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April 3, 2002

Mr. Lemuel Dowdy
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Magnuson-Moss Warranty Act Tie-In Issue

Dear Mr. Dowdy:

This letter is in follow up to our telephone conversation regarding concerns that have arisen within the used motor vehicle industry and consumer groups regarding the "tie-in" provisions of the Magnuson-Moss Warranty Act. As we discussed, the issue of tie-ins in relation to the Magnuson-Moss Warranty Act has surfaced during our monitoring of legal developments and pending litigation, and increasingly from inquiries that we have received from dealers, attorneys and industry representatives throughout the United States. In a nutshell, the issue is whether offering less than a 100/100 limited warranty and requiring the consumer to return to the dealership to have the services and/or repairs performed constitutes a violation of the Magnuson-Moss Warranty Act.

The Magnuson-Moss Warranty Act, which was enacted in the 1975, requires manufacturers and sellers of consumer products to provide consumers with detailed information about warranty coverage offered in written warranties. The Magnuson-Moss Warranty Act also prohibits limited warranties that contain "tie-in" provisions. The Act states in relevant part:

> No warrantor of a consumer product may condition his written or implied warranty of such product on the consumer's using, in connection with such product, any article or service (other than an article or service provided without charge under the terms of the warranty) which is identified by brand, trade, or corporate name;

15 U.S.C. §2308(a).

This provision has become known as the "anti-tying" provision of the Act because it prohibits the inclusion of provisions that condition performance of the seller's obligations under a warranty upon the consumer's use of a particular product or service. The FTC included an illustration of an impermissible tie-in in its 1987 publication titled A Businessperson's Guide to Federal Warranty Law. The FTC's example assumes the consumer sale of a vacuum cleaner with a warranty containing the following provision:

> In order to keep your new Plenum Brand Vacuum Cleaner warranty in effect, you must use genuine Plenum Brand Filter Bags. Failure to have scheduled maintenance performed, at your expense, by the Great American Maintenance Company, Inc. voids this warranty.

A Businessperson's Guide to Federal Warranty Law (May, 1987) at pg. 7.

The FTC explained that this was an example of an impermissible tie-in because it requires "a purchaser of the warranted product *to buy an item or service* from a particular company *to use with the warranted product* in order to be eligible to receive a remedy under the warranty." Id. (emphasis added). If one were to use an example by analogy that would apply to the motor vehicle industry, it is clear that a manufacturer of a motor vehicle cannot say that it will honor its warranty only if the consumer buys a particular type of oil. In this case, the obligation to purchase the additional product would be an inappropriate "tie-in" to the manufacturer's warranty. This is not the case, however, when a dealer offers less than a 100/100 warranty and requires the consumer to return to the dealership to have the services and/or repairs performed.

It has become common practice in the used motor vehicle industry for dealers to offer a "50/50" (or similar type) limited warranty in connection with the sale of used motor vehicles in order to offer consumers protections that would otherwise be unavailable to them. There are currently 213 million vehicles on the road in the United States.[1] As international competition and production creates more durable vehicles, the survival rate of motor vehicles continues to increase with the median age of motor vehicles in operation today approaching 8.5 years.[2] Motor vehicles over 10 years old have been the fastest growing segment with 30% of the vehicles on the road now over 10 years old.[3] Additionally, another 28% are 7-10 years old, meaning approximately 128 million of the total 213 million motor vehicles on the road today are over 7 years old.[4] As the credit worthiness of the average consumer continues to decline, these older used motor vehicle are more in demand every year.

Research by the Federal Reserve Board indicates that household debt is at a record high relative to disposable income.[5] In 2000, 18% of the applicants for used vehicle loans had no credit history or had scores below 620, up from 16% in 1999.[6] The number of new bankruptcies filed during calendar year 2001 rose to a historic high of 1,492,129 cases, a 19% increase from the 1,253,444 cases filed in 2000 and a 3.4% increase from the prior high of 1,442,549 cases filed in 1998. The total number of new bankruptcies filed in the fourth quarter of 2001 (Oct. 1 to Dec. 31) was 364,921, an 18% increase over the same period a year ago and the highest

fourth quarter ever.[7] Given these numbers, it is becoming next to impossible for individuals with impaired credit to find and obtain affordable and reliable transportation, which, in today's world, has become a necessity, not a luxury.

