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A/g General Manager - Adjudication
Australian Competition and Consumer
Commission

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Subject Third Line Forcing Notifications lodged by Subaru (Aust) Pty Ltd (N40609,
N40610, N40611 and N40612)

Please see attached.

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Mr Paul Palisi
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Dear Mr Palisi

Third Line Forcing Notifications lodged by Subaru (Aust) Pty Ltd (N40609, N40610, N40611 and N40612)

We refer to your correspondence dated 22 December 2003, enclosing copies of the submissions received by the Commission in respect of the above notification. Our client appreciates the Commission giving it an opportunity to comment on the issues raised by Esanda and the MTAA.

1. Background - summary of concerns

- 1.1 We understand the essence of the concerns expressed by Esanda and MTAA to be as follows:
- (a) the notified conduct does not exhibit any public benefit or, to the extent that any such benefits can be demonstrated, they might be retained by dealers and not passed on to consumers;
 - (b) the notified conduct gives rise to public detriment. This is primarily due to the alleged removal of the ability of Subaru dealers to choose their supplier of wholesale floorplan finance, with resultant foreclosure of opportunities to competitors of GMAC (**Subaru Finance**). The removal of choice is alleged to result from:
 - (i) the exclusive availability of Subaru Insurance and Subaru Full Service Leasing to those dealers who do acquire inventory finance from Subaru Finance (**Wholesale Dealers**) (albeit only during the commercial pilot period of these new products, currently scheduled to end on 30 June 2004); and

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- (ii) the refusal by Subaru Australia to supply discounts, allowances, rebates or credits to non-Wholesale Dealers in respect of the promotional programs supported by Subaru Finance, Subaru Insurance and/or Subaru Full Service Leasing.
- (c) The removal of the ability of Subaru dealers to choose their wholesale financier is alleged to adversely affect competition in both the wholesale and retail finance markets in which Subaru Finance competes.
- 1.2 The Commission has requested that our client address, in particular, *'the concern relating to dealers being forced to accept finance arrangements from a particular supplier (GMAC, in this instance) in order to obtain supply of particular products (from Interleasing or Swann Insurance) as a result of the refusal to supply these products if dealers do not acquire finance from GMAC'*. This corresponds with the public detriment alleged in paragraph (b) above.
- 1.3 We have addressed the concern identified by the Commission, regarding the alleged 'forcing' of dealers to accept finance arrangements from GMAC, before examining the public benefits and anti-competitive detriments arising from that conduct.
2. **Executive summary**
- 2.1 It is our client's strong view that the concerns expressed by Esanda and the MTAA do not demonstrate that the public benefits accruing from the notified conduct are outweighed by any alleged public detriment. Therefore, the statutory test for the revocation of immunity set out in section 93(3A) cannot be discharged.
- 2.2 The public benefits accruing from the notified conduct are significant, including the promotion of industry cost savings, resulting in contained or lower prices at the wholesale and retail levels of the motor vehicle supply chain; promotion of competition in the wholesale finance market, and in the retail finance, insurance and motor vehicle markets; and the expansion of consumer choice.
- 2.3 The public benefits are not outweighed by the alleged public detriments identified in the submissions received by the Commission. In particular:
- each Subaru dealer retains absolute discretion to acquire inventory finance, and the right to offer the branded insurance or leasing products, from any financier, insurer or leasing service provider, based on the competitive terms offered by those providers. Evidence from Subaru's dealership network supports the exercise of this discretion in practice;
 - none of Subaru Australia, GMAC, Swann or Interleasing have power in their respective markets, which in turn could be leveraged into, and distort, related markets via third line forcing conduct; and
 - any opportunities that are foreclosed to competitor financiers (which is denied) will not prevail beyond the short term. Both Subaru Insurance and Subaru Full Service Leasing will be made available to consumers via non-Wholesale Dealers at the end of the commercial pilot period, currently scheduled to expire on 30 June 2004.

2.4 In addition, the notified conduct will not have a detrimental effect on competition in either the wholesale or retail markets for finance services, due to the competitive structure of those markets.

