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# Final Report

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Monday  
November 19, 1984

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## Part II

## Federal Trade Commission

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16 CFR Part 455  
Trade Regulation Rule; Sale of Used  
Motor Vehicles; Final Trade Regulation  
Rule

## FEDERAL TRADE COMMISSION

## 16 CFR Part 455

## Trade Regulation Rule; Sale of Used Motor Vehicles

AGENCY: Federal Trade Commission.

ACTION: Final Trade Regulation Rule.

**SUMMARY:** The Federal Trade Commission issues a final Rule, the purpose of which is to reduce oral misrepresentations, and consumer reliance thereon, in the used car transaction by providing consumers with accurate information concerning warranty coverage and other important information. The Rule requires used car dealers to disclose, on a window sticker ("Buyers Guide") posted on used cars offered for sale to consumers, information about the warranty coverage offered, the meaning of an "as is" sale and other related information.

This notice contains the Rule's Statement of Basis and Purpose incorporating a Regulatory Analysis and the text of the Rule.

EFFECTIVE DATE: May 9, 1985.

**ADDRESS:** Requests for copies of the Rule and the Statement of Basis and Purpose should be sent to Public Reference Branch, Room 130, Federal Trade Commission, 6th Street and Pennsylvania Avenue, NW., Washington, D.C. 20580.

**FOR FURTHER INFORMATION CONTACT:** Lemuel W. Dowdy, Division of Marketing Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, D.C. 20580 (202) 376-2893.

## SUPPLEMENTARY INFORMATION:

## List of Subjects in 16 CFR Part 455

Motor vehicles, Trade practices.

TRADE REGULATION RULE  
CONCERNING THE SALE OF USED  
MOTOR VEHICLES, STATEMENT OF  
BASIS AND PURPOSE AND  
REGULATORY ANALYSIS

## I. Introduction

## A. Overview of the Rule

In recent years, more than ten million used cars have been sold annually by franchised and independent dealers. For many consumers, the purchase of a used car represents a substantial, necessary investment in a reliable means of transportation. Despite the significance of this investment and the relative unfamiliarity of most consumers with the mechanical operation of an automobile, many used car buyers currently receive little accurate

warranty and mechanical condition information to assist them in their purchase. Consumers' ability to obtain this information has been hampered by various unfair and deceptive practices identified during the course of this rulemaking proceeding. The record establishes that these practices have resulted in substantial consumer injury in the used car market. To correct these unfair and deceptive practices in the used car industry, it is necessary to promulgate the accompanying Trade Regulation Rule. By providing for the disclosure at the point of sale of information concerning the extent of warranty coverage, the Commission believes that used car dealers will be discouraged from engaging in the deceptive practices established in the record. Instead, used car buyers will be able to make informed purchasing decisions based on accurate and complete information about warranty protection offered.

The record demonstrates that used car dealers and their agents have engaged in deceptive sales practices. These include:

- (1) Misrepresenting the mechanical condition of a used vehicle;
- (2) Misrepresenting the terms of any warranty offered in connection with the sale of a used vehicle; and
- (3) Representing that a used vehicle is sold with a warranty when the vehicle is sold without a warranty.

The record also demonstrates that used car dealers and their agents engage in unfair practices. These include:

- (1) Failing to disclose, prior to sale, that a used vehicle is sold without any warranty; and
- (2) Failing to make available, prior to sale, the terms of any written warranty offered in connection with the sale of a used vehicle.

The Commission has concluded that these acts and practices are deceptive or unfair within the meaning of Section 5 of the Federal Trade Commission Act and are appropriately remedied by the Trade Regulation Rule being promulgated today.

The primary purpose of this Rule is to prevent and discourage oral misrepresentations and unfair omissions of material facts by used car dealers concerning warranty coverage. The Rule provides a uniform method for written disclosure of such information by means of a "Buyers Guide." The Rule requires clear disclosure through the Buyers Guide of the existence of any warranty coverage and of the terms and conditions of any warranty offered in connection with the sale of a used car, including the duration of coverage and the percentage of total repair costs to be

paid by the dealer. The Rule also includes certain additional disclosures that are incorporated on the Buyers Guide, including: A list of the fourteen major systems of an automobile and defects that can occur in these systems; a suggestion that consumers ask the dealer if a pre-purchase inspection is permitted; and a warning against reliance on spoken promises that are not confirmed in writing. When the used car transaction is conducted in Spanish, the Rule requires that a Spanish-language version of the Buyers Guide be provided to the consumer, and the Rule includes a text for a Spanish-language version. In addition, the Rule provides that the Buyers Guide disclosures are to be incorporated by reference into the sales contract, and are to govern in the event of an inconsistency between the Buyers Guide and the sales contract. The Rule further requires dealers to give copies of the Buyers Guide reflecting the final terms of sale to the consumer.

This overview has highlighted the central elements of the Rule. Virtually all other provisions of the Rule, including certain definitions, are designed to ensure the integrity of this disclosure scheme. The Commission believes that this Rule, which requires that warranty information be provided in written form, will effectively curb many of the unfair and deceptive practices identified in the rulemaking record with minimal intrusion into the business operations of used car dealers.

## B. Historical Background

The used car rulemaking proceeding grew out of an investigation begun by the Commission's Seattle Regional Office in 1973. That investigation resulted in a 1973 report which recommended that the Commission, pursuant to its authority under section 6(g) of the FTC Act,<sup>1</sup> regulate the sale of used cars through a system of required inspections by dealers, disclosure of defects, and mandatory warranties on parts found to be without defects.<sup>2</sup> Subsequently, at the Commission's direction, the staff of the Bureau of Consumer Protection in Washington, D.C. continued the investigation.

In 1975, during the pendency of the staff investigation, the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act ("Magnuson-Moss Act") became effective.<sup>3</sup> In Title I of the

<sup>1</sup> 5 U.S.C. 46(g).<sup>2</sup> Seattle Regional Office Used Car Analytical Programming Guide (September 17, 1973).<sup>3</sup> Pub. L. 93-637 (Jan. 4, 1975), codified at 15 U.S.C. 2301 et seq.

Magnuson-Moss Act, Congress directed the Commission to initiate a rulemaking proceeding dealing with "warranties and warranty practices in connection with the sale of used motor vehicles."<sup>4</sup> This statutory directive expressly authorized the Commission to proceed under both Title I of the Magnuson-Moss Act and any other statutory authority available to the Commission.<sup>5</sup>

An Initial Staff Report by the staff of the Bureau of Consumer Protection was published in December 1975. In that report, the staff recommended that the Commission initiate a rulemaking proceeding.<sup>6</sup> The Initial Staff Report described warranty practices, as well as a variety of other practices related to the sale of used cars, that, in the staff's opinion, violated Section 5 of the Federal Trade Commission Act,<sup>7</sup> as well as Title I of the Magnuson-Moss Act.

In compliance with the congressional directive, the Commission, after reviewing the Initial Staff Report, published an Initial Notice of Proposed Rulemaking ("Initial Notice") on January 6, 1976.<sup>8</sup> The Initial Notice proposed a Trade Regulation Rule designed to remedy the allegedly unlawful practices through (1) a "window sticker" posted on each car disclosing warranty terms, warranty disclaimers, prior use of the vehicle, mileage, prior repairs, and dealer identification information; and (2) a specified form of warranty disclaimer to be used in "as is" sale contracts. Additional remedies suggested for public comment in the Initial Notice included disclosure of mechanical defect information and a "pre-purchase inspection opportunity" which would have given consumers the right to take a car to a third party for inspection prior to purchase.

The Commission amended the Initial Notice with the publication of additional questions for public comment in a May 21, 1976, Federal Register notice ("Second Notice").<sup>9</sup> These additional

questions focused on whether dealers should be required to disclose known defects and to disclose whether or not each car had been inspected for defects. The questions also sought comment on the best format for communicating the disclosures to the consumer. Other questions published in this Second Notice asked whether the Vehicle Identification Number (VIN) should be added to the form and whether disclosures should be required in sales of used cars between dealers.

Following publication of the Second Notice, the staff attempted to focus public comment by preparing and circulating to interested parties a suggested format (in the form of a window sticker)<sup>10</sup> for the disclosures proposed in the Initial and Second Notices. A Final Notice establishing the dates and locations of public hearings, setting the final date for receipt of written comments, and designating issues for consideration in accordance with § 1.13(d) (5) and (6) of the Commission's Rules of Practice, 16 CFR 1.13(d) (5), (6), was published on September 15, 1976.<sup>11</sup>

Written comments on the Initial and Second Notices and on the suggested format were received through October 22, 1976. Numerous comments were made by consumers, used car dealers, dealers associations, consumer groups, state and local law enforcement officials, members of Congress, legal aid attorneys, auto rental and leasing associations, federal agencies and other interested parties. Books, articles, research reports, and interviews conducted by Commission staff were also submitted for the rulemaking record.<sup>12</sup>

Following the written comment period, public hearings were held in six cities from December 6, 1976, through May 4, 1977.<sup>13</sup> All witnesses were given an opportunity to make an opening presentation followed by cross-examination conducted by Commission staff and by designated representatives of used car dealers, the auto rental and leasing industries, and consumer groups.<sup>14</sup> Rebuttal statements were

accepted after the hearings until August 31, 1977.<sup>15</sup>

The written comments, the materials placed on the record by the Presiding Officer and the Commission staff, the hearing transcripts and exhibits, and the rebuttal statements comprise the principal evidentiary record of this proceeding. After the receipt of rebuttal statements, reports to the Commission based on the rulemaking record were prepared by the Presiding Officer,<sup>16</sup> who made findings on the issues that had been designated by the Commission for the public hearings, and by the Commission staff,<sup>17</sup> who summarized and analyzed the record evidence and made recommendations to the Commission for a Trade Regulation Rule.

The Presiding Officer found *inter alia*, that many used car dealers misrepresent or fail to disclose material facts relating to the mechanical condition of used cars and the dealer's responsibility for making repairs after sale. The staff, after coming to a similar conclusion, recommended a revised Trade Regulation Rule which would have required mandatory inspection and disclosure of defects regarding certain mechanical and safety components of used cars. The revised rule would have also required disclosures of warranty coverage, repair cost estimates, prior use, mileage, availability of service contracts, vehicle identification information, and dealership identification information. These disclosures were to be made on a "window sticker" attached to the side window of the used car.

Pursuant to § 1.13(h) of the Commission's Rules of Practice, 16 CFR 1.13(h), publication of the Final Staff Report initiated a sixty-day comment period which afforded the public an opportunity to comment on the reports

Research Group; Car and Truck Renting and Leasing Association; American Automotive Leasing Association; and National Automobile Dealers Association.

<sup>15</sup> Rebuttal statements are filed in Category "Q" of the record and are contained in volumes labeled 215-54-1-17.

<sup>16</sup> Report of the Presiding Officer on Proposed Trade Regulation Rule For Sale of Used Motor Vehicles (16 CFR Part 455), May 22, 1978 (hereinafter cited as "Presiding Officer's Report"). Notice of publication of the Presiding Officer's Report was given on June 30, 1978. 43 FR 28521 (1978).

<sup>17</sup> Sale of Used Motor Vehicles, Final Staff Report to the Federal Trade Commission and Proposed Trade Regulation Rule (16 CFR Part 455), September, 1978 (hereinafter cited as "Staff Report"). Notice of publication of the Staff Report was given on November 14, 1978. 43 FR 52729 (1978). Many of the citations in this statement are to the Staff Report, which recounts and summarizes the records evidence.

<sup>4</sup> 15 U.S.C. 2309(b).

<sup>5</sup> *Id.*

<sup>6</sup> Staff Report on the Used Motor Vehicle Industry: Proposed Trade Regulation Rule and Staff Memorandum (hereinafter cited as "Initial Staff Report"). The rulemaking record of this proceeding has been designated No. 215-54 in the Commission's Public Reference Branch. The Initial Staff Report and related documents are filed in category B of the record and are contained in volumes labeled 215-54-1-2.

<sup>7</sup> 15 U.S.C. 45.

<sup>8</sup> 41 FR 1089 (1976).

<sup>9</sup> 41 FR 20896 (1976). The publication of the Second Notice resulted from early comment criticizing the initial proposed rule.

<sup>10</sup> See Final Staff Report at Appendix D, *infra* n. 17.

<sup>11</sup> 41 FR 39337 (1976).

<sup>12</sup> The written comments and other written materials are filed in categories "C-M" of the rulemaking record and are contained in volumes 215-54-1-3 through 215-54-1-13.

<sup>13</sup> Hearings were held in Boston, Cleveland, Dallas, Los Angeles, San Francisco, and Washington D.C. The transcripts of the hearings were filed in Category "P" of the proceeding and are contained in volumes labeled 215-54-1-16.

<sup>14</sup> The designated representatives were Automobile Owners Action Council; San Francisco Consumer Action and California Public Interest

of the Presiding Officer and the staff. This comment period was originally scheduled to close on January 4, 1979. In order to allow additional time for comments, including comments on an FTC Bureau of Economics report placed on the record on January 5, 1979, the Commission extended the comment period for thirty days to February 13, 1979.<sup>18</sup>

On July 26, 1979, the staff's summary of post-record comments, memorandum recommending modifications in the proposed rule, and a memorandum from the Director of the Bureau of Consumer Protection outlining an alternative "optional inspection" rule were forwarded to the Commission. On September 25, 1979, the Commission heard oral presentation from selected rulemaking participants who had been invited to present their views directly to the Commission as provided in § 1.13(i) of the Commission's Rules, 16 CFR 1.13(i).<sup>19</sup> On October 11, 1979, the Commission met to consider whether to adopt a final rule, and if so, what form the rule should take. Although no final determination was made during that meeting, the Commission rejected the mandatory inspection approach recommended by staff and directed the staff to analyze an optional inspection rule.<sup>20</sup>

On April 4, 1980, the staff forwarded to the Commission a memorandum recommending adoption of an optional inspection rule. On May 16, 1980, the Commission met to consider the redrafted rule and, with certain modifications, tentatively adopted the staff recommendations.<sup>21</sup> The

Commission further directed the staff to prepare a request for technical comment by the public on the likely effectiveness of the optional inspection proposal, the format and comprehensibility of the proposed disclosure form and any drafting errors in the text of the proposed Rule. Pursuant to § 1.14(a) of the Commission's Rules of Practice, 16 CFR 1.14(a), the Commission published the request for comment in the August 7, 1980, *Federal Register*.<sup>22</sup> Comments were accepted through November 7, 1980.<sup>23</sup>

On January 14, 1981, the staff forwarded to the Commission a summary of the technical comments and final recommendations for modifying the proposed optional inspection rule in light of those comments. A supplemental recommendations memorandum and revised summary of comments was forwarded by staff to the Commission on February 20, 1981. On April 14, 1981, the Commission met and determined not to adopt the "optional inspection rule." In its place, the Commission approved a Rule requiring, by means of a window sticker, the disclosure of warranty information and the disclosure of certain major defects known to the dealer at the time of sale. At the same meeting, the Commission directed the staff: to revise the list of defects that must be disclosed if known; to contract for consumer testing of the comprehensibility of the window sticker; to conform the text of the Rule to the concepts adopted in substance by the Commission; and to return the Rule and the Statement of Basis and Purpose to the Commission for promulgation.

On August 14, 1981, the Commission voted to promulgate a final Trade Regulation Rule Concerning the Sale of Used Motor Vehicles and publish a Statement of Basis and Purpose for the Rule.<sup>24</sup> On August 18, 1981, the Federal Trade Commission promulgated the final rule. [16 CFR Part 455 (1982)].

Section 21 of the FTC Improvements Act of 1980, 15 U.S.C. 57a-1 (Supp. IV 1980), gave Congress the power to veto a rule promulgated by the FTC if the Senate and the House of Representatives each adopted a concurrent resolution disapproving the rule within the time period provided in

the statute. On May 18, 1982, the Senate passed Senate Concurrent Resolution 60 disapproving the Used Car Rule by a vote of 69-27. 128 Cong. Rec. Section 5402 (May 18, 1982). On May 26, 1982, the House of Representatives, by a vote of 286-133, joined the Senate in disapproving the FTC rule. 128 Cong. Rec. H2882-83 (May 26, 1982). Pursuant to 15 U.S.C. 57a-1, these actions constituted a veto of the rule. However, the legislative veto provision in Section 21 of the FTC Improvements Act of 1980 was held unconstitutional by the Supreme Court on July 6, 1983, *U.S. Senate v. FTC*, — U.S. — (1983), 103 S. Ct. 3556 (1983); *U.S. House of Representatives v. FTC*, — U.S. — (1983), 103 S. Ct. 3556 (1983). This decision invalidated the Congressional veto of the rule.

Prior to the Congressional veto, several parties sought judicial review of the rule in the United States Court of Appeals for the Second Circuit, *Miller Motor Car Corporation, et al. v. FTC*, 2d Cir. No. 81-4144. Pursuant to a stipulation by the parties in that proceeding, the court entered an order permitting withdrawal of these causes pending Congressional consideration of the rule. The order provided that the petitioners could reinstate the cases twenty days after any decision of the Supreme Court of the United States that has the effect of invalidating Senate Concurrent Resolution 60. On July 26, 1983, the lawsuit challenging the Used Car Rule was duly reinstated.

On August 9, 1983, the Commission determined that the rule would become effective six months after entry of a judgment by the court of appeals disposing of the reinstated petitions for review in *Miller Motor Car Corporation*. On the same date, the Commission determined to reexamine the rule to consider whether modifications are appropriate.

On August 16, 1983, petitioners in *Miller Motor Car Corporation*, filed a motion in the United States Court of Appeals for the Second Circuit seeking leave to make additional oral submissions and written presentations before the Federal Trade Commission. Pursuant to this motion and the Commission's own August 9, 1983, decision to reconsider the rule, the Commission entered into a joint stipulation with petitioners agreeing to a remand. On September 14, 1983, the court of appeals entered an order remanding the Used Car Rule proceeding to the Commission and granting the petitioners in *Miller Motor Car Corporation* leave to make additional submissions.

<sup>18</sup> 44 FR 914 (1979). These post-record comments are filed in Category "S" of the record and are contained in volumes labeled 215-54-1-19.

<sup>19</sup> The participants were: National Automobile Dealers Association; San Francisco Consumer Action and California Public Interest Research Group; National Independent Automobile Dealers Association; American Car Rental Association; Virginia Independent Automobile Dealers Association; Consumer Bankers Association; Automobile Owners Action Council; National Consumer Law Center; and American Imported Automobile Dealers Association.

<sup>20</sup> The Commission also eliminated from further consideration the staff's proposals for disclosure of prior use and mileage of used cars.

<sup>21</sup> The Commission directed the staff (1) to delete the requirement that a dealer give an estimate of the cost to repair any system marked "Not OK"; (2) to add a requirement that dealers disclose all known defects (in addition to those discovered during the course of an inspection); (3) to eliminate a disclosure relating to vehicles that had been declared a "total loss" by insurers; and (4) to include in the text of the Rule a list of the unfair or deceptive practices in accordance with *Katherine Gibbs School (Inc.) v. FTC*, 612 F.2d 658 (2d Cir. 1979).

<sup>22</sup> 45 FR 52750 (1980).

<sup>23</sup> The comment period was scheduled to close on October 7, 1980, but was extended to November 7, 1980, in response to requests from the National Automobile Dealers Association and the Center For Auto Safety. See 45 FR 66810 (1980). These comments are filed in Category "T" of the record and are contained in volumes labeled 215-54-1-20.

<sup>24</sup> 48 FR 41328 (1981). This Statement of Basis and Purpose supersedes the Statement of Basis and Purpose adopted with the 1981 Rule.

The order also required the Commission to: (1) Reopen the record with respect to 16 CFR 455.2(c) and related sections, dealing with disclosure of known defects, and any other issues that the Commission, in its discretion, might elect to consider pursuant to the Federal Register notice of August 9, 1983, and (2) provide all interested persons with notice of this action and an opportunity to submit comments and rebuttal thereto. Except for purposes of the remand, the court retained jurisdiction over the rule.

On December 16, 1983, the Federal Trade Commission published an invitation of public comment in the Federal Register, 48 FR 55784 (1983). This notice invited written public comments on the provisions of the rule requiring dealers to disclose known defects. The purpose of the comment period was to assist the Commission in determining whether these provisions should be modified or eliminated.

In addressing these questions, commenters were asked to place particular emphasis on information obtained (such as data bearing on costs or benefits of the rule or changes in state or local laws or regulations) since the closing of the original rulemaking proceeding on August 31, 1977. Commenters were also urged to submit their views on matters of policy concerning the defect disclosure provisions as to which no previous opportunity to submit comments has been provided.<sup>25</sup>

The comment period was scheduled to end on January 16, 1984, but it was extended to January 31, 1984. On March 2, 1984, the Commission announced a 20-day period for rebuttal submissions.

The National Automobile Dealers Association petitioned the Commission on January 31, 1984, requesting an extension of the comment period for 60 days to allow NADA to complete and submit a cost/benefit study. The Commission denied this request, stating that it would consider accepting the study when it was completed. NADA submitted the completed cost/benefit study on March 22, 1984. On April 3, 1984, NADA filed an errata submission correcting a calculation in the cost/benefit study. The Commission received the study and the errata submission as record documents. Because the NADA study presented an extensive analysis of

the costs and benefits associated with the defect disclosure requirement, the Commission announced a 20-day rebuttal period to allow interested parties to respond to the study and the errata submission. This rebuttal period ended on May 14, 1984.

On July 10, 1984, the Commission tentatively adopted a revised rule that eliminated provisions requiring that dealers disclose known defects. In addition, the rule modified the wording and prominence of the disclosures on the window sticker. On July 31, 1984, the Commission announced a 30-day comment period seeking comments on technical issues concerning the tentatively adopted rule and substantive comments on the implications of a survey of used car buyers recently placed on the rulemaking record.<sup>26</sup> After careful consideration and review of the comments submitted during the recent comment and rebuttal periods as well as the original rulemaking record taken as a whole, the Commission has voted to promulgate a revised Trade Regulation Rule concerning the sale of used motor vehicles.

### C. Description of the Industry

With new car prices steadily rising, the used car market has become an increasingly attractive source of personal transportation for consumers. Industry data show that three of every four used car purchasers in this country buy used cars as their primary form of personal transportation.<sup>27</sup> The used car market continues to expand over the new car market.<sup>28</sup> In 1979, two of every three cars sold in the United States were used. Consumers in that year spent \$66.7 billion, including the value of trade-ins, in purchasing 18.5 million used cars from all sources.<sup>29</sup> Dealers retailed 10.48

million of those cars for total revenues of over \$45 billion.<sup>30</sup>

### 1. Used Cars Purchased

The typical used car purchased in 1979 can generally be described as a \$3,660 intermediate-sized sedan slightly under five years old with 29,000 miles on the odometer. Twenty-nine percent of all used cars bought were one year old or less, 34 percent were two years old, and 37 percent three or more years of age.<sup>31</sup> Average prices were \$6,300 for the latest models, \$5,000 for year-old cars, \$4,000 for 2-year old models, and \$2,900, \$2,300, \$1,800, \$1,500 and \$1,000 respectively for cars 3-7 years of age and older.<sup>32</sup> Average mileage of these cars at the time of purchase ranged from 9,900 miles for the newest models to 66,250 miles for the oldest.<sup>33</sup>

### 2. Used Car Sellers

Sales by dealers accounted for 60 percent of all used car sales in 1979. Some 21,000 franchised new car dealers who also sell used cars dominate the dealer share of the used car market and retailed about 7.8 million units, or 42 percent of all used cars sold in 1979. Their total revenues were \$32.6 billion, almost one-half the total amount paid by consumers for all used cars.<sup>34</sup> Cars sold at these dealerships for an average price of \$4,200 and had been driven an average of 21,200 miles at the time of purchase.<sup>35</sup>

Independent dealers selling only used cars usually retailed older, less expensive cars; in 1979, the average car sold by such dealers cost \$3,700 and had 32,800 miles on the odometer.<sup>36</sup> With

1979. The value of trade-ins amounted to some 36 percent of the total market sales figures. *Id.* at 2. Other industry tabulations include only "net" payments to dealers, excluding trade-in value, and would therefore be significantly lower than the Hertz estimate.

The Hertz data also assume one transaction from driver to driver. For example, a car traded by a consumer to a dealer and subsequently resold to another private individual, even after several dealer-to-dealer title transfers, was counted as one transaction. The Hertz sales figures may therefore differ from other industry estimates that count the intermediate transfers as individual sales.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*, 7/21/80 at Table V. All dollar figures are rounded to the nearest \$100. Thirteen percent of the cars were 7 or more years old.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* All mileage figures are rounded to the nearest 100. Intermediate-sized cars had the following average mileages: 1 year—13,200; 2 years—20,000; 3 years—30,000; 4 years—42,300; 5 years—51,600; and 6 years—58,600.

<sup>34</sup> *Id.* at Table III; Mitchell, National Automobile Dealers Association (NADA), Oral Presentation before the Commission, September 25, 1979, TR 5.

<sup>35</sup> *Id.* at Table V.

<sup>36</sup> *Id.*

<sup>25</sup> Although the Commission sought comments during the rulemaking proceeding on the general question of whether dealers should be required to disclose known defects on a window sticker [See 41 FR 20896 (May 21, 1976)], the Commission did not invite comments on the specific known defects disclosure provision that was included in the rule promulgated on August 14, 1981.

<sup>26</sup> A report on a National Survey of Private Buyers and Sellers of Used Automobile (Baseline Survey).

<sup>27</sup> Used Car Data, 1979 Hertz Corporation Poll, published in *Hertz News*, October 1, 1979, with additional data published on July 21, 1980 (hereinafter cited as 1979 Hertz Poll), 7/21/80 at 1. These data combine an analysis of 10-year used car sales data with the results of a 1979 Hertz national mail poll of used car buyers, internal Hertz data, and published industry figures. These publicly-issued studies have not been considered or relied upon by the Commission in making its decision to promulgate this Trade Regulation Rule; rather, this information is presented for illustrative, background purposes. While the Commission has not, therefore, considered the evidentiary value of these reports, the Commission notes that data from these studies have been cited by a major industry association in a post-record comment. National Independent Automobile Dealers Association (NIADA), T-742 at 4, 9.

<sup>28</sup> For example, in 1979, 10.3 million new cars were sold compared to 18.5 million used cars. See 1979 Hertz Poll, *supra* n. 27, Table IV.

<sup>29</sup> *Id.* Thirty-four percent of used car buyers traded in an older car when they bought one used in

unit sales of 3.3 million, their market share in 1979 was about 18 percent and total revenues were \$12.6 billion.<sup>37</sup> There are some 36,000 independent used car dealers.<sup>38</sup>

Private sales to individuals at an average price of \$2,835 accounted for the remaining 40 percent of used car sales in 1979.<sup>39</sup> These cars had an average of 36,999 miles on the odometer.<sup>40</sup> For purposes of this data, this category includes direct sales by fleet operators, such as government agencies, public utility companies, and lease-rental companies that periodically retail their vehicle fleets. Retail fleet operator sales to individuals comprised less than two percent of all used cars sold in 1979, although this category of used car seller is increasing.<sup>41</sup>

Commissioned sales agents are uniformly used in the industry by all but the smallest dealerships.<sup>42</sup> There is a high degree of movement of commissioned sales agents from dealer to dealer within the industry.<sup>43</sup>

### 3. Used Car Buyers

Compared to new car buyers, used car purchasers are typically younger—36 as opposed to 45 years of age—and their family unit earns less.<sup>44</sup> It appears from the statistics cited earlier in this section that many would-be new car buyers are seeking personal transportation from the used car market because of the lower cost involved.<sup>45</sup> Twenty-eighty percent of used car buyers in 1979 reported having professional or technical occupations and another 17 percent held managerial, official or proprietorship positions.<sup>46</sup> Some 15 percent of the used

car buyers in 1979 who had previously purchased cars were in the used car market for the first time.<sup>47</sup> Sixty percent of used car buyers in that year financed an average of 69 percent of the purchase price, a figure which parallels the 61 percent new car transactions that are financed.<sup>48</sup>

### Basis For a Rule

Our examination of the record in this proceeding convinces us that deceptive and unfair acts and practices are prevalent in connection with the sale of used cars. Consumers are frequently misled or deceived by affirmative misrepresentations concerning both the extent of warranty coverage offered by used car dealers and the mechanical condition of used cars. Moreover, consumers are harmed by dealers' failure to provide timely disclosure of "as is" sales or warranty terms. In the following section, we set forth a description of the used car industry and of the unfair and deceptive practices that the Commission seeks to address by the Trade Regulation Rule promulgated today.

#### A. Deceptive Practices in the Industry

The record in this proceeding demonstrates deceptive and unfair acts and practices by used car dealers. The principal abuses recorded relate to oral misrepresentations by dealers regarding: (1) Warranty responsibilities for after-sale repairs, and (2) mechanical condition at the time of sale. Such oral statements are often inconsistent with the warranty terms, or disclaimers thereof, provided in the written sales contract. Consumer injury occurs because consumers make purchasing decisions based on dealer deception, and not only fail to get the car they bargained for but face unexpected expensive repair bills.

#### 1. Warranty Practices

a. *General Overview.* The record demonstrates the material significance to consumers of information concerning warranty coverage.<sup>49</sup> Nonetheless, many used car dealers mislead consumers into believing that they have broad post-purchase warranty coverage when in fact consumers receive limited or no warranty protection against repairs that may become necessary after the sale.<sup>50</sup> Frequently, dealers and their

sales agents not only fail to disclose conspicuously the limited nature of their repair responsibility, but also orally misrepresent the extent of warranty coverage.<sup>51</sup> In many cases, dealers make verbal promises to repair defects after sale that are contradicted by final written contract terms disclaiming all repair responsibility.<sup>52</sup>

Abuses are particularly prominent in that portion of the used car market in which cars are sold with no warranty coverage or "as is." The record demonstrates that, in many "as is" sales, dealers regularly make oral representations of vehicle quality (condition) and warranty coverage (promise to repair after sale) that are not memorialized in the contract. Instead, those oral representations are contradicted by "as is" contract terms which enable dealers to renege on their oral promises legally.<sup>53</sup> Consumers, relying on these oral misrepresentations, often believe that they will receive more protection with respect to post-sale repairs than is actually provided. In fact, however, there is widespread failure by dealers to honor oral promises relied on by consumers in making purchasing decisions in both "as is" and warranted sales.<sup>54</sup> When dealers fail to honor their oral promises, used car buyers often face expensive and unexpected repair bills.<sup>55</sup> Such unanticipated repair bills occasionally result in loan default and vehicle repossession.<sup>56</sup>

b. *"As Is" Sales and Warranty Terms in the Marketplace.* A significant proportion of used cars are sold by dealers on an "as is" basis, with no written or implied warranty.<sup>57</sup> Two studies involving used car purchasers indicate that about half of all buyers purchase used cars with no warranty.<sup>58</sup>

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Staff Report at 295-296 n. 96.

