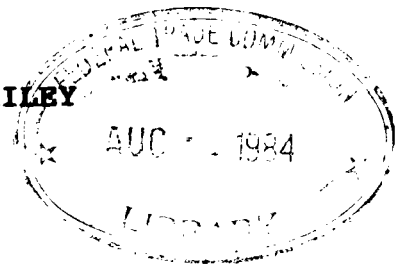

STATEMENT OF COMMISSIONER PATRICIA P. BAILEY
ON THE USED CAR RULE

July 10, 1984

Today the Federal Trade Commission meets in open session to pass its latest final judgment on the Used Car Rule. Following a novel, and wholly unwarranted, year long "reconsideration" proceeding, Bureau of Consumer Protection staff now ask the Commission to modify the rule adopted unanimously by the Commission in August 1981 by deleting the provision that would require used car dealers to inform buyers about major defects which they know about in cars they offer for sale.

This new version of the rule retains the requirement of the Buyers' Guide window sticker, but removes from it any reference to the mechanical systems of the car as well as the section for disclosure of known defects. Frankly, in this form, it reminds me of Woodrow Wilson's description of the Vice-Presidency: "The chief embarrassment in describing it is that, in saying how little there is to be said about it, one has evidently said all that there is to say."

The FTC's rulemaking authority is a potentially powerful tool for promoting consumer welfare, but this rule, without the known defects provision, is little more than a consumer education campaign masquerading as significant, industrywide regulation. The revised rule has already been and no doubt will continue to be heralded by some as a measure which will deliver important protection to the millions of Americans who buy used cars at a total cost now in excess of $85 billion a year. But it is not;

and in good conscience, I cannot vote to approve the rule in its newly proposed form. I do not believe the proposed new version adequately addresses the prevalent industrywide abuses documented in the record and I do not believe that in its born-again format it can realistically meet any adequate cost/benefit analysis.

In order to amplify my decision, let me recap the events and analysis that resulted in the adoption of the 1981 rule. In 1976, the Congress directed the FTC to investigate the used car market and to promulgate an industrywide rule concerning warranty and other sales practices, if the evidence developed during the proceeding called for such relief. As a result, the Commission conducted hearings in six cities across the country involving more than 200 witnesses, commissioned studies, and sought public comment on a variety of issues connected with the sale of used automobiles. The result is an exhaustive 50,000 page record which clearly documents two specific, prevalent problems in the used car marketplace: first, dealers misrepresent or fail to disclose essential facts about the mechanical condition of used cars at the time of sale and, second, dealers either fail to disclose or misrepresent what, if any, warranty coverage is offered on the car. The record also reveals that more than half the used cars sold in this country are purchased "as is," which means that dealers have no responsibility to repair anything that goes wrong after the car is driven off the lot. Unfortunately, rulemaking evidence confirms that consumers don't understand that the car is being sold "as is," or what that term means.

To address these extensive problems in the used car industry, the Commission considered a variety of remedial approaches, including both mandatory and optional inspection rules. Following public comment and vigorous debate, the Commission determined to eliminate any inspection component from the final rule and to retain only those elements of prior versions of the rule that required the disclosure of information already in the hands of the dealer. The primary justification for the rule the Commission promulgated in August 1981, was twofold: we found a need to counteract consistent verbal misrepresentations of and the failure to disclose both a used car's mechanical condition at the time of sale and the warranty (repair) coverage offered by the dealer. Thus after lengthy comment and consideration we decided to address those problems by requiring dealers to disclose in writing that warranty coverage offered and to advise buyers in writing of details about each car's mechanical condition that they knew about. The Commission believed that a rule with those basic requirements represented the least intrusive and least costly, yet still effective means of addressing those serious problems.

Significantly, surveys which are in the rulemaking record reveal that of all the factors consumers weigh in making a used car purchasing decision, they consider mechanical condition at the time of sale by far the most important. Unfortunately, studies also confirm that consumers have far less access compared to dealers to mechanical information about vehicles they may wish to purchase and that as a rule they do not feel they possess a

high degree of general mechanical knowledge. This is, of course, not surprising given the complexity of a piece of machinery with somewhere in the neighborhood of 15,000 parts.

