

How will OEMs evolve from automotive manufacturers to sellers of new mobility services, disrupting traditional distribution models globally?

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For decades, one business model has endured in the automotive industry: consumers buy their cars from independent dealers, not from automotive manufacturers (OEMs). But the automotive industry is changing. OEMs are exploring new revenue streams and distribution systems, including the sale of automotive-related mobility and connectivity services. Is the connected car or vehicle poised to disrupt traditional automotive distribution models?

Longstanding U.S. franchise and other national distribution laws across the globe – whether federal, regional, or local – govern the distribution of vehicles and now also mobility services, and the aftersales services market is still largely the dealers’ domain. In this hoganlovells.com interview, Dr. Patrick Ayad, a partner in Munich and Global Head of Automotive and Mobility at Hogan Lovells, and Colm Moran, a partner in the Hogan Lovells Los Angeles office, discuss to what extent OEMs will become distributors of new mobility and aftersales services, replacing or at least transforming the role traditionally played by dealers.

As the automotive industry changes, the way mobility services are distributed is changing, too. How are consumers influencing these changes, and how are OEMs addressing them?

Moran: On the issue of mobility in the automotive industry, you have a lot of discussion about the popularity of ride-sharing programs – like Uber, Lyft, and Didi – and the perspective that maybe the next generation of car owners isn’t going to be so interested in owning cars – they’ll be fine just having ride-sharing programs. The scope of this ongoing discussion includes whether an effective distribution model would be a system where the vehicles aren’t actually sold to consumers.

The OEM, for example, could set up a subsidiary that owns a fleet of model “A,” and the customer is just sharing and paying a fee to use the vehicle on a daily, weekly, or monthly basis. The vehicle would not be owned by the customer, so there is no retail sale. This is an area that OEMs are starting to take more seriously — that is, setting up entities to own fleets of vehicles that would be used for ride-sharing purposes.

Ayad: Yes, and that is a very significant development: the transformation from an automotive company into an automotive and mobility company, which includes the distribution of services.

Now, the rules for distribution of mobility services may be different than the rules for distribution of cars. OEMs are currently bringing in new subscription models – in the United States, Europe and globally – where you don't buy the car, you don't own it – you use it. You subscribe to the car for, let's say, one or two years. It's a sort of leasing, but different because it's not your car, in the sense of leasing it; it's more like a long-term rental. It's not even registered under your name, ideally. It belongs to the OEM and they may even set up a different company for that, which manages the fleet and does everything else – you don't have to worry about servicing or washing the car or anything like that.

It's really user friendly. It may be shared, or it may not, and it may be that you can change your car. Say you have your basic car, but then you can access a sports car for the weekend five times a year or so, or a convertible to use in nice weather. Such subscription models take away the ownership – it's more the *usership* and easy access whenever you like.

Would automotive dealers still have a role in this scenario?

Ayad: This is a new way of distributing and also, here again, the OEMs want to do this directly. So they might not need the dealers to sell the cars, but they'd still want the dealers to do the service on the cars, or the delivery of the cars, or explain the new mobility services to consumers. And here it may be more possible to do things differently than before. It may not be subject to the strict rules that we have for the distribution of vehicles, but that's a local question.

The other distribution issue would be the *connectivity services*, not related to driving the car, but related to the services *in* the car. The distribution of connectivity services will need to be addressed in the consumer terms, but again, from a distribution perspective, there is a profit here. The question is – to what extent will the OEM need to include the dealers in the distribution of such services?

These connectivity services, such as remote access to unlock or even start your car, would be offered by the OEMs – the dealers can hardly offer them. At the moment, these connectivity services go directly from the OEM to the consumer. In the future, OEMs may need support to further distribute such services.

Are OEMs focusing on any other aftersales services for distribution?

Ayad: At present, about 80 percent of the aftersales market is in the independent aftersales market, so 80 percent of the market share of servicing cars is outside the OEM world. And now the key question is – do the OEMs intend to regain control here? – because it may be a profitable business.

Also, in light of the fleets that they'd probably own as a car manufacturer, the OEMs would then need to provide servicing of these cars that they would now own. How do they do this? Do they have their own service model? Do they use their dealers? Do they bring in alternative distribution models? So there is also a change in the distribution world when it comes to aftersales.