3. Initial comments

3.1 We make a number of initial comments to provide context to our discussion:

- As the Commission is aware, Subaru Australia, GMAC (trading as Subaru Finance), Swann (trading as Subaru Insurance, under licence from GMAC) and GMAC's related body corporate, Interleasing (trading as Subaru Full Service Leasing, under licence from GMAC) operate in highly competitive Australian markets for the distribution (and retail) of motor vehicles, commercial finance and insurance services. None of these corporations enjoy market power in the relevant markets. As the Commission is aware, Subaru itself enjoys only a 3.3% share of the motor vehicle market, amongst more than 40 vehicle brands. The Federal Court has expressly held that there is no separate market for the distribution of Subaru vehicles.¹ The proportionate impact of the notified conduct in the relevant markets for finance and insurance services must be considered in this context.
- It would not normally be in Subaru Australia's interests, from an inter-brand competition perspective, to support any program that would require its dealers to obtain finance on uncompetitive terms at the wholesale level, and thus reduce their ability to compete (in both an inter- and intra-brand context) at the retail level. For that reason, Subaru Australia is concerned to ensure that the choice of wholesale financier remains at the discretion of each dealer, on the most competitive terms available to that dealer.

4. 'Forcing' of dealers to accept inventory finance arrangements with GMAC (Subaru Finance)

4.1 Our clients reject out of hand the allegation that '*Subaru is effectively forcing its authorised dealers to obtain wholesale vehicle (inventory or floorplan) finance from GMAC*', and thus foreclosing opportunities to other suppliers of wholesale financial services.²

4.2 In short, neither Subaru Australia nor GMAC are requiring Subaru dealers to acquire goods or services from any third party. Granted, during an initial commercial pilot period, the new Subaru Insurance and Subaru Full Service Leasing products will only be available to consumers via those dealers who also support the Subaru brand through the acquisition of Subaru Finance. However, each Subaru dealer retains absolute discretion to acquire inventory finance, and the right to offer insurance or leasing products, from any financier, insurer or leasing service provider, based on the competitive terms offered by those providers.

4.3 As outlined above, none of Subaru Australia, GMAC, Swann or Interleasing have power in their respective markets, which in turn could be leveraged into, and distort,

¹ See *Regents Pty Ltd v Subaru (Aust) Pty Ltd* (1998) ATPR 41-647.

² See Esanda submission, Executive Summary; '*the penalties for rejecting the GMAC finance tie are so severe that dealers will be denied the opportunity to choose, on the normal commercial basis, whether or not to acquire wholesale vehicle finance from GMAC*' (Esanda page 2); '*dealers will [not] continue to have a genuine choice (based on price and other terms) to obtain wholesale finance from GMAC's competitors*' (Esanda page 4).

related markets via third line forcing conduct. Therefore, absent any contractual obligation, from an economic perspective it is incorrect to assert that the wholesale finance eligibility condition imposed by Swann and/or Interleasing denies Subaru dealers a genuine choice of their inventory financier supplier. Accordingly, the argument that dealers will be compelled to accept inventory finance from Subaru Finance by the notified conduct, or that opportunities will be foreclosed to competitors of Subaru Finance, cannot be sustained.

- 4.4 Subaru dealers themselves operate in a highly competitive market (both in intra- and inter-brand terms). Inventory finance is a significant overhead which has a direct impact on a dealer's costs, and thus their ability to constrain retail vehicle prices. The ability to offer the Subaru Insurance and Subaru Full Service Leasing products to their customers during a short commercial pilot period is an insufficient incentive to deal with GMAC if it was seeking to extract monopoly rents. As indicated in the submission of dealer John Pooley, a dealer's choice of financier must be based on competitiveness in order to keep retail pricing competitive downstream. Therefore, if a Subaru dealer chooses to acquire services from GMAC this will be due to the relative competitiveness of its offer. This is indicative of, rather than inimical to, the operation of the competitive market mechanism. It may not assist those competitors who are unable or unwilling to offer competitive terms, but is wholly consistent with the process of competition that Part IV of the TPA is directed to promoting.
- 4.5 Regardless, it is certainly not the case that Subaru dealers are being forced to accept uncompetitive wholesale finance terms. When licensing the 'Subaru' name for finance and insurance products, Subaru Australia sought expressions of interest from a number of wholesale financiers, and selected GMAC by reference to competitive criteria. The finance service benefits introduced through these branding arrangements have assisted *all* dealers in improving their competitive position, as competitive pressure has been exerted on other providers of finance, insurance and leasing services to respond with comparable benefits. For example, the Commission has previously been notified by Subaru Australia and GMAC of a Wholesale Dealer promotional program on WRX vehicles (N40533 and N40534). That program falls within the scope of the conduct subject of the omnibus notification currently before the Commission. In response to that program, a number of GE wholesale dealers (and one Esanda wholesale dealer) in Sydney and Brisbane approached GE and requested a comparable promotional package. As could be expected in the operation of the competitive market mechanism, GE responded by developing a competing retail finance offer.
- 4.6 In any event, we emphasise that any opportunities that are foreclosed to competitor financiers of Subaru Finance (which is denied) will not prevail beyond the short term. Both Subaru Insurance and Subaru Full Service Leasing will be made available to non-Wholesale Dealers at the end of the commercial pilot period, as indicated in paragraphs 1.6, 1.7 and 1.12 of our covering letter to the Form G notifications (dated 21 October 2003) (**Covering Submission**). This period is scheduled to expire within a matter of months, on 30 June 2004.
5. **Alleged public detriment**
- 5.1 The alleged forcing of Subaru Finance services discussed in paragraph 4 above is in turn alleged by Esanda and the MTAA to result in a detrimental effect on competition in

