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FEDERAL TRADE COMMISSION
16 CFR PARTS 700, 701, 702, 703, AND 239
FINAL ACTION CONCERNING REVIEW OF INTERPRETATIONS OF MAGNUSON-MOSS WARRANTY ACT; RULE GOVERNING DISCLOSURE OF WRITTEN CONSUMER PRODUCT WARRANTY TERMS AND CONDITIONS; RULE GOVERNING PRE-SALE AVAILABILITY OF WRITTEN WARRANTY TERMS; RULE GOVERNING INFORMAL DISPUTE SETTLEMENT PROCEDURES; AND GUIDES FOR THE ADVERTISING OF WARRANTIES AND GUARANTEES

AGENCY: Federal Trade Commission.

ACTION: Notice of final action.

SUMMARY: The Federal Trade Commission ("the Commission") is announcing its final action in connection with the review of a set of warranty-related rules and guides: (1) the Interpretations of the Magnuson-Moss Warranty Act, 16 CFR Part 700 ("Interpretations"); (2) the Rule Governing Disclosure of Written Consumer Product Warranty Terms and Conditions, 16 CFR Part 701 ("Rule 701"); (3) the Rule Governing Pre-Sale Availability of Written Warranty Terms, 16 CFR Part 702 ("Rule 702"); (4) the Rule Governing Informal Dispute Settlement Procedures, 16 CFR Part 703 ("Rule 703"); and (5) the Guides for the Advertising of Warranties and Guarantees, 16 CFR Part 239 ("Guides").

The Interpretations represent the Commission's views on various aspects of the Magnuson-Moss Warranty Act ("the Act"), 15 U.S.C. 2301 et seq., and are intended to clarify the Act's requirements. They are similar to industry guides in that they are advisory in nature, although failure to comply with the Act and the Rules under the Act as elucidated by the Interpretations may result in corrective action by the Commission. Rule 701 specifies the information that must appear in a written warranty on a consumer product. Rule 702 details the obligations of sellers and warrantors to make warranty information available to consumers prior to purchase. Rule 703 specifies the minimum standards which must be met by any informal dispute settlement mechanism that is incorporated into a written consumer product warranty and which the consumer must use prior to pursuing any legal remedies in court. The Guides are intended to help advertisers avoid unfair or deceptive practices in the advertising of warranties or guarantees.

A request for public comment on the Interpretations, Rule 701, Rule 702, and the Guides was published on April 3, 1996. The comment period closed June 3, 1996. A request for public comment on Rule 703 was published on April 2, 1997. The comment period closed August 1, 1997. After careful review of the comments received in response to both requests, the

Commission has determined to retain the Interpretations, Rules 701, 702, and 703, and the Guides without change.

FOR FURTHER INFORMATION CONTACT: Carole I. Danielson, Investigator, Division of Marketing Practices, Federal Trade Commission, Washington, D.C. 20580, (202) 326-3115.

SUPPLEMENTARY INFORMATION: On April 3, 1996, the Commission published a Federal Register notice[1], soliciting written public comments concerning four warranty rules and guides: (1) the Commission's Interpretations of the Magnuson-Moss Warranty Act, 16 CFR Part 700; (2) the Rule Governing Disclosure of Written Consumer Product Warranty Terms and Conditions, 16 CFR Part 701; (3) the Rule Governing Pre-Sale Availability of Written Warranty Terms, 16 CFR Part 702; and (4) the Guides for the Advertising of Warranties and Guarantees, 16 CFR Part 239. On April 2, 1997, the Commission published a second Federal Register notice, this time soliciting written public comments concerning Rule 703.[2] On June 13, 1997, the Commission extended the comment period on Rule 703 until August 1, 1997.[3] The Commission requested comments on these rules and guides as part of its regulatory review program, under which it reviews rules and guides periodically in order to obtain information about the costs and benefits of the rules and guides under review, as well as their regulatory and economic impact. The information obtained assists the Commission in identifying rules and guides that warrant modification or rescission.

A. BACKGROUND

1. 16 CFR Part 700: Interpretations of the Magnuson-Moss Warranty Act ("Interpretations").

The Magnuson-Moss Warranty Act, 15 U.S.C. 2301 et seq., which governs written warranties on consumer products, was signed into law on January 4, 1975. Soon thereafter, the Commission received many questions concerning the Act's requirements. In response to these inquiries, the Commission decided to provide guidance in order to facilitate compliance with the requirements of the Act. The Commission published a policy statement in the *Federal Register* (40 FR 25721) on June 18, 1975, to provide interim guidance during the initial implementation of the Act. As the Commission continued to receive questions and requests for advisory opinions, however, it determined that guidance of a more permanent nature was appropriate. Therefore, on July 13, 1977, the Commission published in the Federal Register (42 FR 36112) its Interpretations of the Magnuson-Moss Warranty Act.