Despite staff's persistent revisionist view of this rulemaking record, in fact the record leaves little doubt as to the considerable information dealers possess about the quality and mechanical condition of the vehicles they offer for sale. Indeed, whether dealers obtain used cars from consumers, other local dealers or at auctions, the record evidence is clear that either from their own or the selling dealers' inspections, they know a great deal about their vehicles' mechanical condition and defects.

The experience in the state of Wisconsin, which has a mandatory inspection law, is illustrative. A study by the Center for Public Representation evaluated the impact of the Wisconsin law, and found that two-thirds of the dealers in Wisconsin who responded did no more in the way of inspecting the cars they sold after the law went into effect than they had before. In other words, the study showed that most dealers already were inspecting their cars even when there was no legal obligation to do so. Of course, common sense and the realities of the business world dictate that this be true: dealers possess substantial information about the cars they sell because their business requires them to.

Exacerbating the inequities of the used car bargaining relationship are the deceptive sales practices prevalent in the used car industry. No one can argue that this record does not

amply demonstrate that many dealers fail to disclose defects known by them to exist at the time of sale or that consumers have been misled by affirmative oral misrepresentations about the condition of cars sold. The record evidence on these points is more than "substantial"; it is irrefutable. In a study conducted by the California Public Interest Research Group, different teams of "test shoppers" first obtained independent inspections of used cars and then later tested the dealer's willingness to impart this information to a subsequent, "prospective buyer." In 75 of 101 completed tests, the used car dealer did not disclose to the purchaser defects found in the diagnostic report that had been provided to the dealer.

The requirement that used car dealers disclose known defects directly addresses these acknowledged problems by arming consumers with precisely the information about a car's mechanical condition that they say is most important to them in considering a used car purchase. In fact, the importance of mandating the disclosure of defects information was specifically recognized by one of the leading industry trade associations, which participated extensively in the Commission's rulemaking proceeding. In comments on the Used Car Rule filed on February 1979, the National Independent Automobile Dealers Association (NIADA) wrote:

> It is always difficult and often impossible to determine the exact condition of a used product. Its parts are worn and may have been subjected to abusive treatment by previous owners. Neither buyer nor seller can ever be certain that some latent defect which evades discovery will not surface after resale. Disclosure of significant known defects,

> however, would assure that consumers, who would possess the same information as the dealer about the car's condition, could bargain for a reasonable price and warranty coverage to reflect the car's known mechanical condition.
>
> NIADA believes that a beneficial balance in consumer and dealer knowledge can be achieved by means of a rule requiring a window sticker which would disclose both significant known defects and defects discovered during any state-required safety inspection. By "significant known defects", we mean all defects which the dealer is personally aware of other than cosmetic or minor defects.

Although not affirmatively recommending a defect disclosure rule, the National Automobile Dealers Association (NADA) nevertheless also indicated its view that compared with other available remedies, the least intrusive way possible to address the problems identified in the record would be to require the disclosure of known defects.

Moreover, consumers themselves want and believe they need defect-related information, a fact which is confirmed by both the existing record in this proceeding and the Commission's most recent round of public comments, in which hundreds of consumers overwhelmingly opposed modification or deletion of the known defects disclosure requirement. In addition to the lengthy list of consumer groups that continue to support the 1981 rule, it is important also to highlight the continuing, collective endorsement of the state attorneys general for that rule. Writing for himself and 41 other attorneys general, General Miller of Iowa noted the historical difficulties associated with

a state-by-state effort to remedy this nationwide problem and stated the strong opposition of these state enforcement officers to any modification of the rule promulgated in 1981.