<sup>40</sup> *Id.* at 296-297 n. 96.

<sup>41</sup> In some extreme cases, these repair bills approach 20-50 percent of the car's selling price. *Id.* at 58-61, 299, n. 101.

<sup>42</sup> *Id.* at 300 n. 102. A legal aid attorney in Los Angeles testified that about half of the vehicle repossession cases with which he is familiar originated from dealers' failure to honor oral promises to repair in "as is" sales. Rouda, TR 3446.

<sup>43</sup> Used car dealers confirm the widespread use of "as is" sales. Many dealers reported selling cars exclusively on an "as is" basis or noted that a high percentage of used cars are retailed "as is." Some dealers testified that they rely on "as is" sales only for a small portion of cars sold and offer written warranties on newer models. Although most "as is" sales do involve older, generally cheaper cars, this is not necessarily so. A number of dealers suggest that any used car offered for sale may be sold "as is." Staff Report at 249-252 nn. 2-9.

<sup>44</sup> In the Survey Research Laboratory (hereinafter cited as SRL) study, *Beliefs and Experiences of*

Continued

<sup>37</sup> *Id.* at Tables III, V.

<sup>38</sup> Lemov, NIADA, Oral Presentation before the Commission, September 25, 1979, TR 84.

<sup>39</sup> 1979 Hertz Poll, *supra* n. 27, 7/21/80 at Table V.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 4.

<sup>42</sup> Vojtko, TR 4274; Bigham, TR 5274-77. Small dealerships are staffed solely by the owner.

<sup>43</sup> Warwick, TR 5363; Bigham, TR 5274-77. One sales agent who described these practices in detail had been employed at different times by 20 franchised dealerships since 1963. Warwick, TR 5380.

<sup>44</sup> Family income averages \$20,000 a year for used car buyers and \$29,500 for new car buyers. 1979 Hertz Poll, *supra* n. 27 10/1/79, at 5.

<sup>45</sup> The Hertz data calculates that ownership and operating costs for the typical used car purchased in 1979, based on buyer expectations of 3 years and 30,000 miles of driving, are less than 24 cents a mile. The same costs for the average new 1979 model—a slightly smaller, mid-range unit—are 36.5 cents a mile, about one-third more. *Id.*, 7/21/80, at 2. Used, standard-sized models can be less expensive to run than new, smaller cars because of the discounts available on them in today's market compared to the premium prices commanded by the smaller cars.

<sup>46</sup> *Id.*, 10/1/79, at 5. Another 33 percent were laborers, craftsmen, or foremen; the remaining buyers reported their occupations as retired (5%), unemployed (4%), student (3%) or other (10%). *Id.*

<sup>47</sup> *Id.* at 2.

<sup>48</sup> *Id.* at 7. The Hertz Poll new car figure is based on a *Newsweek* Survey. Federal Reserve System Figures for 1977 show some 75 percent of new cars financed in that year.

<sup>49</sup> Staff Report at 291-305.

<sup>50</sup> See I.L.A.Lc(1) and (2) *infra*.

"As is" sales have a significant legal impact on consumers. In most states that have adopted the Uniform Commercial Code (UCC), the contract terms "as is" or "with all faults" exclude the implied warranties of merchantability and fitness for a particular purpose that normally would arise in a used car transaction under state law.<sup>69</sup> As a result, dealers selling cars "as is" are not legally responsible, as a rule, for defects that exist at the time of sale or repairs that become necessary after the sale is completed.<sup>60</sup> The legal effect of "as is" sales assumes particular importance for consumers in used car transactions because of the parol evidence rule enacted in most states as part of the Uniform Commercial Code. Under the parol evidence rule, evidence of any oral agreement that contradicts the final written contract terms is excluded.<sup>61</sup> Thus, in the event of a dispute over the extent of the dealer's responsibility for post-purchase repairs, consumers generally cannot use evidence of oral promises to repair in order to establish dealer liability.

Because of the severe legal consequences of an "as is" sale, consumers who purchase "as is" and experience post-purchase repair problems constitute a large percentage of used car complainants. State and

local law enforcement and consumer agency officials report that "as is" sales represent a substantial portion of their used car cases and complaints; and legal aid attorneys, representing low-income consumers, agree that most of the used car problems affecting their clients occur in "as is" sales transactions.<sup>62</sup>

The terms of written warranties given to used car buyers vary markedly in duration, coverage, and allocation of costs between buyers and sellers.<sup>63</sup> Warranty duration generally ranges from 30 days or 1,000 miles to 12 months or 12,000 miles, with the longer duration terms typically given for late model cars.<sup>64</sup> When warranties are given, most extend for a period of 30 days, regardless of vehicle age.<sup>65</sup>

The warranty coverage of vehicle components tends to vary even more widely than does warranty duration. Coverage rarely extends to all vehicle systems and components. Rather, protection typically extends to the "drive train" (engine, transmission, and rear axle), or to "safety" components in those instances where dealers are required to warrant their cars under state safety inspection laws.<sup>66</sup>

The warranty term that varies most widely relates to allocation of cost—the respective shares of total costs to be paid by the dealer and buyer for repairs that become necessary after sale. Some dealers give warranties covering 100 percent of the repair costs for the more expensive, late model cars.<sup>67</sup> However, "split-cost" coverage is far more representative of the written warranties associated with used car sales.<sup>68</sup> "Split-cost" involves shared responsibility by the dealer and buyer, each paying a stated percentage of total repair costs. Although the percentage split figures vary considerably,<sup>69</sup> many dealers

indicate that a 30-day warranty with an even "50-50" cost allocation is most common.<sup>70</sup>

Percentage discounts, substantively the same as "split-cost" warranties, are also common cost allocation terms used by dealers in warranties. Generally, discount terms give the buyer a 10-25 percent reduction on the cost of parts and labor for repairs made by the dealer after sale.<sup>71</sup> Some dealers restrict the discount to parts only or to labor only.<sup>72</sup>

A number of dealers also report selling service contracts with their used cars. The terms of service contracts sold to buyers vary almost as widely as those of written warranties<sup>73</sup> and range in cost from under \$50 to over \$200.<sup>74</sup> Unlike warranties, service contracts are priced separately and are not included in the price of the vehicle.<sup>75</sup>

In sum, the record evidence reveals a broad range of warranty terms offered to used car buyers to protect against repair expenses that become necessary after sale. In addition, most written warranties given by dealers cover only a portion of repair expenses that may become necessary after sale.

#### c. Dealer Deception.

##### (1) "As Is" Sales.

By far the most common abuse evidenced in the record with respect to warranties is the frequent dealer practice of making oral promises to repair defects arising after sale that contradict the written "as is" clause in the sales contract.<sup>76</sup> Dealers often couple these promises with oral representations about mechanical condition.<sup>77</sup> Thus, the record is replete with examples of "as is" sales in which representations were made to the effect that a particular vehicle was in "good condition" and assurances were given to the consumer that "if anything goes wrong, just bring it in and we'll take care of it."<sup>78</sup> Representations as to mechanical condition are rarely, if ever, incorporated into sales contracts.<sup>79</sup> They

*Dissatisfied Purchasers of Used Motor Vehicles*, 52 percent of the responding buyers across the country reported receiving no warranty with their used car. HX 160(A), Appendix C, Question 21. In the study *An Investigation of the Retail Used Motor Vehicle Market: An Evaluation of Disclosure and Regulation* (hereinafter cited as Wisconsin Study), 43 to 55 percent of the sampled purchasers in Wisconsin, Iowa, and Minnesota bought their used cars "as is." HX 164(A), Table IV-20 at 30. Approximately half of the individual consumers who presented testimony in this proceeding complained of dealer practices involving "as is" sales. Staff Report at 252 n. 10.

<sup>69</sup> Uniform Commercial Code section 2-316(3)(a) states: (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty.

<sup>60</sup> See generally Staff Report at 483-498 for a full discussion of state laws relating to "as is" sales.

<sup>61</sup> Section 2-202 of the UCC states:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) By course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and

(b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

<sup>62</sup> Staff Report at 249-251.

<sup>63</sup> See generally Staff Report at 253-260. In the Wisconsin Study, for example, 75-82 percent of Wisconsin dealers surveyed varied their warranties according to vehicle age, condition, and price. HX 164(A) at 44 and Table V-4, Question 4.

<sup>64</sup> Staff Report at 254 nn. 14-15.

<sup>65</sup> *Id.* at 255 n. 16.

<sup>66</sup> *Id.* at 255-256 nn. 17-18. A representative of the Center for Auto Safety, who surveyed dealer practices in Cleveland, Dallas, and Washington, D.C., by means of "test shoppers," observed that the "drive train" limitation was the most common restriction on 30-day warranties offered by the dealers surveyed. Wilka, TR 6458-59. However, coverage even under this type of restricted warranty may vary. One state official noted that the most popular warranty observed in Connecticut was a "drive train" warranty that covered only the "rear end" (i.e., differential and rear axle) and transmission. Simmons, TR 540.

<sup>67</sup> Staff Report at 257 n. 21.

<sup>68</sup> *Id.* at 257-260 nn. 22-29.

<sup>69</sup> *Id.* at 59-60 nn. 27-29.

<sup>70</sup> *Id.* at 258 nn. 23-24. The 30-day, 50/50 warranty was offered 25-40 percent of the time by dealers surveyed in the Wisconsin Study, for example—more than any other. HX 164(A) at Table V-4. Thirty-five percent of all dealers surveyed in Dallas, Cleveland, and Washington, D.C., by the Center for Auto Safety offered test shoppers a 30-day, 50/50 warranty. Wilka, TR 6458.

<sup>71</sup> Staff Report at 259 n. 25.

<sup>72</sup> *Id.* at 259, n. 26.

<sup>73</sup> *Id.* at 260-261, n.30.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> Presiding Officer's Report at 46-47, 125; Staff Report at 275-277, 286-287.

<sup>77</sup> Presiding Officer's Report at 125; Staff Report at 275-276.

<sup>78</sup> Staff Report at 276-277 n.85.

<sup>79</sup> Presiding Officer's Report at 47.



are, instead, almost always restricted to oral statements made during the bargaining process.<sup>80</sup>

As a result, used cars buyers with little or no mechanical condition information<sup>81</sup> about particular vehicles have been assured by salespersons of the quality of the vehicle they are buying. They often purchase "as is" and, by direct misrepresentation or inference, are led to believe that the seller will correct defects discovered after sale. Later, when defects are discovered and the buyer returns to the seller seeking repairs, he/she learns not only that the assertions about mechanical condition are untrue, but also that his/her sales contract fails to hold the seller responsible.<sup>82</sup> Thus, consumers purchasing "as is" but relying on contradictory oral promises are stripped of the protection afforded by either express<sup>83</sup> or implied warranties and, at the same time, have no legal recourse against the dealer because prior or contemporaneous oral statements that contradict final written contract terms are generally not legally binding.<sup>84</sup> Evidence in the record demonstrates that this predicament occurs frequently in the used car market<sup>85</sup> and is often cited as the chief problem in used car sales.<sup>86</sup>

Several dealer practices lead to the situation described above. First, dealers commonly fail to provide adequate written definitions as to the real meaning of an "as is" sale.<sup>87</sup> Rather, when explanations are forthcoming, they typically take the form of oral statements relating a variety of plausible excuses as to why the vehicle can only be sold "as is". Thus, consumers are told that the vehicle's age, or mileage, or low selling price

demand that the sale be on an "as is" basis.<sup>88</sup>

In light of these dealer practices, it is not surprising that a significant portion of used car buyers do not understand the legal significance of the phrase "as is."<sup>89</sup> In three studies of used car buyers, from 25 percent to as many as 59 percent of the persons surveyed failed to identify a correct description of an "as is" sale or mistakenly believed that the seller, or the seller and buyer jointly, would be legally responsible for repairs after sale.<sup>90</sup> These buyers were responding to hypothetical questions posed after sale. However, the widespread lack of basic consumer understanding about "as is" sales or implied warranties is corroborated in the record by legal aid attorneys, state and local officials, consumers, and consumer groups across the country, and even by some dealers.<sup>91</sup> Many of these same witnesses reported that used car buyers often believe, erroneously, that "as is" means "as it appears to be," referring to visible or known defects (like body rust or dents) as opposed to latent defects, or "as equipped," referring to vehicle accessories already

installed. Indeed, the evidence demonstrates that a great many consumers who buy "as is" erroneously believe their cars are warranted in some manner—that the dealer will fix problems arising after sale—despite the written "as is" contract clause.<sup>92</sup>

It has been suggested that consumers' mistaken beliefs about warranty coverage in "as is" sales may be caused in part by their lack of experience in purchasing cars and by their general marketplace belief that sellers stand behind their products.<sup>93</sup> While this may provide a partial explanation, the record taken as a whole supports the finding that consumers' misunderstandings about their after-sale repair responsibility in "as is" sales stem primarily from deceptive practices by used car dealers and their sales agents.<sup>94</sup>

#### (2) Written Warranty Coverage.

Despite the crucial role that warranty information could play in used car purchasing decisions, many used car buyers who receive written warranties are unaware of their actual liability for repairs that may become necessary after sale.<sup>95</sup> The record further establishes that certain dealer practices lead to consumer misunderstandings regarding written warranty terms. Discrepancies between oral representations of the warranty coverage made while the consumer is first considering purchase and actual written warranty terms are commonplace.<sup>96</sup> Typically, purchasers who receive written warranties believe that more is warranted than is the case.<sup>97</sup> Oral representations of a "full 100%/30-day" warranty, for example, often turn out in fact to be limited "drive train" warranties (engine, transmission, and rear axle) or simple percentage discounts on labor or parts.<sup>98</sup> One consumer stated that an oral 6-month unconditional warranty was contradicted by the written 30-day warranty received.<sup>99</sup> Another consumer

<sup>80</sup> See, e.g., Baker, consumer, TR 466-67, 472 (salesmen said they could not warrant a car selling as cheap as \$1,400, but that consumer would not run into any problems); McCalip, dealer, TR 6918-19 (dealer tells the consumer the car is now "as is," "that's why you're getting a lower price"); Warwick, salesman, TR 5378 (salesman will "talk his way around" the "as is" by saying that the car would cost more with a warranty); Brauchli, local official, TR 3807-08, 3830-31 (if dealer does explain, he will offer the buyer a "special deal", representing that "as is" is merely to protect the dealership, "but for you we'll stand behind the car").

<sup>81</sup> Presiding Officer's Report at 124; see II.A.1.b. *supra*. Some dealers believe that consumers do understand the meaning of "as is" but conveniently forget when problems arise. See, e.g., Corkhill, dealer organization; C-23 at 12. However, other industry members recognized that a most frequently expressed complaint on the rulemaking record relates to lack of understanding on the part of consumers of what an "as is" sale means and that a contributing factor to that lack of understanding is dealer misrepresentation. NIADA, S-739 at 82-83.

<sup>82</sup> Wisconsin Study, HX 164(A) at 13; National Analysts Study, HX 162(A), Table 18, at 21; SRL Study, HX 160(A), Appendix C, Question 14 and accompanying table. But see Table 11 of the Baseline Survey showing that approximately 90 percent of both Wisconsin and non-Wisconsin consumers understood the meaning of an "as is" sale. The data do not raise serious questions about the need for an "as is" disclosure because, in the Commission's view, consumer deception relating to "as is" sales is probably caused more by the dealer's misrepresentations or failure to disclose that a particular car is being sold "as is" than by lack of general consumer understanding of the meaning of "as is". Moreover, as Table 15 of the study demonstrates, Wisconsin consumers were more likely to understand the dealer's post-sale repair responsibilities than were their counterparts in the rest of the country. This difference probably resulted from the "as is" and warranty disclosures mandated by the Wisconsin law.

<sup>83</sup> Staff Report at 263-264 n. 37; 290 n. 90.

<sup>84</sup> *Id.* at 279-280 n. 69. In addition, 28 percent of the responding used car buyers in the SRL Study who learned after sale that they had actually bought "as is" mistakenly believed, or were not sure, at the time of sale that their cars were warranted. HX 160(A), Table 12 and accompanying text at 2-24, Appendix C, Question 20.

<sup>85</sup> *Id.* at 280 n. 69.

<sup>86</sup> Presiding Officer's Report at 128. See nn. 78-83 and accompanying text *supra*.

<sup>87</sup> See generally Staff Report at 261-265, 278-281, and 288-290.

<sup>88</sup> *Id.* at 286 n. 84.

<sup>89</sup> *Id.* at 288 n. 88. In the Wisconsin Study, for example, a much greater proportion of Wisconsin consumers reported receiving 30-day, full coverage warranties than Wisconsin dealers reported giving them. *Id.* at 289, Table 1.

<sup>90</sup> *Id.* at 287 n. 85.

<sup>91</sup> Clifford, L-1134 at 1.

<sup>80</sup> *Id.*

<sup>81</sup> Staff Report at 83-84 n.75.

<sup>82</sup> *Id.* at 274-280.

<sup>83</sup> The "as is" clause also contradicts express, oral representations concerning mechanical condition made during the bargaining process. Thus, it serves to negate express oral warranties as well as implied warranties.

<sup>84</sup> See II.A.1.b. *supra*.

<sup>85</sup> Staff Report at 295-300.

<sup>86</sup> See, e.g., Wolkowitz, Legal Aid, HX 150 at 2; Epstein, Legal Aid, HX 166 at 2.

<sup>87</sup> For example, dealers are all too often silent about the meaning of "as is." When comments are made, they are usually in response to consumers' questions. When consumers who already thought they knew the meaning of "as is" were queried as to the basis for their "as is" knowledge, 62 percent said they already had this knowledge. Only 18 percent reported that the salesperson explained the meaning of "as is." National Analysts Inc., *Report on a Survey of Buyers of Used Cars* (hereinafter cited as National Analysts Study) HX 162(A), Table 19 at 21.



stated that an oral 90-day warranty promise was in fact a 30-day warranty.<sup>100</sup> Another consumer stated that oral representations made during the sales pitch differed from the actual terms of the \$185 service contract received.<sup>101</sup> In one study, verbal assurances given by dealers differed from the actual written warranties in 34 percent of the situations where "test shoppers" were able to see a written warranty.<sup>102</sup> Consumers typically rely on these inaccurate verbal warranty descriptions in making purchasing decisions.<sup>103</sup>

As a result of these dealer practices at the time of sale, used car buyers are typically unaware of the actual terms of the written warranties they receive.<sup>104</sup> Thus, consumers rarely have a complete picture of the true cost of a used car purchase and often have a false impression of the dealer's actual after-sale repair responsibilities. The misrepresentations described above cause consumers to expand substantial sums of money for post-sale repairs which they are led to believe will be paid for by the dealer.<sup>105</sup>

#### d. Dealer Unfairness.

Many used car dealers also fail to provide clear, conspicuous, and timely written disclosure of the meaning of "as is." Many "as is" disclosures are couched in complex, legalistic terms which neither explain the meaning of "as is" in understandable language nor inform the buyer that the dealer is not responsible for any repair after the sale is final.<sup>106</sup> Other "as is" disclosures

oversimplify the true meaning of an "as is" sale by merely stating that the vehicle is sold "As Is," or "As Is—With All Faults."<sup>107</sup>

Some dealers also do not conspicuously disclose the "as is" clauses in the sales contract nor present the clause to the consumer in a timely manner. Instead, disclosures generally are not made until the consumer is already committed to the purchase and is faced with a series of documents to sign in rapid order and in a pressured environment.<sup>108</sup>

As in the case of "as is" disclosure, dealers frequently fail to provide clear, conspicuous and timely disclosure of warranty terms. In many cases involving written warranties, dealers fail to disclose actual limitations and restrictions on coverage when orally describing warranty coverage, so that consumers are left confused about the extent of warranty coverage on the car. A used car salesman testified, for example, that dealers he knew of or worked for in California gave buyers "50/50 warranties" without explaining what that coverage actually meant.<sup>109</sup> In another study, warranty documents received by a large percentage of survey respondents failed to describe the items that the dealer would repair; the dealer's share of repair cost responsibility was also frequently not disclosed.<sup>110</sup> One

legal aid attorney stated that most of his clients did not understand the meaning of a split-cost, 50/50 warranty.<sup>111</sup> Several consumers stated that, at the time of purchase, they were not aware of the terms of the warranty.<sup>112</sup>

Frequently dealers obscure the need for full warranty information disclosure by answering consumers' initial inquiries about warranty coverage with such generalities as "good warranty" or "full guarantee," with no further explanation of terms.<sup>113</sup>

Dealers also often fail to give the buyer copies of the written warranty until after the sales contract has been signed. A consumer group representative testified that, in a study of dealer practices conducted in Cleveland, Dallas, and Washington, D.C., detailed warranty information was given to the "test shoppers" (posing as consumers) only after persistent questioning.<sup>114</sup> In fact, potential buyers are usually not introduced to written warranty disclosures until after they have decided to buy and the sale is about to be finalized.<sup>115</sup> As the transaction is concluded in the pressured atmosphere of the dealer's "closing room,"<sup>116</sup> it is not surprising that consumers often fail to see or fully comprehend specific warranty terms.<sup>117</sup> The record establishes that copies of written warranties are rarely received by consumers before they enter the closing room.<sup>118</sup> At times the document is not provided until after the buyer signs the sales agreement.<sup>119</sup> In some instances, warranty documents are not provided to consumers at all.<sup>120</sup>

The Commission finds that, although the failures to disclose described above are not generally deceptive, such practices are unfair in violation of section 5 of the FTC Act. When dealer representations lead buyers to believe that warranty coverage is other than it in fact is, or that a car is sold with a warranty when it is not, the failure to disclose the true state of affairs constitutes deception. Failure to disclose

<sup>100</sup> Cash, L-1016 at 1.

<sup>101</sup> Kersey, TR 5836-40.

<sup>102</sup> California Public Interest Research Group, A CALPIRG Study: Practices in the Used Motor Vehicle Industry (hereinafter cited as "CALPIRG Study"), HX 82 at 17.

<sup>103</sup> Staff Report at 275-277 n. 66; 286-287 nn. 84-86.

<sup>104</sup> *Id.* at 281 n. 71.

<sup>105</sup> Presiding Officer's Report, "Findings on Issue 6," at 128.

<sup>106</sup> McCalip, dealer, TR 6918. See also Brown, dealer organization, HX 80 at 10 (dealers' written statement disclaiming warranties verbal sales representations which is signed by the buyer at the time of sale). Cf. Rothschild, legal aid, TR 3190 (unclear warranty disclaimers are among primary problems); Alpert, legal aid, J-17 at 3 ("as is" disclosures are technical). Whether the language suffices as an effective disclaimer under state law is, of course, a separate issue. Indeed, Comment 4 to UCC section 2-313, governing express warranties, makes it clear that a seller cannot negate responsibility for express warranties simply by inserting a clause in the contract "generally disclaiming all warranties, 'express or implied.'" Such a clause, the comment states, "cannot be given liberal effect under § 2-316" (Exclusion or Modification of Warranties).

<sup>107</sup> Stine, state official, TR 4361 (occasionally sees a big "as is" stamped at the top of used car contracts with a 50/50 guarantee on brakes and shocks); Friedman, state officials, TR 4472-73 (typical disclosure in Colorado is "this car is being sold on an 'as is' basis"); Goldinger, local official, TR 3554 (current "as is" language in all contract: fails to inform consumers of the limitations of their rights); Fan, legal aid, TR 4130 (Dealers use standard form contract with large "as is"); Sugarman, Dealer, TR 4069 (consumer signs slip of paper stating that the sale is "as is").

<sup>108</sup> Although some dealers profess diligence in disclosing the "as is" nature of the sale, the record demonstrates that when this is so, it is typically after the consumer has decided to buy, or the disclosure is vague, inconspicuous, or incomplete. The most common "as is" disclosure practice evidenced in the record is that potential buyers are not introduced to the "as is" clause, if it is recognized at all, until the sale is about to be finalized. Typically, the buyer is shepherded into the "closing room." (a term used throughout the hearings to denote the room or place, typically within the dealer's place of business, where the potential buyer is taken to discuss the details of the transaction) where he or she is handed a number of documents to simultaneously read, digest, and sign and where the final selling price and financing terms, if any, are determined. Consumers, already emotionally committed to the purchase and anxious to close the deal, often fail to read each document thoroughly. Unless their attention is specifically directed to it, buyers do not see or fully comprehend the "as is" clause disclaiming all warranties. Staff Report at 285-288.

<sup>109</sup> Bigham, TR 5269.

<sup>110</sup> SRL Study, HX 160(A), Appendix C, Questions 23A, 23B. See also Staff Report at 283, n. 75; 285-286, nn. 79-83.

<sup>111</sup> Berry, TR 132-133.

<sup>112</sup> See, e.g., Morrison, L-1068 at 2; Kersey, TR 5836; Carr I-80 at 1; Holliday, I-164 at 1.

<sup>113</sup> Staff Report at 285 n. 80.

<sup>114</sup> Wilka, TR 6457.

<sup>115</sup> SRL Study, HX 160(A), Appendix C, Question 22; Staff Report at 266 n. 42; 282 n. 72.

<sup>116</sup> See n. 90 *supra*. See also Staff Report at 282, n. 73; 538-539.

<sup>117</sup> *Id.* at 268 n. 47; 283, n. 74.

<sup>118</sup> *Id.* at 285 n. 82.

<sup>119</sup> *Id.* at 286 n. 83. Sixteen percent of the used car buyers responding in the SRL Study reported receiving the warranty sometime after signing the contract. SRL Study, HX 160(A) at Appendix C, Question 22.

<sup>120</sup> Staff Report at 284-285 n. 79.

information material in light of other representations also constitutes deception.<sup>121</sup> Absent any dealer practice that leads consumers to expect certain coverage, however, the failure to provide timely and complete information to consumers about important contract terms may cause substantial consumer injury, that consumers cannot reasonably avoid through the exercise of consumer choice, without offsetting benefits to consumers or competition. In such circumstances, the failure to disclose is unfair, but not deceptive.

The record clearly establishes that substantial consumer injury occurs as a result of dealers failing to disclose the meaning of "as is" or failing to disclose warranty terms. As discussed above, liability for post-sale repairs is a material factor in consumer purchasing decisions. Moreover, unexpected liability often causes consumers to be faced with expensive and unexpected repair bills.<sup>122</sup> Information regarding liability for post-sale problems is particularly important because dealers generally know more about the condition of the car than do consumers.<sup>123</sup> Moreover, the Commission discerns no benefits flowing from the practice of failing to provide timely disclosure of the dealer's responsibility for repairing post-sale problems except that dealers avoid the cost of making the disclosure. We believe, however, that the cost of providing such disclosures will be minimal.

We also conclude that consumers cannot reasonably avoid, through free purchase decisions, the injury caused by the dealer's failure to disclose its post-sale repair responsibilities. Information about the warranty terms offered or the fact that a particular car is being sold "as is" can be obtained only from the dealer. The record establishes that copies of the sales contract containing an "as is" clause or the terms of the written warranty are typically received by consumers in the "closing room" after the psychological decision to buy has been made.<sup>124</sup> The record further reveals that the sales contract containing the "as is" clause and the written warranty are often couched in complex, legalistic terms which most buyers cannot readily understand.<sup>125</sup>

When consumers receive these documents along with many other sales documents in the "closing room," where there is little opportunity to consider all documents carefully,<sup>126</sup> In sum, the record shows that information which is essential to an informed consumer choice is not being effectively made available. Since the principal thrust of our consumer unfairness standard is to ensure that sellers do not harm the free exercise of consumer sovereignty or consumer choice, this conduct is unfair within the meaning of the FTC Act.

## 2. Mechanical Condition Practices

*a. Materiality of Mechanical Condition Information.* The utility of a vehicle as a means of transportation is directly affected by its mechanical condition. Therefore, it is not surprising that consumer research indicates consumers' consistent concern about mechanical condition.<sup>127</sup> In fact, mechanical condition at the time of sale is reported by consumers as the most important factor in reaching a purchasing decision.<sup>128</sup> Consumers who are aware of mechanical condition prior to purchase are able to use that information in pricing and selecting vehicles, as well as in budgeting for repair expenses. For example, record surveys indicate that consumers who had potential used car purchases inspected prior to purchase made significant use of inspection results in subsequent bargaining for repairs and price reductions or in making purchasing decisions.<sup>129</sup>

Mechanical condition information is also important because needed repairs resulting from hidden defects are costly to consumers. The rulemaking record demonstrates this fact. The Northern California Auto Club's diagnostic records showed 1,000 defects in 160 vehicles taken from dealers' lots to the diagnostic center by consumers considering purchase. The average estimated cost per vehicle for the repair of defects present was \$162.89.<sup>130</sup> The Missouri Auto Club records showed an estimated average repair cost of \$235.64 per car with 312 defects present in the 56 vehicles it surveyed.<sup>131</sup> In the National

Analysts Study, consumers reported costs for defects repaired and estimated costs for defects which surfaced but remained unrepaired.<sup>132</sup> Actual repair expense ranged from a few dollars to \$1500, with the average at \$109. The average estimated costs for repairs not completed was \$98. The Survey Research Laboratory Report also computed actual and estimated costs of repair.<sup>133</sup> Because this study received data only from complaining respondents, actual and estimated repair costs were significantly higher on a per vehicle basis. Estimated performed repair costs averaged about \$350 per vehicle. In addition, respondents faced future repair costs (repairs yet to be performed) which were estimated at approximately \$275 per car.

