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ARE FLAT RATE REPAIR TIME MANUAL PUBLISHERS INVITING COLLUSION?

*W. Lesser**

*Susan E. Lynch Professor in Science and Business, Dyson School of Applied Economics and Management, Cornell University. The author would like to thank an anonymous reviewer for very helpful comments.

I. INTRODUCTION AND OBJECTIVES

This scenario may sound all too familiar to many. An estimate for an unexpected car (or it could be boat, furnace, etc.) repair comes in well above budget and so a second, or even third, estimate is sought. Alas those estimates are not fundamentally different. The shop hourly charge may vary but the estimated time for the repair is identical. That outcome is hardly a coincidence though as all the shops contacted were using the same repair time estimation manual, known variously as flat rate or labor time guide manuals. Those manuals – examples used here apply exclusively to automobile mechanical repairs although the process operates similarly for other mechanical and collision repairs – provide an estimated repair time for a specific repair on a specified vehicle, say an alternator replacement for a 2012 Toyota Celica with air conditioner. The customer is then charged for those hours (at the shop hourly rate) whether the actual service takes fewer or more hours. Many shops also pay their technicians based on the same number of estimated hours, known as 'flag hours,' again whether the actual time spent is more or less than the manual estimate.[1]

Each automobile manufacturer produces its own flat rate manual for warranty repairs, which may be modified for dealer non-warranty work, while independent repair shops typically purchase manuals (or online services) from one of several providers:

- Chilton Labor Time Guide Manuals[2]
- Motor Labor Guide Manuals[3]
- ALLDATA – subscription service (part of Motor)
- Mitchell PRODEMAND Estimator[4]

Market share data for the private firms are not available but the limited number of firms (3) indicates the sector is quite concentrated. Entry is limited by the multiproduct offering of the companies to the

[1] *See* Gonzalez v. Downtown LA Motors, 155 Cal. Rptr. 3d 18 (2013) at 20-21 (considering if under California's minimum wage law mechanics paid on a 'piece-rate' basis were eligible for the minimum wage during idle hours when there were no vehicles requiring servicing).

[2] *See* Chilton's Labor Guides, AUTOREPAIRMANUALS.biz, https://perma.cc/XB6T-DGWE.

[3] MOTOR LABOR GUIDE MANUAL, https://perma.cc/RY7F-Q5QW.

[4] *ProDemand: Repair Information To Get the Job Done Right*, MITCHELL1, https://perma.cc/GC5V-B6HB (last visited March 18, 2016).

same customers,[5] entry into a multiproduct market being more difficult than for single products. Further limiting entry is the economics of a product with high fixed costs (assembling the manual) and low variable (distribution) costs meaning entrants have lower net returns than do established ones.

Auto manufacturers reportedly use careful time studies for their time estimates[6] although in at least one instance the dealers were permitted, and did in hundreds of instances, to suggest changes in the time estimates in the manual.[7] The source of the non-warranty estimates and those used by the independent publishers are less clear, but there are suggestions the manufacturer times are merely added to "liberally." "Some additional labor time is justified. As cars get older, it often takes longer to remove rusted bolts, clear accumulated road dirt, and the like. But the independent flat-rate manuals still often overestimate the time needed for repairs."[8] By one estimate the warranty manual time estimates are raised by 1.5 times[9] so that "[M]ost mechanics can beat the flat-rate allowance most of the time."[10] One retired General Motors vice president is quoted as saying, "Show me one flat rate time allowance that most technicians will not beat by 10 to 20 percent and I will be surprised."[11]

Any repair, whether using estimates or observed times, will lead to a range of hours depending on the skill and experience of individual technicians. The manual time is intended to represent the average repair time, the time required by a technician of average skill. Some technicians will complete the tasks more rapidly, some less so. For a shop the concept is the posted flag time represents on average the time actually required, a matter of averages. For experienced piece-work technicians who can complete a job in less than the flag time the effect is earnings above his/her hourly rate. Slower technicians will earn commensurably

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[5] *See*, *e.g.*, services offered by Motor, https://perma.cc/PW2N-CJCP.
[6] Joseph Holschuh, *How to Utilize Flat-Rate Billing in Your Service Department*, Farm Equipment (July 20, 2009), https://perma.cc/QWA4-CY8W.
[7] Morrison v. Nissan Motor Co., 601 F.2d 139, 142-43 (4th Cir. 1979) (which reversed a summary judgment for dismissal of a suit for price fixing under 15 U.S.C. § 1 et seq.).
[8] Arthur P. Glickman et al., AVOIDING AUTO REPAIRS RIP-OFFS 11 (Consumers Union of United States 1995).
[9] JIMROAL, *The Truth About The Auto Repair Industry*, https://perma.cc/4LHL-LEP9.
[10] Glickman, *supra* note 8, at 14.
[11] *Id.* (quoting W.G. Buxton).

less. "It is not impossible, or even that uncommon, for a mechanic to flag over 16 hours in an 8 hour day."[12]

In a 1978 study by the National Highway Traffic Safety Administration of consumer losses from auto repairs, inflated manual repair time estimates were identified as a possible source but sufficient information was lacking to calculate the amount of overcharge, if any.[13] However in 1980 the N.Y. Attorney General's Office estimated N.Y. State motorists were being overcharged $73 million annually ($207 million in current dollars) through the use of flat rate manuals.[14]
Manual publishers state the advantage of their use as providing the customer with a fixed cost estimate under which the shop takes the risk the repair can indeed be completed in the projected time. This in contrast to the use of 'time and material' pricing under which the consumer is unaware of the final cost until completion and so takes all the risk of a slower-than-anticipated repair, including when work is done by a less experienced technician. Shops benefit from manual use through enhanced management and the opportunity to reward experienced technicians – those who can beat the flag hours – and hence retain them better.[15]

While there are evident business reasons for repair shops to use flat rate manuals, they can also be utilized to coordinate and raise repair charges across a wide range of repair providers in a market. Here, I develop a damage model in Section II to specify that the independent manual publishers have an economic incentive to raise the cost of repairs across a range of sectors by inflating the flag hours for repairs, and thereby increase the demand for their manuals. In order to communicate the benefits of this approach to their repair shop customers they by necessity must publicize their approach using public media, including magazine articles, advertisements, and trade seminars. As a result, I argue in Section III they are not liable for price fixing, which under

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12 JIMROAL, *supra* note 9.
13 NAT'L. HIGHWAY TRAFFIC SAFETY ADMIN., U.S. DEP'T. TRANSP., DOT HS-803 355, AUTO REPAIR AND MAINTENANCE: PROGRAM TO REDUCE CONSUMER LOSS (1978).
14 Glickman, *supra* note 8.
15 Air Solutions Heating and Air Conditioning, Air Solutions Flat Rate Pricing Manual for Technicians" Undated.

Sherman Section 1[16] requires active collusion, but are liable under Section 5 of the Federal Trade Commission Act of 1914.[17]

I further argue that the typical 'cease and desist' consent decree remedy for a Section 5 violation is inadequate in the case of flat rate manuals because their use is so ubiquitous that it will continue for an extended period even in the absence of ongoing promotion by the publishers. Rather what is required is a disclosure of the methods by which the flat rate times are established so that it is possible for a knowledgeable party to determine if the rates reflect actual time requirements or are indeed inflated, as I argue they are likely to be. Should the values be found to be inflated then a consent agreement must include an order to adopt a non-inflationary estimation methodology.

II. DAMAGE MODEL

To begin it is helpful to recognize a flat rate manual as a particular form of database. With databases the cost is in the compilation of the figures, not in their reproduction and distribution. That is, fixed costs can be high but variable ones are typically low, particularly when distribution is done through the Internet. An obvious profit-enhancing strategy then is to increase sales/use, which distributes the fixed costs over a broader number of units, reducing average costs and raising profits for all sales.

Manual purchasers will buy manuals if the manuals increase repair shop profits, which can be accomplished by lowering costs or raising receipts, or both. Simplifying management and enhancing the satisfaction of customers both lowers costs and raises sales. These are legitimate uses of the manuals. Profits can also be raised by increasing prices for individual repairs by charging customers for more hours than the repairs actually take by overstating the flat rate hours requirement. That is equivalent to raising the effective per hour shop charge above the posted level, which can be considered illegitimate, particularly if customers reasonably assume the repair time estimates represent actual requirements.

