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COMMISSION AUTHORIZED

December 18, 1989

The Honorable Joseph E. Haines
House of Representatives
State of Ohio
State House
Columbus, Ohio 43215

Dear Representative Haines:

The staff of the Federal Trade Commission[1] is pleased to respond to your invitation for comments on House Bill 302, which regulates the sale of "aftermarket crash parts" and mandates the disclosure of certain types of information about these parts. As you have requested, we are providing comments on the consumer welfare and competitive effects of the proposed statute. We believe that the Bill contains provisions that might substantially reduce competition and consumer choice in the market for crash parts. Additionally, although the Bill's disclosure requirements may increase consumers' information, we suggest that the General Assembly balance the possible costs of mandated disclosure against the perceived benefits from it.

I. INTEREST AND EXPERIENCE OF THE STAFF OF THE FEDERAL TRADE COMMISSION.

The Federal Trade Commission ("FTC") is charged with promoting competition and protecting consumers from unfair and deceptive commercial practices.[2] 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.

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[1] These comments are the views of the staff of the Cleveland and Los Angeles Regional Offices and Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or of any individual Commissioner.

[2] *See* 15 U.S.C. § 41 *et seq.*

In the course of its law enforcement activities, Commission staff has become familiar with the issues relating to competition in the market for "aftermarket crash parts." In particular, in *General Motors Corporation*,[3] the staff investigated the effects of General Motors' crash parts distribution system on independent wholesalers, body shops, and others.

More generally, the Commission staff has frequently analyzed the effectiveness of advertising and labeling in providing consumers with reliable product information,[4] and has examined the need for disclosure statements in situations where the unregulated market may fail to provide adequate information.[5]

II. DESCRIPTION OF HOUSE BILL 302.

House Bill 302 (the "Bill") contains several provisions that regulate the marketing and use of aftermarket crash parts.[6] First, repair facilities, installers, or insurers cannot impose a greater charge upon a person who demands original

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[3] 99 F.T.C. 554 (1982).

[4] Working papers and reports published by staff members in the Bureaus of Economics and Consumer Protection of the Federal Trade Commission include: M. Lynch, *et al.*, *Experimental Studies of Markets with Buyers Ignorant of Quality Before Purchase: When Do "Lemons" Drive Out High Quality Products?* (1986); M. Frankena, *et al.*, *Alcohol Advertising, Consumption, and Abuse* (1985).

[5] *See* the following FTC staff reports and comments: *Ippolito and Mathios, Health Claims in Advertising and Labeling: A Study of the Cereal Market (1989); Calfee and Pappalardo, How Should Health Claims for Food Products Be Regulated?* (1989); comments to *Food Safety and Inspection Service, United States Department of Agriculture, on the Standard for Frankfurters and Similar Cooked Sausages,* Docket No. 85-009E, 52 *Fed. Reg.* 2415 (June 22, 1987 [Final Rule, 9 C.F.R. Part 319]); and comments to *Food Safety and Inspection Service, United States Department of Agriculture, on Labeling of Meat Food Products, Under Certain Circumstances, that Contain Mechanically Separated (Species),* Docket No. 86-049P, 9 C.F.R. 317, Nov. 8, 1988.

[6] As defined in the Bill, "aftermarket crash part" means a replacement for any of the non-mechanical sheet metal or plastic parts that generally constitute the exterior of a motor vehicle, including inner and outer panels. A "non-OEM" aftermarket crash part is one not made by or for the manufacturer of the motor vehicle.

equipment manufacturer ("OEM") parts than would have been imposed had the person accepted non-OEM aftermarket crash parts. [7]

Second, if a consumer requests a written estimate,[8] the repair facility or the installer must supply to the consumer an estimate that contains a listing of each non-OEM aftermarket crash part intended for use and have attached, or printed on the estimate, a statement that discloses to the customer that:

> This estimate has been prepared based on the use of aftermarket crash parts supplied by a source other than the manufacturer of your motor vehicle. Nonoriginal equipment manufacturer aftermarket crash parts, most of which are not made in the United States, may vary in terms of quality, fit, performance, and warranty from the original parts supplied on your vehicle. Failure of these parts and other parts of your vehicle that are attributable to the use of nonoriginal equipment manufacturer aftermarket crash parts may not be covered by your vehicle's manufacturer's warranty or by guarantees provided by the repair facility or installer.