both the wholesale and retail markets for financial services.³ However, there is simply no evidence that the notified conduct will result in any anti-competitive detriment in the financial services markets identified - let alone that such detriment would outweigh the public benefits demonstrated in paragraph 5.2 below. We have considered concerns in relation to both the wholesale and retail functional levels in turn.

Effect on competition in the wholesale finance market

- 5.2 We are concerned that the Esanda and MTAA submissions fail to appreciate the structure and nature of competition within the relevant markets. As the Commission is aware, the wholesale finance market is highly competitive, GMAC does not enjoy power in any such market. Competitive floorplan products are offered to motor vehicle dealers by Esanda, GE/AGC, Primus, St George, Volkswagen Finance, DaimlerChrysler Finance, BMW Finance, Toyota Finance and Ford Credit, along with ordinary commercial credit facilities offered by the banks and other financial institutions, vendor finance and the dealer's own capital finance. Even on an extremely narrow market definition, restricted to the supply of commercial finance products to motor vehicle dealers, the *maximum* proportion of the market potentially affected by the notified conduct is 3.3% (consistent with the market share of the Subaru brand). Accordingly, the conduct will not create barriers to entry or otherwise harm competition in the wholesale finance market.
- 5.3 From an economic perspective, no opportunity is foreclosed to Esanda (or any other inventory financier) to offer competitive finance products, or to offer dealers a competing bundle of finance and retail insurance products (as may be facilitated by Esanda, for example, through its membership of the ANZ group of companies). No barriers to entry, regulatory, contractual or otherwise apply. Whether or not Subaru Finance's competitors chooses to respond with comparable offers will be a matter for them to decide, based on normal commercial considerations.
- 5.4 We also reject the 'floodgates' arguments on page 4 of the Esanda submission in relation to the potential expansion of 'tie' arrangements by GMAC to other dealership networks. Firstly, this argument is irrelevant to the application of the statutory test to the conduct notified by Subaru Australia, GMAC, Swann and Interleasing. Secondly, any other such arrangements - whether proposed by GMAC or any other motor vehicle distributor or financier - would also be subject to constraint by the third line forcing prohibition, and review by the Commission on its own merits under the notification process.
- 5.5 Accordingly, in our view, it is incorrect to state that the notified conduct will require Subaru dealers to acquire services from Subaru Finance in a manner that will cause anti-competitive detriment in the wholesale finance market.

Effect on competition in the retail finance market

- 5.6 Esanda has also alleged that the notified conduct is likely to have a detrimental effect on competition in the retail finance market. This is on the basis of an 'industry practice' that

³ *The tie will result in significant public detriment, including the removal of choice and a diminution in competition in the market for providing wholesale financial services to motor vehicle dealers. Subaru dealers will not have a real choice as to competitive financing alternative. They will be compelled to accept GMAC wholesale finance, thus foreclosing business to competitors of GMAC, including Esanda* (Esanda page 2); and *The forcing of GMAC wholesale finance in Subaru dealers is inherently anti-competitive and will inevitably distort the demand for, and supply of, wholesale motor vehicle finance* (Esanda page 4); *Dealers are increasingly forced to accept uncompetitive finance arrangements in order to obtain supply of particular brands* (MTAA page 2).

