



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
SAN FRANCISCO REGIONAL OFFICE

901 Market Street, Suite 570
San Francisco, CA 94103-1768
Voice: (415) 744-7920
Fax: (415) 744-7940

COMMISSION AUTHORIZED

April 29, 1994

The Honorable Ted Weggeland
Transportation Committee
California State Assembly
State Capitol
P.O. Box 942849
Sacramento, CA 94249-0001

Dear Mr. Weggeland:

The staff of the Federal Trade Commission¹ offers this comment on Assembly Bill No. 3539. This bill would make more explicit the status of businesses that offer the service of "brokering" new vehicle sales. These businesses may include individual brokers and organizations such as credit unions and buying clubs. We believe that the provisions of this bill that would enable those services to compete more effectively would benefit California consumers by saving them money and inconvenience.

I. Interest and experience of the Federal Trade Commission.

The Federal Trade Commission is empowered to prevent unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.² Consistent with this statutory mandate, the Commission and its staff work to identify restrictions that hinder competition and increase costs without providing countervailing benefits to consumers.

The Commission has long been concerned about restrictions imposed on retailing methods that can be beneficial to consumers. In the retail automobile market in particular, the Commission has

¹ These comments represent the views of the staff of the San Francisco Regional Office and the Bureau of Competition of the Federal Trade Commission, and do not necessarily represent the views of the Commission or any individual Commissioners.

² 15 U.S.C. § 41 et seq.

ruled that dealers in the Detroit area unreasonably restricted competition by agreeing to limit their hours of operation.³ The staff of the Commission has published economic research about automobile marketing.⁴

The staff of the Commission has submitted comments to state governmental bodies nationwide about proposals to restrict competition among automobile marketers. The staff has frequently commented on proposals to prohibit brokering or regulate off-premises sales, most recently in Indiana,⁵ and also in Missouri,⁶ California,⁷ Wisconsin,⁸ Illinois,⁹ and Michigan.¹⁰

³ Detroit Auto Dealers Ass'n, Inc., FTC Dkt. No. 9189 (February 22, 1989), aff'd in part and remanded in part, 955 F.2d 457 (6th Cir.), cert. denied, 113 S. Ct. 461 (1992); consent agreements accepted for public comment (January 24, 1994; April 14, 1994).

⁴ See 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 an area were costly to consumers.

⁵ Comment to Rep. Rick McConnell (February 22, 1994).

⁶ Comment to Sen. J. B. Banks (April 6, 1990).

⁷ Comment to Sen. Quentin L. Kopp (January 5, 1990).

⁸ Comment to Wisconsin Department of Transportation (November 3, 1989).

⁹ Comment to Sen. Aldo A. DeAngelis (March 21, 1989). The bill would also have expanded dealer licensing provisions. Another proposal, the subject of a comment to Gov. James R. Thompson (September 8, 1989), would have tightened market area restrictions on franchised dealerships and extended those restrictions to franchised auto service centers. Governor Thompson amendatorily vetoed the provisions relating to car dealerships and automobile service centers and vetoed the dealer licensing bill. The staff also commented on a bill to prohibit car dealers from holding sales outside their local markets. Comment to Rep. Woods Bowman (April 24, 1987).

¹⁰ Comment to Sen. Dick Posthumus (September 29, 1988). For other comments on state proposals concerning vehicle sales, see comments to Florida Sen. Gwen Margolis (March 29, 1988); South Carolina Rep. David C. Waldrop, Jr. (March 21, 1988); California Assemblyman Richard Katz (January 29, 1988); and Texas Gov. William P. Clements, Jr. (June 1, 1987).

II. Description of A.B. 3539.

This bill would make more explicit how the law governing vehicle dealers applies to brokering services for new motor vehicle sales. The law's definition of "dealer" already includes services that brokers provide.¹¹ The bill would add a separate definition of "brokering," describing it as an arrangement under which a dealer, for a fee or other consideration and for someone else, arranges, negotiates, assists, or effects the purchase of a vehicle that the dealer does not own.¹²

The bill would revise how dealers treat inter-dealer transfers of new vehicles, in part by simplifying the definition of "new vehicle," to mean one that has not been the subject of a retail sale.¹³ In their advertisements, dealers, such as brokers, that lack new-vehicle franchises would no longer be required to describe the vehicles that are the object of their services as "used."¹⁴ Other provisions of law would still

¹¹ Vehicle Code §§ 285(a) and (b) define a "dealer" to include one that "negotiates" a "sale or exchange of an interest" in a vehicle and receives or expects "commission, money, brokerage fees," or other value from the seller or purchaser, and one that deals in vehicles, "whether or not such vehicles are owned" by the "dealer." The statutory conditions for obtaining a dealer's license, set out in Vehicle Code § 11703, would not prevent an individual or firm that only provided the services described here from obtaining one. A dealer must have an established place of business, but for a dealer that does not offer vehicles for sale at retail, that place of business can be simply an office. Vehicle Code § 1671(a).