Third, if the person requesting the repair chooses to receive an oral estimate or none at all, the repair facility or installer must provide to the person a similar disclosure statement. The same disclosure document as is given with a written estimate must be provided with the final invoice.

III. THE COMPETITIVE EFFECTS OF H.B. 302.

The apparent purpose of H.B. 302 is to protect uninformed consumers from purchasing allegedly low-quality or overpriced non-OEM replacement parts. Whether there now exists substantial quality or price variation between OEM and

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[7] Insurers are prohibited from requiring the use of non-OEM aftermarket crash parts as a precondition of payment for a repair. Also, the Bill would require insurers to provide to consumers a written disclosure stating that customers may refuse to accept the use of non-OEM aftermarket crash parts in the repair of the damaged vehicle. We do not comment on these aspects of H.B. 302.

[8] Under current Ohio law, if the anticipated cost of a motor vehicle repair exceeds twenty-five dollars, the consumer is entitled to an estimate of the cost of repairs, and at the consumer's option, may receive the estimate in writing, orally, or waive the estimate. Ohio Admin. Code § 109:4-3-13 (1978).

non-OEM parts is a factual question that we do not address here. We note, however, that some consumers might prefer a lower quality part if its price is also lower. The primary adverse effect of H.B. 302, if enacted, is that the restraints on the prices repair shops could charge for OEM parts may make it more difficult for consumers to make such price-quality trade-offs.

It may be that some consumers of auto repair parts are not knowledgeable about the alternatives that exist in this market, and are thus not well situated to make an informed choice between parts of different quality. If the legislature finds that a significant information problem exists, government regulation designed to provide adequate information may be appropriate. Section IV of these comments discusses whether such an information problem is likely to exist in the crash parts market, and discusses whether H.B. 302's disclosure provision is likely to remedy any such problem.

A. Trade-offs and Consumer Choice.

A consumer's choice of replacement part quality will be determined by a number of factors, such as the relative prices of low- and high-quality parts, the relative quality of these parts, the age and pre-crash condition of the vehicle. (The existence of third-party coverage for many auto body repairs will likely also alter consumers' incentives to make these price-quality trade-offs. We offer no comments, however, on how consumer incentives might be altered in this respect.) It is plausible that some consumers would prefer to purchase lower quality parts, provided that their price is low enough. For example, an owner of an older automobile may prefer lower quality crash parts – at lower cost – because the life expectancy of the vehicle is short. The owner of a newer automobile, by contrast, might be willing to pay a higher price to obtain a higher quality part. Consumers are better off when they have the ability to make choices reflecting their preferences for quality.

House Bill 302 could substantially impair the ability of consumers to make such trade-offs. Subsection (D), in part, states that "no repair facility [or] installer . . . shall impose a greater cost upon a person who refuses to accept the use of non-OEM aftermarket crash parts than would have been imposed with the acceptance of non-OEM crash parts." This provision attempts to equalize the prices of OEM and non-OEM parts, thus eliminating perhaps the only attraction of non-OEM parts, assuming that consumers perceive the quality of non-OEM parts to be below that of OEM parts.[9]

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[9] While we take no position on the actual extent of quality differences between OEM and non-OEM parts, we think it likely that many consumers currently perceive OEM parts as being superior to their non-OEM counterparts, which would result in OEM parts commanding a higher price than non-OEM parts.

