COMMISSION AUTHORIZED

V890091

FEDERAL TRADE COMMISSION
Chicago Regional Office

Suite 1437
55 East Monroe Street
Chicago, Illinois 60603
Area Code 312 353-8156

September 8, 1989

The Honorable James R. Thompson
Governor of the State of Illinois
Office of the Governor
Springfield, Illinois 62706

Dear Governor Thompson:

The staffs of the Federal Trade Commission's Chicago Regional Office and Bureau of Competition are pleased to have this opportunity to respond to your letter of August 21, 1989, requesting our comments on House Bill 776.[1] The bill, in essence, would prevent automobile manufacturers from licensing repair shops to operate in areas where their new car dealers provide repair services and would further restrain the ability of manufacturers to franchise more than one dealer in any market.[2] We believe that the bill, if enacted, would most likely injure consumers by reducing competition, increasing costs, and raising prices in the market for repair services and could have similar effects in the market for new automobiles.

INTEREST AND EXPERIENCE OF THE FEDERAL TRADE COMMISSION

Our interest in this legislation stems from the Commission's mandate to enforce the consumer protection and antitrust laws of the United States. The Federal Trade Commission is charged with promoting competition and protecting consumers from unfair methods of competition and unfair or deceptive acts or practices.[3] In fulfilling this mandate, the staff of the Federal Trade Commission often submits comments, upon request, to federal, state, and local governmental bodies to help assess the competitive and consumer welfare implications of pending policy issues. In enforcing the Federal Trade Commission Act, the Commission staff has gained substantial experience in analyzing the impact of both private and governmental restraints on competition.

---

[1] These comments represent the views of the staffs of the Federal Trade Commission's Chicago Regional Office and Bureau of Competition and do not necessarily represent the views of the Commission or any individual Commissioner.

[2] HB 776 would also amend the Illinois Business Corporation Act of 1983, Ill. Rev. Stat. ch. 32. We express no comment upon these amendments.

[3] See 15 U.S.C. § 41 et seq.

During recent years, the Commission has been actively involved in issues relating to the retail automobile market. In 1984, for example, the Commission issued the Used Motor Vehicle Trade Regulation Rule ("Used Car Rule") in an effort to educate consumers about their warranty rights and to prevent the injury that can be caused by oral misrepresentations in used car transactions.[4] The Commission has also recently ruled that automobile dealers in the Detroit area violated the antitrust laws by agreeing to limit their hours of operation.[5] In addition, the Commission staff has conducted economic research concerning automobile marketing.[6]

The Commission staff recently commented on proposed Illinois legislation that would have prohibited brokers from selling new and used cars and that would have expanded Illinois's dealer licensing provisions.[7] We have also commented on Illinois legislation that would have prohibited car dealers from holding sales outside of their local markets.[8] We have also submitted comments to several other states regarding legislative initiatives in the automobile sales area.[9]

---

[4] Used Motor Vehicle Trade Regulation Rule, 16 C.F.R. Part 455. The Used Car Rule requires used car dealers to place a sticker in the window of each car that clearly states the warranty coverage being offered and that suggests consumers obtain an independent inspection of the vehicle prior to purchase. 16 C.F.R. § 455.2. These stickers form part of the contract of sale for a used car. 16 C.F.R. § 455.3(b). Staff compliance guidelines were updated as recently as May 17, 1988. 53 Fed. Reg. 17658 (1988).

[5] Detroit Auto Dealers Ass'n, Inc., FTC Docket 9189 (February 22, 1989).

[6] See Robert P. Rogers, The Effect of State Entry Regulation on Retail Automobile Markets, Federal Trade Commission, Bureau of Economics Staff Report, at 108 (January 1986).

[7] Letter from C. Steven Baker, Director, Chicago Regional Office of the Federal Trade Commission, to the Honorable Aldo A. DeAngelis, Senate of the State of Illinois, concerning Illinois Senate Bill 1978 (March 21, 1989). That legislation was vetoed.