¹² A.B. 3539 § 1, to add Vehicle Code § 232.5. This new definition would not, by its terms, cover similar services offered in conjunction with leasing. The existing definition of "lessor" parallels that of "dealer," by including an individual or firm that negotiates or attempts to negotiate a lease and that expects to receive a commission, "brokerage fees," or other value from the lessee. Vehicle Code § 372.

¹³ A.B. 3539 § 2, to amend Vehicle Code § 430. Currently, a "new vehicle" is one that has not been sold; however, several exceptions preserve the "new" status of vehicles that are transferred among dealers before being sold to consumers. Cf. Vehicle Code § 665, making a similar exception from the definition of "used vehicle."

¹⁴ A.B. 3539 § 3, to amend Vehicle Code § 11713(b).

prohibit a dealer from advertising for sale new vehicles of a line or make for which the dealer lacks a franchise.¹⁵ This bill would permit such dealers to advertise that they offer brokering services.¹⁶

The bill would also regulate brokering services.¹⁷ Brokering agreements with consumers would have to be in writing.¹⁸ Purchase deposits could not exceed 2.5 percent of the selling price and would be refundable on demand, and deposits and purchase funds would have to be placed in trust until delivery (or refund).¹⁹ A dealer could not act as a "broker" and a seller in the same transaction.²⁰ A broker could not accept any compensation from any party other than the consumer.²¹ Brokering service contracts would have to describe in detail the vehicle being obtained, its actual or estimated price, the fee or consideration to be paid for brokering services, and the amount of the deposit.²² The contract would also have to advise that the consumer has the right to cancel if the price exceeds the estimated price and that the deposit is fully refundable, and would have to include a warning that the agreement is for brokering services, not for actual purchase.²³

¹⁵ Vehicle Code § 11713.1(f).

¹⁶ A.B. 3539 § 3, to amend Vehicle Code § 11713(b).

¹⁷ A.B. 3539 § 5, to add Vehicle Code § 11735. Most of these requirements duplicate requirements that already apply when a deposit is paid to a dealer that lacks a new vehicle franchise for the make being purchased. Vehicle Code § 11713(p).

¹⁸ A.B. 3539 § 5, to add Vehicle Code § 11735(a)(1).

¹⁹ A.B. 3539 § 5, to add Vehicle Code § 11735(a)(2), (3), (4), and (5).

²⁰ A.B. 3539 § 5, to add Vehicle Code § 11735(a)(6).

²¹ A.B. 3539 § 5, to add Vehicle Code § 11735(a)(7). This constraint is not necessarily inconsistent with how brokers, including credit unions and buying services, apparently operate. For credit unions, consideration could take the form of the interest paid on their loans; for buying clubs, it could be the fees received from their members.

²² A.B. 3539 § 5, to add Vehicle Code § 11735(b)(2), (3), (4), (5).

²³ A.B. 3539 § 5, to add Vehicle Code § 11735(b)(5), (6).

III. Effects of A.B. 3539.

The bill would clarify the status and perhaps encourage the business of offering, for a fee, to help consumers arrange new vehicle purchases. This service appears in many forms. One source, which has been growing over the last few years, is individual brokers and buying services that offer consumers the service of arranging new car transactions, usually for a set fee. These brokers may solicit competitive bids from dealers for vehicles that meet their customers' requirements. Thus, brokers can save consumers money on the purchase price, and they can also save them "search costs," including the cost of time and effort spent on haggling.

Another source of assistance is credit unions, which sponsor automobile sales conducted through dealers. In such sales, dealers make vehicles available to credit union members at favorable prices. Credit unions encourage these sales to promote opportunities to provide financing. Franchised dealers may agree to participate to attract potential customers and to ensure higher sales volumes, which in turn may make it possible for the dealers to offer substantial savings.²⁴ Consumers may benefit from lower prices, easier shopping, and better financing arrangements.