The Interpretations apply to written warranties on consumer products. They set forth the Commission's views on various terms and provisions of the Act that are not entirely clear on the face of the statute. Thus, the Interpretations clarify the Act's requirements for all who are affected by them -- consumers, manufacturers, importers, distributors, and retailers. The

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1 61 FR 14688 (April 3, 1996).

2 62 FR 15636 (April 2, 1997).

3 62 FR 32338 (June 13, 1997).

Interpretations are not substantive rules, and do not have the force or effect of such rules; like industry guides, they are advisory in nature. Nonetheless, failure to comply with the requirements of the Act and the substantive Rules adopted under the Act as elucidated by the Interpretations could result in enforcement action by the Commission.

The Interpretations cover a wide range of subjects covered by the Act and terms used in the Act, including what types of products are considered "consumer products" under the Act; what constitutes an "expression of general policy" under Section 103(b) of the Act[4] and what the Act requires with respect to such expressions of general policy; how warranty registration cards may be used in connection with full and limited warranties; what constitutes an illegal tying arrangement under Section 102(c) of the Act[5]; and how to distinguish between "written warranty," "service contract," and "insurance."

2. 16 CFR Part 701: Disclosure of Written Consumer Product Warranty Terms and Conditions ("Rule 701").

The language of the Act and its legislative history make it amply clear that Congress intended that the Commission promulgate rules regarding the disclosure of written warranty terms and conditions. Accordingly, on December 31, 1975, the Commission published Rule 701 in the *Federal Register*.[6] Rule 701 sets forth what warrantors must disclose about the terms and conditions of the written warranties they offer on consumer products that actually cost the consumer more than $15.00. Rule 701 tracks the disclosure requirements suggested in Section 102(a) of the Act,[7] specifying information that must appear in the written warranty, and, for certain disclosures, mandates the exact language that must be used. Rule 701 requires that the information be disclosed in a single document in simple, easily understood, and concise language. In promulgating Rule 701, the Commission determined that the items required to be disclosed are material facts about product warranties, the non-disclosure of which would be deceptive or misleading.[8]

In addition to specifying the information that must appear in a written warranty, Rule 701 also requires that, if the warrantor uses a warranty registration or owner registration card, the warranty must disclose whether return of the registration card is a condition precedent to warranty coverage. (16 CFR § 701.4) Finally, it clarifies that, in connection with some "seal of

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4 15 U.S.C. § 2303(b).

5 15 U.S.C. § 2302(c).

6 40 FR 60168, 60188.

7 15 U.S.C. § 2302(a).

8 40 FR 60168, 60169-60170.

approval" programs, the disclosures required by the Rule need not be given in the actual seal itself, if they are made in a publication. (16 CFR § 701.3(b))

3. 16 CFR Part 702: Pre-Sale Availability of Written Warranty Terms ("Rule 702").

Section 102(b)(1)(A) of the Act directs the Commission to prescribe rules requiring that the terms of any written warranty on a consumer product be made available to the prospective purchaser prior to the sale of the product. Accordingly, on December 31, 1975, the Commission published Rule 702 in the *Federal Register*.[9] Subsequently, the Commission amended the Rule on March 12, 1987, to provide sellers with greater flexibility in how to make warranty information available.[10]

Rule 702 establishes requirements for sellers and warrantors to make the text of any written warranty on a consumer product available to the consumer prior to sale. Among other things, the Rule (as amended) requires sellers to make the text of the warranty readily available either by (1) displaying it in close proximity to the product or (2) furnishing it on request and posting signs in prominent locations advising consumers that the warranty is available. The Rule requires warrantors to provide materials to enable sellers to comply with the Rule's requirements, and also sets out the methods by which warranty information can be made available prior to the sale if the product is sold through catalogs, mail order or door-to-door sales.

4. 16 CFR Part 703: Informal Dispute Settlement Procedures ("Rule 703").

In enacting the Warranty Act, Congress recognized the potential benefits of consumer dispute mechanisms as an alternative to the judicial process. Section 110(a) of the Act sets out the Congressional policy to "encourage warrantors to establish procedures whereby consumer disputes are fairly and expeditiously settled through informal dispute settlement mechanisms" and erected a framework for their establishment. As an incentive to warrantors to establish such informal dispute settlement mechanisms ("IDSMs"), Congress provided in Section 110(a)(3), 15 U.S.C. 2310(a)(3), that warrantors may incorporate into their written consumer product warranties a requirement that a consumer must resort to an IDSM before pursuing a legal remedy under the Act for breach of warranty. To ensure fairness to consumers, however, Congress also directed that, if a warrantor were to incorporate such a "prior resort requirement" into its written warranty, the warrantor must comply with the minimum standards set by the Commission for such

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[9] 40 FR 60168, 60189.