When motor vehicles are sold new, they usually come with the benefit of a limited warranty from the manufacturer of the vehicle, with coverage of most major components expiring after 3 years or 36,000 miles, whichever comes first. Therefore, if a dealer does not offer a warranty on the vehicle when it is sold used after the manufacturer's warranty expires, there will be no warranty whatsoever on the vehicle. Currently, the limited warranty offered in the used motor vehicle industry generally states that in the event of a problem, the consumer will bring the vehicle back to the selling dealer to have the repairs and/or warranty services performed with the dealer paying for 50% of the repair costs (parts and labor) and the remaining 50% of the repair costs to be borne by the consumer. While some motor vehicle dealers will offer the limited warranty for a duration of up to 1 year, most limited warranties are valid for a period of 30, 60 or 90 days. The percentage of coverage and the duration of the limited warranty may vary depending on the type of vehicle, its age and prior use.

In the late 1990s, consumer groups suggested that these types of limited warranties "might" violate the Magnuson-Moss Warranty Act's tie-in provisions. After considering commentary from consumer groups questioning whether a 50/50 type of warranty would be considered a violation of the Act, the FTC chose not to specifically prohibit them. See 64 Fed. Reg. 19700 (Apr. 22, 1999) and 15 C.F.R. 700-703. The FTC found that no specific prohibition was necessary because consumers have a choice regarding whether to use the limited warranty or have their vehicle serviced at another location. As long as consumers have a choice, the FTC reasoned, the core purpose of the Magnuson-Moss Warranty Act is protected. See 16 C.F.R. 700.10 and 16 C.F.R. 700, Interpretations, Section 1(d) Tying Arrangements.

In addition, although the FTC did not directly deal with the issue of the Magnuson-Moss Warranty Act tie-in provisions in "A Dealer's Guide: The Used Car Rule" (the "Guide"), the Guide does deal with items that touch on the issue. The Guide states that dealers must comply with the Magnuson-Moss Warranty Act. Additionally, it states that dealers may disclose the percentage of parts and labor that will be covered under a limited warranty, and even discusses dealers offering 50% coverage for parts and labor. On the same form, the dealer is required, by statute, to: (i) identify the name and address of the dealership and the name of the contact person for warranty related questions; and (ii) instruct the consumer to see the contact person for warranty related complaints. For over twenty-five years, this requirement has been interpreted to mean that the dealer may require the consumer to pay a portion of the repair charge and the dealer is the entity that the consumer should look to for performance of the warranty services. In 1998, after the FTC reprinted the Guide, which was created "to educate the industry about compliance requirements," 125,000 copies were distributed throughout the United States to the used motor vehicle industry.

Despite the language in the FTC's publications and guides, we are seeing first hand that consumer advocates across the country have begun to take an aggressive

position in arguing that the types of limited warranties discussed above violate the Magnuson-Moss Warranty Act tie-in provisions. Such advocacy includes commentary in published materials distributed at consumer protection seminars and the filing of individual and class action lawsuits. There are a number of class action lawsuits pending that are at the class certification stage. Given that warranties with less than 100% coverage for warranty related services are common place in the used motor vehicle industry, if class actions are certified and decisions rendered in favor of consumers, virtually every used motor vehicle transaction involving a limited warranty that has taken place during the past few years is in jeopardy. According to a number of attorneys handling these cases, they are concerned that without some additional authority to support their position motions to certify the class actions may well be granted.

In addition to the lawsuits filed by plaintiffs' attorneys, motor vehicle dealers in the State of Pennsylvania have be subjected to regulatory action with respect to this issue. The Pennsylvania Attorney General's Bureau of Consumer Protection has entered into an Assurance of Voluntary Compliance (AVC) with a used car dealer that it claimed offered 50/50 warranties that did not comply with the requirements of the Magnuson-Moss Warranty Act and, in turn, Pennsylvania's Automotive Trade Practices and Consumer Law Statutes. According to the AVC, the Attorney General believes that offering a 50/50 limited warranty to motor vehicle purchasers under which they are required to have any covered repairs performed at the dealer's repair garage and to pay 50% of the cost of labor and 50% of the cost of parts for the covered repairs violates the requirements of the Magnuson-Moss Warranty Act tie-in provisions. Because any failure to comply with the requirements of the Magnuson-Moss Warranty Act is deemed to be an unfair method of competition and unfair or deceptive act or practice, the Attorney General further asserted that the dealer violated Pennsylvania's Automotive Trade Practices Code and Consumer Protection Statute. The dealer did not admit to any violation, but did pay a civil penalty of $500 and costs totaling $1,000 to the Attorney General. Representatives of the Pennsylvania Attorney's General Office have agreed to defer to the FTC for further guidance before pursuing any more of these cases.