The great bulk of repair cost is borne by the purchaser.<sup>134</sup> Moreover, out-of-pocket costs caused by defects often go beyond the cost of repairs. Purchasers of defective vehicles can lose their only form of transportation, a loss which may lead to other dislocations, including missed work and loss of wages.<sup>135</sup> Other costs may be incurred when safety-related defects cause or contribute to accidents that damage property and cause personal injury or death.<sup>136</sup> The impact on the poor from the purchase of a defective used vehicle may be particularly severe, since an unexpected repair bill may seriously disrupt an already strained budget.<sup>137</sup>

Therefore, the Commission finds that mechanical condition information is material to the used car transaction. Dealer misrepresentations regarding mechanical condition are therefore deceptive acts and practices.

*b. Deception Concerning the Mechanical Condition of Used Cars.* The record demonstrates that misrepresenting a car's mechanical condition is a common dealer practice.<sup>138</sup> Record testimony and

<sup>122</sup> HX 162(A) at 34-36. Respondents reporting defects (136 out of 400) were asked to provide actual and projected repair costs.

<sup>123</sup> SRL Study, HX 160(A) at 12.

<sup>124</sup> Seattle Regional Office Study, B-1 at 31; National Analysts Study, HX 162(A) at 34; Wisconsin Study, HX 164(A) at Table IV-19. See also Baer, consumer organization, TR 3665; Baron, legal aid, TR 3911; Nowicki, state official, TR 2867-69; Newcomb, legal aid, J-74 at 1.

<sup>125</sup> Staff Report at 64 n. 49.

<sup>126</sup> *Id.* at n. 50.

<sup>127</sup> *Id.* at 64-65.

<sup>128</sup> Staff Report at 103 n. 102. One salesman testified that some dealers purposefully kept their sales staff ignorant about known defects to assure that salespeople would present the car for sale in a positive manner. Bigham, TR 5274-77. Some dealers, disputing that they engage in affirmative misconduct, state that they have difficulty

Continued

<sup>121</sup> See Ward Lab., Inc. 55 F.T.C. 1337 (1959), *aff'd* 276 F.2d 952 (2nd Cir.), *cert. denied* 364 U.S. 827 (1960).

<sup>122</sup> *Id.* at 298-297 n. 96.

<sup>123</sup> See Section IV.A.1.a *infra*.

<sup>124</sup> Staff Report 281-290.

<sup>125</sup> *Id.* at 288-284.

<sup>126</sup> *Id.* at 282-286.

<sup>127</sup> National Analysts Study, HX 162(A) at 8-9; Wisconsin Study, HX 164(A) at 16-17.

<sup>128</sup> Wisconsin Study, HX 164(A) at 16-17 and Table IV-1.

<sup>129</sup> Northern California Auto Club, HX 116(A) at 5-7; Missouri Auto Club, HX 158(A) at 5-7; Staff Report at 68 n. 54. See also Wisconsin Study, HX 164(A) at Tables IV-16, IV-17.

<sup>130</sup> HX 116(A) at 3-5; TR 4906-07.

<sup>131</sup> HX 158(A) at 4-5; TR 6828-29.

documentary evidence regarding such misrepresentations are supported by data reported in several studies. In one study, complainants reported that sales agents commonly made general statements about the overall quality of the car. These statements were coded as very favorable in 34 percent of the cases, favorable in 56 percent, and neutral in the remaining 10 percent. Only 2 of the over 800 respondents reported that the salesman made a negative comment.<sup>139</sup> Complainants were also asked if any specific representations were made about different vehicle components, and responses to this question were cross-tabulated against reported defects. The study found that where a specific component had been represented as being in good condition, the complainant was more likely to have had a problem with that component than if no specific positive comment had been made.<sup>140</sup> This finding suggests that defects have been hidden behind contradictory oral statements.<sup>141</sup>

In the National Analysts Study, consumers reported that dealers discussed mechanical condition in about three-quarters of the cases and nearly always described it as good or very good.<sup>142</sup> These descriptions were later thought to be inaccurate 13 percent of the time.<sup>143</sup>

The National Analysts Study also correlated defect discovery data with disclosure practices data. The correlation revealed that consumers encountered greater post-sale defect problems when the salesperson remained silent with regard to defects than when he or she did disclose defects.<sup>144</sup>

The Wisconsin Study provided additional data on the accuracy of dealer representations by comparing representations of mechanical condition made by dealers and private sellers. With regard to general mechanical condition, 17.1 percent of the consumers surveyed reported inaccurate information from the dealer compared to 9.4 percent who reported receiving

inaccurate information from private sellers.<sup>145</sup>

The Missouri and Northern California Auto Club Studies provide additional data on the accuracy of sales representations. In these studies, respondents were asked whether, before the consumer's Auto Club inspection, the salesman had said anything about the condition of each system in which the Auto Club subsequently found a problem. Out of a total of 1,312 defects discovered by the inspection, only 87 were discussed in any manner by a salesman.<sup>146</sup> Of the 87 defective components discussed, 14 had been described by the salesman as being in good condition, 12 had been described as "probably alright" and 60 had been described as being in need of repair.<sup>147</sup>

The possibilities for deception in the used car market were described by Stanley Hoynitski, who testified on behalf of the Pennsylvania Automobile Dealers Association.

The used car business is a natural business for some unscrupulous businessmen. . . . The nature of the motor vehicle, with its many thousands of internal parts, makes it highly susceptible to hidden defects, known or unknown to the seller. There is need to protect the consumer from these unscrupulous dealers who I acknowledge have crept into the [used car] business.<sup>148</sup>

One factor which facilitates a dealer's ability to make general representations about the quality of a used car without questioning by consumers is the general industry practice of appearance reconditioning known as "detailing."<sup>149</sup> After dealers obtain vehicles, they routinely engage in detailing, whereby the vehicle's interior, exterior, trunk, and engine compartment are thoroughly cleaned in order to enhance the car's saleability.<sup>150</sup> Because many consumers rely on appearance cues in estimating a vehicle's mechanical condition, consumer injury can result when detailing obscures poor mechanical condition. That consumers think an attractive car is also sound mechanically is well-established in the record through testimony and documentary evidence.<sup>151</sup> Furthermore,

survey data demonstrate that consumers judge a car's mechanical condition based on appearance cues and think that "clean" cars are in substantially better mechanical condition than cars described as being somewhat less attractive.<sup>152</sup> Another study shows that dealers identify "exterior condition" as the most important factor affecting a consumer's purchasing decision.<sup>153</sup> Therefore, it is not surprising that dealers invest heavily in detailing. One dealer association official stated that his membership spent an average of \$53 per car on appearance work.<sup>154</sup> Regardless of whether "detailing" is used solely to make the car more marketable or to disguise poor mechanical condition, the practice of detailing contributes to the persuasiveness of dealer representations that a car is in sound mechanical condition when such is not the case.

c. *Consumer Reliance on Dealer Representations and Injury.* The record clearly demonstrates the existence of a substantial information disparity between the buyer and seller in the used car market relating to the mechanical condition of used cars.<sup>155</sup> Used motor vehicle purchasers do not have at their disposal, as a general rule, information sufficient to arrive at an informed buying decision. Insofar as mechanical condition is concerned, consumers are dependent, with rare exception, on the seller's representations to inform them of mechanical condition.<sup>156</sup> The record also shows that many purchasers base their assessments of the condition and value of a particular vehicle on dealer oral representations and on the physical appearance of the car.<sup>157</sup> The record shows that consumer injury results from buyer reliance on oral representations and promises by the seller which are inconsistent both with the actual condition of the car as known to the dealer and with the terms of the written contract. Moreover, representations as

controlling oral representations made by salespeople. See, e.g., Vojtko, TR. 4274; Jones, C-56 at 3.

<sup>139</sup> SRL Study, HX 160(A) at 13.

<sup>140</sup> *Id.* at Table 7.

<sup>141</sup> This finding may, to some extent, have resulted from consumers' propensity to remember the sales agent's representations about a particular component more clearly if they had a problem with that component.

<sup>142</sup> HX 162(A) at Tables 13 and 14.

<sup>143</sup> *Id.* at Table 15. We note there is no basis for inferring that the dealer knew the information was inaccurate.

<sup>144</sup> *Id.* at Table 25.

<sup>145</sup> HX 164(A) at Table IV-4.

<sup>146</sup> Northern California Auto Club, HX 116(A) at 4-5; Missouri Auto Club, HX 158(A) at 4-5.

<sup>147</sup> Since one respondent did not respond, there were a total of 86 responses rather than 87.

<sup>148</sup> Hoynitski, dealer organization, TR 8037.

<sup>149</sup> The Commission does not hold that "detailing" in and of itself is deceptive. However, as described herein, detailing can lend credence to oral misrepresentations.

<sup>150</sup> Staff Report at 97-98 n. 94.

<sup>151</sup> *Id.* at 99 n. 95.

<sup>152</sup> *Id.* at 100-101 nn. 96, 97.

<sup>153</sup> Wisconsin Study, HX 164(A) at 43.

<sup>154</sup> Negri, dealer organization, TR 4103.

<sup>155</sup> Presiding Officer's Report at 90-92; Staff Report at 83-97.

<sup>156</sup> Presiding Officer's Report at 90, 128.

<sup>157</sup> Staff Report at 118-122. The record does show that a minority of consumers obtain third-party inspections by independent mechanics. *Id.* at 93-95, 119-120. The record contains conflicting evidence as to whether such inspections are allowed throughout the industry. Dealers and others asserted that inspection opportunities are currently available to consumers. *Id.* at 87. However, the record demonstrates that off-premises inspections are not allowed on a regular basis. *Id.* at 89. Thus, in the current state of the market, consumers obtain little information about the mechanical condition of a prospective used car purchase from any source other than the dealer.

to the mechanical condition are seldom, if ever, incorporated into sales contracts. They are restricted almost entirely to oral statements made by the dealer during the selling process and, thus, are unenforceable should the consumer attempt to sue to recover damages for dealer misconduct.<sup>158</sup>

Based on the evidence in the rulemaking record, the Commission finds that many used car dealers have knowingly misrepresented the mechanical condition of the cars they sell and thereby cause substantial injury to consumers.

#### *B. Prevalence Of Unfair and Deceptive Acts and Practices in the Marketplace*

In assessing the prevalence, or frequency, of unfair and deceptive practices occurring in the used car industry, the Commission has examined a number of factors. These include the number of consumer complaints reported to the Commission and to state and local agencies; documentary evidence such as written warranties and warranty disclaimers used by dealers in used car transactions; testimony offered by state and local law enforcement officers, consumer agency officials, legal aid attorneys, consumer group representatives, individual consumers, used car dealers, present and former used car sales agents, mechanics and automobile repair instructors; and empirical studies of used car dealer practices, the mechanical condition of used cars on dealers' lots, and used car buyer attitudes and beliefs. This evidence is set forth in detail in section II.A. above, and establishes that many dealers misrepresent or fail to disclose material facts concerning the terms and extent of warranty coverage and the mechanical condition of cars at the time of sale.

In recent years approximately ten million used cars have been purchased annually from the nation's 60,000 used car dealers.<sup>159</sup> These dealers, as an established business practice, make oral representations concerning warranties and mechanical condition. The record demonstrates that many dealers or their sales agents make oral promises to repair after sale which are contradicted by "as is" warranty disclaimers or other written contract terms. Additionally, many dealers fail to inform consumers prior to purchase of limitations on warranties provided to them or of the

meaning of key terms in the purchase contract (e.g., the "as is" clause). In those cases where warranty coverage is disclosed before the sale is consummated, it is typically in the pressured atmosphere of the "closing room", where consumers' full understanding of contract terms is thwarted. Consumers unexpectedly learn the full extent of their repair responsibility when dealers fail to honor these oral promises or when discrepancies between verbal and written warranties are discovered after sale.<sup>160</sup>

Moreover, the record demonstrates that many dealers also misrepresent the mechanical condition of the cars offered for sale. Several studies in the record demonstrate that dealer representations of condition at the time of sale are inconsistent with consumer perception of the condition of the car immediately after the sale.<sup>161</sup>

In the face of repeated testimony concerning the large number of used car complaints filed by consumers with consumer agencies or legal aid offices and record studies, some dealers and dealer organizations argue that the number of valid consumer complaints about used cars and used car dealers is insignificant when compared to the total volume of used cars sold.<sup>162</sup> The National Automobile Dealers Association (NADA) concludes that the National Analysts Study provides evidence that unfair and deceptive sales techniques are not prevalent in the used car industry.<sup>163</sup> Accepting the data that demonstrate 13 percent of the respondents in that study received inaccurate information, NADA concludes that the 13 percent deceptive rate figure does not establish prevalence.<sup>164</sup> Assuming approximately 10 million sales by used car dealers per year, a 13 percent deception rate would suggest a possible 1.3 million incidences of deception per year.<sup>165</sup> Data from the

Wisconsin Study, cited by NADA,<sup>166</sup> demonstrate that 20.8 percent of the responding consumers report misrepresentation by dealers of mechanical defects.<sup>167</sup> The Commission believes that these record studies reveal a widespread occurrence of deceptive practices that is otherwise reflected in the rulemaking record.<sup>168</sup>

In addition, the Commission recognizes the formal complaints actually filed by consumers represent only a small portion of problems experienced by used car buyers.<sup>169</sup> A scientific measure of the level of unreported problems was provided as an adjunct to one of the studies entered into the record. In that study, it was estimated that complaints reflect only one to three percent of actual problems.<sup>170</sup> Similarly, although the actual number of warranty and warranty disclaimer documents in the record is small, state and local consumer agency officials, legal aid attorneys, and some industry members report that they are typical of the industry.<sup>171</sup>

We therefore determine that the rulemaking record taken as a whole demonstrates the prevalence of unfair and deceptive practices. The clear and unavoidable conclusion established by the record is that many dealers do misrepresent or fail to disclose material facts relating to the dealer's responsibility for making repairs after sale or misrepresent the mechanical condition of vehicles offered for sale. The practices are pervasive and among the chief sources of complaints received by various consumer protection organizations throughout the country.<sup>172</sup> The record evidence is therefore sufficient to convince the Commission that these unfair and deceptive practices are prevalent.

<sup>158</sup> NADA, S-738 at 181.

<sup>159</sup> Wisconsin Study, HX 164(A) at Table IV-21.

<sup>160</sup> The Commission has earlier noted limitations on its interpretation of the results of the CALPIRG Study. See n. 138 *supra*. Although the methodology and results of other record studies have been challenged (see Presiding Officer's Report at 105-116; Staff Report at 19-37), the Commission believes that these studies, while not necessarily flawless in methodology in every respect, provide probative evidence of practices in the used car market which other record testimony corroborates.

<sup>161</sup> Staff Report at 44 n. 8; Andreasen, TR 6944-45; 6966-68; 6979-80. The Commission notes that dealer organizations, in their post-record comments, reject the "tip of the iceberg" theory. NIADA, S-739 at 70-71; NADA, S-738 at 173-174. The Commission notes that consumer complaints are but one measure of the existence of a market problem.

<sup>170</sup> Staff Report at 45 n. 9.

<sup>171</sup> *Id.* at 268-70 nn. 48, 50-55.

<sup>172</sup> Presiding Officer's Report at 47-48.

<sup>160</sup> In the CALPIRG Study (where test shoppers saw a warranty before sale), verbal and written warranties given by dealers differed 34 percent of the time. HX 82 at 17.

<sup>161</sup> See, e.g., National Analysts Study, HX 162(A) at Tables 14, 15; SRL Study, HX 180(A) at Table 7; Wisconsin Study, HX 164(A) at Table IV-4; HX 116(A) at 4-5; HX 158(A) at 4-5; Staff Report at 103-107 nn. 102-107.

<sup>162</sup> Staff Report at 42-43, n. 6. See, e.g., NIADA, S-739 at 70-72; NADA, S-738 at 174-187.

<sup>163</sup> NADA S-738 at 179.

<sup>164</sup> *Id.* at 179-180.

<sup>165</sup> This figure is based on 10 million sales per year by used car dealers. The significance of the National Analysts Study is enhanced by the fact that data are drawn from a sample of all purchasers in 20 states and is therefore not limited to complaints. HX 162(A) at 1-4. The Wisconsin Study data demonstrate a 17.1 percent deception rate. HX 164(A) at Table IV-4.

<sup>158</sup> Presiding Officer's Report at 47.

<sup>159</sup> Staff Report at 455, Appendix 1. For data on the number of used car dealers nationwide, see Mitchell, NADA and Lemov, NIADA, Oral Presentation before the Commission, September 25, 1979, TR 5, 84.

### C. Legal Basis for the Rule

#### 1. Rulemaking Authority

The Commission's authority to promulgate this trade regulation rule is derived from two sources. The first of these is section 109(b) of the Magnuson-Moss Warranty Act, which states in pertinent part:

The Commission shall initiate within one year after the date of the enactment of this Act a rulemaking proceeding dealing with warranties and warranty practices in connection with the sale of used motor vehicles; and, to the extent necessary to supplement the protections offered the consumer by this title, shall prescribe rules dealing with such warranties and practices. In prescribing rules under this subsection, the Commission may exercise any authority it may have under this title, or other law, and in addition it may require disclosure that a used motor vehicle is sold without any warranty and specify the form and content of such disclosure. (emphasis supplied) <sup>173</sup>

As the rulemaking record establishes, warranty practices in the used car market have resulted in significant consumer injury. In the preceding section of this Statement, <sup>174</sup> we have summarily described the practices which have deceived buyers about the extent and terms of their warranty coverage. There, we recounted evidence concerning oral misrepresentations by dealers about the scope and terms of warranty coverage as well as unfair failures to disclose the limited nature of their post-sale repair responsibilities. In many instances, verbal promises to repair have been negated by final contract terms containing an "as is" clause that disclaims all responsibility for post-sale repairs. These promises are exacerbated by widespread consumer misunderstanding of the term "as is" and by dealers' failure to disclose, in an adequate and timely manner, the existence and meaning of this term.

These practices, therefore, fall squarely within the scope of section 109(b). By addressing them in a Rule, the Commission is following its statutory mandate "to supplement the protections offered to the consumer" by the Warranty Act.

The second source of statutory authority for this rulemaking is the Federal Trade Commission Act, a source implicitly preserved by 109(b), which permits the Commission to "exercise any authority it may have under this title, or other law" in promulgating rules under that Section. Section 111(a)(1) of the Warranty Act is more explicit:

Nothing contained in this title shall be construed to repeal, invalidate or supersede the Federal Trade Commission Act. . . . <sup>175</sup>

Section 5(a)(1) of the FTC Act declares unlawful "unfair or deceptive acts or practices in or affecting commerce," and section 18(a)(1)(B) of the Act authorizes the Commission to enforce that statutory provision by prescribing

Rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce. . . . Rules under this Subparagraph may include requirements prescribed for the purpose of preventing such acts or practices. <sup>176</sup>

The Commission believes that the record should contain a preponderance of substantial reliable evidence in support of a proposed rule before that rule is promulgated. This belief is based partly on the Commission's perception of its function and partly on statutory and judicial authority. Any rule promulgated by the FTC may be challenged in court and may be set aside if "the court finds that the Commission's action is not supported by substantial evidence in the rulemaking record . . . taken as a whole," FTC Act section 18(e)(3)(A), 15 U.S.C. 57(e)(3)(A) (West Supp. 1983). Congress imposed this high standard as a "greater procedural safeguard" because of the "potentially pervasive and deep effect" of FTC rules. *American Optometric Ass'n v. FTC*, 626 F.2d 896, 905 (D.C. Cir. 1980) (Quoting H.R. Rep. No. 1107, 93d Cong., 2d Sess. 45-46, 1974 U.S. Code Cong. & Ad. News 7702, 7715.) Therefore, the Commission takes seriously its responsibility to determine if there is a preponderance of substantial reliable evidence to support a proposed rule, and to see that any supporting evidence is clearly recorded.

Initially, the Commission requires substantial evidence for the factual propositions underlying the determination that an existing act or practice is legally unfair or deceptive. When substantial evidence both supports and contradicts such a finding, the Commission bases its decisions on the preponderance of the evidence. Before promulgating a rule rather than bringing individual cases, however, the Commission believes the public interest requires answers to the following additional questions: (1) Is the act or practice prevalent? (2) Does a significant harm exist? (3) Will the proposed rule reduce that harm? and (4) Will the benefits of the rule exceed its costs? <sup>177</sup>

<sup>173</sup> 15 U.S.C. 2311(a)(1).

<sup>174</sup> 15 U.S.C. 57a(a)(1)(B).

<sup>177</sup> Although the Commission believes that these questions should be asked and, to the extent possible, answered in every rulemaking on the basis

In analyzing each of these questions, three types of evidence are frequently brought to bear: quantitative studies, expert testimony, and anecdotes. The Commission has the flexibility to marshal evidence for a rulemaking record that combines the best mix of these three. However, it has a responsibility to see that the best evidence reasonably available is included. <sup>178</sup>

The best evidence will often be surveys or other methodologically sound quantitative studies. Carefully prepared studies can often give a reliable answer to each of the four questions. First, reliable estimates of the incidence of a practice are an integral part of an assessment of prevalence and are frequently well-suited to quantitative methods. Second, the overall harm caused by a problem is best measured by determining both the magnitude of consumer injury when it occurs and the frequency of such an injury. This issue is also well-suited to quantitative analysis. Third, the effectiveness of a proposed remedy can often be shown only by quantitative studies since informally observed changes may be influenced by other, uncontrolled factors, or may be the result of chance (*i.e.*, not statistically significant). Finally, quantitative studies are most helpful when comparing costs with benefits.

In many instances, of course, precise quantitative answers to these questions are not possible, or could be obtained only at a prohibitive cost. In such cases, the Commission will seek alternative ways to conduct a systematic assessment of the benefits and cost of its regulatory proposals. As in considering the merits of a rule, the Commission will balance the benefits and costs of obtaining additional information. Although carefully structured quantitative studies are generally preferred as evidence in a rulemaking record, the Commission believes that it is possible in some instances to support a rule without such studies.

of the best evidence reasonably available, it recognizes there is room for variation in the specific answers that would justify the issuance of a rule, depending upon the circumstances of each particular rulemaking. Different industries lend themselves in varying degrees to answering these questions. The characteristics of the industry, the ability to reasonably gather information, the burdensomeness of the regulation, and the agency's ability to address the unfair or deceptive practice by alternative means must be considered.

<sup>178</sup> The concept of "reasonably available" takes into account the practical resource constraints on the ability of the Commission or parties to a rulemaking to marshal evidence bearing on a particular problem.

<sup>175</sup> 15 U.S.C. 2309(b).

<sup>174</sup> For further discussion of the abuses relating to warranties, see Section II.A.1. *supra*.

The second type of evidence is expert testimony. The primary use of expert testimony is in providing underlying technical details, such as medical or engineering facts or information concerning state law and procedures. Expert testimony is also useful to address the methodology of quantitative studies, and its possible effects on the results. Finally, experts can give their own opinions regarding the issues facing the Commission. These opinions are usually predictions of what quantitative studies would show. As such, they are less satisfactory than an actual study. When an expert's opinion conflicts with the conclusions of a study, the study itself is generally more reliable, unless deficiencies in the methodology or execution of the study have been established and a better study would, in all likelihood, support the expert's opinion.

A third type of evidence is anecdotes. Narratives of specific consumer injuries are helpful in certain ways. They call attention to a possible problem; they illustrate the contours of a known problem; and they may suggest areas for further inquiry. By themselves, anecdotes are generally good evidence that some harm exists. Without thorough exploration of the details of individual examples, however, anecdotes cannot establish the cause of a problem. Moreover, anecdotes give little evidence of the frequency of the harm, they provide limited evidence for the effectiveness of a proposed rule and virtually no evidence of the balance of benefits and costs. Therefore, anecdotal evidence is rarely sufficient to provide the "substantial evidence" which the Commission requires in the rulemaking record.

The foregoing section of this Statement describes practices which, as discussed below, are unfair or deceptive practices under section 5 of the Act. In addition to the warranty practices outlined above, the record also demonstrates that used car buyers are often deceived about the mechanical condition of the cars they purchase by various practices.<sup>179</sup>

## 2. Section 5 Analysis

*a. Deception.* Certain elements undergird all Commission findings of deception. On October 14, 1983, the Commission adopted a Policy Statement on Deception setting forth in detail an

<sup>179</sup> The most serious of these forms of deception occurs in the sale of "as is" cars. At least 50 percent of all used cars are sold with no warranty. See Staff Report at 248-53; 295-300. See also Presiding Officer's Report at 46-47; 124-25.

analysis of its deception jurisdiction.<sup>180</sup> The Commission summarized its deception authority by stating that it will find an act or practice deceptive if there is a representation, omission, or practice that is likely to mislead consumers acting reasonably under the circumstance, and the representation, omission, or practice is material. These elements articulate the factors actually used in earlier Commission cases to identify whether an act or practice was deceptive.<sup>181</sup>

The requirement that an act or practice be "likely to mislead" reflects the long established principle that the Commission need not find actual deception to hold that a violation of Section 5 has occurred.<sup>182</sup> This concept was explained as early as 1964, when the Commission stated:

In the application of the [the deception] standard to the many different factual patterns that have arisen in case before the Commission, certain principles have been well established. One is that under Section 5 actual deception of particular consumers need not be shown.<sup>183</sup>

Similarly, the requirement that an act or practice be considered from the perspective of a "consumer acting reasonably in the circumstances" reflects the fact that virtually all representations, even those that are scrupulously honest, can be misunderstood by some consumers. The Commission has long recognized that the law should not be applied in such a way as to find that honest representations are deceptive simply because they are misunderstood by a few.<sup>184</sup> Thus, the Commission has noted that an advertisement would not be considered deceptive merely because it could be "unreasonably misunderstood by an insignificant and unrepresentative segment of the class of persons to whom the representation is addressed."<sup>185</sup> In

<sup>180</sup> Commission letter to Hon. John D. Dingell, Chairman, Subcommittee on Oversight and Investigations (hereinafter cited as "Deception Statement"). Letter from Commission to the Honorable Bob Packwood and the Honorable Bob Kasten (March 5, 1984). See also Cliffdale Associates, Inc., Docket No. 9156 (March 23, 1984).

<sup>181</sup> *Sears, Roebuck and Co.*, 95 F.T.C. 406 (1980), *aff'd*, 676 F.2d 385 (9th Cir. 1982).

<sup>182</sup> See generally, *Deception Statement* at 4-7 and cases cited therein for a more detailed discussion of the "likely to mislead" principle.

<sup>183</sup> *Statement of Basis and Purpose, Cigarette Advertising and Labeling Rule*, p. 84, 29 FR 8324 (1984).

<sup>184</sup> *Heinz W. Kirchner*, 63 F.T.C. 1282 (1963), *aff'd*, 337 F.2d 751 (9th Cir. 1964). However, if a representation or practice is directed at a distinctive target group, the Commission will determine the effect of the representation on a member of that group. *Ideal Toy Co.*, 64 F.T.C. 297, 310 (1964). See *Deception Statement* at 7-14.

<sup>185</sup> *Heinz W. Kirchner*, 63 F.T.C. 1282 at 1290.

recent cases, this concept has been increasingly emphasized by the Commission.<sup>186</sup>

The third element of deception is materiality. As noted in the Commission's policy statement, a material representation, Commission, act, or practice involves information that is important to consumers and, hence, likely to affect their choice of, or conduct regarding, a product. Consumers thus are likely to suffer injury from a material misrepresentation.<sup>187</sup> This element too is well established in past Commission deception cases.<sup>188</sup>

*b. Unfairness.* The Commission's authority to prohibit unfair acts or practices in the marketplace is well established. The Commission and the courts have developed an extensive body of law concerning unfair practices.<sup>189</sup>

The Wheeler-Lea amendment of 1938 and the 1975 and 1980 FTC Improvements Acts constitute legislative recognition that, in an imperfect system, certain commercial practices may impose undue costs and risks on individuals, depriving them of the benefits normally associated with free and vigorous competition.<sup>190</sup> In this proceeding, the Commission is exercising its unfairness jurisdiction to determine whether dealers' failure to disclose the "as is" nature of the sale or to make warranty terms available to consumers prior to the sale of a used car is an unfair practice.

In December 1980, the Commission prepared a formal statement analyzing the legal basis for the exercise of its Section 5 consumer unfairness jurisdiction.<sup>191</sup> That document reviewed

<sup>186</sup> See, e.g., *American Home Products*, D.8918 (1981); *Sterling Drug*, D.8919 (July 5, 1983); *Bristol-Myers*, D.8917 (July 5, 1983), appeal docketed. No. 83-4167 (2d Cir. Sept. 12, 1983). This concept also is discussed at DS 7-15 and the cases cited therein.

<sup>187</sup> The policy statement specifically recognizes that an act or practice need only be likely to cause injury to be considered deceptive. Actual injury is not required. DS 16.

<sup>188</sup> *American Home Products*, 98 F.T.C. 136 (1981), *aff'd*, 695 F.2d 681 (3d Cir. 1982) *Ford Motor Co.*, 84 F.T.C. 729 (1974) (consent), *modified*, 547 F.2d 954 (6th Cir. 1976), *reissued*, May 16, 1977 (slip opinion). See *Statement of Basis and Purpose, Cigarette Advertising and Labeling Rules*, DS 15.

<sup>189</sup> See generally, *FTC v. R.F. Keppel Bros.*, 291 U.S. 304, 313 (1934); *Statement of Basis and Purpose, Trade Regulation Rule for the Prevention of Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking*, 29 FR 8324, 8355 (1964); *All States Industries Inc. v. F.T.C.*, 423 F.2d 423 (4th Cir.), *cert. denied*, 400 U.S. 233, 244-45 n.5 (1972); *Spiegel, Inc.*, 88 F.T.C. 425 (1975), *aff'd in part*, 540 F.2d 287 (7th Cir. 1976).

<sup>190</sup> See, e.g., *Horizon Corporation*, 97 F.T.C. 464 (1981).