In eliminating any inspection component in the final rule in favor of a simple defects disclosure requirement, the Commission has candidly recognized that the rule represents a compromise response to the deceptive practices found in the used car marketplace. Indeed, a number of rulemaking participants, including the attorneys general, expressed a preference for more stringent regulatory measures. It was my belief then and it is my belief now, however, that the 1981 rule is fully supported by the record, is legally sound, survives careful cost/benefit scrutiny, and is the least intrusive means by which the extensive injury documented in the record may be effectively addressed. Indeed, rigorous analysis of the rule prepared by the Bureau of Economics revealed that the price of printing the disclosure sticker would be somewhere between 15 and 20 cents apiece. Coupled with the limited time necessary to fill out the Buyer's Guide, the Commission determined that the costs of complying with the rule would be minimal -- despite the wild, theoretical projections of certain industry groups.

Unfortunately, staff has opted for a "buyer beware" approach that -- to use an automotive analogy -- effectively removes the engine from the car. Although I have searched staff's proposal in vain for hidden benefits, I have concluded that without a defects disclosure requirement, there simply is not a sufficiently strong consumer protection rationale here to justify

the costs to dealers and the Commission to implement and enforce this trade regulation rule.

Indeed, while the disclosure of any warranties provided for a car is important information, in all other respects the revised rule will do little more than duplicate the FTC's consumer education campaign on used cars announced with much fanfare last Fall. As a part of that effort, the Commission released a fact sheet and a series of public service announcements which highlighted the need to understand the nature of the "As Is" auto purchase, the extent of any warranty coverage offered, and the desirability of obtaining independent inspections. While this was -- and is -- helpful advice, I hardly believe that turning the same information into a mandatory disclosure law with its attendant enforcement responsibilities will result in the correspondingly significant public benefits needed to justify industrywide regulation.

There is, however, another, more specific reason for rejecting this rule, and that is that it will result in the unfair abrogation of traditional dealer duties to the buyer. The various disclosures found in the 1981 Buyer's Guide -- including a listing of major known defects, a major system's checklist (with its accompanying suggestion that consumers inquire about the current condition of each of the systems listed), and a pre-purchase independent inspection disclosure -- were intended to operate hand-in-glove to provide a series of interrelated incentives for dealers to tell consumers what they already know about the current mechanical condition of a car. The revised

rule rejects the first two of these important disclosures in favor of shifting the responsibility for the discovery of a car's condition entirely to the buyer, who must seek out third-party inspection of the car.

Staff's stated rationale is to discourage buyer reliance on dealer-supplied information. While I certainly do not oppose and indeed encourage consumers to make use of independent sources of information about a car's condition, staff's one-sided approach strikes me as being a particularly expensive, inefficient, and unfair system. It is, in fact, analogous to requiring consumers to obtain independent substantiation for advertising claims, the responsibility for which we all agree as a matter of public policy best resides with those who make the product claims. In this case, as the record demonstrates, most dealers already conduct inspections or buy inspected cars from other dealers under defect disclosure contracts, and therefore have substantial defects data at hand. What makes the most sense then in terms of promoting efficiency and increasing consumer welfare is to create a system of legal checks and balances to inspire and ensure dealer fulfillment of their obligations through accurate disclosures to consumers -- and this is, of course, precisely what the 1981 rule provided.

Perhaps even more significant than the inherent unfairness of shifting the financial and other burdens of defect discovery to the purchaser, however, is the highly questionable quality of the "protection" which will now be afforded to consumers under an independent inspection rule. No one would contest that, in

theory, inspection of a car by one's own mechanic is sound practice. In recognition of this, the Commission sought to encourage this practice through the 1981 Buyer's Guide. However, the record makes plain that, for a variety of reasons, consumers do not -- and often cannot -- take advantage of independent inspections in substantial numbers. I believe it is completely unrealistic to presume that nonbinding encouragement by the federal government to seek third-party inspections is likely to have a significant, salutory effect on consumer perceptions that such procedures are costly, inefficient, inconvenient, and uncertain in effect, or to change dealer opposition to the practice in any truly meaningful fashion.