[10] 52 FR 7569.

IDSMs; Section 110(a)(2) directed the Commission to establish those minimum standards. Accordingly, on December 31, 1975, the Commission published Rule 703, 16 CFR Part 703.[11]

Rule 703 contains extensive procedural standards for IDSMs, which must be followed by any warrantor who wishes to incorporate an IDSM, through a prior resort requirement, into the terms of a written consumer product warranty. These standards include requirements concerning the mechanism's structure (*e.g.*, funding, staffing, and neutrality), the qualifications of staff or decision makers, the mechanism's procedures for resolving disputes (*e.g.*, notification, investigation, time limits for decisions, and follow-up), recordkeeping, and annual audits. The Rule applies *only* to those firms that choose to be bound by it by placing a prior resort requirement in their written consumer product warranties. Neither Rule 703 nor the Act requires warrantors to set up IDSMs. Furthermore, a warrantor is free to set up an IDSM that does not comply with Rule 703 as long as the warranty does not contain a prior resort requirement.

In the twenty years since Rule 703 was promulgated, most developments in mediation and arbitration programs for the resolution of consumer warranty disputes has taken place in the automobile industry. It is unclear how many companies, if any, continue to utilize a Rule 703 mechanism.[12] Most vehicle manufacturers no longer include a prior resort requirement in their warranties; thus, they and any dispute resolution programs in which they participate are not required to comply with Rule 703.

The fact that most warrantors do not include prior resort requirements in their warranties does not mean, however, that warrantors have abandoned informal dispute resolution programs. On the contrary, due to the terms of state lemon laws[13] (as explained more fully below), all major

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[11] 40 FR 60190.

[12] General Motors ceased incorporating an IDSM in its warranty beginning with its 1986 models and no longer operates a 703 program. Ford discontinued operation under Rule 703 with its 1988 model year cars. Chrysler discontinued its Rule 703 program with its 1991 models. Similarly, American Honda, Nissan, Volvo, and other auto manufacturers have all discontinued operating Rule 703 programs. The Commission has not been notified that any of these manufacturers has reinstituted a prior resort requirement in their warranties. Although they are not required to do so, the IDSMs for the major auto manufacturers continue to file annual audits with the Commission. These audits are placed on the public record and can be obtained from the FTC's Public Reference Branch, Room 130, 6th St. and Pennsylvania Ave., N.W., Washington, D.C. 20580; 202-326-2222.. (FTC File No. R711002)

[13] State lemon laws give consumers the right to a replacement or a refund if their new cars cannot be repaired under warranty. Under these lemon laws, if a reasonable number of repair attempts fails to correct a major problem, the manufacturer must either replace the car or refund the full purchase price, less a reasonable allowance for the consumer's use of the car prior to

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automakers participate in either manufacturer-sponsored or state-run dispute resolution programs that frequently are modeled on the minimum standards set out in Rule 703 even though they are not required to do so under any provision of federal law.

5. 16 CFR Part 239: Guides for the Advertising of Warranties and Guarantees, ("Guides").

In May, 1985, the Commission published the Guides in the Federal Register.[14] The Guides were intended to help advertisers avoid unfair or deceptive practices when advertising warranties or guarantees. They took the place of the Commission's "Guides Against Deceptive Advertising of Guarantees," 16 CFR Part 239, adopted April 26, 1960, which had become outdated due to developments in Commission case law and, more importantly, changes in circumstances brought about by the Magnuson-Moss Warranty Act and by Rules 701 and 702 under that Act. The 1985 Guides advise that advertisements mentioning warranties or guarantees should contain a disclosure that the actual warranty document is available for consumers to read before they buy the advertised product. In addition, the Guides set forth advice for using the terms "satisfaction guarantees," "lifetime," and similar representations. Finally, the Guides advise that sellers or manufacturers should not advertise that a product is warranted or guaranteed unless they promptly and fully perform their warranty obligations.