<sup>191</sup> See Letter from the Commission to the Honorable Wendell H. Ford and the Honorable John

Continued



the Commission's prior exercise of its unfairness jurisdiction and clarified the criteria for its future use of this authority.

Consumer injury is the central focus of any inquiry regarding unfairness. Not every instance of consumer injury is unfair, however, because virtually any commercial practice involves a complex mix of benefits and costs. In its statement, the Commission observed that:

To justify a finding of unfairness the injury must satisfy three tests. It must be substantial; it must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided.<sup>192</sup>

The Commission's unfairness authority does not extend to trivial or speculative harm. "An injury may be sufficiently substantial, however, if it does a small harm to a large number of people, or if it raises a significant risk of concrete harm."<sup>193</sup> Furthermore, except in aggravated cases where tangible injury can be clearly demonstrated, subjective types of harm—embarrassment, emotional distress, etc.—will not be enough to warrant a finding of unfairness. Rather, economic or other tangible harm must also be present.<sup>194</sup>

Failing to disclose warranty terms and "as is" disclaimers before the bargaining process begins causes substantial injury to consumers. Consumers who overestimate the extent of warranty protection are likely to pay significantly more for the car than they would if this information had been disclosed. Such information is particularly important when dealers misrepresent the mechanical condition of the car. The only arguable countervailing benefit to consumers or competition produced by a dealer's failure to disclose warranty terms in a timely manner would be that dealers can avoid the exceedingly small cost of disclosure. The injury caused by failing to disclose warranty terms, however, far outweighs any countervailing benefit.

Further, we conclude that the injury produced by a dealer's failure to disclose this information could not reasonably be avoided through the exercise of consumer sovereignty.

C. Danforth (Dec. 17, 1980) (hereinafter cited as "Commission Unfairness Statement"). See also Horizon Corporation, 97 F.T.C. 464 (1981); Letter from the Commission to the Honorable Bob Packwood and the Honorable Bob Kasten (March 5, 1982) (hereinafter cited as "Commission Letter").

<sup>192</sup> Commission Unfairness Statement, *supra* note 191.

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

Consumers must rely on the dealer to provide accurate information about written warranties provided with a vehicle. Consumers cannot use general knowledge of warranties offered by used car dealers to predict what a particular dealer will offer because warranty terms given to used car buyers vary markedly.<sup>195</sup>

### 3. Regulatory Analysis

Section V of this Statement sets forth a detailed discussion of the benefits and costs of each rule provision. This analysis is no different from that embodied in the statutory requirement to conduct a regulatory analysis.<sup>196</sup> For this reason, the Commission has integrated the regulatory analysis with the Statement of Basis and Purpose for the Rule.

### D. Remedies

Section 109(b) of the Magnuson-Moss Warranty Act explicitly authorizes the Commission to issue rules "dealing with" used car warranties and warranty practices and, in prescribing such rules, to require a "disclosure that a used motor vehicle is sold without any warranty" as well as the specific "form and content of such a disclosure."<sup>197</sup> Complementary remedial authority is found in section 18 of the FTC Act, which authorizes the Commission, in addition to issuing rules defining unfair or deceptive practices, to include in its rules "requirements prescribed for the purpose of preventing such acts or practices."<sup>198</sup>

In fashioning any such remedy for the deceptive practices found to exist in the rulemaking record, the Commission is bound to show a "reasonable relationship" between the remedy and the practice.<sup>199</sup> The Commission's approach to fashioning a remedy in rulemaking is different from that used in individual cases because rules regulate innocent parties as well as law violators. This distinction makes careful attention to the effectiveness of the remedy particularly important in

rulemaking. Evidence of the effectiveness of a remedy may be more difficult to obtain than evidence establishing the existence and prevalence of unlawful practices because evidence bearing on the effect of a remedy is inherently predictive. However, the Commission believes that remedies, as all other aspects of a rule, should be supported by the best evidence reasonably available.

After a careful examination of the record, the Commission has developed a Rule that it believes will be an effective remedy for the unfair and deceptive practices in the used car industry. The Commission, therefore, believes that the Rule and each of its elements described below represent a justifiable exercise of its statutory authority.

### 1. Warranty and "As Is" Disclosures

The record clearly demonstrates that "as is" sales are fraught with dealer misrepresentations regarding both mechanical condition of cars sold and dealer after-sale repair responsibility.<sup>200</sup> In addition, the record demonstrates that many consumers do not understand the nature of an "as is" sale.<sup>201</sup> Such ignorance is aggravated by dealer practices that result in inconspicuous, untimely, and unclear disclosures.<sup>202</sup> The record further demonstrates that dealers orally misrepresent the terms of written warranties and service contracts and fail to make timely, conspicuous, and clear disclosure of warranty and service contract terms.<sup>203</sup>

To remedy these unfair and deceptive practices, the Rule requires that, on the window sticker, dealers indicate whether a warranty is offered or whether the car is sold "as is", i.e., without any warranties.<sup>204</sup> If a warranty is offered, the dealer must disclose on the sticker the systems that are covered, the percentage of total repair costs paid for by the dealer and the duration of the warranty.<sup>205</sup> If a service contract is offered, the dealer must indicate its cost.

Some industry members argue that warranty or "as is" disclosure requirements are unnecessary because they duplicate the pre-sale availability requirements of the Magnuson-Moss Warranty Act and existing state law

<sup>195</sup> See discussion of warranty terms in the used car industry in Section II A.1.b. *supra*.

<sup>196</sup> Section 22 of the Federal Trade Commission Act, as amended, 15 U.S.C. 57b-3. The statutory authority specifically provides for integrating the regulatory analysis with the Statement of Basis and Purpose. See FTC Act section 22(b)(3)(A)(ii), 15 U.S.C. 57b-3.

<sup>197</sup> 15 U.S.C. 2309(b).

<sup>198</sup> 15 U.S.C. 57a(a)(1)(B). The Commission's authority to adopt such requirements was recognized in *Katharine Gibbs School (Inc.) v. FTC*, 612 F.2d 658, 662 (2d Cir. 1979).

<sup>199</sup> *FTC v. National Lead Co.*, 352 U.S. 419, 428-29 (1957); *Jacob Siegel Co. v. FTC*, 327 U.S. 608 (1946). This standard was recently held applicable to Section 18 rulemaking. *American Optometric Ass'n v. FTC*, 628 F.2d 896, 911 n.8 (D.C. Cir. 1980).

<sup>200</sup> Staff Report at 103-130, 262-280, 295-299; NIADA, S-739 at 82-83.

<sup>201</sup> See n. 92 and accompanying text *supra*.

<sup>202</sup> Staff Report at 262-80; 295-300; NIADA, S-739 at 82-83.

<sup>203</sup> *Id.* at 280-290; 303-305.

<sup>204</sup> This remedial approach has been commented upon favorably by one industry organization. See NIADA, S-739 at 112-113, 120-121, Appendix B.

<sup>205</sup> *Id.* at 111-113, 130-121, Appendix B.



with regard to "as is" disclosures.<sup>206</sup> The warranty and "as is" disclosures required by this Rule do not duplicate Magnuson-Moss Act requirements but supplement them as specifically directed by Congress in Section 109(a). Section 109(a) specifically directed the Commission to address, with regard to the used car industry alone, the appropriate disclosure for sales in which "no warranty" was given. The Act itself does not require disclosures regarding "as is" sales. Likewise, state laws with regard to "as is" sales do not require point of sale disclosures but disclosure prior to consummation, i.e., in the "closing room."<sup>207</sup>

These requirements will remedy the deceptive practice of misrepresentation concerning post-sale repair responsibilities and unfair failure to disclose warranty coverage. Moreover, the fact that the disclosure will be available to consumers on a window sticker will ensure that consumers will receive warranty information at a time when the information can influence their purchasing decision. The Baseline Survey indicates that a disclosure of warranty information on a window sticker increases consumers' understanding of the dealer's post-sale repair responsibility.<sup>208</sup> Therefore, the warranty disclosure provisions of the Rule, which respond directly to both the dealer deceptions about warranties and unfair failures to disclose warranties, will provide an effective remedy for the documented abuses.

## 2. Spoken Promises Warning

The Rule also requires a disclosure to consumers that, unless oral promises are reduced to writing, they are difficult to enforce. As noted above, the record is replete with evidence that dealers orally misrepresent both the mechanical condition of used cars and the dealer's after-sale repair responsibility.<sup>209</sup> The record demonstrates that consumers rely on oral statements made by dealers at the point of purchase even though those oral statements are not confirmed in writing.<sup>210</sup> Consumers are therefore frequently deceived at the point of purchase by representations which are not only untrue but also unenforceable. A warning to consumers that all oral

promises should be reduced to writing is therefore clearly justified by the record.<sup>211</sup>

We believe that the level of oral misrepresentation at the used car lot can be reduced if consumers are informed of the need to secure a written record of all promises made in connection with a used car sale.<sup>212</sup> By introducing this information into the used car market, the Commission expects consumer reliance on oral statements to decrease and insistence on a written confirmation of representations made at the time of sale to increase. If the consumer is able to obtain written confirmation of those statements in a sales contract that can be used in the event of a dispute, many dealers are likely to be more reluctant than they are at present to make false or misleading oral statements. As a result, a "spoken promises" warning should act as a deterrent to deception in the used car market and is clearly related to deceptive practices by used car sellers.

## 3. List of Major Mechanical and Safety Systems

The list of major mechanical and safety systems is designed to address the record evidence that misrepresentations concerning mechanical condition are often made on a system-by-system basis. The components listed are those most likely to be represented by dealers as being in good condition without any confirmation of such representations in writing.<sup>213</sup>

The list of systems on the Buyers Guide is reasonably related to these abuses. The list provides a framework for consumers to evaluate the extent of the warranty coverage which must be indicated on the warranties section of the sticker. Consumers will also be able to utilize the list when comparing the warranties offered on different cars or offered by different dealers. The list also serves other remedial purposes. By identifying the major components of the car, the list counters the specific dealer misrepresentations that certain consumer-noted problems are minor.<sup>214</sup> It also identifies for consumers

the systems they may wish to have inspected by a third party prior to purchase. Further, it provides information about major defects that could occur in these systems to provide further guidance to consumers on what should be evaluated during the third-party inspection.

## 4. Notice of Availability of Pre-Purchase Inspection Opportunity

Pre-purchase inspection by a third party can provide consumers with valuable information regarding the mechanical condition of a used car and can considerably enhance the consumer's bargaining position.<sup>215</sup> However, the record demonstrates that few consumers actually seek independent inspections by a qualified mechanic.<sup>216</sup> The record shows that this result is in part caused by certain dealer practices which discourage the consumer's use of independent pre-purchase inspections.<sup>217</sup>

Dealers make general representations that their cars are in sound mechanical condition.<sup>218</sup> Consumers rely on dealer representations of sound mechanical condition and thus do not perceive a need to obtain an independent pre-purchase inspection.<sup>219</sup> In addition, the record demonstrates that dealers commonly "detail" cars. Since consumers often believe that "good looking" cars are "good running" cars, this dealer practice discourages consumer belief in the need for inspections.<sup>220</sup>

Although the record does not support imposition of a mandatory right to independent, off-the-lot, pre-purchase inspections,<sup>221</sup> it does support a required disclosure which suggests that consumers inquire about the availability of an independent, pre-purchase inspection. Such a disclosure focuses consumer attention on the idea of pre-purchase inspection as a means of evaluating a car's mechanical condition. In addition, the notice allows consumers to gauge dealers representations concerning mechanical condition by measuring those representations against dealer willingness to permit third-party inspections and independent confirmation of such representations.

<sup>206</sup> See Merrill-Wahus, dealer organization, T-165; Sapp, dealer organization, T-503; Stores, dealer organization, T-567; Boniface, dealer, T-217; Nicholson, dealer, T-710; Lahmann, dealer, T-714.

<sup>207</sup> Staff Report at 483-488.

<sup>208</sup> See n. 293 *infra*.

<sup>209</sup> Staff Report at 103-130; 282-90; 295-315.

<sup>210</sup> *Id.* at 108-110, 274-277. While the industry recognizes that oral misrepresentation occurs, it denies prevalence. See, e.g., NIADA, S-739 at 70-71; NADA, S-738 at 174-187.

<sup>211</sup> Industry members also recognize the need for such a disclosure. See, e.g., Virginia Independent Automobile Dealers Association, T-700 at 8; NIADA, S-739 at 121; NIADA, T-742 at Appendix 1. Industry objections to earlier proposals for this disclosure were addressed to tone rather than substance. See, e.g., NADA, T-740; Antoniewicz, dealer organization, T-500; Sapp, dealer organization, T-503. The language of the disclosure has since been modified.

<sup>212</sup> The Commission notes that certain industry members reach a similar conclusion. See NIADA, S-739 at 112-113.

<sup>213</sup> Staff Report at 109-115.

<sup>214</sup> Staff Report at 108 n. 104.

<sup>215</sup> Staff Report at 87-70.

<sup>216</sup> *Id.* at 83-84.

<sup>217</sup> *Id.* at 87-89 n. 81.

<sup>218</sup> *Id.* at 103-108.

<sup>219</sup> *Id.* at 109-130.

<sup>220</sup> *Id.* at 87-103.

<sup>221</sup> See Section IV.C. *infra*.

### III. Section-by-Section Analysis

#### Section 455.1(a)—List of unfair or deceptive acts or practices.

The record of this rulemaking proceeding documents the widespread occurrence of a variety of unfair or deceptive practices in the used car market. These practices are specifically enumerated in this subsection of the Rule.<sup>222</sup> As set forth below, engaging in any of the practices enumerated in this section is not a violation of the Rule. Compliance with the Rule is attained by meeting the requirements of §§ 455.2 through 455.5 of the Rule. Nevertheless, the Commission, based on the record of this proceeding, considers these practices to be unfair or deceptive under Section 5 of the Federal Trade Commission Act, so that violations will be subject to future law enforcement actions by the Commission.

#### Section 455.1(b)—Definition of rule violation.

As noted immediately above, compliance with the Rule is attained by meeting the requirements of §§ 455.2 through 455.5 of the Rule. Each violation of this Rule, which is issued pursuant to section 18 of the Federal Trade Commission Act, carries a civil penalty of up to \$10,000 which the Commission may seek in the appropriate federal district court. It is therefore essential that the provisions of this Rule precisely describe the responsibilities of each person covered. To insure such precision, this subsection limits any rule violation to the failure to comply with the remedial provisions set forth in §§ 455.2 through 455.5 of the Rule. By defining a Rule violation in terms of compliance with these explicit requirements, there is no question as to the steps that a used vehicle dealer must take to comply with the Rule.

#### Section 455.1(c)—Definitions.

The scope of the Rule adopted here is determined largely by the definition of key terms described in this subsection. As set forth below, each of these terms has been specifically defined so as to insure the most appropriate coverage of the Rule.

#### Section 455.1(c)(1)—"Vehicle".

As initially proposed,<sup>223</sup> the Rule would have covered any motorized

vehicle, including motorcycles, designed to carry not more than 15 people. However, upon consideration of the evidence in the record, the Commission has concluded that, while the definition of "vehicle" should be broad enough to include the many personal use vehicles on the market, the definition should not be so broad as to cover vehicles that are generally used for commercial activity. Under §455.1(c)(1), coverage of the Rule has been limited to vehicles, other than motorcycles, of a size and weight most often purchased by individual consumers.<sup>224</sup>

The size and weight limitations in the definition of "vehicle" are designed so as to include light-duty trucks which are frequently used for personal activities, because the record reflects numerous consumer complaints concerning such vehicles.<sup>225</sup> Conversely, large trucks are excluded from the definition because of their specialized commercial nature and because buyers of large trucks generally appear to be more knowledgeable and sophisticated than the average used car buyer.<sup>226</sup> To distinguish between trucks used for commercial purposes and those used for personal transportation, the Commission has relied upon criteria developed by the Environmental Protection Agency for the classification of light-duty trucks.<sup>227</sup> The size and weight parameters set in the definition of "vehicle" also exclude large recreational vehicles from the Rule. There is insufficient evidence in the record to conclude that sales of these vehicles are characterized by the deceptive practices that the Rule is designed to prevent.

Finally, the definition of "vehicle" excludes motorcycles. While some witnesses suggested inclusion, there is little record evidence regarding deception by motorcycle dealers.<sup>228</sup>

Section 455.1(c)(2) defines "used vehicle" in a manner consistent with the Commission's decision in *Peacock Buick, Inc.*<sup>229</sup> In *Peacock*, we concluded that the term "used car" should include "any vehicle driven more than the limited use necessary in moving or road testing a new vehicle prior to delivery to a consumer."<sup>230</sup>

An alternative definition to "used vehicle" suggested during the rulemaking proceeding turned on whether a car had been previously sold to a person who "purchased the vehicle

in good faith" for a purpose other than resale or whether a car had been previously used in a variety of specified situations (e.g., as a rental or driver education car or as a demonstrator). Based on record comment<sup>231</sup> and our own analysis, we have concluded that this definition would be not only confusing to consumers and dealers but also difficult for the Commission to enforce. Accordingly, the Commission has adopted the present definition in an effort both to clarify and to simplify the question of which vehicles are covered by the Rule.

In adopting this definition, the Commission specifically intends to include within the scope of the Rule cars identified on the record as "demonstrators."<sup>232</sup> Many states, for the purpose of titling laws, identify as "new" vehicles for which title has not passed to a purchaser despite extensive use of the vehicle as a demonstrator model. However, the record reflects that used cars sold as "demonstrators" are subject to dealer oral misrepresentations concerning overall quality of mechanical condition.<sup>233</sup> Therefore, the Commission has concluded that, notwithstanding the various state titling laws, there is substantial record justification and legal precedent for including demonstrators within the scope of the Rule.<sup>234</sup>

Insofar as a vehicle is sold for its parts and not as an operating vehicle, there appears to be no need to provide consumers with the kind of information customarily used to evaluate an automobile as a means of personal transportation. Accordingly, the definition of "used vehicle" specifically excludes those used cars sold only for salvage.

<sup>221</sup> Staff Report at 404.

<sup>222</sup> "Demonstrators" included cars represented as "dealer demonstrators," "factory demonstrators," "executive demonstrators" and the like. *Id.* at 344.

<sup>223</sup> See, e.g., Towle, TR 577-83; Brewton, TR 2761-66.

<sup>224</sup> Our decision to include demonstrators in the definition of "used vehicle" does not in any way preempt state titling laws which identify demonstrator models as "new" cars. The Rule adopted here does not interfere with the classification of demonstrators for purposes of title; the Rule only requires that, if driven more than the limited number of miles needed to move or road test a vehicle, a car, when offered for sale, must display the Buyers Guide so as to provide consumers with warranty disclosures. Moreover, it should be noted that the Rule does not conflict with other federal statutes. At most, some dealers may find that they will have to post the federally-mandated new car vehicle disclosure sticker (required under the Monroney Act, 15 U.S.C. 1231 *et seq.* (1972)), as well as the Buyers Guide, in those few instances (e.g., demonstrators) where a vehicle straddles the line between new and used.

<sup>225</sup> Although one participant contended that a substantially similar list failed to meet the specificity requirements enunciated in *Katharine Gibbs School (Inc.) v. FTC*, 612 F.2d 658, 662 (2nd Cir. 1979), the Commission believes that the list of unfair or deceptive practices meets the Gibbs standard. See NADA, T-741, at 31.

<sup>226</sup> 41 FR 1089 (1976).

<sup>227</sup> Staff Report at 397-399.

<sup>228</sup> Staff Report at 400-402.

<sup>229</sup> *Id.* at 401.

<sup>230</sup> 41 FR 56316 (1976).

<sup>231</sup> Staff Report at 403.

<sup>232</sup> 86 FTC 1532 (1975).

<sup>233</sup> *Id.* at 1566.

*Section 455.1(c)(3)—“Dealer”.*

This subsection defines a “dealer” in terms of the number and frequency of used car sales or offerings. The original rule proposed by the Commission defined a dealer as anyone who engaged in the business of offering for sale or selling used cars to the general public. Based on testimony in the record indicating the difficulty of interpreting the phrase “in the business of,”<sup>235</sup> the Commission has concluded that a numerical standard would be easier to enforce and would provide better notice to the public concerning the applicability of the Rule. The record reflects that most states set the dividing line between a dealer and a casual seller of used cars at between three and six vehicles each year.<sup>236</sup> We have determined that five vehicles is the optimal cut-off point because any number less than that may unnecessarily include within the Rule occasional private sales of personal cars by their owners. Conversely, a number greater than five increases the risk that the Rule will be inapplicable to the so-called “curbstone” seller who, though buying and selling a substantial number of used cars per year (often from a residential location) may not formally be engaged in what would be termed the “business” of used car sales.<sup>237</sup>

The definition of “dealer” also excludes those who engage in the private sale of used cars, other than those who sell more than five cars per twelve-month period. Although a number of witnesses testified in favor of subjecting private sales to the requirements of the Rule,<sup>238</sup> the Commission does not find any basis to extend the provisions of the Rule to the private market. Indeed, the record discloses considerable evidence indicating that, in many instances, consumers receive more accurate information about the mechanical condition of used cars from private parties than from used car dealers.<sup>239</sup> The record also indicates that private parties generally do not offer warranties in connection with the sale of their used cars.<sup>240</sup> Therefore, the Commission finds that the record has not documented a sufficient incidence of deceptive sales practices in the private market to justify what would be a substantial expansion of the Rule’s scope.

<sup>235</sup> Staff Report at 405–407.

<sup>236</sup> *Id.* at 406.

<sup>237</sup> *Id.*

<sup>238</sup> *Id.* at 407.

<sup>239</sup> HX 164(A) at Tables IV–3, IV–4.

<sup>240</sup> See, e.g., HX 164(A) at Table IV–20 (97.6 percent of respondents reported receiving no warranty from the private seller).

A considerable amount of discussion in the record focused on the question of whether the Rule should cover both franchise and independent used car dealers. Our review of the record in this regard convinces us that both types of used car dealers should be included within the scope of the Rule, since the frequency of dealer misrepresentation concerning warranty coverage and mechanical condition, as well as the severity of defects occurring soon after sale, is sufficiently great among both franchise and independent dealers.<sup>241</sup>

The definition of dealer specifically excludes banks, financial institutions, and a lessor selling leased vehicles to the vehicle’s lessee, to a buyer procured by the vehicle’s lessee, or to the lessee’s employee. Thus, in most instances, sales of leased vehicles by the vehicle’s lessor, where the lessor retains no actual or constructive possession of the vehicle, are exempt from the Rule.

By the terms of this exemption, banks and financial institutions selling used cars forfeited as collateral on consumer loans also need not comply with the requirements of the Rule. Various banking representatives have requested that this exemption be extended to the affiliates and subsidiaries of banks and financial institutions.<sup>242</sup> The gravamen of the banks’ arguments is that confusion will occur if the Rule does not explicitly permit banking affiliates and subsidiaries to conduct the same type of used car sales as the banks themselves may conduct without coming under the Rule. However, the Commission believes that the record does not include sufficient evidence to determine the extent to which existing banking regulations might permit financial institutions to engage in the retail sale of used cars through businesses operated by their affiliates and subsidiaries. Therefore, the Commission declines to extend the exemption for banks to include banking affiliates and subsidiaries.<sup>243</sup>

Some witnesses appearing in the proceeding argued in the rulemaking record that fleet sales of used cars are not made in a retail sales environment.<sup>244</sup> However, the record

<sup>241</sup> Staff Report at 408–415.

<sup>242</sup> See Motion of Consumer Bankers Association, April 13, 1981; American Bankers Association, T-747. While we are mindful of the Federal Trade Commission Act’s exclusion of banks from the Commission’s jurisdiction under Section 5, the Commission believes that subsidiaries of financial institutions which are engaged in the business of selling used cars are covered by this Rule.

<sup>243</sup> The Commission notes that these issues may be more appropriately explored in the context of an exemption proceeding under section 16(g) of the Federal Trade Commission Act.

<sup>244</sup> Staff Report at 415.

demonstrates that many fleet operators sell significant numbers of used cars to individual consumers at retail.<sup>245</sup> As a result, the Commission has determined that fleet sales should remain within the coverage of the Rule. Fleet operators remain free to petition the Commission and present evidence indicating that an exemption would be appropriate.

The Commission intends, by the exemptions from the definition of “dealer,” to remove from the scope of the Rule used car sales where the absence of a retail sales environment substantially diminishes the risk of the deceptive practices that we have found to be characteristic of used car sales presentations.

*Section 455.1(c)(4)—“Consumer”.*

This subsection defines the class of persons intended to be the direct beneficiaries of the disclosures required by the Rule. The definition adopted here extends beyond the definition of “consumer” in the Magnuson-Moss Act<sup>246</sup> and in other product information disclosure statutes<sup>247</sup> to include any person who is not a used car dealer. The record fails to establish that business purchasers in general are more knowledgeable than other consumers with regard to mechanical condition and warranty information. The Commission, absent record evidence to the contrary, cannot presume that those purchasing used cars for other than personal use, particularly small businesses that may be owned and operated by individuals, are more sophisticated than individual private purchasers with respect to the warranty coverage that may be provided or the mechanical condition of used cars. Moreover, we believe that a definition of consumer which would require dealers to differentiate purchasers on the basis of knowledge or sophistication in the area of used cars would unfairly burden used car dealers. It is, in our judgment, extremely difficult to predict who is likely to shop at a particular used car lot or what will be level of sophistication among the various persons who decide to buy. To require that the dealer estimate the sophistication of prospective purchasers would be an onerous task that would unnecessarily increase a dealer’s risk of violating the Rule. Therefore, in order to insure the necessary pre-sale

<sup>245</sup> *Id.* at 416.

<sup>246</sup> Under sections 101 (1) and (3) of the Magnuson-Moss Warranty Act, 15 U.S.C. 2301 (1), (3), a “consumer” means a buyer of any product normally used for personal, family, or household purposes.

<sup>247</sup> E.g., Consumer Credit Protection Act, 15 U.S.C. 1602.

availability of the information disclosures prescribed in the Rule without unduly burdening used car dealers, the Commission has adopted a more inclusive definition of "consumer."<sup>248</sup>

*Sections 455.1(c) (5), (6), (7)—“Warranty,” “Implied warranty,” and “Service contract”.*

These subsections define the terms “warranty,” “implied warranty,” and “service contract” in a manner which conforms to the definitions of those terms in the Magnuson-Moss Warranty Act.<sup>249</sup> Persons subject to this Trade Regulation Rule should be aware that the provisions of the Magnuson-Moss Warranty Act and the Commission’s Rules interpreting that Act are fully applicable to any written warranty offered in connection with the sale of a used car.<sup>250</sup> Persons affected by this Rule should therefore consult the terms of the Magnuson-Moss Warranty Act and the Commission’s Rules interpreting that Act for a clear explanation of the duties arising under the Act.

In the definition of “service contract”, we intend to clarify our intent not to regulate service contracts in those states which classify such contracts as “repair insurance”. In those states, service contracts are regulated by state insurance authorities and are therefore excluded from the Commission’s jurisdiction by the McCarran-Ferguson Act.<sup>251</sup>

*Section 455.1(c)(8)—“You”.*

The term “you” in the operative sections of the rule refers to used car dealers. However, in the Buyers Guide prescribed by the Rule, “you” refers exclusively to the purchaser of a used car. This distinction is recognized in the definition set forth in this subsection. The Commission has adopted this distinction in an effort to clarify and simplify the Buyers Guide.

<sup>248</sup> Certain dealers may have clientele (e.g., large businesses that regularly purchase used vehicles) that clearly do not require the disclosures provided by the Rule. Although the Commission believes that these dealers are few in number, the Commission would consider the advisability of exempting such dealers from the Rule. Therefore, it would be appropriate for such dealers to file a petition for exemption with the Commission to enable the Commission to consider these specialized situations.

<sup>249</sup> 15 U.S.C. 2301(6)(B), (7), (8).

<sup>250</sup> See, e.g., 15 U.S.C. 2302-2308. See also 16 CFR Parts 700 (interpretations of Magnuson-Moss Warranty Act); 701 (disclosure of written consumer product warranty terms and conditions); 702 (presale availability of written warranty terms); and 703 (informal dispute settlement procedures).

<sup>251</sup> 15 U.S.C. 1011.

*Section 455.2(a)—General duties.*

The Rule requires that before offering a used vehicle for sale to a consumer, dealers prepare and display the “Buyers Guide” on the side window of the vehicle. This placement should attract consumer attention without blocking the driver’s line of sight during a test drive or otherwise interfering with a dealer’s sales presentation.<sup>252</sup> The Rule also prescribes the precise size, type style, and format of the window sticker. In the Commission’s opinion, a uniform method of disclosure will alleviate confusion and possible deception which might result from inconsistent versions of the Buyers Guide. A standardized form will also minimize the risk to dealers who might otherwise post a disclosure form which does not satisfy the Rule’s requirements and who would thereby subject themselves to potential liability. Finally a standardized form will facilitate consumer comparison of warranty coverage offered by different dealers of different vehicles.

In order to evaluate the effectiveness of the Buyers Guide in communicating information to consumers concerning a used car, the Commission’s staff arranged for a series of consumer comprehension tests.<sup>253</sup> Based on the consumer testing results, the Commission incorporated into the 1981 Buyers Guide a variety of technical changes in the graphic design of the Guide and the language used to convey the various information disclosures. The Buyers Guide included in the Rule we promulgate today has been revised to make the warranty and “as is” disclosures more prominent.

As explained below, the Buyers Guide contains several information disclosures that the Commission believes to be necessary to prevent deception in the used car marketplace: (1) A warning concerning the importance of obtaining oral promises in writing; (2) a listing of a major systems of an automobile; and (3) a recommendation that consumers ask about pre-purchase inspection opportunity.

The Buyers Guide encourages consumers to obtain in writing all promises made in connection with a used car sales presentation. This

<sup>252</sup> The Rule also permits the removal of the Used Car Buyers Guide for purposes of a test drive. See § 455.2(a)(1).

