UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
SAN FRANCISCO REGIONAL OFFICE

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COMMISSION AUTHORIZED

January 5, 1990

The Honorable Quentin L. Kopp, Chairman
Senate Committee on Transportation
Room 2195
State Capitol
Sacramento, CA 95814

Dear Senator Kopp:

The staff of the Federal Trade Commission's San Francisco Regional Office and Bureau of Competition are pleased to respond to your request for comments on Senate Bill 582.[1] This bill would eliminate provisions of the California Vehicle Code that regulate vehicle sales by "lessor-retailers" and instead subject them to the regulatory provisions applicable to vehicle dealers. The bill would also amend the Vehicle Code to prohibit car sales from temporary locations. We believe that the regulations would likely raise the prices that California consumers pay for new and used cars, reduce competition by limiting innovative automobile marketing methods, and deprive consumers of the savings that they could realize through such marketing methods.

INTEREST AND EXPERIENCE OF THE STAFF OF THE FEDERAL TRADE COMMISSION

Our interest in this legislation stems from the Commission's mandate to enforce the consumer protection and antitrust laws of the United States. The Federal Trade Commission is charged with promoting competition and protecting consumers from unfair methods of competition and unfair or deceptive acts or

[1] These comments are the views of the staffs of the San Francisco Regional Office and the Bureau of Competition of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner.

practices.[2] In fulfilling this mandate, the staff of the Federal Trade Commission often submits comments, upon request, to federal, state, and local governmental bodies to help assess the implications for competition and consumers of pending policy issues. In enforcing the Federal Trade Commission Act, the Commission has gained substantial experience in analyzing the impact of both private and governmental restraints on competition.

During recent years, the Commission has been involved in issues relating to restrictions that might limit alternative types of retailing beneficial to consumers. The Commission has addressed the competitive implications of time and place restrictions in various retail markets. For example, the Commission has promulgated a Trade Regulation Rule on Ophthalmic Services to eliminate restraints on the commercial practice of optometry.[3] The Commission has also addressed restrictions occurring in the auto industry. For example, the Commission recently ruled that automobile dealers in the Detroit area violated the antitrust laws by agreeing to limit their hours of operation.[4] In addition, the Commission staff has conducted and published economic research concerning automobile marketing.[5]

The Commission staff has recently submitted comments to a number of state governmental bodies nationwide concerning various legislative proposals to restrict certain types of competition among automobile marketers. The Commission staff commented on two Wisconsin legislative proposals: one that would curtail

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[2] See 15 U.S.C. § 41 <u>et seq</u>.

[3] <u>See</u> Trade Regulation Rule on Ophthalmic Practice, 54 Fed. Reg. 10285 (March 13, 1989). (The rule bans restrictions on the practice of optometry such as limitations on branch offices, prohibitions on lay associations, prohibitions on commercial locations and bans on trade names).

[4] Detroit Auto Dealers Ass'n, Inc., FTC Docket 9189 (February 22, 1989). (The Commission decided that an agreement by area dealerships limiting hours of operation unreasonably restricted competition.)

[5] <u>See</u> Robert P. Rogers, The Effect of State Entry Regulation on Retail Automobile Markets, Federal Trade Commission, Bureau of Economics Staff Report (January 1986). (The Report concluded that state laws restricting the number of automobile dealers in a given area were costly to consumers.)

automobile dealers' participation in off-site car sales,[6] and one that would have amended the state's fair dealership law to make it difficult for a grantor of dealerships to terminate dealers in response to changes in demand for products or to improve distribution systems.[7] The Commission staff submitted comments on an Illinois bill that would have strengthened market area restrictions on franchised automobile dealerships and that would have extended those restrictions to manufacturer-franchised auto service centers;[8] a bill that would have prohibited brokers from selling new and used cars and that would have expanded Illinois's dealer licensing provisions;[9] and a bill that would have prohibited car dealers from holding sales outside of their local markets.[10] We have also submitted comments on other states' legislative initiatives concerning automobile sales.[11]

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[6] Letter from C. Steven Baker, Director, Chicago Regional Office of the Federal Trade Commission, to Thomas L. Gais, Wisconsin Department of Transportation (November 3, 1989).

