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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
LOS ANGELES REGIONAL OFFICE

V890006

COMMISSION AUTHORIZED

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February 26, 1990

The Honorable John L. O'Brien
Speaker Pro Tempore
House of Representatives, State of Washington
Joseph Vance Building
Seattle, Washington 98101

Dear Representative O'Brien:

The staff of the Federal Trade Commission¹ is pleased to respond to your invitation for comments on House Bill H-2212, which defines standards for the certification of "aftermarket crash part" quality, and which mandates the disclosure of certain information to consumers. We suggest that the General Assembly balance the possible costs of mandated disclosure and certification standards against their perceived benefits.

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.

In the course of its law enforcement activities, Commission staff has become familiar with the issues relating to competition in the market for crash parts. In particular, in General Motors Corp.,³ the staff investigated the effects of General Motors' crash parts distribution system on independent wholesalers, body

¹ These comments are the views of the staff of the Los Angeles Regional Office 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.

³ 99 F.T.C. 554 (1982).

shops, and others. In addition, the staff has recently provided comments on proposed Ohio legislation to regulate the sale of aftermarket crash parts.⁴

More generally, the staff has frequently analyzed the effectiveness of advertising and labeling in providing consumers with reliable product information,⁵ and has examined the need for disclosure statements and performance standards in situations where the unregulated market may fail to provide adequate information.⁶

II. DESCRIPTION OF H-2212

H-2212 (the "Bill") regulates the marketing and use of aftermarket crash parts. Aftermarket crash parts are exterior sheet metal or plastic replacement parts for automotive vehicles, generally replaced as the result of a collision. Although both original and non-original equipment manufacturers produce crash parts, Sections 3 and 5(3) of the Bill specifically refer to "aftermarket crash parts" as those not produced or supplied by the original equipment manufacturer ("OEM").

The Bill contains three major provisions. First, "unless [the consumer] agrees to accept noncertified parts," all aftermarket crash parts used to prepare estimates must be certified as meeting certain specifications as to finish, function, and corrosion resistance. Under Sections 4(2) and

⁴ Letter from Mark D. Kindt, Director, Cleveland Regional Office, and Marcy J. K. Tiffany, Director, Los Angeles Regional Office, to the Honorable Joseph E. Haines, Ohio House of Representatives (December 18, 1989).

⁵ Working papers and reports published by staff members in the Bureau of Economics 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); J. Lacko, Product Quality and Information in the Used Car Market, (1986).

⁶ Although none of these studies specifically address the automotive crash parts market, the basic principles discussed are highly relevant to assessing the need for government mandated quality standards and information disclosures in all markets. See, e.g., 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); J. Hilke, Minimum Quality Versus Disclosure Regulations: State Regulation of Interstate Opened-Ended Investment Company and Common Stock Issues (1987).

5(5), "certification" indicates that the non-OEM part is "at least the same quality with respect to fit, finish, function, and corrosion resistance" as the OEM part being replaced.⁷ Second, repairers are prohibited from using noncertified crash parts without the customer's written consent. Third,⁷ even when repairers use certified crash parts, they must disclose to consumers that they are non-OEM parts, and that they will invalidate any remaining OEM warranties on those parts.⁸

III. THE COMPETITIVE EFFECTS OF H-2212

The apparent purpose of H-2212 is to protect uninformed consumers from having allegedly low-quality, non-OEM replacement parts installed in their automobiles. The Bill attempts to provide this protection through mandatory disclosure and certification requirements.

In some situations, mandatory disclosures by themselves might be insufficient to solve the problems stemming from inadequate consumer information. For example, when it is costly for consumers to assimilate and act on the information contained in a disclosure, performance standards (and an accompanying certification procedure) can, under some circumstances, benefit consumers by providing useful information about quality in a form that most consumers can readily understand. The Bill attempts to do this by articulating performance standards that a crash part must satisfy if it is to be marketed to consumers as a "certified" part.