If consumers do not perceive that OEM and non-OEM parts differ in quality, they may still base their purchase decisions on attributes of repair parts other than price, *e.g.*, on whether the parts were manufactured domestically. Otherwise, the prices of OEM and non-OEM repair parts would tend to equalize, since consumers would regard OEM and non-OEM parts as close substitutes for one another. Whether consumers actually base their purchases on attributes other than price and quality is unknown. However, if they do, and if information available to consumers about these product attributes is in some way inadequate, one possible solution would require the disclosure of currently unavailable relevant information, such as the manufacturer's name, or the country of origin of the part. This is different from the approach taken in subsection (B) of H.B. 302, which requires that the repairer disclose that many non-OEM parts are made abroad, but does not require the disclosure of any specific information about the particular manufacturer that the repairer intends to use.[10]

B. Quality Variations and Product Availability.

Even if quality variations do exist, Subsection (D) may increase the cost to consumers of shopping for desired combinations of price and quality in repair parts. Repair shops currently have an incentive to install either OEM or non-OEM parts, depending upon a particular customer's preferences and the prices (to the repair shop) of OEM and non-OEM parts. As a result, consumers may be able to obtain valuable information about the price-quality trade-off at a single body shop. Subsection (D) would reduce any individual repairer's incentive to offer both OEM and non-OEM parts, thereby making it more difficult for consumers to shop for automotive repairs.[11] The bill may also increase the overall price of automotive repairs and limit the availability of non-OEM parts.

Subsection (D) would reduce repair shops' incentives to offer both OEM and non-OEM parts because it would permit a shop to quote only one rate to a prospective customer, regardless of whether the shop planned to install OEM or non-OEM parts. For example, if a shop prepares an estimate that reflects the lower price of non-OEM parts, and the customer subsequently refuses to allow non-OEM parts to be used, the shop must either perform the repairs at the low price, but using

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[10] Since many auto manufacturers are located overseas, it will often be the case that the OEM replacement parts are also manufactured abroad. In such instances, disclosing that some non-OEM parts are imported may not provide the consumer with much useful information.

[11] The seminal article on search costs is Stigler, *The Economics of Information*, 69 J. Pol. Econ. 213 (1961).

higher cost OEM parts, or it must simply refuse the job. It cannot prepare a new estimate reflecting the cost of more expensive parts.

Similarly, a repair shop cannot present a customer with two estimates, letting the customer choose the price-quality combination that he likes best. This is because the consumer could demand that the higher-quality (and higher-cost) parts be provided at the low price, thus making the job unprofitable for the repairer. To avoid this possibility, firms wishing to perform repairs using non-OEM parts might find it necessary to specialize in the use of non-OEM parts. If such specialization were to occur, a consumer wishing to obtain two estimates would have to visit two different repair shops.[12] It would thus become more costly for price-conscious consumers to shop for low-price repair estimates.

Subsection (D) actually may be even more restrictive than is suggested by the preceding analysis. The discussion above assumes that the Bill would prevent a repair shop from offering any particular customer two different prices. Subsection (D) could be interpreted to mean that a shop cannot offer different customers different prices. Suppose, for example, that two customers order the replacement of a front fender on a 1980 Honda Civic, one of whom would be satisfied with non-OEM parts, the other of whom would not. Subsection (D) may be read to prevent the repair shop from charging the OEM customer a higher price than the non-OEM customer, even though such an outcome would be the expected consequence of normal competitive forces, and would be consistent with the preferences of auto repair customers.

If this interpretation of subsection (D) is correct, repair shops would have little incentive ever to perform repairs at a price that reflects the use of non-OEM parts. Charging a low price would bind the shop to perform similar future repairs at the same low price, irrespective of whether these future repairs use OEM or non-OEM parts. Repair shops would have an incentive to use non-OEM parts, but attempt to charge an OEM price. However, it would appear likely that most customers would demand OEM parts at these higher prices. Even if they did not, the direct gains from the use of low-price parts would accrue to the shops, not the customers who purchased those parts. Unless some shops choose to specialize exclusively in performing non-OEM repairs, customers wishing to have repairs performed at a low price with non-OEM parts might find it more difficult to find a shop willing to provide this service.