Shops which utilize flat rate manuals with overstated hour repair requirements will then experience a profit increase, which will both help assure repeat manual purchases and the extension of sales to other non-adopting shops once the benefits of manual use are appreciated. Manual

[16] 15 U.S.C. § 1 (2004).

[17] Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41-58 (LEXIS through 2015).

producers to expand sales must convey information on the benefit of manual use to would-be purchasers, which I argue here is done in a way which violates section 5 of the FTC Act. However, the approach of overstating hours will not be effective if (a) consumers shift business to lower priced non-manual using shops, or (b) if the higher prices cause a sharp decline in the overall demand for repairs. Let us consider the reduced demand possibility first. Because the demand curve for products and services is downward sloping, the 'Law of Demand' says that higher prices lead to reduced demand. That is for all practical purposed universal. What changes is the degree of the effect. If quantity demand declines less than proportionally to the price increase, total revenue (price x quantity) increases, and vice versa. The degree of the effect can be measured by the elasticity of demand;[18] if it is less than one (in absolute value as the numbers are negative due to the negative slope of the demand curve) then demand is inelastic meaning revenues rise with price increases, and again vice versa.

Estimated demand elasticities for auto repairs are notably inelastic, in the -.36 to -.40 range[19] meaning higher prices will increase overall repair shop sector revenues. These estimates make intuitive sense because there are few options (substitutes) to a repair, buying a different car or driving it broken, both of which have clear limits, all the more at the current level of technical sophistication where cars are way too complex for home repair. Moreover, if the car is inoperable or fails inspection the repair becomes critical for many owners, reducing the opportunity for consumers to comparison shop. And of course shop owners do not need to be aware of the formal concept of demand elasticities; they need merely to observe closely the response of their customers to price increases.

But some shifting to lower priced repair shops, including in my scenario to those shops not using flat rate manuals, is possible over time. Under that scenario higher price manual-using shops will lose customers, and profits. That possibility though is more of an impetus for low-priced shops to raise prices (including by adopting the use of flat rate manuals)

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[18] The formula is dQ/dPxP/Q where Q is quantity demanded and P price. See any introductory microeconomics text or online explanation, e.g., "Demand and Elasticity" *available at* http://cobe.boisestate.edu/econ/lreynol/web/micro202/Chapter_9_elasticity.pdf.

[19] ROBERT H. FRANK, MICROECONOMICS AND BEHAVIOR, 125 (Christina Kouvelis et al. eds., 9th ed. 2015). Cambridge: Harvard Univ. Press reported in R.H. Frank, *Microeconomics and Behavior*, McGraw-Hill, 9th Ed., 2014, Table 4.5.

than for higher priced ones to lower theirs. The low demand elasticities noted above indicate more is to be gained by individual shops by raising prices than by lowering them. Manual producers then need to convey the message that if *all* shops use their manuals, thereby raising prices universally, all repair shops will benefit. This is of course the classic case of price fixing, except here there is no explicit agreement among the shops.

In essence my damage model is based around the well-established theoretical premise that completion works most effectively when consumers are well informed about product attributes like quality and can effectively shop for better prices.[20] Few consumers are knowledgeable about the required repairs to restore a broken car to safe operating condition, while the widespread use of flat rate manuals limits the range of competing repair prices, reducing the incentive to search for lower estimates. Those conditions present a strong opportunity to overstate repair times to the benefit of repair shops and indirectly flat rate manual sellers.

It has been argued in court that it would be against the economic interest of automobile manufactures for their part to raise repair costs as that would discourage repeat car sales.[21] That interpretation however overlooks two attributes of the automobile market. One is that sales seem affected only to a limited degree by repair costs, as any reading of *Consumer Reports* repair frequency reports will verify.[22] Second, auto dealerships make most of their income from repairs and parts, not new car sales. According to a *Forbes* article, "Financial results for the six publicly traded, new-car dealer groups in the United States show that to a great extent, dealerships are in the business of selling new and used cars

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20 One of the six requirements for the existence of perfect competition is the presence of perfect knowledge about product prices and attributes at zero cost. *See*, *e.g.*, Geoff Riley**,** *Perfect Competition - Economics of Competitive Markets*, TUTOR2U, *available at* https://perma.cc/4CKP-UJUX.

21 Link v. Mercedes-Benz of North America, Inc.*,* 788 F.2d 918, 923 (3d Cir. 1986) ("Experts testified that because of Mercedes' interest in encouraging repeat customers, it would be against its [Mercedes-Benz's] economic interest to raise or fix repair prices.").

22 *Buying Guide 2014*, Vol. 78, No. 13, CONSUMER REPORTS, Oct. 2013, at 145-56 (which reports by year, make and model repair frequencies for 17 major components and used to value the reliability as a used car and, by extension, a prediction of reliability as a new car for the current model year. Some makes/models are rated "Much Worse Than Average" for years and even decades, suggesting minimizing repair costs is a low priority for many purchasers).

so they can service them and finance them." "The gross margin for service and parts was 57 percent for the Penske group [a publicly traded new car dealership system], vs. just 8 percent for new-vehicle sales."[23] It is likely that if service was not as profitable for auto dealerships they would demand greater margins on new car sales, meaning high service fees can increase not decrease the profit of manufacturers.

Now that it has been discussed how inflated flat rate hours when universally applied benefit shop owners as well as manual producers, it is necessary to describe how those benefits are conveyed by manual producers in potentially illegal ways. Here are quotes from trade advertisements:

"The 'Choice' system can help change this picture by charging the right price to the customers (instead of giving it away)…"[24]

"The more effective a service department is at flat-rate billing, the more profitable it will be for the dealership and the techs, and the happier the customers will be."[25]

[E]ven the smallest steps toward flat-rating can yield a 5-10% improvement in efficiency.[26]

"[F]lat-rating works by beating the averages."[27]

"The standards are designed to be utilized by Nissan dealers in work process control for improved service shop productivity and efficiency."[28]

From this economic overview it can be concluded that flat rate manual producers and users have an incentive to inflate the estimated repair time hours, and that the manual producers in their marketing pitches strongly hint that repair time estimates are indeed overstated. Costs are born by repair shop customers, those needing auto repairs.

Lacking from this model is an explanation of how this system purportedly functions, as it has both vertical and horizontal behavioral components. Vertically, manual producers in their self-interest to sell

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[23] Jim Henry, *The Surprising Ways Car Dealers Make The Most Money Off You*, FORBES (Feb. 20, 2012), a*vailable at* https://perma.cc/R9XD-GPK3.
[24] Air Solutions *supra* note 15 (emphasis in original).
[25] Holschuh, *supra* note 6.
[26] *Id*.
[27] *Id*.
[28] *Morrison*, *supra* note 7, at 144.

more manuals signal to their customers, repair shop operators, the benefits of using a flat rate manual, benefits which include overestimates of repair time requirements. Due to the number and dispersion of repair shops, the signaling by manual producers must be done through public advertising. Shop operators will perceive that the benefits of inflated-time-estimates flat rate manual use will be more advantageous the more they are employed by competitor shops. Hence, shop operators will tacitly conspire to raise prices by condoning the use of flat rate manuals, resulting in an approximation of retail price maintenance. Consumers will be unfairly treated regarding repair costs as they will reasonably believe the repair time estimates are valid representations of actual time requirements, leading them to curtail a search for a lower overall cost estimate.

What needs to be explored next is if such alleged actions are potentially illegal under the several antitrust laws. In part it must be determined if it is possible to be in violation when the alleged conspiracy is induced indirectly through private or public communication but never explicitly accepted/agreed to. We begin by examining the Sherman Act, sidestep briefly to consider contributory infringement under the patent statutes, and finish with an evaluation of section 5 of the FTC Act.

III. TREATMENT OF INDUCEMENT UNDER THE ANTITRUST AND INTELLECTUAL PROPERTY LAWS

A. Section 1 of the Sherman Act

The Sherman Act section 1 prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."[29] Over time the courts have determined that horizontal agreements among competitors that fix prices are *per se* illegal.[30] What constitutes a 'price' the courts have decided extends well beyond the literal meaning to encompass other restraints such as uniform inputs, which would include the fixed labor input time component prescribed by flat rate manuals.[31] However the courts have determined that section 1 violations require some showing of 'concerted action' among the

[29] 15 U.S.C. § 1 (2004).
[30] *See* United States v. Trenton Potters Co., 273 U.S. 392 (1927).
[31] Nat'l Macaroni Mfrs. Ass'n v. FTC, 345 F.2d 421, 422 (7th Cir. 1965) ("'Fix or establish the kinds or proportions of ingredients to be used ….'").

conspirators.[32] That action can be "accomplished by express contract or by some more subtle means".[33] Vertical price fixing often in the form of retail price maintenance is also legally actionable. However, since *State Oil Co. v. Khan*[34] and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[35] the Supreme Court has held that vertical price fixing cases are to be given rule-of-reason treatment.

