ventures followed, notably between Toyota and the Sabanci family.

Today, about 20 international corporations are present in Turkey, including GM, Fiat, Mercedes-Benz, Renault, Toyota and Hyundai. One of the latest market entrants is China's Chery Group, with an output target of 100,000 cars per year. Many companies manufacture different types of vehicles, such as passenger cars, trucks, buses, tractors, minibuses, pick-ups and trailers.

Turkey is the world's 17th-largest car manufacturer and the automotive industry plays an increasingly important role in the Turkish economy. It is the leading European manufacturer of passenger buses and is also strong in trucks and commercial vehicles. In 2007, Ford Otosan was the biggest manufacturer, with some 286,000 units of light commercial vehicles, followed by Oyak-Renault with some 263,500 units of passenger cars and Tofaş-Fiat with some 212,500 units of light commercial vehicles.

According to the Turkish Automotive Producers Association, the automobile sector was regularly breaking its own records with 1.1m units in 2007 and 1.15m units in 2008 (excluding tractors). The latest increase was due to the strong commercial vehicle segment, which grew by 13 per cent in 2008 while the passenger car segment decreased by 2 per cent. Generally, however, the worldwide economic crisis has hit the Turkish automobile industry quite hard and production in December 2008 was down by 62 per cent against the December 2007 output.

Besides car manufacturing, the automotive component and spare parts industry has developed even more quickly in the past years. Among 200 foreign investors, most of the global automotive leaders have set up joint ventures with Turkish companies and about 70 per cent of the 4,000 automotive components manufacturers in Turkey are SMEs working for the big automotive companies.

The Turkish automobile sector is predominantly export orientated, with the major part of the output going to Russia, the Middle East and the EU. The total number of vehicle exports reached approximately 820,000 units in 2007 and 910,000 units in 2008. Exports to the US, however, were relatively insignificant at only $210m-worth of cars and spare parts in 2008 and the industry has made an increase of its US exports a priority for the future.

In summary, the Turkish automotive industry has benefited from the country's liberal and reformist investment climate and foreign investors have been attracted by incentives such as free land allocation and income tax relief. However, after years of impressive growth the sector has been severely affected by the global economic crisis and it remains to be seen how the export-orientated industry will respond to the challenges of the new market climate.

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