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[12] Such specialization may itself be inefficient, and thus raise the costs of both OEM and non-OEM repairs.

IV. CONSUMERS' KNOWLEDGE OF CRASH PART QUALITY.

Quality variations between OEM and non-OEM parts that do exist could cause consumer injury if consumers are unaware of these variations and purchase low-quality (presumably, non-OEM parts) on the mistaken assumption that all parts are of equal quality.[13] Existing industry institutions already have strong incentives to convey information to consumers about differences, or the lack thereof, between OEM and non-OEM crash parts. However, the proposed mandatory disclosure provision may provide net benefits to consumers if those incentives are not strong enough to provide consumers with adequate information and if the costs associated with mandatory disclosure are relatively small.

There are two ways in which a consumer could be injured by the purchase of a non-OEM part. First, a consumer may believe that an OEM part is being purchased when in fact it is not. This consumer would clearly suffer harm if he has a preference for OEM parts.[14] Second, a low-price, low-quality replacement part may be purchased on the mistaken belief that this part is equal in quality to OEM replacement parts. Obviously, such a consumer will not receive the expected benefits from the purchase.

It is unclear whether a lack of consumer information has created any substantial competitive problems in the crash parts market. If it has, however, notifying customers that non-OEM parts are now commonly used by repair shops,

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[13] The degree to which quality variations exist is controversial. Ford, for example, maintains that "[w]e have yet to find a substitute sheet metal part that comes close to meeting Ford specifications, whether it be in fit and finish or in corrosion protection. *See Public Affairs, Ford Parts and Service Division, Motorists 'Cheated' with Substandard Substitute Sheet Metal*, at 1 (undated). Non-OEM manufacturers contend that, on the average, their crash parts are equal in quality to OEM parts. A 1986 survey of Taiwanese manufacturing facilities conducted by State Farm Insurance inspectors found that the majority of surveyed plants produced crash parts that met or exceeded the quality of OEM parts. *See Foreign Aftermarket Parts and the Quality Question*, J. Am. Ins. 6, 8 (2d Qtr. 1987).

[14] If a consumer unwittingly purchases a non-OEM part that is inferior to an OEM part, this would also injure the reputation of the OEM. Over time, this loss of reputation would hurt consumers as well as the OEM. A false perception that the OEM's parts are of poor quality would reduce the price that consumers would pay for OEM parts. This, in turn, would reduce the OEM's incentive to incur the higher costs of high quality production. Eventually, fewer high quality goods would be offered, contrary to consumers' preferences. *See* M. Lynch, *et al.*, *Experimental Studies of Markets with Buyers Ignorant of Quality Before Purchase: When Do "Lemons" Drive Out High Quality Products?*, Bureau of Economics Staff Report to the Federal Trade Commission, (1986).

and that these parts may differ in quality from OEM parts, could provide consumers with useful information. The disclosure provisions in H.B. 302 might improve market performance if (1) there are significant quality differences between OEM and non-OEM parts, (2) the market fails to provide information about such quality differences, and (3) the costs of mandated disclosure do not offset the corresponding benefits.[15]

The existence of quality differences does not, by itself, necessitate the use of mandated information disclosures, since producers may have both the incentive and the ability to provide consumers with adequate information. Producers of high-quality parts, whether OEM or non-OEM, have substantial incentives to assure consumers that they will deliver the promised quality; otherwise, consumers will not be willing to pay a price that will cover the increased costs of higher quality production. Whether an unregulated market will generate enough information depends upon whether firms have ways of credibly conveying information to consumers.