[7] Letter from Jeffrey I. Zuckerman, Director, FTC Bureau of Competition, to the Honorable William P. TeWinkle, Wisconsin Senate (February 19, 1988).

[8] Letter from C. Steven Baker, Director, Chicago Regional Office of the Federal Trade Commission, to the Honorable James R. Thompson, Governor of Illinois (September 8, 1989). Governor Thompson amendatorily vetoed the provisions of the legislation relating to car dealerships and automobile service centers.

[9] Letter from C. Steven Baker, Director, Chicago Regional Office, to the Honorable Aldo A. DeAngelis, Illinois Senate (March 21, 1989). That legislation was vetoed.

[10] Letter from John M. Peterson, Director, Chicago Regional Office Trade Commission, to the Honorable Woods Bowman, Illinois House of Representatives (April 24, 1987). That legislation was vetoed.

[11] _See_ Letter from Mark Kindt, Director, Cleveland Regional Office, to the Honorable Dick Posthumus, Michigan Senate (September 29, 1988); letter from Paul Davis, Director, Atlanta Regional Office, to the Honorable Gwen Margolis, Florida Senate (March 29, 1988); letter from the Paul Davis, Director, Atlanta Regional Office, to the Honorable David C. Waldrop, Jr., South Carolina House of Representatives (March 21, 1988); letter from Marcy Tiffany, Director, Los Angeles Regional Office, to the Honorable Richard Katz, California State Assembly (January 29, 1988); letter from Jim Moseley, Director, Dallas Regional Office, to the Honorable William P. Clements, Jr., Governor of Texas (June 1, 1987).

SUMMARY OF THE PROPOSED LEGISLATION

California law currently permits automobile lessor-retailers[12] and dealers[13] to conduct off-site automobile sales on property they neither own nor lease. Moreover, lessor-retailers and dealers may use temporary structures. SB 582 would eliminate off-site automobile sales by requiring that all automobile sales be held on property that is owned or leased by the seller and that the site include permanent offices and other sales-related buildings.

AUTOMOBILE MARKETING METHODS

Various techniques can be used to assist consumers in finding licensed automobile dealers willing to sell at discounts. One source is credit unions that sponsor automobile sales conducted through licensed dealers.[14] The credit unions encourage these sales to obtain opportunities to provide automobile financing. Since cars are sold in volume, the credit unions can obtain substantial savings for their members.[15] Finally, credit union sponsored fleet sales may in some cases stimulate business for existing dealerships.[16]

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12 See Cal. Veh. Code §§ 11600 et seq.

13 See Cal. Veh. Code §§ 11700 et seq.

14 A credit union representative familiar with these kinds of sales indicated that an individual credit union generally sponsors no more than one sale per year.

15 For example, in 1986, credit unions surveyed by the Illinois Credit Union League estimated that consumers paid an average of $1,118 less for a used car at a credit union sponsored fleet sale than those consumers would have paid to a "conventional" used car dealer. The Michigan Credit Union League asserts an estimated average savings of $900 per vehicle. Hertz Corporation asserts an estimated savings of approximately $1,000 per car in 1987.

16 Credit unions may offer special financing terms and rates for a fleet sale. Credit unions may pre-approve members for the financing terms and typically keep these terms open for thirty days after a fleet sale. Consumers are given the option to purchase a car that was not available at the fleet sale from a dealership under the sale's financing terms. In Wisconsin, one credit union noted that, at a recent sale, approximately 92 members were pre-approved for the fleet sale. Approximately 42 (continued...)

Car rental companies, such as Hertz and Avis, are a primary source of automobiles for sales conducted on credit union premises. The fleet dealers are seeking a means of selling their used rental cars. Low overhead sales offered in conjunction with credit unions enable fleet dealers to turn over their inventories efficiently.