[8] Letter of April 24, 1987, from John M. Peterson, Director, Chicago Regional Office of the Federal Trade Commission, to the Honorable Woods Bowman, State Representative, concerning House Bills 787 (1986) and 1173 (1987). That legislation was vetoed.

[9] See Comments of the Cleveland Regional Office and Bureau of Economics staffs of the Federal Trade Commission on Michigan House Bill 4390 by Mark Kindt, Director, Cleveland Regional Office (September 29, 1988); letter from the FTC staff to the Florida Senate (March 29, 1988); letter from the FTC staff to the South Carolina House of Representatives (March 21, 1988); letter from Jeffrey I. Zuckerman, Director,

(continued...)

SUMMARY OF HOUSE BILL 776

The State of Illinois currently regulates the sales of new cars in several ways. Dealers are required to obtain licenses from the State.[10] In addition, the Motor Vehicle Franchise Act[11] contains various provisions designed to protect the interests of car dealers. For example, a manufacturer cannot unilaterally establish an additional dealership in the "relevant market area" of a dealer of the same line of cars without that dealer's consent.[12] Should a dealer withhold consent, any attempt by the manufacturer to establish an additional dealership can be challenged through arbitration or in court.[13] Thus, for example, a Mercury dealer could possibly prevent Ford Motor Company from establishing a competing Mercury dealer nearby.[14]

House Bill 776 would amend the Illinois Motor Vehicle Franchise Act[15] to restrict the ability of manufacturers to franchise service centers and restrain further their ability to franchise car dealerships. The bill would amend Section 2[16] of the Act to expand the scope of the Act's coverage to automobile repair firms franchised by an automobile manufacturer. The bill would also amend Section 4[17] of the Act to declare additional

---

[9](...continued)
FTC Bureau of Competition, to William P. TeWinkle, Wisconsin State Senate (February 19, 1988); letter from the FTC staff to the California State Assembly (January 29, 1988); letter from the FTC staff to the Governor of Texas (June 1, 1987).

[10] Illinois Vehicle Code, Ill. Rev. Stat. ch. 95 1/2, para. 5-101 and 5-102.

[11] Ill. Rev. Stat. ch. 121 1/2, para. 751 - 764.

[12] Ill. Rev. Stat. ch. 121 1/2, para. 751 - 764.

[13] See Ill. Rev. Stat. ch. 121 1/2, para. 762.

[14] The Commission's Bureau of Economics conducted a study of "relevant market area laws" and concluded that state laws restricting the number of automobile dealers in an area increase costs to car buyers in this country by as much as $3 billion each year. See Rogers, supra note 6.

[15] Ill. Rev. Stat. ch. 121 1/2, para. 751 - 764.

[16] Ill. Rev. Stat. ch. 121 1/2, para. 752.

[17] Ill. Rev. Stat. ch. 121 1/2, para. 754. Section 4 provides, in part, that "[i]n construing the provisions of this Section, the courts may be guided by the interpretations of the Federal Trade Commission Act (15 U.S.C. § 45 et seq.), as from time to time amended." Ill. Rev. Stat. ch. 121 1/2, para. 754 (a). Section 4 also prohibits a manufacturer from engaging in various enumerated unfair means of competition and deception with respect to its franchised dealerships.

methods of competition and deceptive acts or practices unlawful. Section 4, as amended by HB 776, would prohibit a manufacturer from:

1) granting an additional dealer or automobile service franchise in the market area of an existing dealer or service franchise;[18]

2) renewing or extending a dealer or automobile service franchise in the market area of an existing dealer or repair franchise;[19] or

3) maintaining or extending an automobile service franchise that had been granted indefinitely prior to the effective date of HB 776 in the market area of an existing dealer or service franchise.[20]

The bill, therefore, would prohibit a manufacturer from authorizing a service center to operate in any market area where a dealer had been granted a franchise. Further, the bill most likely would discourage a manufacturer from franchising a repair center in a new area, for any such franchise would preclude the manufacturer from subsequently establishing a new car dealership in the market. As a result, the bill would tend to eliminate manufacturer-authorized service facilities that are not affiliated with new car dealerships. Moreover, the bill apparently would force manufacturers to eliminate all but one new car dealership in each market area defined in a franchise agreement, thereby creating a single outlet in each area for both the distribution of that manufacturer's new cars and the provision of its authorized service.

