Duty to Deal and the General Motors Crash Parts Case

Federal Trade Commission and Department of Justice Panel on Refusals to Deal

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It all began in 1963 when the Federal Trade Commission launched an investigation into the manufacturing and distribution practices of the major automakers, with regard to their sole source crash parts – the parts most frequently damaged in auto crashes. Chrysler, Ford, and GM distributed their bumpers, grills, and various sheet metal parts exclusively through their franchised line dealers – Chevrolet parts exclusively through Chevrolet dealers, Pontiac parts through Pontiac dealers and so on.

Insurance companies instigated the investigations. Congressional investigators were constantly badgering them to keep their auto premiums down. The insurers could pretty well control the labor rates the body shops were charging them. They wanted to set up independent parts wholesalers from whom they might extract similar concessions.

The insurance companies brought along with them the lobbying association for the "independent" body repair shops, or IBSs. They complained that GM and other auto manufacturers -- everyone used the same system-- were discriminating against them because they could not get the parts directly from us. GM franchise car dealers could buy them from us at wholesale for use in their body shops or sell them at a markup to the independents.

Of course, the auto dealers, like any other resellers, had to incur costs of ordering, stocking, financing, insuring, and distributing the parts. They charged for those wholesaling services. The IBSs and insurers went to the Congress and to the FTC to force us to sell directly to independent body shops and to independent wholesalers. The large independent warehouse distributors expressed no interest in the business.

We also believed there was no need to take on additional wholesalers. There was no shortage of GM car dealers to handle the business. We thought they could do the best job of handling the bulky and complex parts because they shared our incentive to keep the vehicle on the road and maintain the integrity of the brand. We believed opening up the system to tens of thousands of body shops would reduce the availability of the parts. We knew it would impose substantial administrative and monitoring costs. We did not feel we could derive any monopoly profits from our parts pricing. Overcharging for parts would have hurt the other 95 percent of the business. Higher priced and less available parts would drive up the costs of repairing our vehicles and make the owners less likely to be repeat customers. One company, Renault, had ceased doing business in this country back in the 50s because of a faulty system of services and repair. In the early 1960s, Chrysler had spent something like $50 million – roughly $350 million in today's dollars -- to convert from the kind of system the Commission was proposing.

But we did offer subsidies for GM dealers to sell the parts to the independent body shops at reduced prices. In order to pacify them and the FTC, on September 1967 we proposed a plan in which we would offer a 12% discount off dealer price to dealers' wholesaling the parts to the IBSs – a program we called "wholesale compensation."

In February 1968, the Commission told us they intended to file suit in order to bring about price parity between the GM dealer and independent body shops. Further negotiations ensued and in the fall of 1968 the Commission accepted our offer to increase the discount for dealer resales to 23%. We increased our prices on all crash part parts in order to recoup the cost of the program, including the costs of monitoring and administration. Later, the Commission would estimate these total costs at $70 million per year -- $250 million in today's dollars. We knew the program would be expensive, but we proposed it as a way to avoid opening up our parts warehouses to everybody – something we believed would be still costlier.

The arrangement did not satisfy our critics for long. In the early 1970s -- in the era of wage and price controls -- the President's Council on Wage and Price Stability launched its own investigations into crash parts pricing – investigations that provided an extended period of full employment for economists like me. The Senate continued to hold its hearings. We pointed out much of the increase in pricing was caused by automotive safety regulations, especially by the bumper standards imposed at the behest of the insurance industry, that had nothing to do with safety, but that accounted for 40% of our crash parts sales volume and thus of any price index. But that's another story.

In 1970 the Commission launched yet another investigation. What did the Commission want this time? Nothing less than a remedy at the manufacturing level – that we be required to make the unique and extremely expensive tools for producing our crash parts available to outside manufacturers. Fortunately, they later dropped this proposal. We heard their Office of Policy Planning and Evaluation concluded it would increase crash parts prices by somewhere between 150 to 580 percent.

But the Commission still wanted GM to sell GM branded crash parts "to all vehicle dealers, independent body shops and independent wholesalers at the same prices, terms and conditions of sale, said prices to be subject to reasonable, cost-justified quantity discounts and stocking allowances."

Much of our ongoing dispute with the Commission – and with the insurers and IBSs -- revolved around whether GM auto dealers charged prices to the independents that "fairly" reflected the dealers' costs of carrying and wholesaling the parts. But one person's "fair" is often another's "excessive" or "discriminatory." The disagreements concerned the appropriate accounting, economic, and statistical methodologies for estimating these costs.