Innovative marketing techniques may in some cases provide cost savings and services for consumers. For example, consumers who purchase used cars at fleet sales may be able to obtain benefits that may not be available to other used car purchasers. Cars purchased at fleet sales generally carry a 12-month or 12,000 mile power-train warranty.[17] Other used cars may carry shorter term warranties or none at all. Some fleet dealers have national service networks through which consumers can have the purchased cars repaired.[18] In addition, some fleet dealers contract with local dealerships and automotive repair firms to perform service under these warranties.

OFF-SITE SALES RESTRICTIONS

The regulations proposed in SB 582 would eliminate off-site automobile sales. If that occurs, consumers could be unable to realize the savings that otherwise might have been available without the proposed restrictions.

The contemplated restrictions would eliminate car sales events in markets not served by permanent dealerships, depriving consumers in these markets of the opportunity to participate in such sales events locally. Off-site sales on credit union

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[16] (...continued) of these members purchased a car at the fleet sale. Of the remaining 50 members, 15 exercised the option and purchased a car from a dealer.

[17] Fleet dealers, like car dealerships, have an interest in maintaining good consumer relations in the communities in which they hold sales. Fleet dealers have an ongoing need to turn over their used rental car inventory and thus have an incentive to provide favorable services to consumers in order to ensure a supply of customers. We understand that Hertz Corporation, for example, provides a 30-day warranty on mechanical problems in addition to the typical 12-month or 12,000 mile power-train warranty.

[18] A national network is especially valuable to a consumer who needs service work while travelling far from the place of purchase.

property or at other temporary locations may be held for several reasons. A fleet dealer such as a car rental company may need to hold such sales to turn over inventory. A traditional dealer may wish to hold an off-premises sale to reduce inventory of overstocked cars. An off-premises sale may also be desirable if customers are supplied to the seller -- such as credit union members at a credit union-sponsored sale. Off-premises sales provide a low-overhead mechanism for bringing sellers and customers together, and the reduced overhead costs can result in savings for consumers. The advantages of selling cars in markets without permanent dealers may not be substantial enough to justify the costs associated with establishing and maintaining a permanent dealership. Some communities are probably simply too small to support permanent dealerships, and temporary off-site sales may provide local consumers with a rare opportunity to purchase a less expensive automobile.

The proposed legislation may also reduce competition in some locales. Off-premises sales conducted in some small communities may provide the only effective alternative to local dealers. Under SB 582, the local dealers would be insulated from this form of competition. As a result, California consumers in these communities may face higher prices for new and used cars.

Moreover, laws prohibiting off-site sales may harm consumers in the rental car market as well. Fleet sales benefit this market by enabling car rental companies to turn over their inventories more efficiently. By restricting fleet sales, SB 582 may tend to increase the cost of car rentals in California.[19]

The apparent purpose of SB 582 is to protect consumers from "fly-by-night" operators. The California vehicle code already addresses this concern.[20] It requires lessor-retailers participating in off-site sales to maintain a principal place of business and to obtain and post a license. The licensing procedure includes an inquiry into the applicant's personal history and requires posting of a bond. Existing law also prohibits dealers from engaging in certain unfair or deceptive acts.[21] Thus, California consumers presently are protected from unscrupulous persons who might operate off-site car sales.

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[19] See G. Stigler, The Theory of Price, 4th Edition (1987).

[20] Cal. Veh. Code §§ 11600 et seq.

[21] See Cal. Veh. Code § 11614.

CONCLUSION

We believe that unjustified limitations on off-site sales by automobile dealers and lessor-retailers are likely to increase their costs and decrease competition. This, in turn, could well increase the prices consumers pay for automobiles. For these reasons, we believe that SB 582 would harm consumers.

We appreciate having had this opportunity to provide our views on this subject.

Very truly yours,

Jeffrey Klurfeld
Acting Director
San Francisco Regional Office