One of the primary concerns being expressed by plaintiffs' attorneys, consumer advocates and some regulators is that if limited warranties with less than 100% coverage continue to be offered, motor vehicle dealers have an incentive to artificially inflate the cost of repairs. For example, if the total cost of a repair would normally cost $200, the dealer and the consumer would each pay $100 under a 50/50 limited warranty. However, if the dealer inflates the cost of the repairs and charges the consumer $400 for the same repair, the consumer would pay $200, thus covering the cost of the entire repair and the dealer theoretically would not incur any financial obligation. This argument is without merit, however, because the average dealership markup is estimated to be 15% on parts and 30% on labor and because both Federal and State Laws afford consumers protection from these types of practices.

Federal and State Advertising Laws mandate that motor vehicle dealers offer any advertised products to consumers in accordance with the advertised terms and prices. Motor vehicle dealers regularly run advertisements for services and provide a list of the costs of repairs and parts at the dealership. A motor vehicle dealer

cannot alter its prices for labor and parts after it discovers that a consumer is requesting that the repairs be performed pursuant to a limited warranty. State Unfair and Deceptive Acts and Practices (UDAP) Statutes and Motor Vehicle Repair Rules further protect consumers by affording them the right to receive a written estimate of the anticipated cost of the repairs prior to commencing the repairs. Using Ohio's Consumer Sales Practices Act and the Administrative Rules promulgated thereunder as an example (O.R.C. § 1345.01 et seq. and O.A.C. 109:4-3-13, respectively), consumers have the right to receive an estimate for any repair if the anticipated retail repair cost exceeds twenty-five dollars. This estimate must be provided before any repair work can begin. Consumers may obtain estimates from a number of repair facilities of they wish. Armed with advance knowledge of the estimated cost of a repair, consumers have a choice of having the repair performed by the dealer or taking the vehicle to another repair facility. Therefore, just as the FTC did not find it necessary in 1999 to prohibit such warranties when this issue was first raised, it is not necessary today. Consumers still have a choice regarding whether to have repairs performed pursuant to the limited warranty or at another location if they can have them performed elsewhere for less.

If the practice of offering limited warranties with less than 100% coverage and having the consumer return to the dealership to have the repairs performed is found to violate the Magnuson-Moss Warranty Act, the result would be devastating to motor vehicle dealers and would have a negative impact on both dealers and consumers across the Country. Although dealers are currently absorbing or paying a portion of repair costs that many consumers cannot afford, they will be faced with offering 100% coverage or selling used vehicles "as-is". Remembering that the median age of motor vehicles in operation today is approaching 8.5 years and that 58% of the motor vehicles on the road now are over 7 years old, few motor vehicle dealers can afford to offer 100/100 limited warranties. If dealers cease offering 50/50 (or similar type) limited warranties, many consumers, in particular those 58% that are buying vehicles 7 years of age or older and those with impaired credit, will not be able to pay for repairs.

Per our discussions, we are not requesting that the FTC adopt a new rule or even a different interpretation of its existing Rules. Rather, we are requesting that the FTC confirm that the way motor vehicle dealers have been offering limited warranties for almost 25 years does not violate the tie-in provisions of the Magnuson-Moss Warranty Act and, in fact, is consistent with publications and guidance previously offered by the FTC. If the FTC's interpretation is other than as stated herein, these limited warranties, which currently provide consumers with additional protection that would otherwise be unaffordable, will cease to exist.

As always, I appreciate your assistance with this matter. If you would like to discuss further the information provided or the position taken herein, please do not hesitate to contact me. I look forward to your response at your earliest convenience.

Very truly yours,

Keith Whann

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[1] 2001 Used Car Market Report, Manheim Auctions, 1400 Lake Hearn Drive NE, Atlanta, GA 30319.
[2] Id.
[3] Id.
[4] Id.
[5] American Bankruptcy Institute citing research by the Federal Reserve Board.
[6] 2001 Automobile Finance Study: An Analysis of the Year-End 2000 Survey of Practices, Consumer Bankers Association, 1000 Wilson Boulevard, Suite 2500, Arlington, VA 22209-3908.
[7] February 19, 2002 Press Release from the American Bankruptcy Institute citing data from the Administrative Office of the U.S. Courts.