<sup>253</sup> Market Facts Inc., “Exploratory Research into Consumer Attitudes Toward the Used Car Buyers Guide,” May 1981. The Commission also contracted for consumer testing for previous versions of the Rule. See Hollander Study (August 1980) and Public Communications Center Study (December 1980). Attachments to Staff Memorandum to the Commission, Final Recommendations Concerning Used Car TRR, dated January 14, 1981.

information is vital to consumers who may try to enforce a dealer’s promises only to find that promises not reduced to writing or included within the terms of the written sales contract are unenforceable. The spoken promises warning, therefore, is designed to reduce dealers’ oral misrepresentations—and consumer reliance thereon—that the record demonstrates occur with frequency in the used car market.<sup>254</sup>

Second, the Buyers Guide lists the major systems in an automobile along with some major defects that may occur in these systems. The Commission has concluded that, in order to benefit from the warranty disclosures required by the Rule, consumers need to be aware of the major automotive systems they should evaluate before purchasing a used car. This is especially so in light of overwhelming record data indicating lack of consumer knowledge with regard to mechanical condition and warranty terms. By prominently displaying this information at the point of purchase, the Buyers Guide will provide consumers with a valuable frame of reference within which to evaluate dealer oral representations regarding mechanical condition and warranty coverage. Consumers can also use the list of major defects as a guide in obtaining a pre-purchase inspection by an independent mechanic.

Third, the Buyers Guide advises consumers to ask the used car dealer about the possibility of pre-purchase inspections. Consumers can use third-party information concerning the mechanical condition of a used car to determine whether the dealer has engaged in misrepresentation or failure to disclose material information during the transaction.<sup>255</sup> This information also may assist consumers in negotiating improved warranty coverage or a lower purchase price.

*Section 455.2(b)—Disclosure of warranty information.*

In section 109(b) of the Magnuson-Moss Act, Congress directed the Commission to initiate this proceeding to determine the need for rules concerning warranty practices in the used car market. As summarized in Section II.A.1 of this Statement of Basis and Purpose, the evidence received by the Commission during the rulemaking proceeding demonstrates that, because of unfair and deceptive dealer practices, consumers generally have little understanding of the extent of warranty coverage (or lack thereof) accompanying

<sup>254</sup> See Sections II.A.1, II.A.2 *supra*.

<sup>255</sup> See Sections II.D.4 *supra*.

the purchase of a used car. Consumers therefore do not fully anticipate the repair costs that may accompany the ownership of a used car.<sup>256</sup> There is also substantial evidence that used car dealers frequently misrepresent or fail to disclose both the terms and conditions of warranty coverage offered to their consumers.<sup>257</sup>

The Commission has determined that the least burdensome, most economical means of insuring the availability of adequate used car warranty information is to provide consumers with point-of-purchase disclosures. Accordingly, § 455.2 of the Rule imposes on used car dealers a duty to fill in and display a Buyers Guide on all used cars sold to consumers. If a warranty accompanies a car offered for sale, a dealer must, under the Rule, inform the buyer whether the warranty is full or limited, what percentage of the repair cost the dealer will pay, the systems covered by the warranty, and the duration of the warranty. The dealer must also indicate, by marking the correct disclosure on the Used Car Buyers Guide, if no warranty accompanies the car (i.e., the car is sold "as is") or if state law "implied warranties" are the consumer's only form of postsale protection.<sup>258</sup> Finally, the Rule requires each dealer to indicate the availability, if any, of a service contract covering repair costs. It is the Commission's belief that this warranty information, when displayed on the Buyers Guide, should prevent the failures to disclose and the misrepresentations of warranty coverage documented in the record. It also should assist consumers in evaluating the long-term cost of used car ownership and thereby reduce the extensive consumer injury that results from unanticipated repair costs.

During the course of this proceeding, the Commission considered several different methods of disclosing the warranty information required by the Rule. Because of the many different warranties in the marketplace and the various methods of describing those warranties, the Commission has adopted a disclosure format that provides blank spaces for the dealer to use in describing the system covered by a warranty and the duration of that warranty. However, notwithstanding the flexibility afforded by this method of warranty information disclosure, the use

of shorthand phrases to describe the systems of a car (e.g., "drive train" to describe the engine, transmission, drive shaft, and differential) is prohibited by § 455.2(b)(2)(ii) of the Rule. The record reflects that shorthand phrases, such as "drive train" or "power train", are used by dealers to connote parts of a car but that consumers do not understand such shorthand terms and are therefore not able to assess the value of a warranty offered on a "drive train."<sup>259</sup> Furthermore, such shorthand terms do not convey identical meaning throughout the used car industry.<sup>260</sup> Therefore, while the Commission wishes to provide flexibility to dealers in describing systems covered by warranties, we are requiring that dealers spell out which specific systems are covered by the warranty.

Some dealers may wish to provide warranty coverage for some systems of a used car and at the same time disclaim all other express or implied warranty coverage for the other systems of the car. In addition, some dealers may wish to list on the Buyers Guide the specific exclusions from the warranty coverage. Therefore, a dealer may use the space provided for the warranty disclosures to write in such disclaimers or exclusions.

#### *Sections 445.2(c-e)—Additional disclosures.*

A number of the Rule's additional disclosure requirements are intended by the Commission to integrate the information provided by the Buyers Guide into the contract of sale between used car dealers and consumers and to memorialize on the form the details of each sales transaction so that the Buyers Guide may be used in the event of a dispute between buyer and seller.

#### *Section 455.2(c)—Name and address.*

#### *Section 455.2(d)—Make and model.*

Section 455.2(c) requires the name and address of the business or dealership selling the car to be listed on the Buyers Guide. By requiring that the seller identify in writing the person responsible for selling each used car and making the disclosures required by the Rule, the Commission intends to enhance the value of the Buyers Guide as evidence in the event that disputes arise between buyers and sellers. The same purpose is served by the requirement in § 455.2(d) that the dealer disclose on the Guide the make, model, model year, and vehicle identification number of each used car.

#### *Section 455.2(e)—Complaints.*

The rulemaking record indicates that dealers report difficulty in controlling the oral representations of salespeople and that salespeople often are not informed of material facts by the dealer.<sup>261</sup> If disputes arise over Buyers Guide disclosures, consumers must be able to identify the person responsible for handling consumer complaints. This is especially true in light of the fact that salespeople in the used car business are often transient.<sup>262</sup> As a result, § 455.2(e) of the Rule requires each dealer to identify on the Buyers Guide the person to contact if a problem arises after sale.

#### *Section 455.3—Incorporation of the Used Car Buyers Guide into sales contract.*

To insure that the disclosures made on the Buyers Guide are available to the consumer, § 455.3(a) provides that each dealer must deliver to the purchaser at the time of sale a copy of the Buyers Guide containing all of the disclosures required by the Rule and reflecting the agreed-upon terms of warranty coverage. Section 455.2(b) provides that changes in the terms of warranty coverage must be reflected on the Buyers Guide.

Section 455.3(b) of the Rule further strengthens the importance of the Buyers Guide by requiring that the information on the window form be incorporated by reference into the sales contract for each used car sold. By integrating the Buyers Guide within the "four corners" of the used car sales contract, the Commission intends that the Buyers Guide become part of the written agreement between buyer and seller, so that, in the event of disputes between buyers and sellers, the information on the Buyers Guide would fall outside the exclusions of the parole evidence rule of contract law.

To inform consumers that the information on the Buyers Guide is a part of the sales contract and governs in the event that the sales contract contains contradictory terms, § 455.3(b) contains a disclosure that must be incorporated into all sales contracts. The Commission believes that the sales contract disclosure will clarify for both consumers and dealers the necessity for the information on the Buyers Guide to accurately reflect the terms of the sale.

By requiring the addition of the specific clause into consumer sales contracts, the Commission intends to insure that the protections of the Rule

<sup>256</sup> Staff Report at 261-305.

<sup>257</sup> *Id.*

<sup>258</sup> A separate "Implied Warranties Only" disclosure is prescribed for use in those states that prohibit "as is" sales, and in those instances where a dealer chooses to sell a used car with neither an express warranty nor an "as is" disclaimer.

<sup>259</sup> Staff Report at 255 nn. 17, 19; 287, n. 85.

<sup>260</sup> *Id.* at 255-256 nn. 18, 19.

<sup>261</sup> *Id.* at 103-109 nn. 102-106.

<sup>262</sup> See, e.g., Warwick, TR 5380.

are available to consumers. Thus, we intend that consumers who are injured by dealer deceptions concerning the disclosures on the Buyers Guide could bring breach of contract actions, since those disclosures are a part of the contract. In other trade regulation rules, we have also required that clauses reflecting particular consumer rights be added to consumer contracts.<sup>263</sup>

#### Section 455.4—Contrary statements.

As noted throughout this Statement of Basis and Purpose, the Commission has found that one of the principal consumer abuses in the used car market is oral misrepresentation concerning the warranty coverage that the dealer intends to provide after the time of sale and the mechanical condition of used cars. To enhance the effectiveness of the written disclosures in the Buyers Guide, the Commission has incorporated into § 455.4 of the Rule an explicit prohibition of oral or written statements or other practices that alter or contradict the disclosures in the Buyers Guide. This provision is not intended to interfere with negotiations between dealers and consumers concerning the terms and conditions of warranty coverage. However, any final warranty terms agreed upon in such negotiations must be identified in the sales contract and summarized on the copy of the Buyers Guide given to the buyer.<sup>264</sup>

#### Section 455.5—Spanish language sales.

Earlier versions of § 455.5 of the Rule had required that the Buyers Guide be in the language in which the sale is conducted. Such an open-ended requirement could have resulted in Buyers Guide translations of varying linguistic quality and accuracy unless the Commission were to publish official Buyers Guide translations in all of the several dozen languages used in the United States. The evidence in the record indicates that, besides English, Spanish is the language most frequently used during used car sales transactions.<sup>265</sup> Therefore, the Commission has decided to limit the scope of § 455.5 to Spanish translations of the Buyers Guide so as to insure that Spanish-speaking citizens may have access to the Buyers Guide information. Where the sale is conducted in Spanish, § 455.5 requires that a Spanish version

of the Buyers Guide be posted and provided to the purchaser. For those dealers who conduct transactions both English and Spanish, both versions of the Buyers Guide may be posted.

#### Section 455.6—Exceptions.

The standards for state exemptions set forth in § 455.6(a) conform to the congressional directive in the FTC Improvements Act of 1980 concerning state exemptions from the Funeral Industry Trade Regulation Rule. The Commission will assess requests for exemptions from state agencies by analyzing the state requirement in comparison to the Rule. The Commission here offers no opinion as to whether there are any state or local regulations currently in effect which do provide a level of protection as great as or greater than that provided by the Rule. Instead, as set forth in § 455.6(b), the Commission will determine the appropriate interrelationship between the Rule and state regulation on a case-by-case basis in the context of an exemption proceeding conducted pursuant to § 1.16 of the Commission's Rules of Practice. Appropriate petitions for exemption made by state governments will be evaluated to determine the overall level of protection to consumers and whether the state scheme that offers protection as great as, or greater than, the Rule is administered and enforced effectively. Should a jurisdiction be granted an exemption under this section, the Commission intends to forgo enforcement of the Rule in that jurisdiction while the exemption is in effect.

#### Section 455.7—Severability.

By this section, the Commission expresses its intention that each provision of the Rule is separate and severable. If one or more parts are found to be invalid, the other portions of the Rule will continue in effect.

#### IV. Alternatives Considered

During the course of this proceeding, the Commission considered several alternatives to the Rule it adopted in August 1981. Each variation involved warranty disclosures including an explanation of "as is" sales, a list of major mechanical systems, a disclosure of known defects, and a spoken promise warning. Except for the known defects disclosure, the Commission is convinced that record evidence indicates each of these features should be included in any rule designed to address the unfair and deceptive practices identified in this record, which lead to consumers

experiencing unanticipated repair costs following purchase.<sup>266</sup>

The options considered could be described generally as various methods for requiring disclosure of information from the dealer concerning the mechanical condition of the cars the dealer offers for sale. Those alternatives were:

1. Disclosure of Known Defects
2. Mandatory Inspection
3. Optional Inspection
4. Mandatory Third-Party Inspection
5. Cooling-off Period
6. Disclosure of Prior Use
7. Disclosure of Odometer Accuracy
8. Disclosure of Estimated Repair Costs
9. Disclosure of Prior Repairs
10. Disclosure of Flooded or Wrecked Vehicles

#### A. Disclosure of Known Defects

The 1981 Rule contained provisions requiring dealers to disclose certain material defects, if known at the time of sale. (See August 1981 Rule 16 CFR 455.2(c) (1982)). That Rule defined the specific defects that were to be disclosed in §§ 455.6 (a) through (i). Sections 455 (j) through (n) set forth tests to be used by dealers to determine the existence of defects.

The August 1981 Rule provided in § 455.2(c) that dealers have knowledge of a defect when they obtain facts or information about the condition of a vehicle (e.g. through an inspection, from a previous owner, from the seller at an auction) which would lead a reasonable person under the circumstances to conclude that the car contained one or more of the defects listed in the Rule.

Finally, the 1981 Rule did not allow dealers to use lower standards for determining that a defect exists in older cars. Consequently, the age of the vehicle would have been irrelevant to the assessment of whether the vehicle satisfied the defect standards.

The Commission has reviewed the known defects disclosure provisions of the August 1981 Rule pursuant to a remand from the United States Court of Appeals for the Second Circuit in *Miller Motor Car Corporation, et al. v. F.T.C.* 2d Cir. No. 81-4144. The court ordered the Commission to reopen the rulemaking record with respect to the provisions requiring dealers to disclose known defects and provide all interested persons an opportunity to submit comments and rebuttal statements.<sup>267</sup> As a result of this review,

<sup>266</sup> For these reasons, the Commission rejected the alternative of issuing no rule.

<sup>267</sup> As stated earlier, the court's order was issued pursuant to a joint stipulation by the parties agreeing to an order remanding the rule to the Commission for reconsideration.

<sup>263</sup> See, e.g., Cooling-Off Period For Door-to-Door Sales, 16 CFR Part 429; Preservation of Consumers' Claims and Defenses (Holder-in-Due-Course), 16 CFR Part 433. See also *Arthur Murray Studio of Washington v. FTC*, 458 F.2d 622 (5th Cir. 1972); *All-State Industries, Inc. v. FTC*, 423 F.2d 423 (4th Cir.) cert. denied, 400 U.S. 828 (1970).

<sup>264</sup> Staff Report at 313 n. 122.

<sup>265</sup> *Id.* at 545 nn. 15 and 16.



the Commission has decided not to include a known defect disclosure requirement in the Rule, to make the warranty and "as is" disclosures on the Buyers Guide more prominent, and to make other minor adjustments to the Buyers Guide.

In reaching its decision, the Commission carefully analyzed the rulemaking record including the comments submitted during the recent comment and rebuttal periods to determine the potential effects of the known defects disclosure requirement, both intended and unintended. The Commission has concluded that the known defects disclosure requirement will not provide used car buyers with a reliable source of information concerning a car's mechanical condition and that the provision would be exceedingly difficult to enforce.

We believe that the warranty and "as is" disclosures—along with the warning about spoken promises and the pre-purchase inspection notice—are effective remedies for the deceptive practices occurring in the used car industry. The record provides solid support for the conclusion that the benefits of these remedies far outweigh their costs. The record does not support, however, a conclusion that the benefits of the defects disclosure requirement outweigh its costs. The Commission's reasons for promulgating a rule without the known defects disclosure provision are set forth below.

#### 1. The Reliability of Information Disclosed Under a Known Defects Disclosure Requirement

Any benefits from a known defects disclosure requirement depend on the extent to which dealers have detailed knowledge about the mechanical condition of the vehicles they sell and whether the dealer's knowledge of defects can be communicated in a way that will not be confusing to potential used car buyers.

*a. Dealer Knowledge of Defects.* In order to provide useful disclosures under the known defects disclosure requirement, dealers must have knowledge of specific defects. If dealers do not ordinarily possess knowledge about specific defects, they would only be able to discover such information through additional inspections. Inspections will be costly and will ultimately raise the price of used cars.<sup>268</sup>

<sup>268</sup> There is little agreement on exactly how costly these inspections might be. Compare Staff Report 213-29 (estimates range from a few dollars to \$600 or more) with HX-164(A) Table V-9 (Wisconsin dealers' estimates range between \$8.75 and \$50).

Therefore, in determining the costs and benefits of the known defect disclosure requirement, the issue of whether dealers ordinarily have knowledge about specific defects is an important one.

Despite the importance of this question, there is relatively little direct evidence that addresses it. The record does indicate that most experts and commenters agree that all dealers assess the *general* condition of the cars they sell and that individual dealers may examine cars thoroughly. However, even during the initial rulemaking proceeding there was disagreement concerning what the record reveals about the extent of the *average* dealer's knowledge of the condition of specific systems in his or her cars at the time of sale. The Presiding Officer concluded that:

In many instances, dealers themselves do not know the extent of defects present in a vehicle. To be sure, nothing in the record would indicate that dealers are regularly caught short, buying or taking in trade vehicles on which they have made major miscalculations on overall physical condition. The record supports the findings, however, that dealers may not have precise knowledge of all defects which are present in a vehicle.<sup>269</sup>

In 1981, the Commission disagreed with the Presiding Officer and concluded that, although the dealer inspection process is not perfect, dealers know of specific significant defects. This decision was based on the following inferences drawn from record evidence: (1) Dealers routinely inspect vehicles for defects; (2) dealers who purchase cars at auctions can and do inspect for defects after purchase and have an option to rescind or renegotiate the sale if they find sufficient problems with the vehicle; (3) when not purchasing at auction, the industry practice is to appraise a vehicle before purchase (usually through a visual inspection and road test) and (4) after purchase by dealers, additional defects are discovered during further inspections, appearance reconditioning, and repairs.<sup>270</sup> In addition, in 1981, the Commission relied on survey evidence indicating high levels of significant mechanical defects occurring within the first weeks of ownership and a decreasing frequency of defect discovery in subsequent periods.<sup>271</sup>

<sup>269</sup> Presiding Officer's Report at 91 (footnote omitted).

<sup>270</sup> 1981 Statement of Basis and Purpose. 46 FR 41328, 41342.

<sup>271</sup> *Id.* at 41337.

The Commission's current review of both the preexisting rulemaking record and the additional comments submitted during the present proceeding indicates that the conclusion that dealers ordinarily know about specific defects may well be incorrect and, in any event, is not supported by a preponderance of substantial reliable evidence.

First, careful inspections do not always reveal or predict mechanical problems that may occur shortly after the sale. Thus, there is little basis for inferring knowledge from the mere fact that failures occur after purchase. In Wisconsin, where dealers are required to inspect their cars and disclose the results of the inspection, one record study indicates that 51 percent of Wisconsin used car buyers ultimately repaired problems not known when they bought their cars.<sup>272</sup> These data are consistent with another record study which indicates 52.1 percent of Wisconsin consumers, who purchased cars after the Wisconsin law went into effect, discovered defects after the sale.<sup>273</sup> Moreover, in a comment supporting the "known defects" provision, Detroit II,<sup>274</sup> a company currently providing warranties for used cars, points out that even after cars are inspected for inclusion in their warranty program and all "known defects" are repaired, a survey of their buyers revealed that "slightly over 50% of them have some sort of mechanical problem within 45 days of the sale."<sup>275</sup> The Detroit II figures are within the range of the incidence of mechanical problems experienced by used car buyers generally.<sup>276</sup>

Second, dealer knowledge about general condition of a car does not necessarily mean that the dealer has knowledge of specific defects. Although there is evidence that dealers have a

<sup>272</sup> Table 16 of the Baseline Survey shows that 85 percent of Wisconsin consumers made repairs, but only 14 percent (Table 9) knew of problems when they bought the car. Thus, at least 51 percent (85 percent minus 14 percent) experienced unknown problems.

<sup>273</sup> Wisconsin Study HX 164(A) at Table IV-12.

<sup>274</sup> At the time Detroit II submitted its comment, approximately 20 dealers in Florida were participating in the Detroit II inspection/warranty program.

<sup>275</sup> XB-02 at 1 (The Detroit II Corporation, Inc.). Approximately five hundred cars were included in the survey. The reliability of the survey is uncertain because neither the survey questionnaire nor an explanation of the methods used to compile survey data was submitted with the comment.

<sup>276</sup> See Staff Report 46-48. In a national survey, about 34% of respondents reported that they experienced defects in used vehicles. About 50% of these occurred in the first month. HX-162(A) at 29 (National Analysts Study). In a local survey, 68.1% of used cars had defects that appear in the first 90 days after the sale. B-1 at 27 (Seattle Survey).



high degree of confidence in their ability to assess the general condition of a car through a walk-around examination and a test drive,<sup>277</sup> this general assessment of overall condition is probably sufficient to protect the dealer's interest only because most buyers are likely to perform no more than a similarly superficial examination.<sup>278</sup> Moreover, the dealer's evaluation is likely to focus on the cost of appearance reconditioning or detailing because, as the record indicates, many consumers believe that a "good looking" car is also mechanically sound.<sup>279</sup> There is, however, no evidence that such measures are ordinarily adequate to reveal specific mechanical defects.<sup>280</sup>

Third, although the record contains anecdotal evidence indicating that dealers know about specific defects, other record evidence supports the conclusion that most dealers do not have knowledge of specific defects. Indeed, the record contains extensive testimony from dealers and vocational educational instructors that the inspection process is uncertain and imperfect.<sup>281</sup>

Even though the utility of a "known defects" disclosure depends on dealers having system-by-system information about the cars they sell, the provision gives dealers little incentive to inspect their cars. Under the provision, honest dealers who learn of defects must reveal their knowledge on the disclosure portion of the window sticker, whereas

dealers who avoid gaining this knowledge may honestly leave the sticker blank. Disclosing "known defects" calls attention to the car's problems, but does not reward the dealer's integrity for revealing these problems. Thus, a dealer who regularly inspects and honestly discloses all "known defects" may be put at a competitive disadvantage relative to dealers who do not inspect. This factor may then have the unintended and perverse effect of discouraging, rather than encouraging, inspections and disclosure of defects.

#### *b. Buyer Knowledge Under the Defects Disclosure Provision*

The known defects provision was intended to improve a potential buyer's knowledge of a used car's condition by providing information about certain major defects known to the dealer. Based on its conclusion that dealers usually know about the condition of specific systems in the used automobiles they sell, in 1981 the Commission believed that dealer disclosure of major defects would enable consumers to assess more accurately the true cost of ownership, i.e., purchase price plus repair costs for defects. The Commission expected that more accurate knowledge about the true condition of the car would reduce consumer injury resulting from unanticipated repair costs and that such defect information would increase bargaining for desired warranty coverage and the price on a car of known condition.

As stated above, the Commission cannot now conclude from its review of the rulemaking record that dealers generally possess system-by-system knowledge of the cars they sell. This major deficiency in the evidentiary foundation for the known defects disclosure provision casts serious doubt on the effectiveness of this provision as a means of providing information about specific defects to consumers. Another major deficiency in the evidentiary basis for the "known defects" disclosure requirement is that the record surveys, which often provide the best evidence of the effectiveness of a rule provision, do not provide clearcut evidence that a defect disclosure requirement would improve consumers' knowledge of defects. Moreover, the Commission fears that the defect disclosure requirement may confuse consumers and thus cause them to base their purchasing decisions on inaccurate information.

Two record surveys present data that could be used to predict the effectiveness of the "known defects"

disclosure provision. These surveys produced data showing the effects of the Wisconsin mandatory disclosure law which, at the time both studies were conducted, required dealers to inspect each vehicle in a specified manner, make safety repairs, and provide the inspection results to the purchaser prior to signing the sales contract.<sup>282</sup> One of the surveys was submitted to the Commission in 1977 and was considered by the Commission in promulgating the August 1981 Rule. The report on the survey was referred to in the August 1981 Statement of Basis and Purpose as the Wisconsin Study.<sup>283</sup>

The Wisconsin Study was designed to examine the effects of the Wisconsin mandatory inspection/disclosure law. In the study prepared by the Center for Public Representation, Madison, Wisconsin, a consumer questionnaire was sent to over 5,000 purchasers of used vehicles in Wisconsin, Iowa, and Minnesota. One thousand five hundred fifty five consumers responded to the survey. A survey questionnaire was also directed to more than 5,000 used vehicle dealers in Wisconsin and interviews, with written follow-up, were carried out with members of the Dealer Inspection Unit of the Wisconsin Motor Vehicle Department which is responsible for enforcing Wisconsin regulations.

The three states included in the study were chosen because of the differences in their regulatory systems. In 1972, Wisconsin's Division of Motor Vehicles promulgated an administrative regulation, MVD 24, which requires that all used motor vehicle dealers perform a walk around and under-the-hood inspection of each car they intend to sell at retail and record their findings on a disclosure statement.<sup>284</sup> In addition, dealers are required to repair designated safety items determined to be "not OK." Iowa, since 1972, has required that every motor vehicle pass a safety inspection before operational title can be passed.<sup>285</sup> A car not passing inspection can still be sold, but the buyer owns it by a restricted title and cannot drive the vehicle until the safety inspection has been passed. In contrast to Wisconsin and Iowa, Minnesota does not require

<sup>277</sup> Staff Report 77: HX-164(A) at 46 and Table V-7 (The Wisconsin Study).

<sup>278</sup> Staff Report at 83-87.

<sup>279</sup> Staff Report at 99.

<sup>280</sup> One record study presented survey evidence suggesting that dealers fail to disclose known defects when such information is provided by prospective buyers. The California Public Interest Research Group (CALPIRG) undertook a survey that tested for the degree of known mechanical defect disclosure by dealers to consumers. The survey used trained test shoppers who participated in actual sales transactions up to the point of determining what disclosures were made. After a test car was taken from the dealer's lot to a diagnostic center for inspection, the test shopper returned the car with a copy of the diagnostic report and discussed the report with the salesperson. The test shoppers then broke off negotiations. A second test shopper returned on a follow-up visit to determine whether the results of the diagnosis were disclosed to the new prospective buyers. CALPIRG reports that, in 75 of the 101 completed tests, the follow-up purchaser did not receive defect information that had been provided to the dealer. In 47 of these 75 cases of non-disclosure, the second test shopper dealt with the same salesman who had been given the diagnostic results by the first test shopper.

Although these data suggests that, when told about defects, dealers fail to disclose this information to consumers, no inference can be drawn from these data concerning the extent to which dealers generally know about specific defects.

<sup>281</sup> Staff Report at 46-53.

<sup>282</sup> The law also required a window sticker disclosing warranty terms and defining "as is". In 1983 the law was amended to require that inspection results be disclosed on a window sticker along with warranty information.

<sup>283</sup> An investigation of the Retail Used Motor Vehicle Market: An Evaluation of Disclosure and Regulation, Center for Public Representation, HX, 164(A).

<sup>284</sup> Staff Report at 19-23.

<sup>285</sup> *Id.*

dealer disclosure, nor does it have any kind of safety inspection system.<sup>286</sup>

The other survey, entitled "A Report On A National Survey Private Buyers and Sellers of Used Automobiles" was submitted to the Commission in September 1987. Consequently, it was not considered in promulgating the 1981 Rule. This report presented data that was developed from responses to a national telephone survey of private buyers and sellers of used automobiles. The survey was conducted to provide baseline data for a future evaluation of the impact of the rule on the used car market. Transactions for the state of Wisconsin were oversampled so that Wisconsin could serve as a control. In total, 312 interviews were conducted for Wisconsin and 1,431 interviews were conducted for the rest of the country. The survey was performed by a private contractor, the Bureau of Social Science Research, pursuant to a 1978 contract with the FTC's Bureau of Consumer Protection. The data for the survey was collected from October 1979 to February 1980. We will refer to this survey as the Baseline Survey (BLS).

When the Commission promulgated the Rule in 1981, it cited data from the Wisconsin Study suggesting that the Wisconsin law increased overall consumer awareness of defects prior to purchase and that the law made it more likely that consumers would receive defect information from the dealer. However, contradictions in the data presented in the Wisconsin Study become apparent upon close review. On the one hand, the data show some increase in the percentage of post-law buyers who knew about defects before the sale and those who received pre-purchase defect information from dealers.<sup>287</sup> On the other hand, data from the study shows that more consumers in Minnesota (a state with no defect disclosure requirement) reported

awareness of defects prior to sale than consumers in post-law Wisconsin.<sup>288</sup>

Finally, the data in the Wisconsin Study do not show that the Wisconsin defect disclosure requirement made it more likely that consumers would receive the information they felt they needed concerning the car's mechanical condition. Approximately 32 percent of pre-law consumers reported that they lacked needed information on the car's mechanical condition. This percentage decreased only slightly for post-law consumers (28.52 percent).<sup>289</sup> Moreover, there was essentially no difference in the percentage of pre-law and post-law consumers reporting that the dealer gave them accurate information on the mechanical condition of the car they purchased (62.6 percent vs 62.8 percent).<sup>290</sup>

Given the contradictions in the data presented in the Wisconsin Study, the Commission believes that the study is inconclusive with respect to the issue of whether a defect disclosure requirement would increase consumers' awareness of defects.<sup>291</sup> The inconclusive nature of the Wisconsin data tends to indicate that the Wisconsin defect disclosure requirement did not have a strong effect on consumers' knowledge of defects. Such a finding supports the Commission's decision to promulgate the Rule without this provision.

The Baseline Survey provides even more compelling reasons to eliminate the known defect disclosure provision from the Rule. Taken as a whole, the BLS data suggest that the expected beneficial effects of a defect disclosure requirement were not achieved in Wisconsin.<sup>292</sup> On the other hand, the

BLS data do show expected beneficial effects of the warranty disclosures required by the Wisconsin law.<sup>293</sup>

Although the report on the Baseline Survey presents statistics separately for Wisconsin and the rest of the country, the report does not test or elaborate on any differences between the values of the same statistic in the two regions. In the following discussion of the Baseline Survey we will discuss some of those differences and their significance. Even though such comparisons were not made in the survey report, there is nothing in the method of collecting the data that

law required only that dealers present a defect disclosure statement to consumers before signing the contract. Therefore, it could be argued that the Baseline Survey data showing the effects of the Wisconsin defect disclosure requirement should not be compared to the known defects disclosure provision because schemes used by dealers to prevent consumers from reading the defect disclosure are likely to work in Wisconsin but are unlikely to work when the defect disclosures must be placed on the car.