We made one final effort to stave off litigation. In early October 1975 we raised our wholesaling discount to 30% of dealer price on crash parts re-sales to the IBSs. In early February 1976 we announced we would broaden the plan to allow all GM franchised dealers to distribute all GM parts to anyone. This meant independent body shops could now buy a Chevrolet body part from any GM dealer. The program never took hold. The independents stayed with their existing dealer suppliers – Chevrolet for Chevrolet parts, Pontiac dealer suppliers of Pontiac parts and so on. This confirmed our belief that the existing system was an efficient way of getting our parts to the independents.

None of it worked. On March 22, 1976, the Commission issued a complaint charging GM with unfair methods of competition for refusing to deal with everyone on the same terms we gave anyone. It said "wholesale compensation" – the wholesaling parts discount -- had not achieved price parity between the dealers and the independents,

that “the consumer was being asked to subsidize the wholesaling profits of the dealer” (which it was), and that eliminating the program would result in an estimated drop of 10% in consumer prices. So – some thirteen years after the initial investigation had begun, we were in litigation over our right to choose the customers with whom would deal. Said Owen Johnson, Director for the Commission’s Bureau of Competition, “The thrust of the lawsuit is to establish a duty to deal.”

I was the economist assigned to the case.

Did we consider settling? Yes. But Frank Dunne – our lead GM counsel on the case, and his superior, Tom Leary, the recently retired FTC Commissioner, pressed management to stay the course, because in their words, “It was the right thing to do.” They also felt GM would ultimately prevail in the courts, if not with the full Commission. They did not want to surrender GM’s right to freely and voluntarily choose with whom we would and would not deal. They did not want to be forced to accept a system that was less efficient and less competitive. Somehow, the complaints and investigations never resulted in any Commission actions against our competitors!

Our Chairman, Tom Murphy, agreed and the rest is history. We fought the charges to the bitter end.

Three years later, on September 24, 1979, the ALJ found no evidence GM’s refusal to deal and its pricing policies had injured the independent body shops as a class. Every independent body shop witness was doing very well and the industry was doing better than comparable industries – growing their business faster than GM dealer body shops and general repair shops. He found no harm to independent parts distributors. Crash parts prices had risen less rapidly than general inflation and no more rapidly than

the prices of so-called competitive parts such as spark plugs and fan belts. He found that creating a "duty to deal" would increase GM's distribution costs. He said, "The evidence here does not show that GM has discouraged, impeded, or prevented the rise of new competitors in the new GM crash parts market." He concluded GM did not have any predatory intent in establishing the system and that there appeared to be no "substantially adverse effect on competition attributable to the refusal to sell new GM crash parts to anyone other than GM dealers."

He did find that, under Section 5 of the FTC Act, we had unfairly discriminated against the IBSs whom, he found, had to pay more for their parts than our GM dealers. He agreed that some of our dealers were engaged in extensive wholesaling and that they incurred wholesaling costs. He rejected our contention, based on GM financial studies, that when the dealers' wholesaling and carrying costs were taken into account, they actually paid more, on average, for parts installed in their shops the independent body shops were paying.

He ordered us to terminate our wholesale compensation plan. He decreed the implementation of a joint "GM-Commission staff" that would "cooperatively" devise a "non-discriminatory plan" for "distributing new GM crash parts.".

The Commission's staff appealed. The headline in the October 4 Washington Post read, "FTC Challenges Own Ruling on Parts at GM." So did we. Finally, on June 25, 1982, the Commission dismissed the complaint in its entirety. Unlike the ALJ, they did find injury to competition in the auto body shop business – but in their words "barely" and in spite of the fact they could find no overall injury to independent body shops as a class.

The Commission found the injury to body shop competition was offset by business justifications – that creating a duty to deal would result in higher costs of distribution, which ultimately would be passed on to consumers of new GM crash parts — just as we had said. They found no injury to competition in wholesale parts distribution. Most importantly, they rejected the proposed remedy as unworkable. They did not want the Commission to be involved in "ongoing supervision of the system." They did not want to, in effect, become another Council on Wage and Price Stability, having "to commit extensive resources to reviewing GM's interpretations of to whom and at what price it should sell crash parts."

The long ordeal was over – after 19 years of investigations and tens of millions of dollars in corporate and Commission resources. We have not opened up our distribution system since. We have not sold crash parts directly to independent body shops or to independent wholesalers. Neither has anyone else. We did drop the costly and ineffective wholesale compensation plan. We have further simplified our pricing program in response to the modern computer and the high-speed Internet.

In the final analysis, the issue came down to who can more efficiently manage GM's business – who can more efficiently choose the customers with whom we deal and the prices we charge. We share the Commission's interests in keeping our vehicles in good repair and keeping the car buyer happy. So the only question is who can do the better job. Thankfully, on June 25, 1982, the Commission finally said, and for very good reasons, it did not want to second guess us any more. We can only hope in the future the courts and the Congress also will share these sentiments!

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