THE POTENTIAL EFFECTS OF HOUSE BILL 776

A. The Market for Car Repair Services

Car repair services are offered by manufacturer-authorized service centers and by repair shops that are operated without official manufacturer sanction. Traditionally, authorized service has been available only from new car dealers. A variety of firms offer non-authorized service, including independent repair shops, general repair service chain outlets, specialized service centers, and filling stations. Consumers may prefer to obtain authorized service for several reasons. For example, some manufacturers limit their warranties to repairs performed by authorized service centers.[21] In addition, some

---

[18] HB 776, § 4(e)(13), amending Ill. Rev. Stat. ch. 121 1/2, para. 754.

[19] HB 776, § 4(e)(14), amending Ill. Rev. Stat. ch. 121 1/2, para. 754.

[20] HB 776, § 4(e)(15), amending Ill. Rev. Stat. ch. 121 1/2, para. 754.

[21] We understand, for example, that non-emergency repair services must be obtained from authorized centers under General Motors Corporation warranties.

consumers may value the manufacturer's representation of quality implicit in its authorization and be willing to pay a premium to obtain the assurance.

We understand that one manufacturer, General Motors Corporation, has recently instituted a pilot program in the Chicago area known as "Delco Tech." Under the program, GM licenses independent service centers to provide repair services under the Delco Tech tradename.[22] Delco Tech shops receive service bulletins, receive training from GM, and are authorized to sell GM parts. According to GM, Delco Tech shops charge much less for GM-authorized service than do new car dealers.

HB 776 would prevent a manufacturer like GM from establishing or maintaining a franchised service center in the market area of a car dealer, as defined in the dealership agreement. To the extent consumers value manufacturer-authorized service, the bill may prevent manufacturers from offering that service in the most efficient way. For example, a manufacturer may conclude that authorized service can best be provided by facilities that are separate from car dealerships or that efficient service requires more outlets in a given area than does distribution of new cars. Or it may find that a particular independent garage in a city provides service more efficiently than does its own dealer. Any loss of efficiency caused by restricting the manufacturer's options for offering authorized service will be reflected in higher prices that consumers will have to pay.

Moreover, HB 776 may enable some dealers to charge prices for repair service that exceed their costs. The bill would effectively force manufacturers to confine the provision of authorized service to new car dealers; indeed, it would apparently force them to franchise no more than one dealer in a market area. When a supplier unilaterally decides to distribute its product or service through dealers assigned exclusive sales territories, a presumption arises that the territorial restraints established increase the efficiency of the distribution process.[23] When the government requires the use of exclusive territories, however, no such presumption arises. A distributor may be able to charge a supra-competitive price because the manufacturer is barred from establishing competing outlets. Further, by reducing the number of service providers, the bill may increase the risk of collusion among them. Because the restrictions contained in HB 776 would apply to all motor vehicle manufacturers, the risk of anticompetitive effects is

---

[22] GM reports that Delco Tech shops are not currently authorized to perform warranty work. GM presumably might decide to confer this authorization in the future, especially after it has had an opportunity to assess the results of its experimental program.

[23] See generally Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). As long as a manufacturer does not agree with other manufacturers to impose territorial restraints on their respective dealers and does not impose them at the behest of a dealer cartel, such restraints in franchise agreements will not violate the antitrust laws if they are otherwise reasonable.

enhanced. Consumers, of course, may suffer if HB 776 prevents manufacturers from restraining supra-competitive pricing of authorized repair services.