Although the comparison is not perfect, the Commission believes that studies of disclosures in different formats can provide useful information regarding the likely effect of the rule. Because the Baseline data reflect knowledge at the time of sale, and disclosure in Wisconsin occurs before the sale is concluded, the Wisconsin experience provides a reasonable assessment of the value of presale disclosure. Moreover, if we accept the argument that studies of the effectiveness of a law requiring defect disclosures prior to signing the sales contract have no relationship to the effectiveness of defect disclosures on a car's window sticker, then there is no empirical evidence in the record showing the likely effect of such a window sticker disclosure. Given the other significant problems with the defect disclosure requirement discussed in Section IV A of this Statement, the absence of such evidence would support our decision to promulgate a rule without a defect disclosure provision.

<sup>293</sup> An important purpose of a warranty disclosure is to make consumers aware of warranty coverage at a point when they can use this information in their purchasing decisions. Although the sample sizes are small, the Baseline Survey suggests that the Wisconsin warranty/as is disclosure accomplishes this purpose. About the same percentage of Wisconsin consumers (34 percent) as non-Wisconsin (35 percent) consumers learned of the warranty "while thinking about the car". Wisconsin consumers, however, were more likely to learn of the warranty "while negotiating" (58 percent vs 41 percent). Moreover, a higher percentage of non-Wisconsin consumers learned of the warranty late in the transaction. Table 12 shows that twenty percent of non-Wisconsin consumers learned of the warranty "when signing" the sales contract while only 5 percent of Wisconsin consumers learned of the warranty this late in the transaction.

The Baseline Survey also suggests that Wisconsin consumers had a better understanding of the dealer's post-sale repair responsibilities than non-Wisconsin consumers. This effect is shown in Table 15, Part B by the fact that Wisconsin dealers were more likely to correct post-sale problems when their customers thought the dealer should pay. Seventy-eight percent of consumers who brought their cars back to the dealer in Wisconsin reported that the dealer corrected or helped pay for the problem. Sixty-nine percent of non-Wisconsin consumers who brought their cars back to the dealer actually obtained repairs from the dealer.

<sup>288</sup> HX 164(A) at Table IV-12. This table indicates that 38.7 percent of Wisconsin post-law consumers who bought from dealers were aware of defects prior to purchase, whereas 40.7 percent of Minnesota consumers buying from dealers knew about defects prior to purchase.

<sup>289</sup> Wisconsin Study HX 164(A), Table IV-2.

<sup>290</sup> *Id.* Table IV-3.

<sup>291</sup> The Wisconsin data also indicated that prices paid by Wisconsin consumers who purchased from dealers fell by 8.73 percent after the Wisconsin inspection/disclosure law went into effect. The authors of the study stated that these apparent savings should not be considered as benefits of the Wisconsin law for three reasons. First, they could not be sure that price shifts were attributable to the Wisconsin law. Second, they were concerned that the price drop may have been a short run phenomenon. Third, they felt that, even if price changes were caused by the Wisconsin law and are permanent, they should not be treated as net increases in the welfare of Wisconsin consumers. In their view, the drop in price not only makes a used vehicle less expensive to buy, it also makes the existing stock of vehicles less valuable. Thus, the price decline reduced the trade-in value of used vehicles, causing welfare losses to some consumers.

<sup>292</sup> The August 1981 Rule required disclosure of defects on the window sticker. However, at the time the Baseline Survey was conducted, the Wisconsin

<sup>286</sup> *Id.*

<sup>287</sup> As noted in August 1981 Statement of Basis and Purpose:

The Wisconsin Study indicates that 28.1 percent of pre-law buyers who bought from dealers were aware of defects prior to purchase. This percentage increased to 38.7 percent among those who purchased from dealers following passage of the mandatory inspection law. HX 164(A) at Table IV-12. This increase in defect awareness was accompanied by an increase in the number of buyers who stated that their knowledge of defects came from information supplied by the dealer. In the Wisconsin Study, 1 percent of pre-law respondents said that they learned of defects before purchase from dealers. In the post-law sample, 9 percent said they learned of defects before purchase from dealers. Computed from data in HX 164(A).

46 FR 41342 (1981).

would make comparisons between the two subpopulations inappropriate. The sample sizes in the subpopulations of Wisconsin consumers are large enough to permit valid statistical conclusions to be drawn by comparing data from Wisconsin consumers with data from non-Wisconsin consumers.

In comparing the value of a simple statistic (such as an average or a proportion responding in a particular way) for Wisconsin with its value for the rest of the country, it is, in general, incorrect to attribute all of the difference to the Wisconsin used car law. Nevertheless, it is important to know whether any differences exist. A finding of no difference in consumer experiences with used car transactions where strong remedies are present casts doubt on the effectiveness of such remedies.

The Baseline Survey suggests that the Wisconsin defect disclosure requirement has not increased the amount of information consumers receive about the mechanical condition of a used car. Fourteen percent of Wisconsin consumers, compared to 15 percent in the rest of the country, know about a problem with the car before purchase. Of those who knew about a defect, the percentage of non-Wisconsin consumers reporting that mechanical problems were disclosed by the dealer (24 percent) is higher than the percentage of Wisconsin consumers reporting defect disclosures from the dealer (20 percent), although the difference is not statistically significant.<sup>294</sup> Thus, 3 percent of Wisconsin consumers responding to the survey learned of a defect from the dealer, compared to 4 percent of consumers elsewhere.<sup>295</sup>

The BLS also suggests that the Wisconsin defect disclosure requirement did not improve consumers' ability to predict future repair costs. For problems known at the time of purchase, Table 14 of the BLS indicates that consumers outside of Wisconsin were just as likely to consider repair costs to be about what they expected as Wisconsin consumers. Moreover, Wisconsin consumers are no more likely than others to be "very satisfied" with their

purchase (62 percent in Wisconsin, 63 percent elsewhere), and are slightly more likely to be "very dissatisfied," (12 percent vs 5 percent) (Table 19 A).<sup>296</sup> They also give their cars slightly lower ratings on overall mechanical condition and body and interior condition (Table 19, B and C), although only the difference in mechanical condition rating is statistically significant.

As Table 16 indicates, a higher percentage of Wisconsin consumers (65 percent) than non-Wisconsin consumers (60 percent) had repairs performed after the sale. If all problems known at the time of purchase are later repaired, then 51 percent of Wisconsin consumers fixed problems that were not known when they bought the car, compared to 46 percent of non-Wisconsin consumers.<sup>297</sup> These data are quite consistent with the Detroit II comment indicating that a large percentage of cars experience mechanical problems even after inspection and repair.<sup>298</sup>

In sum, the data compiled in the Baseline Survey generally show that some of the expected benefits of the Wisconsin warranty disclosure requirement were observed in Wisconsin, but the data do not show that the law's defect disclosure requirement had achieved beneficial results. This difference in the warranty disclosure data compared to the data relating to defect disclosures generally supports the Commission's view that the beneficial effects of a defect disclosure requirement in the Used Motor Vehicle

Rule are questionable. No one comparison of Wisconsin and the rest of the country compels this conclusion. Nonetheless, in our view, the overall pattern of results supports our decision to promulgate a Rule without the "known defects" disclosure provisions.

The fact that the data compiled in the Baseline Survey generally do not show that the Wisconsin defect disclosure has achieved beneficial results and that the data in the Wisconsin Study is inconclusive on this point, must be considered as strong evidence supporting the Commission's decision to promulgate a Rule without the known defect disclosure requirement. The Commission is particularly concerned about the reliability of defect disclosures from dealers and the enforceability of a provision requiring such disclosures. Given these concerns, the lack of survey data showing significant benefits for defect disclosures confirms the Commission's belief that requiring such disclosures will not serve the public interest.

In addition to our serious questions concerning the effectiveness of a defect disclosure provision in making consumers aware of defects prior to purchase, we are equally concerned that the defect disclosure provision included in the 1981 Rule may confuse consumers and cause them to make inaccurate assumptions about the condition of a car after reading the defect disclosure. In cases in which the dealer knew of defects in the car, the provision was intended to result in disclosure of that information to potential buyers. However, in many cases dealers might not inspect or might not discover existing defects. In these cases, the "known defect" disclosure portion of the sticker would be left blank. Disclosure, therefore, might be the source of substantial confusion because the absence of disclosed defects does not necessarily mean that none exists.<sup>299</sup> These concerns are particularly significant given the conclusion that in Wisconsin, most buyers do not learn of defects from the dealer.

Unfortunately, there are at least five separate circumstances in which the dealer could list "no known defects": (1) A dealer inspects and accurately determines that no defect exists; (2) a dealer inspects but fails to discover a

<sup>294</sup> Baseline Survey, Table 9.

<sup>295</sup> Table 9 of the Baseline Survey shows that 14 percent of Wisconsin consumers were aware of mechanical defects before they bought their used cars. Twenty four percent of these consumers reported that they learned of mechanical problems from the dealer. Therefore, 3 percent of all Wisconsin consumers responding to the survey learned of mechanical problems from the dealer (20 percent of the 14 percent who knew about defects). Likewise, 4 percent of all consumer respondents in the rest of the country learned of mechanical problems from the dealer (24 percent of the 15 percent who knew about defects).

<sup>296</sup> The difference in the proportion who are "very dissatisfied" is statistically significant. Consumer satisfaction is a good measure of the effectiveness of a defect disclosure remedy because the occurrence of major unknown problems after the sale is likely to have a significant effect on a consumer's level of satisfaction. Whether defect disclosures merely make consumers aware of the condition of a car, or induce dealers to make repairs or improve warranty coverage, consumer satisfaction should improve as a result. Consequently, it is reasonable to expect that consumer satisfaction would be significantly lower in states without a defect disclosure requirement compared to Wisconsin where dealers are required to inspect their cars and disclose major defects, if defect disclosure benefits consumers.

<sup>297</sup> For Wisconsin consumers, 65 percent made repairs (Table 16), but only 14 percent (Table 9) knew of the problems when they bought the car. Thus, 51 percent (65 percent minus 14 percent) experienced unknown problems.

Survey data indicate that 83 percent of Wisconsin consumers repair defects known at the time of sale, compared to 71 percent in the rest of the country. Adjusting for this factor, 53 percent of Wisconsin consumers fixed problems not known at the time of sale, compared to 49 percent elsewhere. If the same fraction of problems discovered after sale are repaired, then 64 percent of Wisconsin consumers (53 percent divided by 83 percent) experienced a problem after sale, compared to 69 percent in the rest of the country (49 percent divided by 71 percent).

<sup>298</sup> XB-02 (The Detroit II Corporation, Inc.).

<sup>299</sup> The "known defects" disclosure provision had no mechanism by which a system could be declared defect-free. A dealer could assure consumers that a system is "OK" by providing a warranty for the system. Although the warranty disclosure provision of the Rule facilitates the dealer's offering this assurance, a known defects provision would not help the buyer in this case.

defect that does exist; (3) a dealer does not inspect and a defect exists; (4) a dealer does not inspect and there is no defect; and (5) a dishonest dealer does not reveal a known defect.<sup>300</sup>

Thus, a buyer relying on the absence of a disclosure of a known defect may incorrectly assume that no defect exists, when in fact the buyer would only know that the seller had claimed no knowledge of a defect. The disclosure that the dealer is not aware of any defects in a car provides no information about the actual existence of an undiscovered or latent defect. Thus, buyers may not only be getting no useful information about a car's condition, but may be affirmatively harmed by mistakenly inferring that the dealer's lack of knowledge about defects means that no defects exist.<sup>301</sup> Unscrupulous dealers or salespersons could easily exploit the likelihood that consumers will mistake the absence of a disclosure for a claim that the car is of high quality. For example, dealers might highlight that there are no "known defects" in the car or argue that the requirement to disclose known defects makes an independent inspection unnecessary—"If we knew of any problems, we'd have to tell you about them."<sup>302</sup>

The danger that buyers may mistake a claim of "no known defects" for a claim about the car's overall quality or about its freedom from specific defects is especially great if the car is sold "as is." In fact, a "common abuse" identified in the original rulemaking record with respect to warranties was oral misrepresentations by dealers exploiting buyer confusion about their legal rights in "as is" sales.<sup>303</sup> If the "known defects" provision is retained, dealers selling "as is" cars could easily use the absence of disclosed defects in an effort to assure buyers that, because the car contains no "known defects", the "as is" warning is irrelevant. In addition, buyers may be further confused by incorrectly assuming that a dealer's

disclosure of no known defects satisfies the window sticker's admonition to get "all promises in writing".

In view of the extensive evidence of dealer misrepresentations concerning the mechanical condition of their cars coupled with the likelihood that defect disclosures would be confusing to consumers or even be used to facilitate dealer misrepresentations, the Commission believes that a known defect disclosure will not serve the public interest. It gives the wrong signal to consumers by encouraging them to focus their attention on dealer-controlled information about a car's mechanical condition. In contrast, the warranty disclosure requirements, the warning about spoken promises and the pre-purchase inspection notice encourage consumers to avoid reliance on dealer-controlled information about a car's mechanical condition. The presence of the defect disclosure requirement on the Buyers Guide is confusing and likely to undermine the effectiveness of the essential protections afforded by the rule.

## 2. Enforceability

Another major reason for promulgating a Rule without the known defects disclosure requirement is the enforcement problems this provision would present. In order to establish a violation of the "known defects" provision it would be necessary to prove that (1) the car is defective, (2) the defect was present at the time of sale, and (3) the dealer (or the dealer's agent or employee) knew about the defect at the time of sale. The "knowledge" element may be proved by showing that the dealer had obtained "facts or information about the condition of [the] vehicle \* \* \* which would lead a reasonable person under the circumstances to conclude that the car contained one or more of the defects [enumerated in the rule]."<sup>304</sup>

Unlike some other rules, a Rule with a "known defects" disclosure provision is not self-enforcing.<sup>305</sup> Rather, dealers would have every incentive to avoid inspecting their cars as well as to avoid disclosing defects if any are found. Indeed, the more prevalent are disclosures by other dealers in the marketplace, the more incentive any individual dealer would have *not* to

disclose defects in his or her cars. When many dealers inspect and make honest disclosures, consumers, are even more likely to infer that lack of a disclosure implies "no defect." Thus when inspections are prevalent, dealers can benefit by failing to reveal the true condition of their cars.<sup>306</sup> Given the lack of any self-enforcing mechanism, the level of compliance with the "known defects" disclosure provision would depend wholly on the degree of the FTC's enforcement presence in the marketplace. This is particularly troubling because enforcement of this provision is likely to be quite difficult.

First, our means of targeting potential violators are seriously flawed because unknown defects frequently show up in cars soon after sale. The data discussed above indicate that a majority of buyers experience problems after sale that were not known at the time of sale.<sup>307</sup> Thus, cars sold by the average dealer may have many undisclosed and, indeed, unknown defects that surface following sale. Because the number of latent defects may vary considerably, an "unlucky" but honest dealer may have undisclosed defects that appear at an even higher rate. Thus, the prevalence of complaints would not provide an accurate gauge for targeting our enforcement efforts.

The only enforcement technique that avoids these problems is the use of "test shoppers". One "shopper" would approach a dealer as a potential buyer, receive permission to take a car to a diagnostic center for inspection, return the car to the dealer and discuss the inspection report with the salesperson. A second "shopper" would subsequently return to the dealer to determine whether defects included in the inspection report were being disclosed to new prospective buyers. However, such an enforcement mechanism would be both costly and intrusive. Moreover, it relies on the reliability and consistency of opinion among mechanics, an issue about which there is some doubt.<sup>308</sup> Finally, holding dealers

<sup>300</sup> A dishonest dealer may reveal another, more minor defect to give the appearance of honesty.

<sup>301</sup> The "known defects" disclosure in the 1981 Rule contained a warning that the absence of a disclosed defect does not necessarily mean that the car is free from defects. However, there is no evidence that this warning would be effective. For example, a consumer comparing a car with a disclosed defect and car with an undisclosed defect may find the inference that the car with no disclosed defect was in better condition irresistible despite the warning.

<sup>302</sup> The Commission expects that dealers will use the warranty disclosure portion of the window sticker as a sales tool. We can hardly expect this use to be confined to one portion of the sticker, however.

<sup>303</sup> 1981 Statement of Basis and Purpose 46 FR at 41333 (1981); Staff Report 275-77, 286-87; Presiding Officer's Report 46-47, 125.

<sup>304</sup> 1981 Rule 455.2(c).

<sup>305</sup> We have noted previously that auction facilities have rules that allow dealers to rescind or renegotiate the sale, if the dealer purchasing the vehicle finds major problems. This right to rescind or renegotiate the sale is a self-enforcing remedy in that it allows the buyers and sellers at auctions to settle their differences without the need for a third party intervenor.

<sup>306</sup> See XB-21 at 33 (NADA) and XB-22 at 24 (NIADA) for dealers' arguments on this point.

<sup>307</sup> Baseline Study at Tables 9 and 16; XB-02 at 1 (The Detroit II Corporation, Inc.). See discussion in Section IV. A.1.b. *supra*.

<sup>308</sup> A study done by the California Public Interest Group (CALPIRG) demonstrates the extent to which mechanics can differ. Part of the CALPIRG plan was to take used cars to a diagnostic center to obtain reports on their condition. Before doing this, CALPIRG compared diagnostic centers to determine their reliability. The results of this comparison demonstrates the inconsistency of mechanics in noting defects:

Continued

liable for failure to disclose defects brought to their attention by test shoppers places a continual burden on dealers to update their disclosure forms whenever a potential buyer alleges a problem. This would substantially increase the costs of the provision, possibly even requiring dealers to remove previously inspected cars from sale until the allegations of a defect could be verified and the form updated.

Second, even if we were able to identify potential targets, the standards set forth in the "known defects" provision are sufficiently ambiguous that winning a contested enforcement action would be extremely difficult. For example, the "known defects" disclosure provision would have required disclosure of a defect for "oil leakage excluding normal seepage." The use of terms such as "abnormal" and "improper" in the criteria for determining whether a system has a major known defect imply that it is up to the dealer to determine when along a continuum the presence of a particular condition becomes a defect.<sup>309</sup> Such

We found that while there is some consistency amongst diagnosticians who are checking the same car—it is frequently weak. For example, out of the total problems noted by one or more of the diagnosticians for the three cars, which had undergone six diagnoses each, there was only one instance in which even five out of the six diagnosticians noted the same problem (a worn front tire). There were only four problems which four of these diagnosticians commonly noted (bad wiper blades, cracked windshield, inoperative backup lights, and poor brake condition). Three of the six diagnosticians agreed upon 12 other problems with these vehicles.

There were 15 problems out of 63 which at least two of the six diagnosticians noted. The remaining 31 problems uncovered by only one of the six diagnosticians were not confirmed by any of the others.

Out of the 36 total problems noted by the diagnosticians for the two cars which had been taken for five diagnoses each, there was one instance when all five diagnosticians agreed that a common problem existed (a dirty air filter). There were only three other instances in which four of the diagnosticians noted a common problem (bad tailpipe, leaking valve cover, bad gas filter), and five in which only three of the five did so. At least two of the five commonly noted 13 different problems, while 14 of the 36 problems noted in two cars had been mentioned by only one diagnostician and not confirmed by any of the other four.

The charts show instances where one diagnostician indicates that a brake job will be necessary in the near future, another says it is necessary immediately, and a third one indicates that the brakes have another 5,000 miles of lining left. In another case, two diagnosticians indicate that a left rear axle seal is leaking, while a third one notes that it is the right rear axle seal that should be replaced.

HX 82 at 6.

<sup>309</sup> Eight of the twenty-four defect criteria included in the August 1981 Rule used relative terms such as "abnormal" and "improper." See 1981 Rule, 16 CFR 455.6 (1982).

ambiguities would make compliance with the provision difficult and were a major focal point for dealer's complaints about the provision.<sup>310</sup> These same ambiguities, however, will also make winning a contested enforcement action very difficult.

Even if we were to meet the burden of establishing that a car is defective, we would still be required to prove that the defect existed at time of sale. This again is a formidable task since the appearance of a defect shortly after the sale does not imply that the defect existed prior to sale. New mechanical problems may develop and latent defects may appear at any time.<sup>311</sup> Although the August 1981 Rule would have prohibited dealers from considering a car's age in determining whether a defect exists, this standard is clearly unrealistic for certain categories of problems.<sup>312</sup> Further, because certain conditions occur naturally as a car ages, it is difficult, if not impossible, to determine reliably at what point such a condition becomes a "defect." Additionally, mechanics may disagree about what constitutes a defect or whether a defect in fact exists.<sup>313</sup>

There could also be a serious problem in proving that a dealer had knowledge of a defect. There is no recordkeeping requirement accompanying this provision and, even if one were added, the dealer's incentives to comply would be problematic. Absent records of dealer inspections, the Commission would be forced to either limit enforcement actions to blatant defects—such as body rust or bald tires—that develop over long periods of time, or prove cases based on constructive knowledge. In proving constructive knowledge we risk the evolution of the "actual knowledge" standard into a "should have known" standard. However, with a "should have known" standard, we risk the "known defects" disclosure requirement, in effect, becoming a mandatory inspection requirement.<sup>314</sup>

<sup>310</sup> See Staff's Summary of Comments in Response to the Dec. 18, 1983 Comment Period and the March 2, 1984 Rebuttal Period at 43–44, & nn. 146, 148.

<sup>311</sup> See discussion in Section IV.A.1.a. *supra*.

<sup>312</sup> See XB–23 at 16, American Car Rental Association.

<sup>313</sup> See n. 308 *supra*.

<sup>314</sup> Because the Rule requires that the form be made part of the sales contract by reference, consumers may litigate provisions of the Rule in private disputes. Thus, even if the FTC were to conduct its enforcement activities in ways that assiduously sought to avoid the development of a "should have known" standard, such a standard might have evolved through private litigation.

Finally, the Commission notes the problems of proof in its cases alleging defects in new automobiles. In most of these cases there have been thousands of vehicles with the relevant manufacturing defect, manufacturers have had regular reporting systems to identify problems, and engineering analyses have been able to establish the cause of the problem. Even so, establishing a manufacturer's knowledge of a defect has been one of the most difficult aspects of these cases. Establishing that an *individual* used car dealer has knowledge of a *particular* defect in a series of sales of *individual* cars of different makes, models and ages would be a very difficult, resource-intensive undertaking.

In sum, the vague terms used to define defects and the formidable evidentiary barriers created by the need to establish dealer knowledge of defects would severely limit the Commission's ability to enforce the "known defects" disclosure provision. In the Commission's judgment, such a use of its resources would be inappropriate, particularly in comparison to other enforcement priorities. Moreover, the Commission believes it is inappropriate, and likely to undermine respect for the law in general and the Commission's rules in particular, to promulgate rules where enforcement will necessarily be problematic at best.

The Commission stated in the August 1981 Statement of Basis and Purpose that it expected dealers to comply with the defect disclosure requirement since failure to comply with the requirement might be enforced by a fine of up to \$10,000 for each violation. In addition, the Commission relied on findings presented in a record survey (the Wisconsin study) showing that, under Wisconsin's mandatory inspection-disclosure law, more consumers were aware of defects prior to purchase and the percentage of buyers receiving pre-purchase defect information from dealers increased after the Wisconsin law went into effect.<sup>315</sup>

The threat of fines may or may not be sufficient to assure some compliance with the rule, but we can be reasonably assured that full compliance is far from guaranteed and that compliance by the "bad actors" in the industry is questionable at best. The effectiveness of fines in achieving compliance is affected substantially by two factors: First the ability of the regulated industry to bring its practices into compliance with the rule, and second, the regulated industry's perception of the likelihood of

<sup>315</sup> See n. 287 *supra*.

punishment. As we discussed earlier in this statement, the Commission is very concerned about the ability of the industry to understand its obligations under the "known defects" provision. The Commission is even more concerned about its ability to enforce this provision. The ambiguity which, of necessity, characterized dealer obligations under the known defects disclosure provision would make it difficult for dealers to comply with the rule or, at least, to know whether they are in compliance with the rule even when they take steps to comply. In addition, the difficulties inherent in bringing even a single case to court under a "known defects" standard is likely to make rule enforcement, at best, sporadic. As consequence, it is not at all clear that fines will produce anything more than perfunctory compliance with the rule.

Finally, the Commission does not believe the Wisconsin Study provides a good basis upon which to assess dealer compliance with the "known defects" disclosure provision. Given the inconclusive nature of the Wisconsin data, the Commission does not believe the data support a prediction of substantial dealer compliance. Moreover, the Baseline Survey indicates that whatever levels of compliance have been achieved have not significantly benefitted consumers.<sup>316</sup>

#### 4. Alternatives to the Known Defects Disclosure Requirement

During the course of the review proceeding held pursuant to the court remand order in *Miller Motor Car, supra*, the Commission has considered several alternatives to the known defects disclosure requirement. The Commission considered, first, whether changes could be made to this provision to resolve the significant problems discussed in detail above. The Commission also reevaluated the mandatory and optional inspection provisions that were considered as alternatives to the known defect disclosure requirement when the Commission issued the August 1981 Statement of Basis and Purpose. The Commission, however, has determined that neither approach is preferable to simply promulgating a rule without the known defects disclosure requirement.

#### 5. Modifications to the Known Defect Disclosure Requirement

<sup>316</sup> See Section IV.A.1.b *supra*.

The known defects disclosure requirement could be modified to reduce the likelihood that disclosure would cause dealers to incur additional inspection costs. These changes could clarify or eliminate some of the relative terms used in the defect criteria and more clearly define the "reasonable person" standard. However, even if the known defects disclosure provision could be made so clear that dealers would disclose known defects without incurring additional inspection costs, the provision would not, in the Commission's view, provide significant benefits to consumers.

The Commission believes that any disclosure remedy that encourages consumers to rely on dealer-provided information about a car's mechanical condition undermines other more important disclosures required by the Rule. The warranty disclosures, the spoken promises warning, and the pre-purchase inspection notice are intended to signal that consumers should not rely on the dealer for information about a car's mechanical condition. This message is critical because the rulemaking record shows that many dealers misrepresent the condition of the cars they sell. On the other hand,

encouraging consumers to rely on disclosures from the dealer to determine a car's mechanical condition presents a confusing and contradictory message that may itself (or with the aid of a shrewd dealer) dissuade consumers from shopping for the best warranty terms or obtaining independent inspections. Therefore, although it may be possible to modify the known defect disclosure provision to make its defect standards more precise and limit the standard for determining the dealer's knowledge of a defect, this alternative would still undermine the effectiveness of more important disclosures on the window sticker.

Additionally, enforcement of the rule could arguably be enhanced by requiring dealers to maintain records of inspections when they inspect cars.

However, such recordkeeping requirements are not likely to be followed by dealers inclined to break the law, and can only serve to discourage dealers from inspecting their cars prior to sale. Consequently, the Commission does not believe that modifying the known defect disclosure provision is a viable alternative.

#### B. Mandatory Inspection

In August 1981, the Commission considered and rejected a requirement that dealers inspect their cars and disclose the results of the inspection.<sup>317</sup> The Commission again rejects the mandatory inspection alternative. In addition, some of the reasons stated above for eliminating the known defect disclosure provisions apply with equal force to the mandatory inspection requirement.

The mandatory disclosure provision would have involved a checklist in which each major mechanical system was to be checked "OK" or "NOT OK," together with an indication of the reason for any "NOT OK" checks. Dealers would have been required to follow a specified inspection protocol when performing inspections.

This approach was proposed by staff in a 1978 Staff Report to address the problem of dealer misrepresentation of mechanical condition directly. Under this alternative, buyers would have had a specified number of days to report any problems with "OK" systems, and, during the period to report problems, dealers would be responsible for repairing any defects in these systems.

Industry members expressed concern about the increased post-sale liability that would be incurred by dealers who checked systems "OK."<sup>318</sup> In addition, because "OK" checks in effect created warranties under state law, some industry members questioned whether a rule that required dealers to inspect and check "OK" where appropriate would contravene the intent of Congress expressed in 102(b)(2) of the Magnuson-Moss Warranty Act, which explicitly prohibits the Commission from mandating warranties.<sup>319</sup>

There was also concern by dealers and dealer organizations that dealers' cost of operation would increase under a mandatory plan;<sup>320</sup> that is, that

<sup>317</sup> The determination occurred at a Commission meeting held on October 11, 1979.

<sup>318</sup> See NIADA, S-739, at 44, 88, 101; Wilkerson, S-588; Cadwin, S-624; Suvan, S-489; Roland, S-553. See also, NIADA, S-739 at 88; Murphy, S-708 at 1; Knauf, S-410 at 1.

<sup>319</sup> NADA, S-738 at 62-77; AAA, S-633 at 2; NIADA, S-739, S-562; Delaware Valley Auto Dealers Association, S-461; Texas Independent Automobile Dealers Association, S-1006; Virginia Independent Automobile Dealers Association, S-1023.

<sup>320</sup> NADA, S-738; NIADA, S-739; Texas Independent Automobile Dealers Association, S-1006; Patnode, S-999; Bryson, S-376; Suvan, S-489.



dealers would have to pay for the inspection of each car offered for sale and would pass those costs on to the buyer in the form of higher selling prices for cars.<sup>321</sup> Such a result would not have been dictated by market forces but would have been uniformly required for every used car as a result of government intrusion into the marketplace.

The issue of the costs of inspection was addressed extensively in the record. The staff believed that because a majority of dealers currently inspect cars, inspection costs for most dealers would not increase.<sup>322</sup> As noted above, however, the Commission is not convinced that present inspection practices would provide the detailed, system-by-system information that a mandatory inspection rule would require.<sup>323</sup> Furthermore, for those dealers who did not currently inspect, staff projected a cost range of \$15-30 per car.<sup>324</sup>

While the mandatory inspection proposal was favored by many consumer organizations,<sup>325</sup> the Commission, in light of the aforementioned concerns, determined that this remedial approach was not feasible.

