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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
LOS ANGELES REGIONAL OFFICE

COMMISSION AUTHORIZED

January 29, 1988

Richard Katz
Chairman
Assembly Transportation Committee
State Capitol
P.O. Box 942849
Sacramento, CA 94249-0001

Dear Mr. Katz:

We are pleased to submit this letter in response to your request for comments on the proposed Department of Motor Vehicles' regulation regarding advertising by automobile dealers, including specifically automobile brokers.¹

The California Department of Motor Vehicles' (DMV) proposed amendment to Regulation 403.04, Article 4, entitled "Vehicle Availability," would prohibit dealers from advertising a specific vehicle or a class of vehicles unless it is in the dealer's possession or available to the dealer, "pursuant to a franchise agreement with the manufacturer or distributor of the vehicle(s)."

The Federal Trade Commission is empowered under 15 U.S.C. §§ 41 et seq. to prevent unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce. Pursuant to this statutory mandate, the Commission has attempted to encourage competition among alternative providers of goods and services by, among other things, identifying and seeking the removal of restrictions that impede competition, increase costs, and harm consumers without providing significant countervailing benefits. The Commission has acquired significant expertise in advertising restrictions in general which may be of use to you. Additionally, the Commission staff has studied the impact of certain state statutes affecting automobile dealers, and the

¹ These comments represent the views of the Los Angeles Regional Office, and the Bureaus of Consumer Protection, Competition and Economics and do not necessarily represent the views of the Commission or any individual Commissioner. The Commission, however, reviewed these comments and authorized their submission.

information produced by those studies may be useful in analyzing the effects of the proposed regulation.²

The importance of advertising in a competitive economy cautions against placing restrictions on advertising in the absence of evidence that consumers are likely to be misled. As a general proposition, restrictions on truthful, non-deceptive advertising by competitors tend to raise prices for the goods and services offered by those competitors.³

The proposed regulation would place significant restrictions on advertising by automobile brokers, who neither maintain inventories nor hold franchises from vehicle manufacturers or distributors. In this case, the restriction may deprive consumers of the truthful, non-deceptive information that they can purchase cars through brokers. Without this information, consumers may needlessly limit their comparison shopping, thereby reducing pressure on competitors to hold down prices.

² The Staff Report by FTC Economist Robert Rogers, "Effect of State Entry Regulation on Retail Automobile Markets" (January 1986), concluded that state laws that restrict the entry of new dealerships (for example, "relevant market area" (RMA) legislation similar to California's) raised automobile prices, on average, by 6%. The results of this FTC study are consistent with other studies showing that increased prices result from RMA laws. See Eckard, E.W., Jr., "The Effects of State Automobile Dealer Entry Regulations on New Car Prices," Economic Inquiry, Vol. XXIV, No. 2 (April 1985), pp. 223-42, and Smith, R.L. "Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution," Journal of Law and Economics, Vol. XXV (April 1982), pp. 125-57. (Smith notes at p. 154, "The result [of state regulation of manufacturer-dealer relations in automobile franchising] has been a significant increase in vehicle prices -- resulting in a large wealth transfer from consumers to dealers and a reduction in the volume of new-vehicle sales.")

³ Cleveland Regional Office and Bureau of Economics, Federal Trade Commission, Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (1984); Bureau of Economics, Federal Trade Commission, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry (1980); Benham, The Effects of Advertising of the Price of Eyeglasses, 15 J.L. & Econ. 337 (1972). See also American Medical Ass'n, 94 F.T.C. 701 (1979), aff'd 638 F.2d 443 (2d Cir. 1980), aff'd mem. by an equally divided Court, 455 U.S. 676 (1982) ("broad bans on advertising and soliciting are inconsistent with the nation's public policy").

If there is evidence of deception,⁴ a disclosure requirement may adequately protect consumers from deception while retaining to the extent possible the benefits of competition and truthful, non-deceptive advertising. We note that the current version of DMV Regulation 403.04 already appears to require, among other things, that an automobile broker disclose that an advertised car is not in its possession. Unless there is evidence of systematic deception by brokers subsequent to the adoption of the current rule, there may simply be no need for additional regulation of broker advertising.


As a practical matter, the effect of the proposed regulation may extend beyond advertising; the rule may indirectly prohibit automobile brokerage. Since automobile brokers would not be in a position to meet the requirements of the proposed regulation and would have trouble advertising or informing others of their services, the operations of automobile brokers may be inhibited or even eliminated.⁵

We recognize that controversy exists about the competitive effects of automobile brokerage. We take no position on what those effects might be. However, it is our view that restrictions on advertising should not be utilized as an indirect method of eliminating automobile brokers from the market.

In sum, to the extent that the proposed regulation limits truthful, non-deceptive advertising, the regulation may harm consumers. Given the complexity of the issues involved, the purposes of the proposed regulation and its probable costs and benefits should be carefully evaluated.

Thank you for considering our comments. We would be happy to supply copies of the studies and other materials cited in this letter if you so desire, or to provide any other assistance.

Sincerely,



Marcy J. K. Tiffany
Regional Director
Los Angeles Regional Office

⁴ For an illustrative discussion of some of the factors the Federal Trade Commission considers in determining whether an advertisement is deceptive, see, Policy Statement on Deception, appended to Cliffdale Associates, Inc., et al., 103 FTC 110, 174-184 (1983).

⁵ See, e.g., "Auto Brokers See Threat in DMV Proposal," Los Angeles Times, November 13, 1987, §I at p. 1.