An effective rebuttal in such cases is to identify a legitimate business reason for the observed conduct. In *Monsanto Co. v. Spray-Rite Service Corp.* the Supreme Court declared there are legitimate business reasons a manufacturer and its distributors might wish to exchange information so that the mere evidence of an information exchange is insufficient to establish a conspiracy. "A manufacturer and its distributors have legitimate reasons to exchange information about the price and reception of [their] products in the market".[36]

The courts identified the market structures of the relevant markets to indicate susceptibility to the exercise of market power. The most susceptible were determined to be those which were highly concentrated, dealt in fungible products, and were subject to inelastic demand – the so called 'plus factors'.[37] The flat rate manual business as has been discussed is highly concentrated and their products are generally interchangeable. For their part, repair shops are faced with inelastic demand, so at least the conditions for tacit collusion apply to the flat rate manual business.

No 'concerted action' is suggested among the flat rate manual producers, among the repair facilities nor between the facilities and manual producers so that Sherman section 1 does not apply to the issue under examination here. Indeed, the courts made that interpretation clear as applied to the production and use of the manuals in *Jules Link and*

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32 Fragale & Sons Beverage Co. v. Dill, 760 F.2d 469, 473 (3d Cir. 1985) ("Because of this concerted action requirement, unilateral or independent activity, no matter what its motivation, does not violate section 1.").

33 *Nat'l Macaroni Mfrs. Ass'n supra* note 31, at 427 ("Price fixing is contrary to the policy of competition underlying the Sherman Act… It makes no difference whether [] the price fixing is accomplished by express contract or by some more subtle means; …").

34 State Oil Co. v. Khan, 522 U.S. 3, 22 (1997) ("[V]ertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason.")

35 Leegin Creative Leather Prods. Inc. v. PSKS, Inc. 551 U.S. 877, 907 (2007) ("Vertical price restraints are to be judged according to the rule of reason.").

36 Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984).

37 Todd v. Exxon Corp., 275 F.3d 191, 198, 208 (2d Cir. 2001).

Solomon Katz v. Daimler-Benz of North America Holding Co., Inc. Link and Katz are representatives of a class of purchasers of non-warranty repairs from the defendant Mercedes dealership who charged the parent firm "conspired with their authorized dealers 'to fix, raise and maintain rates charged for non-warranty auto repairs performed on Mercedes-Benz automobiles by … basing the rates on the parties' prices and labor times set forth' in a manual known as the MBNA [Mercedes Benz of North America] Labor Time Guide."[38]

The plaintiffs submitted evidence that the dealers sent employees to seminars at which Mercedes taught and distributed the service management control system and time guides; evidence of agreements "to which dealers agreed to accept Mercedes' recommendations concerning use of time guides and service management control systems."[39] The appeals court however found that while the plaintiffs "demonstrate[ed] an opportunity for conspiracy" … they could not "'exclude the possibility' that Mercedes' dealers 'were acting independently'" and hence not in violation of section 1.[40]

Even if the other dimensions of the case had applied, *Illinois Brick* would have made it impossible for the plaintiffs to recover damages from Mercedes Benz. That case prohibits indirect purchasers of a good or service from recovering antitrust damages.[41]

B. Section 2 of the Sherman Act

Section 2 makes an offense of "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . ."[42] In *U.S. v. Grinnell Corp.* the Supreme Court identified that a violation of section 2 required (1) the possession of market power in the relevant market and (2) the willful acquisition or maintenance of that power.[43] While the manual producers may in their highly concentrated market potentially have market power there is no indication they applied that power horizontally to enhance their position. Rather the premise

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[38] Link v. Mercedes-Benz of North America, Inc., 788 F.2d 918, 920 (3d Cir. 1986).
[39] *Id*. at 922.
[40] *Id*. at 923-24.
[41] Ill Brick Co. v. Illinois, 431 U.S. 720, 735-41 (1977).
[42] 15 U.S.C. § 2 (2004).
[43] 384 U.S. 563, 570-71 (1966).

here is vertical inducement to inflate repair costs meaning section 2 is not at issue.

That said, one section 2 case does provide some indication of the Court's interpretation of inducement, in that instance through a private communication. The case involved American and Braniff Airlines and their operations at Dallas-Fort Worth International Airport. The two lines had a joint 76 percent market share, and a 60-90 percent share between 15 major cities.[44]

In February 1982 Crandal, American's CEO, called Putnam, Braniff's, complaining about the price competition between the two lines:

Putnam: "Do you have a suggestion for me?"
Crandal: "Yes, I have a suggestion for you. Raise your goddam fares twenty percent. I'll raise mine the next morning."

Rather than raising Braniff's fares though Putnam sent the government a tape of the conversation. The question before the appeals court then was whether an attempted monopolization could occur in the absence of an actual agreement.

The court cited *Swift*.[45] In *Swift*, the court stated that, "when that intent and the consequent dangerous probability exist, this statute, like many others, and like the common law in some cases, directs itself against that dangerous probability as well as against the completed result."[46] The subsequent issue was then whether American's Crandall had actually attempted to monopolize or merely solicited an agreement. Here the court cited *United States v. May*[47] and *United States v. Robles*[48], both of which involved a solicitation, the former by telephone, the latter by mail. In both cases the courts concluded the contacts initiated a course of conduct intended to violate the law. In *American Airlines* the appeals court decided "solicitation accompanied by the requisite intent may constitute an attempt"[49] as it was found to in this instance. That is, an attempt can exist absent an agreement.

The Court determined that, "the government need not *allege or prove* an agreement to monopolize in order to establish an attempted joint

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[44] United States v. American Airlines, 743 F.2d 1114, 1115-16 (1984).
[45] Swift & Co. v. United States, 196 U.S. 375, 396 (1904).
[46] *American Airlines supra* note 44, at 1118.
[47] 625 F.2d 186, 194 (8^{th} Cir. 1980).
[48] 185 F. Supp. 82, 85 (N.D. Cal. 1960).
[49] *American Airlines supra* note 44, at 1121.

monopolization under section 2 of the Sherman Act."[50] Previously the appeals court had noted "only the section 1 Sherman Act and the Wilson Tariff Act charges require proof of a combination or conspiracy".[51] Hence the courts have recognized that a conspiracy is possible even if merely solicited and absent evidence of acceptance. That matter is relevant to the flat rate inducement case as is discussed below.

Recognizing the preceding cases applied to horizontal agreements, those among competitors, another relevant dimension was made clear in *United States v Yellow Cab Company*. In it, Mr. Justice Murphy recognized the scope of antitrust law extended to vertical arrangements as well. "The fact that a manufacturer and users of its products of whom the manufacturer has acquired control may be regarded as a vertically integrated enterprise does not prevent a restraint of such users from dealing with other manufacturers from constituting a violation of the Sherman Anti-Trust Act."[52] The decision did not apply to a trial of the merits of that case but rather overturned a lower court ruling by addressing the antitrust treatment of vertical restraints in general.[53]

C. Contributory Inducement

One area of the law where the concept of an indirect action, a solicitation if you will, can constitute a violation is well developed is under patent law, and particularly contributory infringement. Infringement may be either direct or indirect:[54]

"(a) Except as otherwise provided in this title, whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States, or imports into the United States any patented invention during the term of the patent therefor, infringes the patent.
(b) Whoever actively induces infringement of a patent shall be liable as an infringer.

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[50] *Id.* at 1117 (emphasis added).
[51] *In re* Japanese Elec. Prods. Antitrust Litig., 723 F.2d 238, 252 (3d Cir. 1983). *See* United States v. Robles, 185 F. Supp. 82 (N.D. Cal 1960) (A solicitation by letter was held to be an attempt to unlawfully import a narcotic); *See also* United States v. May, 625 F.2d 186 (8th Cir. 1980) (Defendant through a telephone call to someone in control of certain relevant records engaged in a course of conduct designed to culminate in the unlawful concealment of government records).
[52] United States v. Yellow Cab. Co., 332 US 218, 227 (1947).
[53] *Id*. at 220.
[54] Patent Act, 35 U.S.C. § 271(a)-(c)(LEXIS through 2015).