The Commission also believes that the mandatory inspection alternative should be rejected because it is more likely to undermine the effectiveness of more important disclosures required by the Rule than either the defect disclosure requirement or an optional inspection provision. A mandatory inspection checklist, by its very nature, serves to induce consumer reliance on the dealer's inspection, discouraging consumers from seeking independent inspections. Moreover, consumers who rely on dealer inspections may well forego the search for important warranty protections. In addition, this emphasis on the results of a mandatory inspection works to the consumer's detriment because the dealer can be required only to disclose current defects, not conditions indicating that components may fail in the near future and require expensive repairs. Consumers who

obtain independent inspections can find out whether components currently functioning adequately may need expensive repairs in the near future. Of course, consumers who obtain good warranty protection will not have to bear the expense of repairing malfunctions that occur during the warranty period. In short, the Commission is concerned that a mandatory inspection rule has the potential to do more harm than good because it encourages reliance on dealer inspections and, as a consequence, discourages consumers from seeking more reliable information. Finally, the Baseline Survey suggests that Wisconsin's version of the same remedy has not achieved significant beneficial effects.<sup>326</sup>

#### C. Optional Inspection

In promulgating the 1981 Rule, the Commission also considered an optional inspection provision as an alternative to the known defect disclosure requirement. Under this alternative, as under the mandatory inspection proposal, dealers would be required to post a window sticker with a list of mechanical systems. However, the checklist would have an additional column: "No Rating."<sup>327</sup> The dealer would have no obligation to inspect. If a dealer chose not to inspect, the mechanical systems could simply be checked "No Rating." Additionally, if the dealer inspected and found a system not to be defective, but did not want to assume liability for its condition, the dealer could also check "No Rating."<sup>328</sup> This alternative would give dealers the flexibility to determine whether to inspect as well as whether to assume responsibility for the condition of nondefective systems. If, however, the dealer did inspect or otherwise discovered specified systems to be defective, he or she would have to disclose such systems as "Not OK" and describe what the particular problem was.

There is little difference between optional inspection and known defects disclosure except that the former approach provides a format which

permits dealers to disclose what components or systems are "OK" and, thus, counterbalance defect disclosures.

The Commission rejected the optional inspection approach in 1981 and we reject it today because of concerns expressed by consumer groups and industry representatives. First, some groups expressed concern that an optional inspection rule would detract from warrant disclosures, especially those relating to "as is" sales, by focusing the buyer's attention on the condition of individual components at the time of sale rather than on the dealer's continuing responsibility—if any—for post-sale repairs.<sup>329</sup> Others were concerned that a simple "OK"/"Not OK"/"No Rating" evaluation system might not clearly and accurately communicate a car's individual condition and, thus, could lead to consumer confusion and, perhaps, even deception.<sup>330</sup> Some believed that if dealers of older and cheaper used cars chose not to inspect, checked "no rating" and sold "as is" with no warranty, the consumer could conceivably be harmed by an optional inspection rule, since the "no rating" option could undermine a consumer's attempt through litigation to enforce oral dealer promises about condition.<sup>331</sup>

The question was also raised as to whether the optional inspection approach would provide consumers with useful information. A number of commentators believed that dealers, particularly in "as is" sales, would simply mark all systems "No Rating".<sup>332</sup>

In addition, there was some concern about the cost of an optional inspection approach. Dealers and dealer organizations claimed that the cost of inspection, even on an optional basis, would be high, and that consumers would ultimately shoulder those costs through higher used car prices.<sup>333</sup>

<sup>329</sup> Many commentators stated that buyers would not understand that an "OK" check identified a condition at the time of sale rather than a warranty of future performance. See AOAC, T-708 [Appendices B-6, B-9, B-12]; CALPIRG, T-733 at 29; CAS, T-733; NCLC, T-833 at 14-15; NADA, T-740 at 26; NIADA, T-742 at 21-22.

<sup>330</sup> See AOAC, T-708; CALPIRG, T-727 at 8-12, 34; CAS, T-733; Cueller, T-238; Strickland, T-678; NADA, T-740; NIADA, T-740 at 18-19, 33; NIADA, T-742 at 14-15, 25.

<sup>331</sup> AOAC, T-708 at 16 (Appendix B-6); CALPIRG, T-727 at 1, 31-32; Kaufman, T-150; Cueller, T-238; Hartman, T-287; NADA, T-740 at 31; Stokes, T-567.

<sup>332</sup> AOAC, T-708 at 7-15A; CALPIRG, T-727 at 15-18; CAS, T-733; NADA, T-740 at 21; Merrill-Wahus, T-165; Carter, T-66.

<sup>333</sup> Berrier, T-699(b); NADA, T-740 at 22; NIADA, T-742 at 5, 9. The dealer arguments concerning costs were counterbalanced against the evidence that in Wisconsin, after implementation of a mandatory

Continued

<sup>321</sup> Virginia Independent Automobile Dealers Association, S-1023; Smith, S-970; Mitchell, S-569; Carter, S-615; Hawley, S-980.

<sup>322</sup> See Staff Report at 213-241.

<sup>323</sup> See Section IV.A.1.a. *supra*.

<sup>324</sup> However, one dealer association conducted a survey of mechanics which produced a cost of inspection ranging from \$25 to \$250 per car. See post-record comment of NIADA, T-742 at Appendix III. See generally NIADA, S-739; Whetman, S-790; Texas Independent Automobile Dealers Association, S-993.

<sup>325</sup> See AOAC, T-708; CALPIRG, T-727 at 1; Center for Auto Safety, T-733; NCLC, T-833; Newton, T-316; Pfeffer, T-371; Ransstrom, T-508; Carter, T-596.

<sup>326</sup> See Section IV.A.1.b. *supra*.

<sup>327</sup> In the version of the optional inspection rule published in the August 7, 1980, Federal Register, the column indicating that a car had not been inspected and that the dealer was making no promises about condition was called "We Don't Know." Technical comments suggested that "We Don't Know" carried pejorative connotations. Therefore, staff recommended that the column be labeled "No Rating." See staff Memorandum to the Commission, Final Recommendations concerning Used Car TRR dated January 14, 1981, at 17-18.

<sup>328</sup> Some such scheme is necessary to avoid the problem of requiring a warranty.



As stated above, the optional alternative is essentially a known defects disclosure requirement (known defects would be disclosed as "Not OK" with a mark next to the appropriate defect(s) listed on the form) with a format that allows dealers to indicate which systems are "OK." Therefore, all of the problems associated with the known defects provision apply equally to the optional inspection alternative. This alternative may undermine other more important disclosure remedies included in the rule. Dealers may ignore the defect disclosure requirement and routinely give all systems a "No Rating" designation or may use the disclosure checklist to corroborate their deceptive representations. Policing the defect disclosure component of the optional inspection alternative will create insurmountable enforcement problems. Finally, if the optional inspection provision were to define some defect criteria by using relative terms such as "abnormal," and use the "reasonable person" standard to determine the dealer's knowledge of defects, this alternative may force dealers to incur substantial additional inspection costs.

#### *D. Mandatory Third-Party Inspection Opportunity*

The staff considered, but did not recommend, a mandatory pre-sale third-party inspection opportunity for consumers.<sup>334</sup> Under this alternative, dealers would have been required to allow consumers to take the car off the lot for purposes of obtaining a third-party inspection; consumers would have been assured the availability of independent diagnostic analysis. However, record comments suggested such a rule would result in increased costs, including increased insurance and personnel time. Consumers would thus face the direct costs of inspection, as well as the likely pass-through by the dealer of his or her costs. Because of the potential costs involved in a mandatory, third-party inspection opportunity, the staff did not recommend that the Commission include such a requirement in the final rule.

#### *E. Cooling-Off Period*

Some consumer organizations recommended that a cooling-off period be added to the optional inspection

rule.<sup>335</sup> The cooling-off period would apply only to vehicles that had not been inspected. Its purpose was to give purchasers of vehicles that had not been inspected an opportunity to discover defects on their own and to give dealers an incentive to inspect in order to avoid the cooling-off period.

The staff rejected the cooling-off period alternative because it appeared to have significant costs and uncertain benefits.<sup>336</sup> The costs to dealers included those arising from the danger of theft, the consumer's use of the vehicle as a free rental car or for "joy riding," uncertainties in financing arrangements (decreasing the rate of inventory turnover or increasing the dealer's capital requirements), increases in insurance rates, repeated detailing expenses, and repeated inspection expenses. If dealers attempted to recover these costs through a user fee to consumers who returned cars, the effectiveness of the cooling-off period would have been reduced since consumers would have little economic incentive to rescind. The Commission did not consider a cooling-off provision a viable option, and therefore the issue of a cooling-off period remedy was not discussed by the Commission as an alternative to, nor in conjunction with, the inspection or disclosure options.

#### *F. Disclosure of Prior Use*

The Final Staff Report recommended that the Commission include a disclosure of a car's prior use on the Buyers Guide.<sup>337</sup> "Prior use" refers to the manner in which a car was used prior to being offered for sale on the used car lot—e.g., as a taxi, rental car, police car, etc. In the Final Staff Report, the staff proposed that each of these "prior uses" be listed on a window sticker and that the dealer check an appropriate box.

At the October 11, 1979 meeting, the Commission rejected the disclosure of prior use because it believed that staff had failed to demonstrate that consumers were injured when prior use was not disclosed. The Commission stated that, although it appeared prior use was material to consumers, the record did not sufficiently demonstrate that disclosure of prior use provided consumers with an accurate indication of a car's mechanical condition.<sup>338</sup>

#### *G. Disclosure of Odometer Accuracy*

The Final Staff Report recommended that the Commission include mileage disclosure on the Buyers Guide,<sup>339</sup> even though it duplicated federal law.<sup>340</sup> Staff's arguments focused on the fact that, under the law, disclosure need not be made until the time of sale, which often occurs in a pressure situation with the consumer confronted by a number of forms. Therefore, consumers did not always read the odometer disclosure form. Staff also stated that the repeated disclosure on the Buyers Guide was minimally burdensome since the dealer simply had to copy readings from the odometer disclosure form.

The Commission disagreed. On October 11, 1979, it rejected staff's proposal primarily because it duplicated federal law and therefore appeared unnecessary.

#### *H. Disclosure of Estimated Repair Cost*

In the Final Staff Report, staff proposed that dealers be required to disclose estimated costs of repair for items checked "Not OK."<sup>341</sup> Staff believed that such a disclosure would enable dealers to reveal to mechanically unsophisticated consumers the true impact of the "Not OK" check. However, at the May 16, 1980 meeting, the Commission rejected the staff's recommendation. The Commission decided that a disclosure of the estimated range of cost would not provide meaningful repair information to consumers, since mechanics could not be specific about repairs for problems not fully diagnosed. The Commission was also concerned about the cost of ascertaining what precise repairs might be necessary.<sup>342</sup>

#### *I. Disclosure of Prior Repairs*

The initial rulemaking notice on January 6, 1976, included a proposed rule provision that would have required a description of repair work performed by used car dealers.<sup>343</sup> Staff, however, recommended dropping the proposed disclosure of prior repairs because there was no record evidence to support a finding that prior repairs are reliable indicators of current mechanical condition. Moreover, since consumers consider prior repairs to be a negative

inspection law, the costs of inspections to more than two-thirds of the dealers did not rise. See, e.g., HX 164(A) at V-8. The lack of significant benefits from inspection in Wisconsin revealed by the Baseline Study, however, suggests that more thorough and more costly inspections may be necessary to enhance consumer information significantly.

<sup>334</sup> See Staff Report at 87-92 nn. 80-83; 41 FR 1091-1092 (1976).

<sup>335</sup> CALPIRG, T-727 at 2; CAS, T-733. Other witnesses suggested varying time periods. Staff Report at 183, nn. 245-248.

<sup>336</sup> Staff Report at 185-190.

<sup>337</sup> *Id.* at 337-383.

<sup>338</sup> This point was raised by several commentators. NADA, S-738; American Car Rental Association, S-738; Consumer Bankers Association S-737.

<sup>339</sup> Staff Report at 384-391.

<sup>340</sup> Motor Vehicle Cost Savings Act, 15 U.S.C. 1988(a)(1). Further, the seller must disclose that the actual mileage is "unknown" if he or she knows the reading is different from the vehicle's true mileage. 15 U.S.C. 1988(a)(2).

<sup>341</sup> Staff Report at 167-68.

<sup>342</sup> See Rork, S-18 at 1; Connors, S-633 at 2; Glahedge, S-678 at 2.

<sup>343</sup> 41 FR 1089 (1976).

attribute, disclosure of prior repairs would have reduced dealer incentive to make such repairs. Finally, the record indicates that most consumers could not make effective use of repair information because they lack the technical expertise to distinguish repairs which might indicate more serious problems from repairs which actually improve the value of the vehicle. The Commission agreed with staff's recommendation to eliminate the proposed prior repair disclosure.<sup>344</sup>

#### *J. Disclosure of Flooded or Wrecked Vehicles*

The Final Staff Report recommended that the Commission include a disclosure that vehicles had been flooded or wrecked and established as an insurance "total loss."<sup>345</sup> In staff's view, the record established that such vehicles are not desired by consumers and are often mechanically inferior to vehicles which have not been wrecked or flooded. However, the Commission decided at the May 16, 1980, meeting that, because insurance companies base their decision as to whether a car is totalled on the market value of the car, and not exclusively upon the amount of damage, the information provided could result either in unjustifiable depreciation in the value of a car or in a failure to disclose severe damage.<sup>346</sup> The provision for disclosure of the fact that a vehicle had been flooded or wrecked was therefore deleted from the rule.

#### **V. Economic Impact on Small Businesses and Consumers**

##### *A. Analysis of the Used Car Rule—Projected Benefits, Costs, and Effects*

As set forth earlier, the Rule comprises five components—two affirmative disclosure requirements relating to the specific vehicle (a disclosure of warranty information, and of the meaning of an "as is" sale), and three other general information disclosures (a spoken promises warning, a major systems list, and a pre-purchase inspection notice). Each element is designed to remedy particular abuses reflected in the rulemaking record and, thus, to a certain extent, is segregable from the whole for the purposes of

analyzing projected benefits, costs and effects of the Rule.

However, certain of the projected benefits and costs may not be readily segregable, and therefore are more appropriately attributable to the Rule as a whole, rather than to any particular element of the Rule. For example, the Commission expects that the disclosures required by the Rule will reduce dealer misrepresentations, consumer reliance on such misrepresentations, and the consumer injury that occurs from unexpected liability for repair costs. Such benefits are likely to arise from the impact on the market of the entire Rule, rather than from the impact of any one particular element.

The direct cost of providing used car information required under the Rule is minimal. The dealer need only obtain the Buyers Guide forms, and complete them with readily available information. The Rule would not prevent any car, with or without any warranty, in any condition from being sold. Seen from this perspective, the costs of the Used Car Rule, insofar as it functions as a disclosure device, are minimal.

We now proceed to an analysis of each component of the Rule individually.

##### **1. Disclosure of Availability and Scope of Warranty Coverage**

The Rule addresses unfair and deceptive dealer practices with respect to warranty coverage and service contract terms.<sup>347</sup> The record clearly demonstrates that dealers orally misrepresent the terms of written warranties and service contracts.<sup>348</sup> In some cases, salespersons deceptively refer to "good warranty" or "full guarantee" when the warranty coverage offered is severely limited.<sup>349</sup> The allocation of repair responsibility and the duration of the warranty are often overstated or not clarified.<sup>350</sup> In addition, warranty information may not be available for use in the consumer's purchasing decision since warranty terms are often not made known to consumers until after they have decided to purchase.<sup>351</sup> For example, results from one study showed that warranty documents failed to describe the items that the dealer would repair in 24 percent of the cases; the dealer's share of the repair cost was not disclosed 19

percent of the time.<sup>352</sup> Another study found discrepancies between the verbal and written warranty in 34 percent of the cases where test shoppers actually saw the warranty.<sup>353</sup>

The warranty disclosure adopted by the Commission addresses these problems. The shopper will be able to readily ascertain which mechanical systems are warranted, for how long, and how costs of repair will be allocated between the buyer and the used car dealer.

a. *Benefits.* The Rule is designed to provide consumers with pre-sale disclosures of material information regarding warranties at a time prior to the closing of the sales contract. The Commission believes that clear and accurate disclosures of post-sale repair responsibilities at the point of purchase will provide an effective remedy for the consumer injury resulting from dealer misrepresentations of warranty coverage, and from failure to disclose the details of warranty coverage.

If consumers have accurate knowledge of what the dealer will pay in case the consumer encounters problems after the sale, unanticipated repair costs and the consumer injury that results therefrom should be reduced. With warranty information available at the point of sale, the consumer will be better able to make accurate assessments of the probable ownership costs (purchase price plus repair costs) of a car prior to making a purchase decision.<sup>354</sup>

The window sticker will provide consumers with an additional source of information on warranty coverage which they can use as a check against which to measure any oral representations by the dealer about the warranty. With the disclosure on the window sticker, consumers can compare the terms of the written warranty document. Thus, the Commission believes dealers will be less likely to misrepresent warranty coverage. At the same time, consumer reliance on any oral warranty promises should be reduced.

Disclosure of warranty terms also provides another sort of benefit. The terms of the warranty will frequently provide information to the consumer about the condition of the car, since

<sup>344</sup> This occurred at the October 11, 1979, meeting.

<sup>345</sup> Staff Report at 180-184. Cars that are subjected to flood damage in one state are often shipped out of state for sale and without informing the consumer of damage incurred. In the case of "wrecked" vehicles, insurance companies consider the car a total loss when estimated repairs exceed the vehicle's market value.

<sup>346</sup> See generally Jones, Alabama Automotive Dismantlers & Recyclers Association, S-202; Vorhof, Foreign Auto Salvage, S-288.

<sup>347</sup> Staff Report at 280-90.

<sup>348</sup> *Id.* at 303-05.

<sup>349</sup> Presiding Officer's Report at 35.

<sup>350</sup> Staff Report at 284. The SRL Study demonstrates a high percentage of confusion over the dealer's share of repair costs. HX 160(A) at Appendix C. Question 23 A and B.

<sup>351</sup> Staff Report at 282.

<sup>352</sup> SRL Study, HX 160(A), Appendix C. Questions 23A, 23B.

<sup>353</sup> CALPIRG, HX 82 at 17.

<sup>354</sup> The record indicates that some buyers do bargain over warranty coverage. Although the magnitude of such bargaining efforts is difficult to determine, the Commission expects it to increase when buyers have more accurate information about the warranty being offered. Staff Report at 301.

consumers are likely to use the strength of the car's warranty as a signal indicating the dealer's evaluation of the car's mechanical condition. For example, a strong warranty may signal the consumer that the dealer has confidence in the condition of the car. On the other hand, a warranty that does not cover the brake system may lead a shopper to question the condition of the brakes.<sup>355</sup> In general, the lack of a strong warranty may serve to arouse buyer suspicions concerning mechanical condition and may encourage some buyers to seek third-party inspections.

Warranty disclosures made early in the transaction thus will make it possible for consumers to use warranty information to weigh the relative importance of the warranty coverage, the condition of the car, and the price they are willing to pay for it. However, to be used effectively, such disclosures must be made available at a time prior to the signing of the sales contract. If warranty information is not available until late in the transaction, the buyer has little opportunity to utilize the information which the terms of the warranty convey. There is little chance for the final agreement between buyer and seller to reflect the buyer's desire for specific warranty terms or the relative value he or she attaches to warranty coverage, condition of car, and price.

We believe that the availability of warranty information early in the bargaining process should increase consumers' ability to bargain for the terms they desire. This should intensify the pressure on dealers to compete on the basis of the terms of the warranty whenever (and to the extent that) consumers are willing to pay for them. With better information, market forces will be able to work more efficiently to determine the nature of the warranty terms offered.

Of course, to be useful to consumers, the disclosure of information must be easily understandable. Tests of the comprehensibility of the disclosures on the window stickers have shown them to be remarkably clear. Focus group tests by Market Facts, Inc., testing two versions of a form very similar to the one required by the Rule, found that respondents could use the Buyers Guide to determine whether the car had a warranty, what systems were covered, and the length of the warranty.<sup>356</sup> This

<sup>355</sup> The list of major systems which is set forth on the Buyers Guide should provide the shopper with a context in which to evaluate the warranty coverage offered on any given car. See section V.A.3.c. *infra*.

<sup>356</sup> As directed by the Commission, this study was conducted in May 1981, under a staff contract in order to test whether the Buyers Guide, as revised

study suggests that the Buyers Guide will increase consumer certainty as to the warranty coverage offered on a car.

An additional benefit to both buyers and sellers may be reduced litigation costs. Disclosure of warranty terms will provide clear written information about the buyer's rights; a clearer written contract is likely to reduce the impact of oral promises. The Commission thus expects that sellers may be more willing to settle disputes and buyers may be less likely to bring actions for unenforceable oral promises. This should result in a more efficient dispute settlement system.

The Commission believes that clear and conspicuous disclosures of information concerning the availability and scope of warranty coverage is likely to have substantial benefits, given the misrepresentations and failures to disclose and resulting consumer injury demonstrated in the market. We expect reductions in consumer reliance on such oral (and generally unenforceable) warranty promises and in unanticipated repair costs for consumers.

b. *Costs.* The Commission believes that the direct costs of warranty disclosure will consist of the printing, filling out and posting of the Buyers Guide. The Rule itself requires no change in the offering or scope of warranties. Dealers may still sell "as is" or offer a warranty. The Rule requires only that dealers conspicuously disclose the terms of a warranty, if offered, or the fact that the sale is "as is." Thus, the direct costs of the Rule will be minimal.

Some indirect costs may result from warranty disclosure. As warranty disclosures become common, competitive pressures may encourage dealers to increase warranty coverage. In that event, dealers may incur additional post-sale repair costs. Presumably, dealers will not offer warranties with more protection than that for which consumers are willing to pay. Thus, to the extent warranty coverage and therefore post-sale repair costs do increase, such costs will be

in accordance with the Rule changes approved by the Commission on April 14, 1981, would communicate information to consumers.

Previously, the staff had contracted for two studies that tested earlier versions of the Buyers Guide developed during the Commission's consideration of an optional inspection rule. Focus group testing conducted by Hollander & Associates in August 1980, indicated some confusion with parts of the form, including the relationship between the mechanical condition checklist and the warranty disclosures. After redesigning the Buyers Guide, the staff contracted with the Public Communications Center in December 1980 to perform mall intercept and focus group tests. In those tests, respondents understood the warranty information provided by the form and found the meaning of "as is" to be very clear. PCC Study, Tables 2, 3, 4, 8, and 17.

imposed by consumer demand in the market, not by the Rule.

In our judgment, the projected costs of these disclosures will impose minimal burdens on the industry while significant benefits will accrue to consumers. We therefore believe that the warranty disclosure requirements will be cost-effective.

## 2. "As Is" Sales

The Rule would require dealers to check an "as is" box on the Buyers Guide when they sell a vehicle with no warranty. Next to the box will be a simple statement explaining the meaning of an "as is" sale.

The record reveals a great deal of confusion on the part of consumers with respect to the meaning of "as is" sales:

Undoubtedly the most needed disclosure proposed in this proceeding involves "As Is" sales . . . The record is replete with testimony as to the lack of understanding on the part of consumers of the meaning and effect of this term in a sales contract.<sup>357</sup>

Data from three studies on the record show that at least 25%, and perhaps as many as 59%, of buyers cannot correctly describe an "as is" sale.<sup>358</sup>

In addition, the record indicates that the "as is" nature of a transaction is not usually disclosed, if it is disclosed at all, until the sale is about to be made.<sup>359</sup> Some "as is" disclosures are couched in complex legalistic terms.<sup>360</sup> In addition, some dealers will make oral promises to repair problems that arise after sale, even though the sale is made on an "as is" basis.<sup>361</sup> Many buyers, even when aware that a sale is "as is" still believe the seller has a legal responsibility to make post-sale repairs.<sup>362</sup>

a. *Benefits.* The Commission believes the "as is" disclosure will assist in reducing the documented widespread ignorance and misunderstandings with respect to "as is" sales.

The benefits of a clear "as is" disclosure are similar to those benefits resulting from warranty disclosure. Because the disclosure will set out the significance of an "as is" sale, we expect that it will reduce consumer reliance on oral promises to repair problems that arise after sale. We also expect a concomitant reduction in dealer oral misrepresentations that a

<sup>357</sup> Presiding Officer's Report at 79, 163.

<sup>358</sup> Staff Report at 282-283.

<sup>359</sup> *Id.* at 286-87. In some cases, it is never disclosed. *Id.* at 271.

<sup>360</sup> *Id.* at 268.

<sup>361</sup> *Id.* at 275. Many of these promises may be honored. Nevertheless, the "as is" disclosure, together with the spoken promises warning, will inform consumers that such promises may be unenforceable.

<sup>362</sup> *Id.* at 263.

warranty is provided since consumers will be able to use the disclosures on the Buyers Guide to evaluate contradictory dealer oral promises. A related benefit of the "as is" disclosure is the disincentive it provides for dealers to represent that a particular component is in good condition or that the vehicle in general is in good condition in light of the lack of warranty coverage.

Tests of the comprehensibility of the "as is" disclosure have indicated that consumers understand the disclosure and will use it in making purchase decisions.<sup>363</sup>

It is possible that some dealers may decide to offer a limited warranty on one or more non-essential systems rather than sell the vehicle "as is" and check the "as is" box on the Buyers Guide. However, we would not be concerned if this should occur. As long as the disclosures on the Buyers Guide accurately reflect the warranty coverage, the consumer who receives such a limited warranty will be able to assess the value of the warranty in determining whether to purchase the vehicle. Any detriment to the consumer in receiving such a limited warranty will be diminished by the fact that the Buyers Guide disclosures will inform the consumer of the limited scope of the warranty by placing it within a context of systems that could be covered by a warranty.<sup>364</sup>

b. *Costs.* The direct costs associated with "as is" disclosure are minimal. The check box and definition will be printed on the Buyers Guide adjacent to the warranty disclosure section. The dealer must merely check the box if the vehicle is sold on an "as is" basis. Thus, essentially no costs will be imposed beyond those already incurred in posting the window sticker.

### 3. General Information Disclosures

The Rule requires the disclosure of information on three additional aspects of the transaction: a spoken promises warning, pre-purchase inspection opportunity notice, and a list of major mechanical systems. These are to be posted as part of the Buyers Guide. The impact of each of the three disclosures is analyzed separately.

a. *Spoken Promises Warning.* The following notice appears at the top of the Buyers Guide:

**Important:** Spoken promises are difficult to enforce. Ask the dealer to put all promises in writing. Keep this form.

<sup>363</sup> See n. 356, and accompanying text *supra*.

<sup>364</sup> The list of major systems will be particularly useful in providing a context for the evaluation of warranty coverage.

The record demonstrates that many dealers orally misrepresent both the mechanical condition of used vehicles and the dealer's after sale repair responsibility. The record also demonstrates that consumers rely on oral statements made by dealers at the point of purchase even though those oral statements are not confirmed in writing.<sup>365</sup> Further, discrepancies between oral representations of warranty coverage and written warranty terms are commonplace.<sup>366</sup> In the face of consumer reliance on oral promises, dealers continue to make affirmative misrepresentations regarding their used vehicles' warranty coverage and mechanical condition. Consumers are therefore frequently deceived at the point of purchase by representations which are not only untrue but also unenforceable. The Commission believes the record contains substantial justification for requiring a warning to consumers that all oral promises should be confirmed in writing. Inclusion of a spoken promises warning would alert consumers to beware of reliance on dealers' oral representations.

#### (1) Benefits.

The Commission believes that a spoken promises warning will contribute to a reduction in oral misrepresentations of mechanical condition and warranty coverage by dealers and, in conjunction with the other disclosures on the Buyers Guide, assist in deterring deception. The level of misrepresentation at the used vehicle lot will be reduced if consumers are informed of the need to secure a written record of all statements made in conjunction with a used vehicle sale. If consumers do in fact ask dealers to confirm their promises in writing, making them available in case of disputes and enforceable in court, dealers are likely to be more reluctant than they are at present to make false or misleading statements.

At the same time, the introduction of this information into the used vehicle market should lead to a decrease in consumer reliance on oral statements and an increased insistence by consumers on written confirmation of all representations made at the time of sale. Such written confirmation of representations should reduce ambiguity and/or misunderstanding between buyer and seller as to whether or not a promise was made. With promises regarding mechanical condition and warranty coverage in writing, the consumer will have an additional means of checking the representations made in

any warranty or service contract document and can check the statements against the results of an independent inspection, if one is performed. Additional sources of information decrease the necessity of consumers relying exclusively on the oral promises of dealers.

If consumers are able to obtain written confirmation in the Buyers Guide of oral statements made by dealers at the time of sale, these statements become part of the sales contract and can be used in the event of later disputes between buyers and sellers. Having dealer promises in writing should increase the ease of enforceability of these promises and thus decrease the need for post-sale litigation to enforce oral promises.

#### (2) Costs.

The printing costs, as described above, are minimal since the spoken promises warning will appear on every Buyers Guide printed for the dealer.

b. *Pre-Purchase Inspection Notice.* The Buyers Guide contains a notice suggesting that buyers ask dealers about their policies regarding independent pre-purchase inspections:

Ask the dealer if you may have this car inspected by your mechanic either on or off the lot.

Although pre-purchase inspection by a third party can provide consumers with important information regarding the mechanical condition of a used car, the record demonstrates that few consumers actually seek independent inspections by a qualified mechanic.<sup>367</sup> This circumstance may be attributed to dealer policies which disallow such inspections and to factors which inhibit consumers from seeking inspections.<sup>368</sup> More importantly, however, consumers rely on dealers' representations of sound mechanical condition, and, thus, do not perceive a need to obtain an independent pre-purchase inspection.<sup>369</sup>

#### (1) Benefits.

The notice of availability of independent third-party inspections will generate several benefits for consumers and dealers. For consumers, a disclosure of the dealer's policy concerning independent inspections informs consumers that independent inspection

<sup>367</sup> *Id.*

<sup>368</sup> *Id.* at 93-94.