Whether there now exists substantial quality or price variation between OEM and non-OEM parts is a factual question that we do not address here. However, as we discuss below, informed consumers might prefer a lower quality part if its price is also lower. In this section, we describe the analytical framework used by the Commission in determining whether affirmative disclosure should be required in any given case.

⁷ Under sections 4(2) and 5(5), "certified" means that the part has been approved by an independent testing agency that scientifically analyzes the part. Section 5 of the Bill does not require OEM parts to be certified; rather, OEM manufacturers are only obligated to provide a warranty on the crash part equal to that offered on the original part. Forcing makers of non-OEM parts to incur costs not incurred by OEM manufacturer could place the former at a competitive disadvantage.

⁸ Insurers are prohibited from requiring the use of noncertified aftermarket crash parts unless they obtain the written consent of the registered owner or his or her representative. We do not comment on this aspect of the Bill.

A. TRADEOFFS 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 informed choices reflecting their preferences for quality and price.

It is likely, however, 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 consumers cannot evaluate quality, producers may provide lower quality products than consumers desire.

B. THE ANALYTICAL FRAMEWORK: MANDATED DISCLOSURE

Under such circumstances, there are a number of policy measures that might better enable consumers to make informed purchases. One possibility is to simply mandate the disclosure of relevant information. In the current setting, notifying customers that non-OEM parts are now commonly used by repair shops, and that these parts may differ in quality from OEM parts, might provide consumers with sufficient information to permit them to make appropriate product selections. Such a disclosure might improve market performance if (1) there are significant quality differences between OEM and non-OEM parts, (2) the market currently fails to provide information about such quality differences, and (3) the costs of mandated disclosure do not offset the corresponding benefits.⁹

⁹ See generally International Harvester Co., 104 F.T.C. 949 (1984).

C. THE COSTS OF MANDATORY DISCLOSURE AND CERTIFICATION REQUIREMENTS

As indicated above, we have not attempted to determine whether significant quality differences exist between OEM and non-OEM parts. However, the existence of quality differences would 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 about quality differences. 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 can credibly convey information to consumers; e.g., can a high quality firm make truthful statements about its quality that even a skeptical consumer will believe?

Whether mandatory disclosure of information is a useful policy instrument ultimately depends upon whether its benefits to consumers 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 expressed information disclosed is truthful.

When effective private mechanisms for the transmission of information that consumers value already are in place, the additional benefit of statutorily-imposed disclosures and certification standards may be quite limited, and such a program may therefore impose costs that are greater than its benefits. It appears that both OEM¹⁰ and non-OEM firms are already adopting

¹⁰ 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. 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

such mechanisms. For example, in 1985 the Aftermarket Body Parts Association ("ABPA"), composed of non-OEM parts suppliers, recommended that its members offer a five-year limited warranty on crash parts.¹¹ A majority of ABPA members have reportedly followed this recommendation.¹² The ABPA also has developed a certification program which specifies tolerances and characteristics of crash parts sold by participating manufacturers.¹³

The Legislature may wish to consider the full implications of the certification and warranty programs established by the ABPA and other similar organizations. The Legislature 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. We suggest that the Legislature consider whether the Bill offers consumers additional significant benefits in view of the existence of these certifying institutions and warranty programs.

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).

¹¹ ABPA Background at 4 (undated); Letter from Stanley Rodman to Peter Jennings (June 23, 1988) (located at 1-2).

¹² Rodman, supra note 11, at 1.

¹³ 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).

IV. CONCLUSION

In considering House Bill H-2212, FTC staff suggest that the Legislature inquire whether the producers of crash parts are adopting measures that will convey to consumers truthful, nondeceptive information on quality and on the impact of crash part use on existing automotive warranties. The Legislature may then wish to use the information obtained from such an inquiry to assess whether the benefits of mandated information disclosures and certification standards outweigh the corresponding costs.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Marcy J.K. Tiffany', is written over the typed name.

Marcy J.K. Tiffany
Director
Los Angeles Regional Office