(c) Whoever offers to sell or sells within the United States or imports into the United States a component of a patented machine, manufacture, combination, or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer."

Section 271(a) is considered to refer to direct infringement while (b) and (c) are indirect, contributory or induced infringement (although the Patent Act does not use the terms direct and indirect). Section 271(c) applies to the sale of a component of a patented product and hence is not relevant to the sale and use of flat rate manuals. However 271(b) concerns the active inducement of infringement – a range of actions to cause, encourage or aid others in the infringement of a patent.

The case law concludes infringement must have taken place *before* the owner can act. An ancillary issue is if the evidence can be purely circumstantial. The case law is mixed on the latter issue and hence abundant. The intent here is to provide only the flavor of the decisions as the purpose of the review is not to probe patent law specifically, but rather to establish that the law broadly recognizes both inducement and the use of circumstantial evidence to establish a violation. Subsequently, we will examine the application of inducement and circumstantial evidence regarding price fixing.

The case law is consistent in recognizing that the conduct being induced must constitute direct infringement. A leading case is *National Presto Industries, Inc. v. West Bend Co.*,[55] which involved a patent for a device for cutting vegetables into spiral curls. The appeal involved multiple issues of patent validity and infringement of which the inducement to infringe component is the only one of relevance here. The facts are as follows: Presto sold its product commercially beginning in April 1991, and, based on trade rumors of West Bend's efforts to produce a similar product, Presto's chairman informed West Bend's president of its patent application, whereupon West Bend is said to have increased its production efforts, placing its own slicer on the market in September of that year. Presto sued West Bend for infringement on February 18, 1992, the day its parent issued.[56]

[55] 76 F.3d 1185, 1188 (Fed. Cir. 1996).
[56] *Id.* at 1194.

Presto averred that its damages should include West Bend's slicers placed on the market "during a reasonable period before Presto's patent issued" on the interpretation of § 271(b) that "infringement by West Bend's customers was directly, foreseeably, and intentionally caused by West Bend's activities."[57] West Bend acted knowingly in Presto's judgment having been previously informed of the allowed claims of Presto's patent.[58] The question before the appeals court then was whether § 271(b) permits a remedy for products put into commerce prior to the patent's issuance. The answer was no: "§ 271(b) does not reach actions taken before issuance of the adverse patent."[59]

> The principle of liability for "aiding and abetting" the wrongful acts of others is not imposed retrospectively, to make illegal an act that was not illegal when it was done. That is, if the thing that was abetted was not illegal at the time of abetment, but depended on some future event that might not occur (such as issuance of the patent) liability cannot be retroactively imposed.[60]

If this ruling is not sufficiently conclusive, there is *Norberg Manufacturing, Co. v. Jackson Vibrators, Inc.*,[61] which applied to a patent for leveling railroad tracks. The district court determined, "At the onset, plaintiffs must show a direct infringement of the patent . . . Since subsections (b) and (c) spring from the same basic doctrine, it is necessary to include the direct infringement requirement in (b). Furthermore, there is no basis in history or authority for a different rule under (b)."[62] That is, there is no infringement violation nor are damages owing unless/until direct infringement occurs.

But does contributory infringement apply only to willful acts, or can it occur innocently or unknowingly? For direct infringement, the answer is that ignorance or lack of intent is no protection.[63] "Under [35

[57] *Id.*
[58] *Id.* at 1195.
[59] *Id.* at 1196.
[60] *Id.*
[61] 153 USPQ 777 (N.D. Ill. 1967).
[62] *Id.* at 783.
[63] Blair v. Westinghouse Elec. Corp., 291 F. Supp. 664, 670 (D.D.C. 1968) ("It is, of course, elementary, that an infringement may be entirely inadvertent and unintentional and without knowledge of a patent."). *See also* Hilton Davis

U.S.C.S. § 271(b)], a plaintiff has the burden of showing that the alleged infringer's actions induced infringing acts and that he knew or should have known his actions would induce actual infringements."[64] Willful acts may affect the recovery of damages, but the violation stands. For contributory infringement the interpretation varies for Section 271(b) and (c) as § 271(c) refers specifically to "knowing the same".[65] For § 271(b) though "proof of actual intent to cause the acts which constitute the infringement is a necessary prerequisite to finding active inducement."[66] "[M]erely permitting that [other] party to commit infringing acts does not constitute infringement, and it likewise cannot constitute 'facilitating infringing acts.'"[67] And, "[I]nducement requires evidence of culpable conduct, directed to encouraging another's infringement, not merely that the inducer had knowledge of the direct infringer's activities."[68]

What evidence then is required to establish infringement? Certainly direct evidence will suffice, but what of circumstantial? An extreme example of the sufficiency of circumstantial evidence occurred in *Lucent Technologies v. Gateway, Inc.*,[69] which involved a dispute over an online calendar. The method patent claimed a means of inserting information into the program without using the keyboard. Because of the method nature of the allegedly infringed claims, infringement could occur only when the software was actually used. The defendant argued in his/her defense that no evidence was offered of any customer except the plaintiff's experts actually using the calendar program, which would have reduced the liability to indirect infringement only. The expert though was evidently able to convince the court that he and his wife were not the only two people in the world that ever used the feature in question. More generally, "Direct evidence of a fact is not necessary. Circumstantial evidence is not only sufficient, but may also be more certain, satisfying and persuasive than direct evidence."[70]

Chem. Co. v. Warner-Jenkins Co., 62 F.3d 1512, 1523 (Fed. Cir. 1995). ("Accidental or 'innocent' infringement is still infringement.").

[64] Lucent Technologies v. Gateway, Inc., 580 F.3d 1301, 1321-22 (Fed. Cir. 2009).

[65] 35 U.S.C. 271(c) (2010).

[66] Hewlett-Packard Co. v. Bausch & Lomb Inc., 909 F.2d 1464, 1469 (Fed. Cir. 1990).

[67] Tegal Corp. v. Tokyo Electron Co. Ltd., 248 F.3d 1376, 1378 (Fed. Cir. 2001).

[68] *Lucent Technologies supra* note 68, at 1322 quoting DSU Med., 471 F.3d 1293 (Fed. Cir. 2006).

[69] *Id.*

[70] *Id.* at 1318.

So what have we learned from this excursion into patent law? Patent case law recognizes that inducement of customers into illegal acts is possible, but for patents actual infringement must occur, the inducement must be an affirmative act, and the inducer must act knowingly. The evidence of the infringement may however be circumstantial. Beyond the recognition of the possibility of inducing one's customers into illegal acts, relevant to the damage model proposed here,[71] these other requirements set a high bar of proof for depicting the promotion of the use of flat rate manuals as a form of price fixing. Another aspect of the law is required. We explore next if section 5 of the Federal Trade Commission Act suffices.

D. Section 5 of the Federal Trade Commission Act

Under the Federal Trade Commission Act section 5, "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."[72] Congress at the time of the adoption of the Act in 1914 attempted but failed to define specifically which practices were potentially harmful to competition. The developing list was simply far too long to incorporate in the Act while by definition excluding future ones yet to be implemented by the business community. The choice then was to leave to the Commission decisions on which business practices to bar.[73] FTC actions do differ in that they are generally civil acts administered through administrative proceedings before the Commission rather than through the courts.[74]

The two components of section 5, unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce, are subject to separate treatment by the FTC, so we here likewise evaluate them separately, beginning with unfair methods of competition.[75]

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[71] Damage Model, *supra* Section II.

[72] Federal Trade Commission Act of 1914, 15 U.S.C. § 41(a)(1) (LEXIS through 2015).

[73] See *Report of the Senate Committee on Interstate Commerce*, S. Rep. No. 597, 63d Cong., 2d Sess. 13 (1914); see also *Report of the Conference Committee*, H.R. Rep. No. 1142, 63d Cong., 2d Sess. 19 (1914).

[74] *See* Fed. Trade Comm'n v. Invention Submission Corp., 965 F. 2d 1086 (D.C. Cir. 1992) (discussing the Commission's investigatory powers).