Buying clubs and referral services may also arrange to make new cars available to consumers at discount prices. These services, which generally charge an annual membership fee, arrange new car transactions for their members at guaranteed prices with participating franchised dealers. As with the credit unions, dealers may agree with buying clubs to offer cars to the club's members at reduced prices; in return, the dealers gain access to customers and perhaps increased volume. A survey of six automobile buying services by Changing Times magazine concluded that customers buying cars through these services would have realized substantial savings on each purchase.²⁵

These arrangements would be included in the proposed definition of "brokering." Brokers apparently must be "dealers," and A.B. 3539 would not change the law's existing requirements

²⁴ Credit union-sponsored sales may stimulate other business for dealerships, too. Special financing terms and rates may be offered for the sale, and credit union members may shop with pre-approved financing terms. Moreover, these terms may be kept open after the sale ends, so consumers may have the option to obtain a car that was not available at the sale, still under the sale's financing terms.

²⁵ Taking the Hassle out of Car-Buying, Changing Times, Aug. 1988, at 37. See also Kiplinger's Personal Finance Magazine, Dec. 1992; Car Buying for Those Who Hate to Haggle, Business Week, Aug. 30, 1993, at 86.

for becoming a "dealer."²⁶ California law now requires that, in advertisements for such services offered by firms that do not actually sell the vehicles, the vehicles must be called "used." By removing that requirement, specifically authorizing advertisements of brokering services, and redefining what is a "new" vehicle, A.B. 3539 would permit these services to be advertised more accurately. That should enable brokering services to compete more effectively.²⁷

The proposed amendment appears to leave in place provisions that might prevent brokers from naming particular makes or models in their advertisements,²⁸ however, and such a prohibition could still leave brokering services at a competitive disadvantage and increase consumers' costs. A credit union or buying club that had made specific arrangements with particular dealers might wish to publicize the makes and models that the arrangements covered. The advertising prohibition would prevent the credit union or buying club, which would lack new vehicle franchises, from advertising the availability of those vehicles that they do not have on their "premises" or cannot get "directly" from a distributor. In addition, a consumer interested in purchasing a particular model might be most interested in finding a broker that claimed to specialize in it. The ban on advertising brokering services for particular makes could impose costs on the consumer wishing to find that broker. The reason for this advertising restriction is not clear to us. The legislature

²⁶ Vehicle Code §11700 et seq.; cf. Vehicle Code §1671, setting requirements for an office or established place of business.

²⁷ There appears to be a potential inconsistency between two requirements of Vehicle Code §11713(p), which would be perpetuated by the proposed new Vehicle Code §11735. On the one hand, a "dealer" cannot accept a purchase deposit unless the vehicle is on the dealer's premises or "available" to it "directly" from the manufacturer or distributor. On the other hand, though, the statute and the bill establish terms for accepting purchase deposits by dealers, such as brokers, that may not fit those descriptions, either because they lack display or storage facilities or because they do not have vehicles available to them "directly" from the named sources.

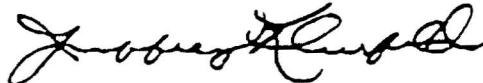
²⁸ Vehicle Code § 11713.1(f) applies to advertisements of vehicles for "sale." It would not apply to an advertisement of brokering services that did not constitute an advertisement for the "sale" of a vehicle. Vehicle Code § 11713(b) prohibits advertising or offering for sale any vehicle not actually for sale on the dealer's premises or available to the dealer directly from the manufacturer or distributor; although the proposed amendment to this section would permit advertisement of brokering services, it does not make clear whether such an advertisement could name particular makes or vehicles.

might be concerned that brokering service advertisements specifying a particular model could be connected with unethical and even illegal methods of procuring vehicles. It may be that some brokers who have claimed the ability to make deals on particularly popular models have violated the law through unfair or deceptive practices in the claims they have made or in their course of dealing. But the legislature might consider whether that problem could be addressed directly, by sanctions against brokers that engage in these practices, rather than by preventing all advertising of brokering services for particular models.²⁹

IV. Conclusion.

The provisions of A.B. 3539 that would enable brokering services, as offered by individual brokers and by organizations such as credit unions and buying clubs, to compete more effectively would benefit California consumers by saving them money and inconvenience.

Sincerely,



Jeffrey A. Klurfeld
Director

²⁹ This comment expresses no views on the effects on consumers or competition of other aspects of California's Vehicle Code that regulate dealer advertising.