OEMs appear to be making serious efforts to differentiate their crash products from those of their non-OEM competitors. General Motors and Ford have apparently engaged in aggressive campaigns to emphasize alleged quality differences. The "Mr. Goodwrench"/"Genuine GM Parts" campaign is particularly prominent. In these advertisements, consumers are told that non-OEM parts are inferior and are exhorted to demand "genuine" GM parts.[16]

Similarly, non-OEM producers are apparently adopting measures to convey information about quality to consumers. In 1985, the Aftermarket Body Parts Association ("ABPA"), composed of non-OEM parts suppliers, recommended that its

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[15] *See generally* International Harvester Co., 104 F.T.C. 949 (1984).

[16] A "Parts & Accessories 'Information' Bulletin" relating to "Imitation Sheet Metal" announced to "All General Motors Dealers":

> Beginning May 19th, General Motors Parts will air the attached radio spot for three successive weeks. A total of 461 national spots will air, with additional spots in select markets. Over 3,000 radio stations nationwide will air this spot during prime, drive-time hours; over 352,000,000 gross impressions will be made! ... What better way to tell the public about the "critical difference" between genuine and imitation parts. And the importance of asking for genuine GM Parts. (Emphasis in original.)

S. M. McAllister, Director, Marketing and Forward Planning, General Motors Parts, National Radio Campaign; Imitation Sheet Metal (May 9, 1986).

members offer a five-year limited warranty on crash parts.[17] A majority of ABPA members have followed this recommendation.[18] The ABPA also has developed a certification program which specifies tolerances and characteristics of crash parts sold by participating manufacturers.[19]

Thus, there appear to exist means by which crash part manufacturers can credibly convey truthful information about their product quality. The presence or absence of features such as voluntary certification and warranties provides consumers with information that helps them to distinguish between producers offering different levels of quality.

The General Assembly may wish to consider the full implications of the certification and warranty programs established by the ABPA and other similar organizations. The General Assembly also may wish independently to investigate the procedures underlying such certification programs and the extent to which organizations such as ABPA are effective in setting warranty and certification standards for their members.

The final consideration is whether the benefits to consumers of mandatory disclosure outweigh the corresponding costs. There are two types of costs generally associated with mandatory disclosure. First, there are the direct resource costs of conveying the mandated information to consumers, which may exceed the costs of voluntarily-supplied consumer information. Second, there is a risk that the language of a mandatory disclosure may mislead consumers, creating a negative public perception when none is justified. This can occur even if the information disclosed is truthful.[20]

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[17] ABPA Background at 4 (undated); Letter from Stanley Rodman to Peter Jennings (June 23, 1988) (located at 1-2).

[18] Rodman, *supra* note 17, at 1.

[19] The ABPA recently established the Certified Automotive Parts Association ("CAPA") to review and direct the testing by Detroit Testing Laboratories ("DTL") of crash parts. ABPA, Aftermarket Parts Testing and Certification Program (undated). The November 1989 Parts Directory listed 607 certified non-OEM crash parts, a 500% increase in the number of parts listed as available in 1987. Certified Automotive Parts Association, *Directory of Certified Aftermarket Body Parts* at 2 (1989).

[20] For example, the disclosure statement requires that the repairer state that part failures attributable to the use of non-OEM parts may not be covered "by guarantees provided by the repair facility or installer." While this is a true statement, it is unclear whether repair facilities or installers currently tend to offer OEM and non-OEM customers different warranty terms. If they do not, this statement may

(continued...)

V. CONCLUSION.

In considering House Bill 302, FTC staff suggest that the Legislature take into account the possibility that the Bill might unreasonably restrict consumer choice in the market for auto crash parts. The Legislature may also wish to take into consideration the benefits and costs of mandatory disclosure.

Sincerely,

Mark D. Kindt
Director
Cleveland Regional Office

Marcy J. K. Tiffany
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[20](_continued)
cause some consumers to infer incorrectly that such differences are relatively common. Also, the failure of the disclosure statement to convey information about manufacturers' warranties may also mislead consumers.