dealerships generally promote and sell the retail products available from their wholesale financier. It is therefore alleged that *'the entrenchment of GMAC wholesale finance throughout the Subaru dealership network is likely to result in GMAC retail finance being the sole finance product offered to retail customers in respect of Subaru'*.⁴

- 5.7 This concern is ill-founded. Firstly, there are no contractual or commercial obligations imposed on dealers by GMAC (nor, that we are aware, any other inventory financier) to restrict the brand of retail finance that may be offered to vehicle consumers. This is reflected in practice. For example, Subaru's largest independent franchisee offers Subaru Finance to its retail customers, but finances its floor stock with Esanda. Conversely, Gardons Motors (Subaru Ballarat) finances its floorplan with Subaru Finance, but offers BMW Finance products to its retail customers in certain instances. In fact, Subaru's own data for 2003 shows that more than 75% of consumers who purchased a Subaru vehicle from a Wholesale Dealer chose another form of retail finance to Subaru Finance.
- 5.8 Secondly, the ability of a dealer to introduce the business of a customer to a particular financier does not limit the options available to a customer to finance their motor vehicle purchase with any financier of their choice. This includes not only the finance companies such as Esanda, GE and Ford Credit, et cetera, but the four major banks and other financial institutions. There is simply no reduction in consumer choice due to the notified conduct, nor any foreclosure of opportunity to any financier to obtain the business of any consumer.
- 5.9 Therefore, it is simply incorrect to suggest that consumers will have their choice of retail finance constrained due to any floorplan arrangements between GMAC and the Subaru Dealers at the wholesale level, such that the notified conduct would have the potential to harm competition in the retail finance market.
- 5.10 In conclusion, our client is of the strong view that the notified conduct will not give rise to any anti-competitive detriment in the relevant markets.

6. Alleged absence of public benefit

- 6.1 Esanda has denied that any public benefits will arise from the notified conduct.⁵ This is also incorrect. In particular, it has focussed on one element of the notified conduct - viz the exclusive availability of Subaru and Insurance and Subaru Full Service Leasing to Wholesale Dealers (albeit only during the commercial pilot period). As outlined in paragraph 3.2 of the Covering Submission, the package of arrangements notified will result in significant benefits to the public. These include a number of public benefits that are directly recognised by the Commission:

⁴ *'Given industry practice (which is that dealerships generally promote and sell the retail finance products available from their wholesale financier), the entrenchment of GMAC wholesale finance throughout the Subaru dealership network is likely to result in GMAC retail finance being the sole finance product offered to retail customers in respect of Subaru' (Esanda page 2) and 'the finance choices offered by dealers to Subaru retail customers will also be restricted to GMAC products, given industry practice under which dealerships generally promote and sell the retail finance products available from their wholesale financier. Accordingly, competition in respect of retail vehicle financing will be harmed as well' (Esanda page 4).*

⁵ *'No effort is made to identify any public benefit likely to result from Subaru offering discounts, allowances, rebates or credits in relation to the supply of vehicles to those Subaru Dealers who acquire their wholesale finance from GMAC. Nor is any public benefit claimed for Swann and Interleasing denying non-compliant Subaru dealers the right to offer insurance and leasing services' (Esanda page 3).*

- (a) **(promotion of industry cost savings resulting in contained or lower prices at all levels in the supply chain)**⁶ the financial services package offered to Wholesale Dealers by Subaru Finance, Subaru Insurance and/or Subaru Full Service Leasing, at competitive wholesale interest rates, assists those dealers to keep their direct costs low, and adds value in terms of its retail product offerings. Whilst these benefits are exclusive to Wholesale Dealers during the commercial pilot period, they will operate to assist *all* Subaru dealers in improving their competitive position, due to the competitive pressure placed on other financiers to respond with comparable terms. This has been exemplified in practice with the response of GE to the Subaru Australia/Subaru Finance WRX promotion, as outlined in paragraph 4.5 above. Orthodox economic theory suggests that, in a highly-competitive market, improved competitiveness at the wholesale level will drive price competition at the retail level, in both an intra- and inter-brand context. This will, in turn, constrain motor vehicle prices at the retail level;
- (b) **(promotion of competition in industry)**⁷ in addition to the competitive pressures generated at the wholesale level discussed in paragraph (a) above, the notified conduct promotes competition in the retail markets for motor vehicles, finance and insurance. These effects are both direct, in terms of discount interest rates and insurance rebates, and indirect, due to the competitive pressures constraining costs at the wholesale level. The Commission has also recognised that product branding, a substantial driver of the notified conduct for Subaru, can be an important competitive tool in a highly dynamic market;⁸ and
- (c) **(expansion of consumer choice)**⁹ the introduction of new Subaru-branded comprehensive motor vehicle insurance and leasing products expands consumer choice in the retail insurance and financial services markets. In fact, the introduction of the Subaru Insurance product was in no small part prompted by market demands from Subaru WRX customers.