[75] *See generally* PETER C. WARD, FEDERAL TRADE COMMISSION: LAW, PRACTICE AND PROCEDURE, Chp. 5 (L. J. Press 2005) (providing a detailed review of the historical development of the policies).

i. Unfair Methods of competition

In general, the 'unfair methods of competition' aspects of section 5 have been interpreted to be coterminous with the Sherman and Clayton Acts[76] such as price fixing.[77] There exists though a component of these powers which exceeds the scope granted by the Sherman and Clayton Acts. That interpretation was made particularly clear in *Chuck's Feed & Seed Co. v. Ralston Purina Co.*

> An anticompetitive practice need not violate the Sherman Antitrust Act or the Clayton Act in order to violate the F[ederal] T[rade] C[ommission] Act . . .The power of the Federal Trade Commission to declare anticompetitive trade practices 'unfair' extends primarily to 'trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate those laws . . .The Federal Trade Commission itself looks to antitrust principles in deciding whether § 5 of the FTC Act has been violated.[78]

Moreover the Department of Justice, jointly with the FTC, issued in 1995 the interpretation that "[p]ursuant to its authority over unfair methods of competition, the Commission may take administrative action against conduct that violates the Sherman Act and the Clayton Act, as well as anticompetitive practices that do not fall within the scope of the Sherman Act or Clayton Act."[79] Indeed, the Court's interpretation of the powers of the FTC in section 5 go back to *Federal Trade Commission v. Brown Shoe,* "The Federal Trade Commission has power under § 5 of the Federal Trade Commission Act to arrest trade restraints in their incipiency without proof that they amount to an outright violation of § 3 of the Clayton Act or other provisions of the antitrust laws" particularly "with regard to trade practices which conflict with the basic policies of

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[76] Clayton Antitrust Act, 15 U.S.C. §§ 12-27 (LEXIS through 2015); Clayton Antitrust Act, 29 U.S.C. §§ 52-53 (LEXIS through 2015).
[77] *See* FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 418 (1990).
[78] Chuck's Feed & Seed Co. v. Ralston Purina Co., 810 F.2d 1289, 1293 (4th Cir. 1987) (citations omitted).
[79] DEPARTMENT OF JUSTICE AND FTC: ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATIONS, Sec. 2.3 (1995), *available at* https://perma.cc/AN9R-UMRB.

the Sherman and Clayton Acts even though such practices may not actually violate these laws."[80]

Further, the broader applicability of section 5 had been endorsed back in 1953 by the Supreme Court in *Federal Trade Commission v. Motion Picture Advertising Service Co.* "The 'unfair methods of competition', which are condemned by § 5(a) of the Federal Trade Commission Act, are not confined to those that were illegal at common law or that were condemned by the Sherman Act. Congress advisedly left the concept flexible to be defined with particularity by the myriad of cases from the field of business."[81]

The courts though have the final word by means of the option for defendants to appeal FTC decisions as protection against the abuse of power by the Commission.[82] Often that authority is used to limit the scope of FTC actions regarding the Commission's definitions of what constitutes 'unfair methods'. That role is particularly evident in *E.I. du Pont De Nemours & Co. v. Federal Trade Commission*, a case involving the pricing of a lead-based antiknock agent to gasoline.[83] In its administrative hearing, the FTC had found the two largest suppliers of the compound followed business practices that "unfairly facilitated the maintenance of substantial, uniform price levels and the reduction or elimination of price competition in the lead-based antiknock market,"[84] despite the fact that the adoption of the practices at issue were non-collusive and independently served legitimate business practices.[85]
The challenged practices were:

> (1) the sale of the product by all four firms at a delivered price which included transportation costs, (2) the giving by Du Pont and Ethyl of extra advance notice of price increases, over and above the 30 days provided by contract, and (3) the use by Du Pont and Ethyl (and infrequently by PPG) of a 'most favored nation' clause under which the seller promised that no customer would be charged a higher price than other customers.[86]

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[80] 384 U.S. 316, 321-22 (1966) (footnote omitted).
[81] 344 U.S. 392, 394 (1953).
[82] FTC v. Sperry & Hutchinson, 405 U.S. 233, 246 (1972).
[83] 729 F.2d 128, 130 (2d Cir. 1984).
[84] *Id.* at 133.
[85] *Id.* at 130.
[86] *Id.*

At the time at issue, 1974-79, Du Pont and Ethyl had a combined 72 percent market share with PPG and Nalco making up the remainder; PPG subsequently exited the industry prior to the FTC's ruling.[87]

Not only was the industry highly concentrated (and had always been so), it was in decline due to new environmental legislation severely restricting and eventually ending the use of lead in antiknock additives. Moreover, the product demand was shown to be highly inelastic and constituted a small part of the final price of gasoline.[88] This combination of factors discouraged entry while encouraging price increases resulting in a product of above average profitability.[89] Discounting when it occurred was initiated by Nalco and responded to by the majors through the offering of additional services like consulting and programming assistance rather than price reductions, that is, through various forms of non-price competition.[90]

The FTC's order prohibited "advance notice of price increases, uniform delivered prices, use of 'most favored nation' clauses by Du Pont and Ethyl, and limiting announcements of price increases to the press and others."[91] The order was premised on the interpretation of section 5 that "it can be violated even in the absence of agreement if the firms engage in interdependent conduct that, because of the market structure and conditions, facilitates price coordination in a way that substantially lessens competition in the industry."[92] As an OECD paper on the subject recognized, markets generally perform better "when participants convey relevant information" such as prices, product attributes, and the like. However, such unilateral revealing of information may cause competitive harm, especially when related to future plans.[93]

The complaint did not claim that the practices were the result of any agreement, express or tacit, among the manufacturers or that the practices had been undertaken for other than legitimate business purposes. "Each acted independently and unilaterally. There is no

[87] *Id.* at 130, 135.
[88] *Id.* at 132.
[89] *Id.*
[90] *Id.* at 133-34.
[91] *Id.*at 134.
[92] *Id.* at 135.
[93] Org. for Econ. Co-operation and Dev. [OECD], Unilateral Disclosure of Information with Anticompetitive Effects, at 11, DAF/COMP(2012)17 (Oct. 11, 2012) *available at* https://perma.cc/R56L-PHXA.

evidence of coercive or predatory conduct."[94] The FTC simply alleged that the practices "individually and in combination had the effect of reducing uncertainty about competitors' prices of lead-based antiknock compounds," and that such reduced uncertainty "unfairly facilitated the maintenance of substantial, uniform price levels and the reduction or elimination of price competition in the lead-based antiknock market."[95]

The appeals court faulted the FTC for not recognizing the legitimate business reasons for the impugned actions and more generally for not establishing "standards" for determining when independent and unilateral actions "become unlawful."[96] "Thus, even if the Commission has authority under § 5 to forbid legitimate, non-collusive business practices which substantially lessen competition, there has not been a sufficient showing of lessening of competition in the instant case to permit the exercise of that power."[97] The FTC order was set aside.[98]

ii. Unfair or deceptive acts or practices

The 'unfair or deceptive acts or practices' prohibitions were added in 1938 by the Wheeler-Lea Act[99] and are often referred to as the consumer protection clause. As explained in the House Report on the amendment summarizing congressional thinking, "This amendment makes the consumer, who may be injured by an unfair trade practice, of equal concern, before the law, with the merchant or manufacturer injured by the unfair methods of a dishonest competitor."[100] It was however not until 1964 that the FTC articulated the factors to be considered, which were later referenced by the Supreme Court in *Federal Trade Commission v. Sperry & Hutchinson*[101] as,

> (1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the

[94] E. I. Du Pont de Nemours & Co. v. FTC, 729 F.2d 128, 140 (2d Cir. 1984).
[95] *Id.* at 133.
[96] *Id.* at 140.
[97] *Id.* at 142 (citation omitted).
[98] *Id.* at 130.
[99] Wheeler-Lea Act, ch. 49, § 3, 52 Stat. 111 (1938) (current version at 15 U.S.C. § 52 (2015)
[100] American Financial Serv. Assoc. v. FTC, 767 F.2d 957, 967-68 (1937) (*quoting* H. R. Rep. No. 1613, 75th Cong., 1st Sess., 3). See also S. Rep. No. 1705, 74th Cong., 2d Sess., 2-3 (1936).
[101] *Sperry & Hutchinson*, *supra* note 82, at 244.

> common law, or otherwise -- whether, in other words, it is within at least the penumbra of some common-law, statutory, or other established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers (or competitors or other businessmen).[102]

Because of the cigarette advertising and Sperry & Hutchinson connections, these principals are often referred to as the Cigarette Rule or S&H Rule.

Within a decade, the FTC had established explicit policies on the concepts of 'unfairness' and 'deception' as applied to consumer transactions. The standards, as well as the violations, are distinct and independent.[103] First released in 1980 was a "Policy Statement on Unfairness."[104] Making reference to the S&H Rule, the policy identifies three criterion:

- The injury must be substantial.

