

Luxury Watches And Spare Parts - The General Court Discusses The Analysis Of Aftermarkets

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Thomas Graf (Cleary Gottlieb Steen & Hamilton LLP, Belgium)

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In a recent judgment of December 15, 2010, the General Court had an opportunity to discuss the competitive analysis of aftermarkets. At issue in that case were complaints by independent watch repairers that they were unable to obtain spare parts from manufacturers of luxury watches. The Commission rejected these complaints *inter alia* on the ground that there was competition in the primary market for luxury watches and therefore no reason for concerns on the aftermarket for repair of such watches. The Court disagreed with the Commission and annulled the Commission's rejection decision. The Court considered that the Commission had not properly assessed whether sales of luxury watches and sales of spare parts constituted one single market or two separate markets.

The question of how to analyze aftermarkets under EU competition law is an important one because many durable goods can generate after sales in the form of consumables, spare parts, or services. A too narrow analysis of such aftermarkets may therefore result in an overly broad application of Article 102 TFEU, applying this provision in situations where the companies concerned are in reality subject to intense competition and consumers are unlikely to be harmed.

The complainants in the luxury watch case argued that the aftermarket for watch spare parts was distinct from the primary market for luxury watches and that each watch manufacturer was dominant over spare parts for its own watches. In rejecting the complaint, the Commission identified two (alternative) reasons why the aftermarket for spare parts should not be treated as being distinct from the market for luxury watches: (1) existing customers could avoid high repair prices by selling their watch on a second-hand market and switching to a different watch and (2) watch makers were constrained by the fact that new customers would choose a different brand if repair prices were uncompetitive.

The Court agreed that both of these factors were relevant for deciding whether primary and aftermarket were a single market or distinct markets. The Court noted that the Commission's analytical approach was consistent both with the Commission's market definition notice and past case law. However, the Court concluded that in the case at hand the Commission had not shown that either of these two factors was met.

On existing customers switching, the Court noted that it was not clear that customers would switch in response to a "moderate" price increase in repair services because the cost of repairs was small and the loss that they would incur by selling the watch on the second-hand market may be higher than the over-charge from repair services that they could avoid.

On constraints exercised by new customers, the Court held that the Commission had not shown that customers take into account repair costs in selecting luxury watches or indeed whether they are even aware of these costs. In other words, the Court expressed skepticism as to whether luxury watches are an area where customers are likely to be influenced by the level of costs in the aftermarket.

The Court therefore did not annul the Commission's decision because of errors of legal principle. Rather, the Court found the Commission's rejection decision to be insufficiently supported as a matter of fact. It did not disagree with the general analytical principles that the Commission applied for assessing aftermarkets. To the contrary, the Court's judgment expressly recognizes that aftermarkets cannot be analyzed in isolation without regard for their interaction with the primary market. The mere possibility that a company may have a high share over its own aftermarket will therefore generally not be sufficient for treating such a company as dominant under Article 102 TFEU. Nor is it sufficient for a definition of a distinct aftermarket that existing customers might face switching costs or may be locked-in. Competition for new customers in the primary market may well constrain a company also vis-à-vis existing customers, particularly if customers can be expected to be aware of aftermarket costs and these costs represent an important portion of total costs.

One question that the Court did not address is to what extent a refusal to supply spare parts may be objectively justified, irrespective of the question of market definition and dominance. In *Haladjian*, the Court expressly recognized the legitimate interest of a manufacturer to protect its authorized dealers from non-authorized spare parts resellers because in that case authorized dealers generated an important part of their margin from the sale of replacement parts through which they financed "the costs associated with setting up the distribution network". The Court therefore held that the limitation of spare part supplies benefited customers because it enabled the provision of "a good distribution network" that ensured "the maintenance and repair of their machines".

More generally, it is well recognized in economic theory that the possibility of generating margins in an aftermarket may drive manufacturers to lower prices for the primary products, as long as the primary market is competitive. A well-known example are game consoles that are sold below costs because of the prospect of generating margin from the sale of computer games. Conversely, if margins in aftermarkets decline, either prices in the primary market will have to go up or the service in the aftermarket may have to decline. It is therefore not evident that consumer welfare is served by narrowly focusing on aftermarkets.

In the luxury watch case, the Court did not have to assess objective justification and consumer harm because the Commission's original decision had not addressed these matters. Now that the Commission will have to re-examine the case, these may well turn out to be relevant considerations.