Eric Arnum, Editor

The FTC Explains Its Change of Heart:

How "Likely Does" Turned Into "Definitely Doesn't"

The Federal Trade Commission, seemingly reversing itself and contradicting a growing amount of casework at the state level, has told the attorney for a used auto dealer association that split-cost warranties are permissible, even when they require the buyer to bring their car back to the dealer that sold it to them.

At issue is the so-called tie-in prohibition of the Magnuson-Moss Warranty Act, which makes it illegal for a warrantor to require the buyer to make an additional purchase in order for the warranty to remain effective. But also at issue is the nature of the split-cost warranty itself, which consumer advocates say are subject to potential abuse because the warrantor gets to decide the cost, and therefore the amount to be split.

Exchange of Letters

In April 2002, a letter written by Keith Whann, counsel for the National Independent Automobile Dealers Association, asked the FTC to clarify its position on split-cost warranties that require all warranted service to be performed by the dealer.

The FTC's answer came in the form of a letter of opinion drafted on Dec. 31, 2002, and announced in the Jan. 3, 2003 weekly wrap-up (File No. P864207). It's not a prohibited tie-in of a service to a warranty because the repair is the very service ***promised*** by the warranty, the FTC reasons.

Lemuel W. Dowdy, staff attorney at the FTC's Bureau of Consumer Protection, told Warranty Week that the FTC Commissioners unanimously concluded the tie-in prohibitions of the Magnuson-Moss Warranty Act do not cover split-cost warranties, such as the "50/50 warranty" popular with used car dealers.

"The opinion letter only goes to the issue of split-cost warranties, where the consumer pays a percentage and the warrantor pays a percentage of the actual repair that's covered under the warranty," he said. So it is not at all like the FTC's classic example of a prohibited tie-in: making an automobile warranty conditional on the customer using a certain brand of motor oil.

"That [oil] doesn't have anything to do with the warranty," he said, "and that's the very reason why the tie-in provision is there: to prevent warrantors from requiring the buyer to use things that don't have anything to do with the warranty, in order to be eligible for warranty coverage."

No Problem with Percentages

Dowty noted that it would be allowable for a used car dealer to provide a 100% warranty, but to make it conditional on all the warranty service and repair work being done exclusively at his shop. It also would be allowable to make it a 25/75 split-cost warranty, or an 80/20 split, for that matter. In other words, the FTC has no problem with the percentages. There's also no problems with a deductible, if it's used instead of or in addition to a percentage split.

The FTC further acknowledges that one cannot separate either the labor or the parts into two pieces -- one covered by the warrantor and one not. So the customer is in reality not free to take the auto elsewhere for their 50% of the job, and then bringing it in so the dealer can do their 50%. The job must, by its very nature, be done all at once. Therefore it is permissible to tie that repair to the warrantor's shop.

The FTC is well aware that as the sole provider of warranty service, the dealer has an opportunity to inflate total costs so as to increase the amount paid by the consumer. However, the FTC believes the consumer who's faced with an overcharging warrantor is always free to take their auto elsewhere for non-warranty service, where the consumer pays 100% of the cost and the dealer pays 0%. They're also free to report the deception to state and federal regulators, as they would be any time a service station tries to overcharge them.

In Footnote 8 of the FTC's letter to Whann, "The Commission recognizes that there is some concern that dealers may inflate the costs of warranted repairs and in this way impose all or most of the repair cost on the purchaser. If such practices occur, they would likely constitute deceptive practices and could also constitute breaches of warranty (as failing to provide the benefit promised in the warranty)."

Fraud Is Fraud

In other words, fraud is fraud, but in this case it's conduct that's separable from the warranty. The FTC found that the 50/50 warrantor also has an opportunity to split costs honestly. It's not the nature of the warranty that's the problem; it's the dealer's honesty or lack thereof. And the FTC will not outlaw something just because dishonest behavior is possible.

"The Commission, in analyzing the tie-in provision, just didn't see how we could logically fit the conduct into the legislative purpose of the tie-in provision," Dowty said. "If deceptive practices are occurring with regards to these warranties, they certainly should be attacked. It's not appropriate to challenge these warranties under the tie-in provision. But it is appropriate to challenge them under deception theories or breach of warranty theories."