B. The Market for New Cars

By prohibiting a manufacturer from "renew[ing]" a franchise established prior to the effective date of the act in a market area of a prior-established dealer,[24] HB 776 would apparently allow manufacturers to maintain only a single dealership in each market area, defined as the dealer's "area of primary responsibility" specified in the franchise contract.[25] Although the size of these areas is thus determined by the franchise agreement, the areas may have been defined expansively for business reasons at a time when the effects of the specification under the bill could not have been foreseen. For example, GM reports that, under its franchise agreements with car dealers, an entire metropolitan area is a dealer's primary area of responsibility. The legislation would therefore eliminate all but one Chevrolet dealership in the Chicago metropolitan area.[26]

Even if this result is unintended and could be prevented through executive or legislative amendatory action, the bill would still impose an additional restraint on the ability of manufacturers to establish efficient distribution networks. Under current law, if a dealer refuses to consent to the establishment of another dealership in its "relevant market area," the manufacturer may nevertheless be permitted to grant the new franchise after arbitration or litigation. Under HB 776, the manufacturer would be absolutely prohibited from "grant[ing] an additional franchise in a market area of an existing motor vehicle dealer . . . ."[27] Therefore, even if market conditions change, such that efficient distribution in a growing area requires another dealership, manufacturers would be denied a forum for demonstrating the need and desirability of adding an outlet.[28]

---

[24] HB 776, § 4(e)(14).

[25] Ill. Rev. Stat. ch. 121 1/2, para. 752 (p).

[26] Our analysis does not consider whether HB 776, by affecting the pre-existing contractual rights of a manufacturer and its franchisees, may run afoul of state or federal constitutional mandates. See Fireside Chrysler-Plymouth Mazda Inc., v. Chrysler Corp., 129 Ill. App.3d 575, 472 N.E.2d 861 (1st Dist. 1984) (aff'g trial court's decision that retroactively applying the Motor Vehicle Franchise Act to the facts of that case would have unconstitutionally impaired vested contractual rights).

[27] HB 776, § 4(e)(13).

[28] Another potential problem that could arise from enacting this legislation stems from using the terms "relevant market area" and "market area" in different ways. The Motor Vehicle Franchise Act defines "relevant market area" as an area around the principal location of a franchisee. That area is either a ten or fifteen mile radius,

(continued...)

As in the market for repair services, the restraints that HB 776 would impose on manufacturers in the market for new cars would most likely result in less efficient distribution systems and could increase the risk of anticompetitive pricing. Consequently, the price of automobiles to consumers would be expected to rise. Some manufacturers may even discover that franchising additional dealers in neighboring states to serve Illinois markets would be profitable.[29] Illinois consumers would then incur needless costs of inconvenience, and jobs might unnecessarily exit the state.

CONCLUSION

We believe that HB 776 is likely to increase the costs of distribution and may increase the risk of anticompetitive pricing in the markets for both car repair services and new automobiles. In particular, the bill would effectively eliminate a valuable new source for manufacturer-authorized repair work. We therefore believe that enactment of HB 776 may injure consumers by resulting in higher prices for some types of repair services and for new cars.

We appreciate this opportunity to comment.

Sincerely,

C. Steven Baker
Director
Chicago Regional Office

---

[28](...continued)
depending upon the population of the county in which the franchisee is located. Ill. Rev. Stat. ch. 121 1/2, para. 752 (q). On the other hand, the bill prohibits manufacturers from establishing, renewing, or maintaining a dealership or service facility in the market area of an existing dealer. However, the size of a "market area" for the purposes of HB 776 is defined in each franchise agreement and can thus vary in size. Thus a dealer's market area could be larger than its "relevant market area."

The differences in these two terms could create anomalous situations. A manufacturer can currently establish a competing dealer within the "relevant market area" of an existing dealer if a reviewing court or arbitrator approves. Under HB 776, however, the manufacturer would be absolutely barred from establishing that dealership in a location outside the "relevant market area" if the location also happened to be within a larger "market area" provided in a dealer's existing franchise agreement.

[29] For example, dealers in northwest Indiana and southeast Wisconsin might be able to serve the Chicago market, dealers in east central Iowa might be able to sell in the Quad Cities market, and dealers in St. Louis might be able to serve Illinois consumers in adjacent areas.