Moran: Outside of the United States, you don't always have the same type of statutory issues. But in the United States there are still a lot of commercial and business issues, and statutory issues in some jurisdictions. Patrick is exactly right that, in addition to mobility as an alternative method of distributing vehicles, you do have the issue of services on the vehicles, be it the concierge-type services or what not. In my view, this is a continuum of, what type of service are you performing?

I'll give one example, where the dealer has given some pushback. Because motor vehicles now are largely so heavily dependent on and controlled by computers, a number of changes can be made just remotely, i.e. over the internet. Let's use Tesla as an example. Tesla rolls out materially substantial changes to the operating features of vehicles through software. It's just downloaded in; you don't take it in to a dealer. You download it into the software package into the vehicle's hardware and update it. Changing engine performance characteristics – Tesla does it all the time, changing all types of features on their vehicles.

Are other OEMs now following Tesla's example?

Moran: The other traditional OEMs haven't gone fully into that stage yet, but they certainly have that capability. And there has been some pushback from dealers that say – wait a second, at a certain point, if you're going to make an update or a change on an aspect of the vehicle, isn't that a warranty?

What kind of legal argument do the dealers have under current laws?

Moran: If it's, say, an aftermarket product, I think there's no argument that that's within the dealer's realm, that is protected by the dealer's agreement or statute for an aftermarket product. But it's an interesting question – that's why everyone says it's a spectrum of issues. What if there is a fault in the computer system on the vehicle and you can just fix it with a download over a Wi-Fi connection? And you can fix hundreds of thousands of vehicles overnight by doing that?

The dealers have expressed some pushback, saying, we should be getting a piece of that service work, as that's work coming by the warranty of the vehicle and we should be profiting on it. In other words, customers should have to come into the dealership to have the update done there.

There's a spectrum where, on one end, you have things like the aftermarket products on the vehicle. To me, I don't think there's any legitimate argument that the dealer in the United States would have this is covered by their agreement. Now they might make some sort of argument based on the trademark of the aftermarket product. But then you go to the other end of the spectrum, and you're fixing some problem with the vehicle software remotely, by a Wi-Fi internet connection. Is that sort of thing on the vehicle under warranty, or does that violate the law in most states?

Ayad: To add, it's not that there aren't any such issues outside the United States. There is a fine line between warranty and aftersales services, also as a matter of practice, as OEMs have traditionally relied on dealers to do such work. Also, going forward, OEMs will introduce further services, such as electricity services. And they will need to think about how to distribute them, with whom, and under which laws.

Do you think these issues will be heavily litigated?

Moran: The way I would sum it up is – we have a certain system of distribution that's been in place, in the United States, for almost 100 years: the distribution of automobiles through independent dealers. There has been an entire statutory scheme that has been constructed over a century around that model. The world is changing, and now we're trying to fit new methods into this existing model. In some cases, it's almost like putting a square peg into a round hole.

If you want a fleet of mobility service vehicles and you're selling subscriptions, is that the sale of an automobile? This is a totally different model, which doesn't necessarily fit neatly into the existing structure. There are going to be a lot of test cases around it – where the contours are, how the law might change, or whether manufacturers can be successful setting up alternative channels of distribution outside of the existing schemes.

Ayad: At least in Europe, these issues are in the first instance heavily negotiated with dealer associations. But there will also be litigation. Eventually, OEMs will still need dealers, or let's call them fulfillment or service partners. There is disruption in the automotive industry everywhere, so why should traditional ways of distribution not be disrupted? In response to this, OEMs are transforming, and so will dealers need to transform – otherwise others will take over.

About Dr. Patrick Ayad

Patrick Ayad runs your business from a legal perspective. He is a global leading practitioner on international contract drafting, procurement, and distribution, as well as an experienced regulatory advisor. Within more than 15 years of experience, he has gained considerable knowledge on commercial and regulatory matters, advising global companies, particularly in the industrial and consumer goods industry sectors, including automotive and mobility.

About Colm A. Moran

Automotive clients call on Colm Moran for his industry knowledge and confidence in litigation matters. He handles motor vehicle franchise law and class action defense. Co-chair of the firm's automotive litigation practice, Moran helps clients all around the United States. Motor vehicle manufacturers rely on his counsel regarding state motor vehicle franchise laws in all 50 states. He has handled litigation for such manufacturers in more than 25 jurisdictions.

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