

## COMMENTS FOR JUNE 16, 2008 USPTO TOWN HALL MEETING

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#### Introduction

Thank you for this opportunity to speak here today. My name is Rick Warren-Boulton. I am an economist and a principal at MiCRA, an economics consulting and research firm here in Washington DC.

We have been asked by the Quality Parts Coalition to determine what would happen to the prices of collision parts if OEMs are able to use design patents to block independent competitors from supplying replacement collision parts for their vehicles. Our study concludes:<sup>1</sup>

1. that eliminating competition in this market would allow the OEM's to acquire a "second monopoly" in the supply of collision parts for their vehicles,
2. that this would result in price increases of as much as 32% on parts that are currently supplied competitively, and
3. that the total cost to US consumers could be as much as one and a half billion dollars per year (\$1.5b)

#### Let me describe the study in more detail

Our estimates are based on a statistical analysis of prices for some 27,000 collision parts from 2000 to 2007. Our methodology for asking what would happen to prices if competition were eliminated is simply to determine, historically, what happened to prices when competition was introduced and how much consumers gained from the introduction of competition. Thus, our estimate of the potential *loss* to consumers if that competition were now eliminated is equivalent to taking away this estimated *gain* to consumers from the introduction of competition.

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<sup>1</sup> The full study is available at <http://www.qualitypartscoalition.com/pdfs/8-2micraanalysisl.pdf>.

Competition in the collision parts aftermarket has benefited consumers by lowering the prices they pay in two ways.

First, competition from independent suppliers on an individual part has forced the OEMs to reduce the prices they charge for their parts. We estimate that, holding constant for other factors, competition in the supply of any particular part results in, on average, about an 8% fall in the OEM price for those parts over the first six years following the entry of a competitive alternatively supplied part. Thus, even consumers who never buy from independent suppliers gain a lot from competition

But for those lucky enough to actually buy their parts from competitive suppliers, the price advantage is even larger. Prices of parts from independents are, on average, 26% lower than those from OEMs. And since OEM prices on those parts are already 8% lower because of competition, this means that prices to customers of independent suppliers are a full 32% lower than what those consumers would have paid for OEM parts, absent competition.

How much does this add up to each year in savings to consumers in total dollars? We understand that OEMs supply about 74% of collision parts, that they face competition on about two thirds of those parts, and that independents supply about 11% of the market (Recycled parts account for the remaining 15% of the market). When combined with our per part estimates, this implies that consumers who buy parts from independents enjoy an annual saving of \$793 million, and that consumers who continue to buy their parts from the OEMs save an additional annual saving of \$723 million. The total is roughly \$1.5 billion a year.

### **Theoretical Perspective**

The OEMs may argue that they have an incentive to keep down the prices of collision parts to competitive levels because higher prices for collision part could hurt sales of new

cars. There are many markets where original equipment suppliers do have strong incentives to keep down the prices of aftermarket parts for their products. In those industries, we may not need to be greatly concerned about OEMs excluding competitors from their aftermarkets.

For at least three reasons, however, this defense does not apply in the auto industry.

First, the vast majority – some 87 % initially – of consumers who would face higher prices are owners of the existing stock of cars. Allowing the OEMs to gain a monopoly in the supply of collision parts for those cars would be giving the OEMs a second and unexpected bite at the apple.

Second, while new car buyers might be expected to be concerned about higher aftermarket prices, individual consumers (unlike large businesses) may not sufficiently take into account the “total cost of ownership”, including the cost of replacement parts and insurance, when purchasing a new car.

Third, much of the higher cost of collision parts will be paid for by insurance. This will lead to higher insurance premiums. But it seems unlikely that consumers will understand or take into account the effect of design patents on their insurance premiums. Even more problematic, much of the higher prices for collision parts will be passed on in the form of higher premiums on someone else’s insurance. There is no reason to expect that a customer will decide not to buy, say, a Ford because Ford’s exercise of design patents has resulted in higher prices on collision parts for Fords, which in turn has resulted in higher insurance premiums for people who buy Hondas.

The OEMs thus have a strong incentive to raise the prices of collision parts on their vehicles to far above the competitive level if they can use design patents to block independent competitors from supplying replacement collision parts for their vehicles. And that is consistent with what we actually observe in the data – that competition has resulted in a significant fall in the prices consumers pay for collision parts.