Injury usually involves monetary harm, but can also include the purchase of unwanted goods or services, defective ones, or unwarranted health or safety risks.

- The injury must not be outweighed by any offsetting consumer or competitive benefits.

Included are considerations of the costs a remedy would entail, along with the burdens to society in general of a regulation.

- The injury must be one which consumers could not reasonably have avoided.

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[102] Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8324, 8355 (1964) (Statement of Basis and Purpose of Trade Regulation Rule 408).

[103] *See Federal Trade Commission Act, Section 5 Unfair or Deceptive Acts or Practices*, *in* FDIC COMPLIANCE EXAMINATION MANUAL VII-1.1 (2015), *available at* https://perma.cc/XKY4-KH8L.

[104] FTC Policy Statement on Unfairness, FTC, (Dec. 17, 1980). Appended to a letter to Senators Ford and Danforth, Consumer Subcommittee.

While it is generally assumed that consumers are able to make their own private purchase decisions without regulatory intervention, certain types of sales techniques may prevent customers from effectively making their own choices.[105]

Policies regarding deception were released in 1983.[106] Three elements underlying all deception cases were identified as:

- There must be a representation, omission or practice that is likely to mislead the consumer.

Misleading or deceptive practices have been found to include false oral or written representations, misleading price claims, sales of hazardous or systematically defective products or services without adequate disclosures, failure to disclose information regarding pyramid sales, use of bait and switch techniques, failure to perform promised services, and failure to meet warranty obligations.

- The practice is assessed from the perspective of a consumer acting reasonably under the circumstances, or a group perspective if the practice is focused on particular groups.
- The representation, omission, or practice must be a "material" one.

Materiality applies when the act or practice is likely to affect the consumer's conduct or decision with regard to a product or service.[107] The Congressional response to these policy statements did not come until 1994, with the enactment of 15 U.S.C. § 45(n):

> The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether

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[105] *Id.* at 3.
[106] FTC Policy Statement on Deception, FTC, (October 15, 1983), https://perma.cc/2LWB-G2AD (statement incorporated in a letter to Representative Dingell, Chairman for the Committee on Energy and commerce).
[107] *Id.* at Summary.

> an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

With this amendment, Congress removed the option of the Commission to use public policy as a primary basis for determining unfairness.

E. Section Conclusions

Multiple laws and their interpretations by the courts recognize that numerous options exist for inducing illegal acts by other parties. Those laws though generally require some explicit act before action can be taken. Sherman § 1 requires proof of a combination or conspiracy, an actual meeting of the minds, although the evidence may be circumstantial. Sherman § 2 mandates an explicit solicitation had been issued while contributory infringement under the Patent Act requires any legal action be withheld until actual infringement has occurred. The requirement of a documented explicit act or agreement means these acts do not apply to the damage model developed here for the use and promotion of flat rate manuals, which does not allege any coordinated actions.[108] These acts do however recognize (a) unilateral solicitation can constitute a violation under some conditions, and (b) restraints may be vertical as well as horizontal.

The broad exception to the requirement of concerted action is found in section 5 of the FTC Act, which has allowed 'cease and desist' orders even in instances when the inducement has been offered with no evidence it was accepted and acted upon. As unilateral solicitation, an independent and unilateral action, is a key component of the flat rate damage model proposed here, it is relevant to explore the scope of legal interpretations under section 5. This is done in Section IV following. At the same time it is essential to determine if the alleged actions actually lessen competition, that is, if they are unfair or deceptive, to consumers. That issue is explored in Section V.

[108] *See supra* Part II.

IV. SIGNALING UNDER SECTION 5 OF THE FTC ACT

The unsolicited and unilateral provision of an inducement to a potentially illegal act is referred to here as 'signaling'. Three forms of signaling are considered:

- Private,
- Private and public, and
- Public.

We examine the case law for each in turn, recognizing that private communications are the most common, and considered the most insidious. Our real interest though relates to public solicitation as that is the form conjectured to be used by the producers of flat rate manuals.

A. Private Communication

Quality Trailer Products Corp. produced a variety of axel products. In 1990, two of its representatives met with an officer of a competitor, noting the competitor's "prices for certain axel products were too low, that there was plenty of room in the industry for both firms, and that there was no need for the two companies to compete on price. They also provided assurances to the competitor that Quality Trailer Products would not sell certain axel products below a specified price."[109] The Commission concluded that, "The invitation, if accepted, would have constituted an agreement in restraint of trade," a violation of section 5 of the FTC Act.[110] The cease and desist order specified a cessation of communications "requesting, suggesting, urging, or advocating that any other producer or seller of axel products raise, fix or stabilize prices or price levels, cease providing discounts, or engage in any other pricing action."[111]

YKK manufactured and distributed zippers and related products, including leasing equipment for installing zippers. It with Tallon, Inc. accounted for approximately 82 percent of all zippers manufactured and/or sold in the US. On July 1, 1988 a YKK attorney sent a letter to Tallon accusing Tallon of "unfair and predatory sales" and requesting Tallon take "immediate action to cease offering free equipment to customers and to withdraw outstanding offers of free equipment to

[109] Quality Trailer Prods. Corp., 115 F.T.C. 944, 945 (1992).
[110] *Id.*
[111] *Id.* at 947.

customers . . ." Subsequently at an October 21, 1988 meeting the YKK attorney asked an attorney for Tallon to "urge Tallon to desist from offering free instillation equipment."[112]

The Commission in its Complaint characterized the offering of free instillation equipment as "a form of discounting" such that an agreement between Talon and YKK would have constituted an unreasonable restraint of competition."[113] The cease and desist order included a prohibition from seeking an end to "providing free equipment or other discounts, cease providing any services or products, or engage in any other pricing action."[114]

Precision Molding Co. manufactured and distributed wooden 'stretcher' bars for mounting painting canvases as the dominant national supplier.[115] Early in 1995 a new competitor was identified, which was offering Precisions' customers a similar product at prices below Precision's, according to documents provided by those customers.[116] During that period Precision delayed a planned price increase, and on June 23, 1995, Precision's president met with an officer of its competitor at its place of business.[117] At the meeting the president of Precision was quoted as calling the competitor's prices "ridiculously low" and that he, the competitor, did not "have to give the product away."[118] Those statements were interpreted by the competitor as "an invitation to fix prices" at which point the competitor warned that price fixing was illegal[119]. Shortly thereafter Precision's president threatened the competitor with a "price war" that it would be unable to survive.[120] Precision's planned price increase was delayed throughout 1995 while attempting to ascertain if the competitor would remain a threat.[121] The decision[122] specified terms similar to those in *Quality*.[123]

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[112] YKK (USA) Inc., 116 F.T.C. 628, 629 (1993).
[113] *Id.*
[114] *Id.* at 631.
[115] Precision Moulding Co., 1996 FTC LEXIS 386, at *7 (1996).
[116] *Id.* at *2
[117] *Id.* at *3
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] *Id.* at *4.
[122] *Id.*at *7-10.
[123] *Quality*, *supra* note 109.

B. Public/Private Communication

Stone Container Corp. manufactured liner board for forming corrugated boxes, the largest such manufacturer in the U.S. Contrary to the Executives' predictions, a January 1993 attempt to raise prices failed because of excessive inventory in the industry. The Executives devised a "strategy to effect a coordinated price increase" consisting of (a) idling plants to reduce inventory, (b) reducing the company's production, and (c) purchasing 100,000 tons from competitors.[124]

Senior Stone officials contacted competitor counterparts to inform them of the proposed strategy and implementation plans. Those steps were followed during the second half of 1993 and communicated to competitors, both privately and through public statements, like press releases and published interviews, Stone's belief that those "actions would support a price increase."[125] The Commission concluded that these communications "constitute[ed] an invitation by Stone Container to its competitors to join a coordinated price increase."[126]

U-Haul is the largest truck leasing company in the U.S. which with its major competitor, Budget, has a 70 percent market share for domestic one-way truck rentals. The third national firm in the industry is Penske.[127]

Through 2006, U-Haul Chairman Shoen was aware that competition from Budget was forcing his firm to lower its rates for one-way rentals. A two-component strategy was developed to secure higher rates: regional managers raise rates, contact Budget managers and inform them of the change and encourage Budget to follow – under the threat that otherwise U-Haul rates would be reduced to the original lower level.[128] If Budget's regional managers decided not to follow a price increase, then U-Haul one-way rates should be lowered below Budget's, and Budget managers were to be informed of the rate reduction. "In this way, U-Haul would teach Budget that its low-price policy was fated to be ineffective." "EITHER WAY, LET THEM KNOW"[129]

Shoen also instructed U-Haul dealers to communicate directly with Budget's dealers. A memo from Shoen to Budget's dealers specified,

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[124] Stone Container Corp., 125 F.T.C. 853, 854 (1998).
[125] *Id.*
[126] *Id.*
[127] U-Haul Int'l Inc., 150 F.T.C. 1, 26 (2010).
[128] *Id.*
[129] *Id.* at 3 (emphasis in original).