Furthermore, there are legitimate reasons why used car dealers would want to provide split-cost warranties, the FTC found. According to the FTC's letter to attorney Whann: "Rather than conditioning the warranty on the purchase of a separate product or service not covered by the warranty, a 50/50 warranty shares the cost of a single product or service. Dealers who pay a proportion of repair costs need some control over the diagnosis of the repair needed and the quality of the repair. Barring dealers from providing the repair under these types of warranties could impose hardships and costs on both consumers and dealers that do not appear warranted by the purpose or intent of the statute."

Red Light, Green Light

The FTC has twice in the past issued comments that led some to believe that split-cost warranties were permissible, and others to believe they were prohibited. In 1998, the FTC publication, "A Dealer's Guide: The Used Car Rule," stated that dealers must always disclose the percentage of parts and labor that will be covered under a limited warranty. The booklet even discusses instances where dealers offer 50 percent coverage for parts and labor. Some took that to mean that all the FTC required of the split-cost warrantor was complete disclosure of the terms.

Then in 1999, the FTC told Congress that split-cost warranties "likely violate" the Warranty Act. The key phrase, which the FTC's own letter sources in Footnote 11, came during a 1999 review of the Magnuson-Moss Warranty Act that's now entombed in the Federal Register (Volume 64, Number 77, Pages 19703-19704, April 22, 1999).

Back then, the FTC took the position that split-cost warranties which require the customer to use the warrantor's shop "already likely violate Section 102(c)," the Warranty Act's tie-in rule. The FTC also told Congress: "Since the consumer must pay a significant charge for parts and labor under these warranties, the warranties may violate section 102(c) by restricting the consumer's choices for obtaining warranty service." Ironically, that sentence was part of an explanation of why the FTC didn't think it needed to ban 50/50 warranties: because they already were illegal.

The current-day FTC noted in its Dec. 31 letter that the four-year-old comment used the word "likely," not the word "definitely." And as much as the word likely suggests more probably true than not, it still leaves enough wiggle room for a change of mind. And so by 5-0 vote, after careful consideration of opinions from both sides, the Commissioners of late 2002 changed their mind to say that split-cost warranties "definitely do not" violate Section 102(c). Or maybe they aren't changing their minds as much as they're merely "adopting the staff's long-held opinion," as the letter suggests.

Definitive Decision

The bottom line? The FTC never came down decisively on one side or the other, although it gave both sides reason to believe they were correct. Now that the Commissioners have had a chance to deliberate, they've decided to agree with the used auto dealers.

The FTC already had the power to grant case-by-case waivers of the tie-in rules to used auto dealers who could make a case for one. In "A Businessperson's Guide to Federal Warranty Law," the FTC states that "Although tie-in sales provisions generally are not allowed, you can include such a provision in your warranty if you can demonstrate to the satisfaction of the FTC that your product will not work properly without a specified item or service. If you believe that this is the case, you should contact the warranty staff of the FTC's Bureau of Consumer Protection for information on how to apply for a waiver of the tie-in sales prohibition."

See Also:

1. **The FTC Explains Its Decision**
   - The FTC's Dec. 31 letter to NIADA
2. Consumer Advocates Object
   - PA AG Press Release: 50/50's "Illegal"
3. Dealers Defend Use of 50/50 Warranties
   - Controls Cost, Shares Risk, Peace of Mind
4. How NIADA Did It
   - Attorney Whann's April 2002 Letter to the FTC
5. Advice Columns Warn Against 50/50

Special Report on 50/50 Warranties:

1. The FTC Explains Its Change of Heart: How "Likely Does" Turned Into "Definitely Doesn't"
2. State Regulators and Consumer Advocates Say the FTC Got It Right in 1999, and Was Wrong in 2002
3. Dealerships Defend Their Reliance on 50/50 Warranties: It's Done for Buyer Peace of Mind, to Control Costs, and to Share the Risk
4. On the Advice of an Attorney: Used Auto Dealers Make an Effective Case Before the FTC
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