- 6.2 These direct and indirect competitive pressures will assist in keeping finance, insurance and motor vehicle prices low, and improve the range and quality of service offerings to consumers. This will ultimately enhance consumer welfare.
- 6.3 Esanda goes on to allege that: *'If, contrary to the above, it is established that Subaru dealers will somehow benefit from the GMAC tie, there is no guarantee that any such 'benefit' will ever be passed on to retail customers in the way of lower prices. While any such benefit in the form of higher dealer profit margins may be an attractive proposition to dealers, it is not a public benefit which should be seen as mitigating the loss of competition resulting from the proposed arrangements'* (page 4). This proposition is also incorrect. As outlined above, the motor vehicle market is highly competitive at both the distributorship and retail functional levels. Orthodox economic theory suggests that, when distribution and retail markets are highly competitive, cost savings upstream are passed on in the form of price restraint at the retail level. Furthermore, a significant proportion of the benefits to consumers from the notified conduct are to be paid directly - for example discounted rates of interest and the

⁶ See *Australian Medical Association Limited & Anor* (1998) ATPR (Com) 50-264.

⁷ *Ibid.*

⁸ See *Newfurn Floor Coverings Limited* (1998) ATPR (Com) 50-259.

⁹ *Ibid.*

insurance rebates typically offered in sums of between \$100-\$3,000 (as outlined at paragraph 1.10 of the Covering Submission). For these reasons, the concern that any benefits of the notified conduct will not be passed on to consumers is unfounded.

7. Residual comments - MTAA submission

7.1 We make a number of residual comments in relation to the submission of the MTAA.

7.2 Firstly, the MTAA has alleged that '*the dealer will be refused discounts, allowances and credits offered by Subaru in relation to the supply of Subaru vehicles to the dealer*' (MTAA page 2). This is not entirely correct. As outlined in paragraph 1.9 of the Covering Submission, the promotions available to Wholesale Dealers within the notified conduct are limited, and are in addition to the extensive program of brand and dealer network promotions sponsored by Subaru Australia. Further, in respect of any 'discounts, allowances and credits' that are so offered to the Wholesale Dealers, limited subventions will be made by Subaru Australia itself (in recognition of the brand benefits provided by the products), with the balance funded by GMAC and/or Swann in recognition of the promotion of their products. Other financiers and insurers remain free to incentivise the Subaru dealers in relation to their own promotional offers, as they see fit.

7.3 Finally, the MTAA submission also refers to a decision of the ACCC's predecessor in relation to an application by Ford to be allowed to engage in solus trading. We assume that the MTAA refer to the Tribunal's decision in *Ford (Ford Motor Co of Australia)* (1977) ATPR 40-043. In this case, the Tribunal's rejection of the franchise solus requirements proposed by Ford focussed heavily on the fact that the relevant conduct would enhance the competitive strength of a '*dominant company*' in its market (with, at that time, a 22% market share). This compares to Subaru Australia, who enjoys only a 3.3% share of the Australian motor vehicle market. In contradistinction to the *Ford* case, we submit that the introduction of innovative product offerings by a small, dynamic player in the motor vehicle market, in conjunction with alliance partners in the highly-competitive finance and insurance markets, and that provides a commercial option but does not mandate any action by any dealer or consumer, is likely to foster competition in the relevant markets.

8. Conclusion

8.1 It is our client's strong view that the concerns expressed by Esanda and the MTAA do not demonstrate that the public benefits accruing from the notified conduct are outweighed by any alleged competitive detriment. Therefore, the statutory test for the revocation of immunity set out in section 93(3A) cannot be discharged.

Australian Competition and Consumer Commission
30 January 2004

We hope that this assists the Commission with its inquiries. Please do not hesitate to contact me or Sarah Barker of this office should you have any further queries in relation to this matter.

Yours sincerely



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