Without the required disclosure of known defects, purchasers will be left with no practical remedy to deception by dealers regarding the mechanical condition of the cars they sell. Exercise of the Commission's Section 5 authority on a case-by-case basis will do little to stem the tide, and indeed it is simply not an appropriate response to problems which are prevalent in the used car industry. Thus, the very real and potentially damaging effect of this proposal will be to inject less rather than more information into the used car marketplace.

Given the strength of the evidentiary underpinnings for and the minimally intrusive quality of the known defects provision, it is not surprising that BCP staff have been forced to look beyond traditional antiregulatory arguments to discover "new" justifications for eliminating this important consumer protection measure. Even so, I am dismayed by the specious reasoning

applied here, the bottom line of which appears to be that, when it comes to important information about a car's mechanical condition, no loaf is better than half of one. While I have no interest in engaging in a point-by-point refutation of staff's reassessment of the record and conclusory views concerning the potential effectiveness of the defects disclosure requirement, I would make several general points in response to staff's arguments -- many of which I had assumed had been laid to rest earlier in this proceeding.

I cannot accept staff's patronizing conclusion that a simple listing of defects known to the dealer would result in consumer "confusion" and undercut the effectiveness of other disclosures, such as those involving warranty coverage and independent inspection. Rather, as I have stated, all of the disclosures found in the 1981 Buyer's Guide were constructed to operate in unison to provide consumers with as much information as possible that is already in the hands of the dealer -- including correct information about a car's mechanical condition and any warranty coverage offered and the dealer's independent inspection policy. The assumption underlying this approach is that, while the government has a role to play in ensuring consumer access to accurate used car information, consumers are then perfectly

capable of making their own determinations as to how that information is used in the ensuing sales transaction.[1]

For example, seen as a complement to -- and not as a mutually exclusive replacement for -- known defects disclosure, the independent inspection notice can serve two related purposes. For one thing, it would alert consumers that a third-party inspection is one means to determine whether a car's mechanical condition is satisfactory. Second, and more important, this information may reduce consumer reliance on unenforceable verbal representations concerning the actual condition of the car. Known defects and warranty coverage disclosures serve a similarly complementary role to one another, since defect information will assist the consumer in evaluating the real cost of the vehicle and the value of any warranty offered by the dealer. Significantly, NIADA also apparently recognized the value of this approach, proposing in its 1980 comment on the rule that the used car sticker include an interdependent set of disclosures concerning known defects, warranty coverage, and pre-purchase inspection policies.

---

1 Of course no system is perfect and it is likely that some consumers will overestimate or underestimate the information they are given by the Buyer's Guide, such as by placing too much reliance on dealer inspections or warranties and too little on third-party inspections, or by assuming that a warranty covers more than it does. These problems always arise in any effort to increase consumer information. What is important is that, while some consumers may read too much into the disclosures, it seems unlikely that the net effect will be to make them more misinformed than they already are -- or will be -- with no disclosures at all.

An argument related to the "consumer confusion" assertion is that consumers may mistakenly assume that a blank disclosure form means that a car is defect free when it may not have been inspected at all. In some cases, unscrupulous dealers may prey on such assumptions by verbally affirming that the car is defect free. The first conclusion again assumes that consumers can not read or think for themselves. In designing the 1981 sticker, the Commission asked groups of people to examine the language, and, frankly, I believe the language in the Buyer's Guide is understandable in conveying to consumers the limitations of the defects disclosure. It says:

> Dealers must tell you in the space below if they know about defects in this car's major systems. The defects that must be disclosed if known are listed on the back of this form. However, there may be defects that are unknown to the dealer. If nothing is listed, the car is not necessarily free of defects. (Emphasis added)

As to the second problem, I readily admit that some dishonest dealers, even if they have inspected a car, may fail to comply with the disclosure requirements and instead verbally misrepresent the condition of the car. (E.g. "This car is in terrific shape.") This is, in part, why the Commission included a major systems checklist at the beginning of the Buyer's Guide, in addition to the required defects disclosure. This checklist, along with its admonition to ask the dealer about the condition of each of the systems listed, provides the least intrusive yet effective foil available to pre-purchase misrepresentations by arming consumers with some basic information they need to inquire independently about the specific aspects of the car's actual

mechanical condition. While not a perfect solution, of course, in my view the more mechanical and other information provided to used car consumers by the dealer or other sources, the better able they will be to protect their own rights in a sales situation. Unfortunately -- and significantly -- staff have eliminated along with the defects disclosure provision both the systems checklist and the important warning to consumers to request the facts about each system.