"[w]hen you and your [regional managers] decide it is time to bring some One-Way rates back up above a money loosing [sic] 35 cents a mile, have your dealers let the Budget and Penske dealers know."[130] In October 2006, Robert Magyar, U-Haul regional manager for the Tampa Florida area, contacted a Budget representative and communicated the U-Haul price increase. Implicit in the conversation was the threat that if Budget did not raise its rates U-Haul would lower its price to the original level. The following October, Magyar repeated the call. "I encouraged them to monitor my rates and to move their rates up. And they did."[131]

Then on February 7, 2008 Shoen held an earnings conference call "aware that Budget representatives would monitor the call." In the call Shoen stated:

- "[H]ey, don't throw money away. Price at cost at least."[132]
- U-Haul will tolerate a small price differential, but only a small one: 3-5%.
- "[I]f it [competitor's lower price] starts to affect share I'm going to respond, that's all."[133]

The administrative judge interpreted those communications, including the public ones conducted via the earnings call, as an attempt to raise and stabilize prices. The FTC order was to cease and desist from such activities.[134]

C. Public Communication

Valassis Communications produced coupon booklets which were distributed through newspapers. Over decades it maintained a fifty-fifty market share with News America Marketing.[135] In June 2001, Valassis increased prices five percent, but News America did not join so in February 2002 Valassis rolled back the increase, leading to a price war with prices falling by [twenty] percent over 2001-04.[136]

On July 22, 2004 Valassis used an earning conference call to communicate with News America representatives a willingness to cease

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[130] *Id.*
[131] *Id.* at 4.
[132] *Id.*
[133] *Id.* at 5.
[134] *Id.* at 23.
[135] Valassis Commc'n, Inc., 141 F.T.C. 247, 248-49 (2006).
[136] *Id.* at 249.

competition for customers. "Valassis executives were aware that News America representatives would be monitoring the call." At the initiation of the call Valasis CEO Alan Schultz laid out the new strategy:

- Valassis would abandon 50 percent share goal and accept current share in mid-40s.
- "[W]e will defend our customers and market share and use whatever pricing is necessary to protect our share."
- For customers with expiring contracts with News America, Valassis would bid at prices substantially above current levels, i.e., those prevailing in 2001.[137]
- "If News America competes for Valassis customers, then the price war will resume."[138]

The FTC, concluding that Valassis acted with an intent to facilitate collusion and without a legitimate business purpose, issued an order banning communicating publicly or privately that it was ready to forbear from competition; to allocate or divide market share; or to raise, fix, maintain or stabilize prices.[139] As important for our assessment here the decision included a comment on the use of public communications, "The Commission has concluded that the fact of public communication should not, without more, constitute a defense to an invitation to collude, particularly where market conditions suggest that collusion, if attempted, likely would be successful (here, a duopoly)."[140] Private negotiation may be "the most efficient route." "But it is clear that anticompetitive coordination also can be arranged through public signals and public communications, including speeches, press releases, trade association meetings and the like."[141]

A similar relevant interpretation of business behavior was laid out in the *DuPont* case.

> The term 'unfair' is an elusive concept, often dependent upon the eye of the beholder. A line must therefore be drawn between conduct that is anticompetitive and legitimate conduct that has an impact on competition. Lessening of competition is not the substantial

137 *Id.* at 250.
138 *Id.* at 251.
139 *Id.* at 251, 275.
140 *Id.* at 283.
141 *Id.* at 284.

> equivalent of 'unfair methods' of competition. Section 5 is aimed at conduct, not at the result of such conduct, even though the latter is usually a relevant factor in determining whether the challenged conduct is 'unfair.' Nor does the statute obligate a business to engage in competition; if that were the case, many acceptable pricing and market decisions would be barred.[142]
>
> 'When a business practice is challenged by the Commission, even though, as here, it does not violate the antitrust or other laws and is not collusive, coercive, predatory or exclusionary in character, standards for determining whether it is 'unfair' within the meaning of § 5 must be formulated to discriminate between normally acceptable business behavior and conduct that is unreasonable or unacceptable.'[143]
>
> In our view, before business conduct in an oligopolistic industry may be labelled "unfair" within the meaning of §5 a minimum standard demands that, absent a tacit agreement, at least some indicia of oppressiveness must exist such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct.[144]

D. Section Conclusions

The preceding case review makes it clear that the FTC does indeed recognize that an inducement to conspire absent evidence of agreement can be a violation of section 5, and further that the inducement may be private, public, or both. What constitutes a violation - the line "between conduct that is anticompetitive and legitimate conduct that has an impact on competition" - is most clearly detailed in *Du Pont*:

- "Section 5 is aimed at conduct, not the result of such conduct",
- "[S]ome indicia of oppressiveness must exist such as (1) evidence of anticompetitive intent or purpose on the part of the

[142] *Du Pont*, *supra* note 83, at 137-38, footnote excluded.
[143] *Id*. at 138.
[144] *Id.* at 139.

> producer charged, or (2) the absence of an independent legitimate business reason for its conduct."[145]

As well the Commission will look for the 'plus factors' of oligopoly of market concentration and a low elasticity of demand which identify the potential to exercise market power.[146] Clearly the auto flat rate manual sector exhibits these plus conditions.[147] However, all the FTC cases apply to horizontal price fixing while the relationship between flat rate manual producers and repair shop owners is vertical in nature and there exists no indication of a conspiracy among the multitudinous repair shops. Moreover, even if the sale price of flat rate manuals were somehow elevated, customers of the repair shops as indirect purchasers would be barred from recovering any damages under *Illinois Brick v. Illinois*.[148]

Having established that unilateral signaling is actionable under section 5 we may conclude as well that unfair methods of competition as interpreted do not apply to the type of behavior exhibited by flat rate manual producers. We must then turn from the 'unfair methods of competition' to the 'unfair or deceptive acts or practices' components of section 5 to determine if the alleged actions of flat rate manual producers is indeed a violation. That is done in Section V following.

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[145] *Id.* at 138-39.
[146] *Todd*, *supra* note 37, at 198, 208.
[147] *See supra* Section II.
[148] *Ill Brick Co.*, 431 U.S. at 724-25 ("[T]his Court rejected as a matter of law this defense that indirect rather than direct purchasers were the parties injured by the antitrust violation. The Court held that except in certain limited circumstances, a direct purchaser suing for treble damages under § 4 of the Clayton Act . . . is injured within the meaning of § 4 by the full amount of the overcharge paid by it and that the antitrust defendant is not permitted to introduce evidence that indirect purchasers were in fact injured by the illegal overcharge.").

V. ARE FLAT RATE MANUAL PRODUCERS VIOLATING SECTION 5 OF THE FTC ACT, AND WHAT CAN BE DONE ABOUT IT?

A. Are There Unfair or Deceptive Acts or Practices in the Use of Flat Rate Repair Manuals?

When examining the consumer protection components of Section 5 there is a choice between 'unfair' and 'deceptive' practices. As a reminder, the FTC policies for the two, respectively, are:[149]

- The injury must be substantial,
- The injury must not be outweighed by any offsetting consumer or competitive benefits, and
- The injury must be one which consumers could not reasonably have avoided

And

- There must be a representation, omission or practice that is likely to mislead the consumer,
- The practice is assessed from the perspective of a consumer acting reasonably in the circumstances, or a group perspective if the practice is focused on particular groups, and
- The representation, omission, or practice must be a "material" one.

To begin in the reverse order, deceptive practices are typically associated with the offering of products or services, including through advertising.[150] Other examples include:

> Making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not available; omitting material limitations or conditions from an offer; selling a product unfit for the purpose for which it is sold; and failing to provide promised services.[151]

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[149] *See supra* Section III.D.b

[150] *See* Ward, *supra* note 75, at 5-12 - 5-16 (providing case examples).