<sup>369</sup> *Id.* at 87-103. One dealer practice that discourages independent pre-purchase inspection is "detailing". The practice of "detailing" involves cleaning and cosmetically reconditioning cars without necessarily making mechanical or safety repairs. *Id.* at 97-103. Consumers who equate appearance with performance do not believe that independent, pre-purchase inspections are necessary.

<sup>365</sup> Staff Report at 103-130; 262-90; 295-315.

<sup>366</sup> *Id.* at 108-110; 274-77.

is one means of corroborating dealers' oral statement regarding mechanical condition. In addition, the disclosure alerts consumers to the fact that independent inspection is a valuable means of determining the condition of the used car at the time of sale. Nevertheless, the decision to allow such inspection will remain voluntary for the dealer; the notice will simply alert consumers to a possible opportunity. Any effects that flow from dealers' decisions to extend this opportunity will be the result of consumer demand and dealers' responses.

If the notice does, in fact, encourage consumers to obtain independent inspections, this may reduce consumer reliance on dealer-controlled information. If, as a result of third-party inspections, buyers find a discrepancy between the results of an independent evaluation and the condition reported by the dealer, buyers would have enhanced their bargaining position with respect to the dealer.<sup>370</sup> On the other hand, the possibility of independent inspections may provide dealers with a disincentive to misrepresent orally mechanical condition in light of the risk that the consumer could discover misrepresentations as a result of third-party evaluations.

The notice not only focuses consumers' attention on the idea of pre-purchase inspection as a means of evaluating a car's mechanical condition but also provides consumers with a means of comparison shopping among the various terms and conditions offered by different used car dealers. This possibility may also provide benefits to dealers. Some dealers may make the availability of independent inspections a component of their marketing strategy. Their willingness to allow third-party inspections could provide consumers with information on the trustworthiness of the dealer. The notice may thus provide dealers with a way of communicating to consumers that their representations are trustworthy and will withstand the test of comparison with a third-party evaluation.

#### (2) Costs.

There are no direct costs associated with this disclosure. As with the spoken promises warning, the notice of availability of pre-purchase inspection is to be pre-printed on the Buyers Guide.

There may be some indirect costs resulting from disclosure of an independent inspection opportunity. If, as a result of the disclosure, consumers begin to value independent off-premises inspections and begin to demand such

inspections, dealers may incur additional costs. These costs may include the costs of increased insurance premiums and employee time to accompany vehicles off the premises to safeguard against misuse or theft and the cost of foregone opportunities to show cars to other prospective buyers while the cars off the lot. Dealers would presumably pass along to consumers any increased costs of this sort and would only offer the opportunity for third-party inspections if, and to the extent that, consumers were willing to pay a price which would allow the dealers to cover those costs. Any costs of this sort would thus be imposed by the market, not by the Rule.

*c. List of Major Systems and Defects.* The Buyers Guide also contains a pre-printed list of 14 major mechanical and safety systems of a car. The list of systems includes all major mechanical systems or components of an automobile.

The record shows that dealer misrepresentations concerning mechanical conditions are often made on a system-by-system basis. The systems listed are those most likely to be represented by dealers as being in good condition, but without any confirmation of such representations in writing.<sup>371</sup>

#### (1) Benefits.

The list of major mechanical systems identifies for consumers the important systems on which they may want to seek mechanical condition information, either from the dealer or through an independent inspection. Furthermore, the list will enable consumers to evaluate which systems are covered by any warranties offered by the dealer. The list may also prompt consumers to seek information on costs to repair systems not in good order.

The record demonstrates that consumers are most interested in the condition of the car at the time of sale but are discouraged from inspecting mechanical condition as a result of dealer practices.<sup>372</sup> Highlighting the importance of mechanical systems may lead consumers to focus on them somewhat more specifically. As consumers begin to be more astute and critical, dealers' marketing incentives may shift away from cosmetic pre-sale reconditioning to remedying mechanical condition factors.

Thus, the list of systems will provide consumers with a framework for systematically evaluating and comparing the mechanical condition and

warranty coverage offered between cars and dealers. The increased availability of information to consumers should also contribute to a reduction in the incidence of unanticipated repair costs by consumers.

#### (2) Costs.

The listing of major mechanical systems will not lead to any direct costs to dealers since it will be pre-printed on the Buyers Guide.

#### 4. Summary

The Commission believes that each of the elements of the Rule will diminish the deceptive practices currently existing in the used car market. We expect that the elements of the Rule, taken together, will provide significant benefits while imposing only minimal direct costs. Any indirect costs that might result from the rule would result from dealer attempts to satisfy consumer demand and, therefore, by definition would be justified by significant benefits.

#### B. Conclusion

In formulating this Rule as the remedy for recorded abuses in the used car industry, the Commission has assessed the economic impact on consumers and small businesses. The Commission concludes that the benefits of this Rule outweigh its costs and that the Rule will be effective in remedying the unfair and deceptive practices established in the record.

#### IV. Other Matters

##### A. Impact Evaluation

The Commission believes it is essential to measure the degree of impact this Rule will have on the used car market, and therefore, has determined to perform an impact evaluation study three years from the effective date of the Rule. Such a study should assist the Commission in assessing the effectiveness of the Rule, and could illustrate whether proceedings to amend the Rule would be appropriate.

##### B. Readability

With the adoption of this Rule, the Commission again recognizes its goal of writing understandable regulations. The Commission has for some time required that disclosures to consumers be written in plain and easily understandable language.<sup>373</sup> The Buyers Guide approved by the Commission in 1981 was designed and reviewed to ensure that the disclosures will be conveyed in a clear and succinct manner. Moreover,

<sup>371</sup> Staff Report at 109-115.

<sup>372</sup> *Id.*

<sup>373</sup> Section 21(a) (2) of the FTC Improvements Act, 15 U.S.C. 57a-1.

<sup>370</sup> *Id.* at 109-130.

various versions of the Buyers Guide were subjected to several rounds of consumer testing to measure comprehensibility. Based on the results of that testing, the Commission believed that the Buyers Guide approved in 1981 would be understood by consumers. The Buyer Guide included in the Rule we promulgate today is similar to the Guide approved in 1981. However, it contains warranty and "as is" disclosures that are more prominent and less complicated than the 1981 Buyers Guide.

The Rule itself is also written in understandable language. This reflects the Commission's commitment to the principle that regulations which apply to small businesses should be readily understood. After reviewing the language of the Rule carefully, the Commission believes that its provisions will be understood by the affected industry members.

Title 16 of the Code of Federal Regulations, Chapter I, is amended by adding Part 455 to read as follows:

**PART 455—USED MOTOR VEHICLE TRADE REGULATION RULE**

Sec.

- 455.1 General duties of a used vehicle dealer; definitions.
- 455.2 Consumer sales—window form.
- 455.3 Window form.
- 455.4 Contrary statements.
- 455.5 Spanish language sales.
- 455.6 State exemptions.
- 455.7 Severability.

Authority: 88 Stat. 2189, 15 U.S.C. 2309; 38 Stat. 717, as amended 15 U.S.C. 41 et seq.

**§ 455.1 General duties of a used vehicle dealer; definitions.**

(a) It is a deceptive act or practice for any used vehicle dealer, when that dealer sells or offers for sale a used vehicle in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act:

- (1) To misrepresent the mechanical condition of a used vehicle;
- (2) To misrepresent the terms of any warranty offered in connection with the sale of a used vehicle; and

(3) To represent that a used vehicle is sold with a warranty when the vehicle is sold without any warranty.

(b) It is an unfair act or practice for any used vehicle dealer, when that dealer sells or offers for sale a used vehicle in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act:

- (1) To fail to disclose, prior to sale, that a used vehicle is sold without any warranty; and
- (2) To fail to make available, prior to sale, the terms of any written warranty offered in connection with the sale of a used vehicle.

(c) The Commission has adopted this Rule in order to prevent the unfair and deceptive acts or practices defined in paragraphs (a) and (b). It is a violation of this Rule for any used vehicle dealer to fail to comply with the requirements set forth in §§ 455.2 through 455.5 of this part. If a used vehicle dealer complies with the requirements of §§ 455.2 through 455.5 of this part, the dealer does not violate this Rule. (d) The following definitions shall apply for purposes of this part:

(1) "Vehicle" means any motorized vehicle, other than a motorcycle, with a gross vehicle weight rating (GVWR) of less than 8500 lbs., a curb weight of less than 6,000 lbs., and a frontal area of less than 46 sq. ft.

(2) "Used vehicle" means any vehicle driven more than the limited use necessary in moving or road testing a new vehicle prior to delivery to a consumer, but does not include any vehicle sold only for scrap or parts (title documents surrendered to the state and a salvage certificate issued).

(3) "Dealer" means any person or business which sells or offers for sale a used vehicle after selling or offering for sale five (5) or more used vehicles in the previous twelve months, but does not include a bank or financial institution, a business selling a used vehicle to an employee of that business, or a lessor selling a leased vehicle by or to that

vehicle's lessee or to an employee of the lessee.

(4) "Consumer" means any person who is not a used vehicle dealer.

(5) "Warranty" means any undertaking in writing, in connection with the sale by a dealer of a used vehicle, to refund, repair, replace, maintain or take other action with respect to such used vehicle and provided at no extra charge beyond the price of the used vehicle.

(6) "Implied warranty" means an implied warranty arising under state law (as modified by the Magnuson-Moss Act) in connection with the sale by a dealer of a used vehicle.

(7) "Service contract" means a contract in writing for any period of time or any specific mileage to refund, repair, replace, or maintain a used vehicle and provided at an extra charge beyond the price of the used vehicle, provided that such contract is not regulated in your state as the business of insurance.

(8) "You" means any dealer, or any agent or employee of a dealer, except where the term appears on the window form required by § 455.2(a).

**§ 455.2 Consumer sales—window form.**

(a) *General duty.* Before you offer a used vehicle for sale to a consumer, you must prepare, fill in as applicable and display on that vehicle a "Buyers Guide" as required by this Rule.

(1) Use a side window to display the form so both sides of the form can be read, with the title "Buyers Guide" facing to the outside. You may remove a form temporarily from the window during any test drive, but you must return it as soon as the test drive is over.

(2) The capitalization, punctuation and wording of all items, headings, and text on the form must be exactly as required by this Rule. The entire form must be printed in 100% black ink on a white stock no smaller than 11 inches high by 7 1/4 inches wide in the type styles, sizes and format indicated.

BILLING CODE 6750-01-M

## BUYERS GUIDE

**IMPORTANT:** Spoken promises are difficult to enforce. Ask the dealer to put all promises in writing. Keep this form.

VEHICLE MAKE \_\_\_\_\_ MODEL \_\_\_\_\_ YEAR \_\_\_\_\_ VIN NUMBER \_\_\_\_\_

DEALER STOCK NUMBER (Optional) \_\_\_\_\_

### WARRANTIES FOR THIS VEHICLE:

☐ **AS IS - NO WARRANTY**

YOU WILL PAY ALL COSTS FOR ANY REPAIRS. The dealer assumes no responsibility for any repairs regardless of any oral statements about the vehicle.

☐ **WARRANTY**

☐ **FULL** ☐ **LIMITED WARRANTY.** The dealer will pay \_\_\_\_\_% of the labor and \_\_\_\_\_% of the parts for the covered systems that fail during the warranty period. Ask the dealer for a copy of the warranty document for a full explanation of warranty coverage, exclusions, and the dealer's repair obligations. Under state law, "implied warranties" may give you even more rights.

#### SYSTEMS COVERED:

\_\_\_\_\_  
\_\_\_\_\_  
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\_\_\_\_\_  
\_\_\_\_\_  
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#### DURATION:

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\_\_\_\_\_

☐ **SERVICE CONTRACT.** A service contract is available at an extra charge on this vehicle. Ask for details as to coverage, deductible, price, and exclusions. If you buy a service contract within 90 days of the time of sale, state law "implied warranties" may give you additional rights.

**PRE PURCHASE INSPECTION:** ASK THE DEALER IF YOU MAY HAVE THIS VEHICLE INSPECTED BY YOUR MECHANIC EITHER ON OR OFF THE LOT.

SEE THE BACK OF THIS FORM for important additional information, including a list of some major defects that may occur in used motor vehicles.

28 pt Triumvirate Bold caps

2 pt Rule

10/12 Triumvirate Bold c & lc  
flush left ragged right  
maximum line 42 picas

10 pt Baseline Rule  
6 pt Triumvirate Bold caps

10 pt Baseline Rule  
6 pt Triumvirate Bold caps

10 pt Triumvirate Bold caps

2 pt Rule

54 pt Box  
42 pt Triumvirate Bold caps

10/10 Triumvirate Bold c & lc  
flush left ragged right  
maximum line 42 picas

1 pt Rule

54 pt Box  
42 pt Triumvirate Bold caps

10/10 Triumvirate Bold c & lc  
4 1/2 picas indent on 2nd  
line

10 pt Triumvirate Bold caps

10 pt Baseline Rule

10/10 Triumvirate Bold c & lc  
maximum line 42 picas

10/10 Triumvirate Bold caps  
flush left ragged right  
maximum line 42 picas

10/10 Triumvirate Bold c & lc  
flush left ragged right  
maximum line 42 picas

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Below is a list of some major defects that may occur in used motor vehicles.

**Frame & Body**

Frame—cracks, corrective welds, or rusted through  
Dogtracks—bent or twisted frame

**Engine**

Oil leakage, excluding normal seepage  
Cracked block or head  
Belts missing or inoperable  
Knocks or misses related to camshaft lifters and push rods  
Abnormal exhaust discharge

**Transmission & Drive Shaft**

Improper fluid level or leakage, excluding normal seepage  
Cracked or damaged case which is visible  
Abnormal noise or vibration caused by faulty transmission or drive shaft  
Improper shifting or functioning in any gear  
Manual clutch slips or chatters

**Differential**

Improper fluid level or leakage excluding normal seepage  
Cracked or damaged housing which is visible  
Abnormal noise or vibration caused by faulty differential

**Cooling System**

Leakage including radiator  
Improperly functioning water pump

**Electrical System**

Battery leakage  
Improperly functioning alternator, generator, battery, or starter

**Fuel System**

Visible leakage

**Inoperable Accessories**

Gauges or warning devices  
Air conditioner  
Heater & Defroster

**Brake System**

Failure warning light broken  
Pedal not firm under pressure (DOT spec.)  
Not enough pedal reserve (DOT spec.)  
Does not stop vehicle in straight (DOT spec.)  
Hoses damaged  
Drum or rotor too thin (Mfr. Specs)  
Lining or pad thickness less than 1/32 inch  
Power unit not operating or leaking  
Structural or mechanical parts damaged

**Steering System**

Too much free play at steering wheel (DOT specs)  
Free play in linkage more than 1/4 inch  
Steering gear binds or jams  
Front wheels aligned improperly (DOT specs.)  
Power unit belts cracked or slipping  
Power unit fluid level improper

**Suspension System**

Ball joint seals damaged  
Structural parts bent or damaged  
Stabilizer bar disconnected  
Spring broken  
Shock absorber mounting loose  
Rubber bushings damaged or missing  
Radius rod damaged or missing  
Shock absorber leaking or functioning improperly

**Tires**

Tread depth less than 2/32 inch  
Sizes mismatched  
Visible damage

**Wheels**

Visible cracks, damage or repairs  
Mounting bolts loose or missing

**Exhaust System**

Leakage

12 pt Triumphvirate Bold lc  
flush left ragged right  
maximum line 42 picas

2 pt Rule

8/9 Triumphvirate Bold c & lc  
flush left ragged right  
maximum line 20 picas  
1 em indent on 2nd line

2 pt Rule

10 pt Baseline Rule  
6 pt Triumphvirate Bold caps

2 pt Rule

10/12 Triumphvirate Bold c & lc  
maximum line 42 picas

**IMPORTANT:** The information on this form is part of any contract to buy this vehicle. Removal of this label before consumer purchase (except for purpose of test-driving) is a violation of federal law (16 C.F.R. 455).

BILLING CODE 6750-01-C

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When filling out the form, follow the directions in (b) through (e) of this section and § 455.4 of this part.

(b) **Warranties—(1) No Implied Warranty—"As Is"/No Warranty.** (i) If you offer the vehicle without any implied warranty, i.e., "as is," mark the box provided. If you offer the vehicle with implied warranties only, substitute the disclosure specified below, and mark the box provided. If you first offer the vehicle "as is" or with implied warranties only but then sell it with a warranty, cross out the "As Is—No Warranty" or "Implied Warranties Only" disclosure, and fill in the warranty terms in accordance with paragraph (b)(2) of this section.

(ii) If your state law limits or prohibits "as is" sales of vehicles, that state law overrides this part and this rule does not give you the right to sell "as is." In such states, the heading "As Is—No Warranty" and the paragraph immediately accompanying that phrase must be deleted from the form, and the following heading and paragraph must be substituted. If you sell vehicles in states that permit "as is" sales, but you choose to offer implied warranties only, you must also use the following disclosure instead of "As Is—No Warranty":<sup>1</sup>

#### Implied Warranties Only

This means that the dealer does not make any specific promises to fix things that need repair when you buy the vehicle or after the time of sale. But, state law "implied warranties" may give you some rights to have the dealer take care of serious problems that were not apparent when you bought the vehicle.

(2) **Full/Limited Warranty.** If you offer the vehicle with a warranty, briefly describe the warranty terms in the space provided. This description must include the following warranty information:

(i) Whether the warranty offered is "Full" or "Limited."<sup>2</sup> Mark the box next to the appropriate designation.

(ii) Which of the specific systems are covered (for example, "engine, transmission, differential"). You cannot use shorthand, such as "drive train" or "power train" for covered systems.

(iii) The duration (for example, "30 days or 1,000 miles, whichever occurs first").

<sup>1</sup> See § 455.5 n. 4 for the Spanish version of this disclosure.

<sup>2</sup> A "Full" warranty is defined by the Federal Minimum Standards for Warranty set forth in 104 of the Magnuson-Moss Warranty Act, 15 U.S.C. 2304 (1975). The Magnuson-Moss Warranty Act does not apply to vehicles manufactured before July 4, 1975. Therefore, if you choose not to designate "Full" or "Limited" for such cars, cross out both designations, leaving only "Warranty".

(iv) The percentage of the repair cost paid by you (for example, "The dealer will pay 100% of the labor and 100% of the parts.")

(v) If the vehicle is still under the manufacturer's original warranty, you may add the following paragraph below the "Full/Limited Warranty" disclosure: **MANUFACTURER'S WARRANTY STILL APPLIES.** The manufacturer's original warranty has not expired on the vehicle. Consult the manufacturer's warranty booklet for details as to warranty coverage, service location, etc. If, following negotiations, you and the buyer agree to changes in the warranty coverage, mark the changes on the form, as appropriate. If you first offer the vehicle with a warranty, but then sell it without one, cross out the offered warranty and mark either the "As Is—No Warranty" box or the "Implied Warranties Only" box, as appropriate.

(3) **Service contracts.** If you make a service contract (other than a contract that is regulated in your state as the business of insurance) available on the vehicle, you must add the following heading and paragraph below the "Full/Limited Warranty" disclosure and mark the box provided.<sup>3</sup>

#### Service Contract

A service contract is available at an extra charge on this vehicle. If you buy a service contract within 90 days of the time of sale, state law "implied warranties" may give you additional rights.

(c) **Name and Address.** Put the name and address of your dealership in the space provided. If you do not have a dealership, use the name and address of your place of business (for example, your service station) or your own name and home address.

(d) **Make, Model, Model Year, VIN.** Put the vehicle's name (for example, "Chevrolet"), model (for example, "Vega"), model year, and Vehicle Identification Number (VIN) in the spaces provided. You may write the dealer stock number in the space provided or you may leave this space blank.

(e) **Complaints.** In the space provided, put the name and telephone number of the person who should be contacted if any complaints arise after sale.

#### § 455.3 Window form.

(a) **Form given to buyer.** Give the buyer of a used vehicle sold by you the window form displayed under § 455.2 containing all of the disclosures required by the Rule and reflecting the warranty coverage agreed upon. If you prefer, you

<sup>3</sup> See § 455.5 n. 4 for the Spanish version of this disclosure.

may give the buyer a copy of the original, so long as that copy accurately reflects all of the disclosures required by the Rule and the warranty coverage agreed upon.

(b) **Incorporated into contract.** The information on the final version of the window form is incorporated into the contract of sale for each used vehicle you sell to a consumer. Information on the window form overrides any contrary provisions in the contract of sale. To inform the consumer of these facts, include the following language conspicuously in each consumer contract of sale:

The information you see on the window form for this vehicle is part of this contract. Information on the window form overrides any contrary provisions in the contract of sale.

#### § 455.4 Contrary statements.

You may not make any statements, oral or written, or take other actions which alter or contradict the disclosures required by §§ 455.2 and 455.3. You may negotiate over warranty coverage, as provided in § 455.2(b) of this part, as long as the final warranty terms are identified in the contract of sale and summarized on the copy of the window form you give to the buyer.

#### § 455.5 Spanish language sales.

If you conduct a sale in Spanish, the window form required by § 455.2 and the contract disclosures required by § 455.3 must be in that language. You may display on a vehicle both an English language window form and a Spanish language translation of that form. Use the following translation and layout for Spanish language sales:<sup>4</sup>

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<sup>4</sup> Use the following language for the "Implied Warranties Only" disclosure when required by § 455.2(b)(1):

Garantías implícitas solamente  
Este término significa que el vendedor no hace promesas específicas de arreglar lo que requiera reparación cuando usted compra el vehículo o después del momento de la venta. Pero, las "garantías implícitas" de la ley estatal pueden darle a usted algunos derechos y hacer que el vendedor resuelva problemas graves que no fueron evidentes cuando usted compró el vehículo.

Use the following language for the "Service Contract" disclosure required by § 455.2(b)(3):

CONTRATO DE SERVICIO. Este vehículo tiene disponible un contrato de servicio a un precio adicional. Pida los detalles en cuanto a cobertura, deducible, precio y exclusiones. Si adquiere usted un contrato de servicio dentro de los 90 días del momento de la venta, las "garantías implícitas" de acuerdo a la ley del estado pueden concederle derechos adicionales.

# GUIA DEL COMPRADOR

**IMPORTANTE:** Las promesas verbales son difíciles de hacer cumplir. Solicite al vendedor que ponga todas las promesas por escrito. Conserve este formulario.

MARCA DEL VEHICULO \_\_\_\_\_ MODELO \_\_\_\_\_ AÑO \_\_\_\_\_ NUMERO DE IDENTIFICACION \_\_\_\_\_

NUMERO DE ABASTO DEL DISTRIBUIDOR (Opcional) \_\_\_\_\_

**GARANTIAS PARA ESTE VEHICULO:**

☐ **COMO ESTA - SIN GARANTIA**

USTED PAGARA TODOS LOS GASTOS DE CUALQUIER REPARACION QUE SEA NECESARIA. El vendedor no asume ninguna responsabilidad por cualquier las reparaciones, sean cuales sean las declaraciones verbales que haya hecho acerca del vehículo.

☐ **GARANTIA**

☐ **COMPLETA** ☐ **LIMITADA.** El vendedor pagará \_\_\_\_\_ % de la mano de obra y \_\_\_\_\_ % de los repuestos los sistemas cubiertos que dejen de funcionar durante el periodo de garantía. Pida al vendedor una copia del documento de garantía donde se explican detalladamente la cobertura de la garantía, exclusiones y las obligaciones que tiene el vendedor de realizar reparaciones. Conforme a la ley estatal, las "garantías implícitas" pueden darle a usted incluso más derechos.

**SISTEMAS CUBIERTOS POR LA GARANTIA:**

**DURACION:**

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

**CONTRATO DE SERVICIO.** Este vehículo tiene disponible un contrato de servicio a un precio adicional. Pida los detalles en cuanto a cobertura, deducible, precio y exclusiones. Si adquiere usted un contrato de servicio dentro de los 90 días del momento de la venta, las 'garantías implícitas' de acuerdo a la ley del estado pueden concederle derechos adicionales.

**INSPECCION PREVIA A LA COMPRA: PREGUNTE AL VENDEDOR SI PUEDE USTED TRAER UN MECANICO PARA QUE INSPECCIONE EL AUTOMOVIL O LLEVAR EL AUTOMOVIL PARA QUE ESTE LO INSPECCIONE EN SU TALLER.**

**VEASE EL DORSE DE ESTE FORMULARIO** donde se proporciona información adicional importante, incluyendo una lista de algunos de los principales defectos que pueden ocurrir en vehículos usados.

28 pt Triumvirate Bold caps

2 pt Rule

10/12 Triumvirate Bold c & lc  
flush left ragged right  
maximum line 42 picas

10 pt Baseline Rule

6 pt Triumvirate Bold caps

10 pt Baseline Rule

6 pt Triumvirate Bold caps

10 pt Triumvirate Bold caps

2 pt Rule

36 pt Box  
32 pt Triumvirate Bold caps

10/10 Triumvirate Bold c & lc  
maximum line 42 picas

1 pt Rule

36 pt Box  
32 pt Triumvirate Bold caps

10/10 Triumvirate Bold c & lc  
6 1/2 picas indent on 2nd  
line

10 pt Triumvirate Bold caps

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maximum line 42 picas

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maximum line 42 picas

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flush left ragged right  
maximum line 42 picas

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A continuación presentamos una lista de algunos de los principales defectos que pueden ocurrir en vehículos usados.

**Chasis y carrocería**

- Chasis-grietas, soldaduras correctivas u oxidado
- Chasis doblado o torcido

**Motor**

- Fuga de aceite excluyendo el escape normal
- Bloque o tapa de recámara agrietados
- Correas que fallan o no funcionan
- Fallo o pistoneo
- Emisión excesiva de humo por el sistema de escape

**Transmisión y eje de cardán**

- Nivel de líquido inadecuado o fuga, excluyendo filtración normal
- Cubierta agrietada o dañada visible
- Vibración o ruido anormal ocasionado por una transmisión o eje de cardán defectuosos
- Cambio de marchas o funcionamiento inadecuado en cualquier marcha
- Embrague manual patina o vibra

**Diferencial**

- Nivel de líquido inadecuado o fuga excluyendo filtración normal
- Cubierta agrietada o dañada visible
- Ruido o vibración anormal ocasionado por diferencial defectuoso

**Sistema de refrigeración**

- Fuga incluido el radiador
- Bomba de agua defectuosa

**Sistema eléctrico**

- Fuga en las baterías
- Alternador, generador, batería, o motor de arranque defectuosos

**Sistema de combustible**

- Escape visible de combustible

**Accesorios averiados**

- Indicadores o medidores del cuadro de instrumentos
- Acondicionador de aire
- Calefactor y descargador

**Sistema de frenos**

- Luz de advertencia de falla dañada
- Pedal no firma bajo presión (Especific del Dpto de Transp.)
- Juego insuficiente en el pedal (Especific del Dpto de Transp.)
- No detiene el vehículo en línea recta (Especific del Dpto de Transp.)
- Conductos dañados
- Tambor o disco muy delgados (Especific del fabricante)
- Grosor de las bandas de los frenos menor de 1/32 de pulgada
- Sistema de servofreno dañado o con escape
- Partes estructurales o mecánicas dañadas

**Sistema de dirección**

- Juego excesivo en el volante (Especific Dpto de Transp.)
- Juego en el varillaje en exceso de 1/4 pulgada
- Engranaje del volante de dirección se agarra
- Ruedas delanteras mal alineadas (Especific del Dpto de Transp.)
- Correas del sistema de servodirección aprietadas o flojas
- Nivel de líquido del sistema de servodirección inadecuado

**Sistema de suspensión**

- Sellos de conexión de rodamientos defectuosos
- Piezas estructurales dobladas o dañadas
- Barra de estabilización desconectada
- Resorte roto
- Montura del amortiguador floja
- Bujes de goma dañados o ausentes
- Estabilizador para curvas dañados o ausente
- Amortiguador tiene fuga o funciona defectuosamente

**Llantas**

- Profundidad de la banda de rodamiento menor de 2/32 de pulgada
- Diferentes tamaños de llanta
- Danos visibles

**Ruedas**

- Grietas visibles, danos o reparaciones
- Pernos de montaje sueltos o ausentes

**Sistema de Escape**

- Fuga

12 pt Triumvirate Bold lc  
flush left ragged right  
maximum line 42 picas

2 pt Rule

8/9 Triumvirate Bold c & lc  
flush left ragged right  
maximum line 20 picas  
1 em indent on 2nd line

VENDEDOR

DIRECCION

VEASE PARA RECLAMACIONES

2 pt Rule

10 pt Baseline Rule

6 pt Triumvirate Bold caps

**IMPORTANTE:** La información contenida en este formulario forma parte de todo contrato de compra de este vehículo. Constituye una contravención de la ley federal (16 C.F.R. 455) quitar este rotulo antes de la compra del vehículo por el consumidor (salvo para conducir el automovil en calidad de prueba).

2 pt Rule

10/12 Triumvirate Bold c & lc  
maximum line 42 picas

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**§ 455.6 State exemptions.**

(a) If, upon application to the Commission by an appropriate state agency, the Commission determines, that—

(1) There is a state requirement in effect which applies to any transaction to which this rule applies; and

(2) That state requirement affords an overall level of protection to consumers which is as great as, or greater than, the protection afforded by this Rule; then the Commission's Rule will not be in effect in that state to the extent specified by the Commission in its determination, for as long as the State administers and enforces effectively the state requirement.

(b) Applications for exemption under Subsection (a) should be directed to the Secretary of the Commission. When

appropriate, proceedings will be commenced in order to make a determination described in paragraph (a) of this section, and will be conducted in accordance with Subpart C of Part 1 of the Commission's Rules of Practice.

**§ 455.7 Severability.**

The provisions of this part are separate and severable from one another. If any provision is determined to be invalid, it is the Commission's intention that the remaining provisions shall continue in effect.

By direction of the Commission,  
Commissioner Bailey dissenting.

Dated: November 9, 1984.

Emily H. Rock,

Secretary.

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