As I have already suggested, the Wisconsin experience and other evidence in the record strongly support a finding that dealers do inspect and therefore know a great deal about the cars they sell. Staff's conclusion that consumers would be lulled by the 1981 rule into believing they are getting reliable defects-related information, when in fact they are not because dealers don't have it, is directly contradictory to what we know about this industry.[2]

---

2 Staff make a related argument that defects disclosures wouldn't help consumers much in any event because some problems are not detectable at the time of purchase and others are likely to crop up after the sale. In support of this proposition, staff cite to the experiences of one recent rule commenter, the Detroit II Corporation, which reveal that even when used cars are inspected and repaired, more than 50 percent develop additional mechanical difficulties within 45 days of purchase. Staff's argument is, apparently, that a person should not find out about and remedy a sore throat this week because that person is likely to develop an earache the next. This, of course, is simply illogical. Detroit II's real point, which seems to have been lost on staff, is that precisely because used cars are likely to develop additional defects after sale, it boggles the mind to think how many are present before sale and, therefore, dealers should be required to tell consumers about those problems that already exist. Moreover, it is highly unlikely that problems which cannot be detected by dealers would be uncovered through independent inspection either.

Finally, I want to comment briefly on the enforcement problems associated with the 1981 rule. I am the first to admit that the known defects disclosure requirement would be tough to enforce. Indeed, as staff note, I have said in the past that it will be an exercise in investigative creativity to develop sound cases against dealers who choose not to comply with that provision. While I acknowledge that this is a problem, however, enforcement is not impossible; it is merely difficult. This is often true with FTC trade regulation rules, such as is the case with the telephone price disclosure requirement found in the Funeral Rule. As with other rules, however, individual cases are possible and they do have an impact on the industry. More importantly, enforcement difficulties are not a reason to omit an important disclosure provision from the rule in the face of overwhelming evidence of dealer deception which will otherwise go unaddressed.

Moreover, the 1981 rule would have for the first time created a legal requirement for dealers to disclose known defects. As has been our experience in other areas, I believe

the rule would create a strong incentive for the vast majority of used car dealers who are law abiding citizens to comply with the rule.[3]

After the purchase of a house, the purchase of an automobile, even a used one, is the next most expensive purchase consumers make. Yet, the record in this proceeding portrays an industry fraught with dealer deception and insufficient consumer information regarding auto defects, both of which keep consumers at a substantial bargaining disadvantage in the used car sales transaction.

In my view, the known defects provision of the 1981 Used Car Rule, coupled with other, secondary disclosures, would attack these problems head on, increasing consumer awareness of total car costs and perhaps ultimately affecting subsequent consumer purchasing behavior. Based on the same rulemaking record and no changed conditions of fact or law that I am aware of, BCP staff opt instead for a rule version which, while preserving certain educational features of the 1981 rule, curiously avoids simply requiring dealers to share with consumers defects information they have obtained in the ordinary course of their business.

---

3 Arguments that standards set forth in the known defects provision are too ambiguous for dealers to comply with or for the FTC to enforce are not realistic. In Wisconsin, where dealers have used comparable standards for several years, a number of dealers who testified during the FTC's rulemaking hearings indicated that they had no trouble understanding the terms used to define whether a defect exists. Moreover, compliance guidelines, which would have been issued pursuant to the enactment of the rule, would have provided industry members with precise guidance as to the meaning of the various defects standards.

While the costs of such regulation are minimal, they will, I believe, far exceed the value of the proposed rule in terms of legitimate consumer protection. Accordingly, and with deep personal regret, I will vote to reject staff's proposal.