[151] *Federal Trade Commission Act, Section 5 Unfair or Deceptive Acts or Practices*, *in* FDIC COMPLIANCE EXAMINATION MANUAL VII-1.1, VII-1.3 (2015), *available at* https://perma.cc/XKY4-KH8L.

The promotion of flat rate manuals does not fit into any of these deceptive practices nor does their use by repair shops involve any direct deception of consumers. Indeed, shops typically post when flat rate hours are used for estimates. Thus, we turn our attention to unfair practices as they might be applied to the use of flat rate manuals from the perspective of repair customers.

- The injury must be substantial.

Injury is typically financial, although personal harm is also included.[152] The 1980 estimate by the N.Y. Attorney General's Office of $ 73 million annually for N.Y. motorists indicates substantiality.[153] The 1980 figure updated to current dollars and allocated over the national population yields an overcharge value of $ 3.5 billion, very notable indeed.[154]

- The injury must not be outweighed by any offsetting consumer or competitive benefits.

Presumably auto repair consumers benefit indirectly from any enhanced efficiency in shop management enabled by manual use. More particularly, customers do benefit from having a fixed repair cost estimate which shields them to a degree from unexpected additional costs should the repair take longer than anticipated. That is, with a fixed cost estimate based on the flat rate manual time requirement quote, the shop not the customer takes on the risk of an excessive repair time requirement. That is a consumer benefit. The issue however is the net benefit; "the consumer injury must not be outweighed by any countervailing benefit to consumers".[155] In the *Harvester* case, the costs for an effective warning system were approximated at $ 2.8 million, but "expenses were not large in relation to the injuries that could have been avoided."[156]

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[152] *See* FTC Policy Statement, *supra* note 104. *See also* Int'l Harvester Co., 104 F.T.C. 949 (1980) (where 'fuel geysering' caused serious burns to at least 12 individuals and one death was found to be injurious to users).
[153] *See supra* Part I.
[154] New York's 19 million residents are about 6% of the national 2014 population of 319 million.
[155] *Harvester*, *supra* note 152.
[156] *Id.*

It is difficult absent further information to estimate the benefit to auto repair consumers of any enhancement in shop management as well as to consumers for avoiding some of the risk of a more extensive repair time than anticipated. However, the rough cost estimate of $3.5 billion does suggest there is a likely net consumer cost overall, even if in some cases costs will be higher than expected. As regards competition, the concept of the damage model[157] is that the flat rate manuals are being used to *reduce* competition among repair shops so there is little reason to anticipate a countervailing benefit through greater competition. Of course it would be possible to produce and market flat rate manuals with correct true average time estimates that could provide the same management benefits to shop owners and guaranteed repair cost estimates to consumers without the inflation of repair hour estimates which creates the alleged unfair practices.

- The injury must be one which consumers could not reasonably have avoided.

"Because consumers should be able to survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory, the question of [avoiding injury] is whether an act or practice unreasonably impairs the consumer's' ability to make an informed decision."[158] Such an impairment can be created by a lack of alternatives in the market – i.e., where most market participants engage in a practice, consumers may have no meaningful way to avoid it. An alternative perspective applying to *Harvester* is, "Since fuel geysering was a risk that they were not aware of, [tractor users] could not reasonably avoid it."[159]

The use of auto repair flat rate manuals is prevalent so it makes it difficult, if not impossible, for consumers to identify non-manual using shops. Moreover, consumers are not aware that times are potentially inflated, and so have no incentive to search for those shops which do not use the manuals. We can then reasonably conclude that the use of flat rate manuals is unfair to consumers provided that the hours are overestimates of true, average time requirements.

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[157] Damage Model, *supra* Section II.
[158] *Federal Trade Commission Act, Section 5 Unfair or Deceptive Acts or Practices*, *in* FDIC COMPLIANCE EXAMINATION MANUAL VII-1.1, VII-1.2 (2015), *available at* https://perma.cc/3DB2-TTDB.
[159] *Harvester*, *supra* note 152, at 92.

B. Proposed Remedies

From the preceding it can be reasonably concluded that flat rate manuals, which use overestimates of repair time requirements, are unfair for consumers under section 5 of the FTC Act. The unfairness is based on the potentially excessive repair time estimates, not on the concept of manuals *per se* as they have potential benefits for repair customers and shop operators. The excessive hours are allegedly generated by the manual producers who signal their existence to shop owners through public media, with the excess charges being paid by the repair customers. Section 5 case history recognizes both signaling and unfair practices as potential violations although the signaling case file focuses on horizontal rather than vertical signaling, the issue with flat rate manuals.

If as proposed a complaint is brought under Section 5, the typical FTC administrative judgment involves a cease and desist order for specified conduct.[160] In the context here that would apply to ad language suggesting using manual times allows repair shops to charge for more hours for the same work. That is, manual producers would likely be prohibited from using terminology like "beating the averages" and "charging the right price to the customers (instead of giving it away)".[161] In the current context that restriction, though beneficial, would likely be inadequate. That is because a major part of a Section 5 violation under my damage model involves the reporting of inflated or otherwise inaccurate repair times, in short being unfair. To resolve fully the overcharge issue the FTC must investigate the repair estimates *per se*. The courts lack the knowledge to judge the published numbers themselves, but can examine the methodology by which the repair time data are generated and on that basis determine if the process is adequate to provide representative values. For example, if the manual producers conduct time studies for individual repair times then the methodology would seem appropriate. If however, they simply extend the time estimates of auto manufacturers by one and a half [162] then in the absence of supporting documentation that approach would seem deficient. If the values represent true average repair times, then there is no violation; if not, then the publishers should be mandated to identify and apply an improved methodology.

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160 *See supra* Section IV.
161 *See supra* Section II.
162 *Id.*

There is precedent for the government to be involved in reporting methodologies. In particular, the Credit Rating Agency Reform Act[163], extended by the Dodd-Frank Wall Street Reform and Consumer Protection Act[164] (Dodd-Frank Act), requires the Securities and Exchange Commission (SEC) to evaluate credit rating agencies and control some internal record-keeping processes. While the Credit Rating Agency Reform Act specifically prohibits the SEC from regulating the rating methodologies, the Dodd-Frank Act does require the Commission to develop regulations regarding the performance statistics of the rating agencies as well as the disclosure of the rating methodologies.[165] What is proposed here is a similar treatment by the FTC of the methodologies used by flat rate manual producers.

VI. CONCLUSIONS

Section 5 of the Federal Trade Commission Act gives the Commissioners a broader authority than under the Sherman and Clayton Acts. In particular, that authority allows for unilateral private and public administrative action, which damage competition and consumers.

The issue addressed here relates to the independent producers of flat rate repair time manuals with particular attention to manuals for the auto repair sector. Those producers are alleged here to be inflating the time requirements of repairs, leading to repair cost overcharges, which are unfair consumer practices under Section 5. Overcharges are possible in the repair sector under the damage model because of a low elasticity of demand for repair services, while widespread use of the same manual time means that the range of cost estimates will be reduced, which discourages consumers from searching further for lower costs. Consumers cannot reasonably avoid the costs associated with inflated flat rate hours.

This scenario applies only if the repair times are indeed overestimated, either intentionally or through the use of an inadequate data collection methodology. A remedy under Section 5 then must exceed the standard FTC 'cease and desist' order applying to the public communication and include a mandate that the independent manual

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[163] Credit Rating Agency Reform Act, Pub. L. No. 109–291, 120 Stat. 1327 (2006).

[164] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[165] *Credit Rating Agencies*, U.S. SEC. & EXCH. COMM'N, https://perma.cc/GC2R-HHAU.

producers document the data collection methodology used for scrutiny by FTC researchers. This process would represent an additional extension of the use of the enhanced FTC authority under Section 5 as the unilateral solicitation is vertical rather than the horizontal violations in the case history. However, "If the Commission is to attain the objectives Congress envisioned, it cannot be required to confine its road block to the narrow lane the transgressor has traveled; it must be allowed effectively to close all roads to the prohibited goal, so that its order may not be by-passed with impunity."[166] After all, "those caught violating the Act must expect some fencing in."[167] Reporting true repair time estimates, if it should come to that, hardly seems a major 'fencing in' for flat rate manual producers.

[166] FTC v. Ruberoid Co., 343 U.S. 470, 473 (1952).
[167] FTC v. National Lead Co., 352 U.S. 419, 431 (1957).