B. ANALYSIS OF THE COMMENTS ON THE INTERPRETATIONS, RULE 701, RULE 702, AND THE GUIDES.

Seven (7) organizations submitted comments in response to the April 3, 1996, Federal Register notice.[15] The small number of comments likely reflects that compliance with these Rules and Guides is not burdensome and that seeking rescission or modification of them is therefore not a high priority for industry members most closely affected by them. In fact, the comments generally reflect a strong level of support for the view that the Warranty Rules and Guides are

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reporting the defect. Most of these laws define a "reasonable number of repair attempts" to be four or more times during the first year of ownership. Consumers may also be entitled to a refund or replacement remedy when a new car has been out of service for repair for the same problem for a cumulative period of thirty days or more within one year following delivery of the vehicle.

[14] 50 FR 18470 (May 1, 1985); 50 FR 20899 (May 21, 1985).

[15] The seven commenters are: (1) American Automobile Manufacturers Association ("AAMA"); (2) Association of International Automobile Manufacturers, Inc. ("AIAM"); (3) Cohen, Milstein, Hausfeld & Toll ("Cohen") by Gary Mason, Esq.; (4) National Consumer Law Center ("NCLC"); (5) National Retail Federation ("NRF"); (6) North American Insulation Manufacturers Association ("NAIMA"); and (7) North American Retail Dealers Association ("NARDA") by James M. Goldberg, Esq., Goldberg & Associates.

achieving the objectives they were fashioned to achieve -- *i.e.*, to facilitate the consumer's ability to obtain clear, accurate warranty information, as well as the consumer's ability to enforce a warrantor's contractual obligations under any written warranty. Some commenters enthusiastically supported the current regulatory regime. For example, AAMA stated that the current system is working well and is not unreasonably costly to warrantors. AAMA stated that the Rules are workable and understood by industry and that there is no evidence that either the adequacy of warranty disclosure or that the legal sufficiency of the warranties given is a major source of complaints; nor is there evidence that customers are unaware of their warranty rights. AAMA cautioned:

> In view of the effectiveness of the current system, AAMA and its members . . . . urge the Commission to proceed cautiously in considering a major overhaul to the Rules. Any comprehensive changes will unavoidably involve substantial compliance costs as warrantors and their staffs will have both to unlearn the current system and to assimilate the new provisions. . . . The Magnuson-Moss Warranty Act and the Rules promulgated under it provide an important avenue for consumer protection and establishing consumer confidence in the marketplace and the products they buy. As presently structured, these Rules are workable and effective, and permit warrantor compliance without unreasonable expense . . . . [A] major overhaul of the system is neither necessary or appropriate.

AAMA recommended that, before making any significant changes to the system, the Commission should first conduct a formal study of the marketplace to ensure that changes are needed, the specific proposed revisions would help, and the benefits achieved would outweigh the costs of the changes to industry and to consumers.[16]

NAIMA echoed AAMA's positive appraisal of the benefits derived from the Warranty Rules and Guides. NAIMA cautioned that, in the absence of such guides, there would be an increase in unfair and deceptive uses of warranties to promote products.[17] NAIMA believes that the warranty regulations benefit both consumers and warrantors: the requirements "increase the consumer's confidence in a warranty and increase the likelihood that a consumer will rely on the warranty . . . [T]he honest warrantor also benefits because of increased consumer confidence in warranties."[18] NAIMA noted that the costs of the warranty regulations are not imposed upon businesses by government, but rather are voluntarily assumed by companies that choose to offer written warranties. As such, NAIMA states that "any cost incurred by a firm would be calculated

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[16] AAMA at 2.

[17] NAIMA at 2.

[18] NAIMA at 4.

into a business decision to offer a warranty or guarantee and should not be weighed as a factor to eliminate or diminish the requirement."[19]

Four other commenters, although not expressly endorsing retention of the present regulatory regime, supported such retention by implication in suggesting modifications to the rules and guides which they believed would provide greater consumer protections and/or minimize burdens on firms subject to the regulations. One commenter (NRF) recommended that the Commission report to Congress that the Rule 702 was no longer necessary and recommend that Congress amend that portion of Magnuson-Moss requiring a pre-sale availability rule so that Rule 702 could be repealed.[20] However, for the reasons discussed herein, the Commission has decided that both Rule 702 and the other Rules and Guides should be retained. In the following, we discuss in more depth each of the suggestions and the basis for the Commission's decision.

1. 16 CFR 700: Interpretations.

a. "Building materials" exemption. Under Sections 700.1(c) - (f) of the Commission's Interpretations, building materials are *not* "consumer products" covered by the Act when they are already incorporated into the structure of a dwelling at the time the consumer buys the home. These same building products *are* "consumer products" covered by the Act when they are sold over-the-counter directly to the consumer by a retailer. Two commenters (Cohen and NAIMA) argued that the dichotomy created by this interpretation is confusing and irrational. They asserted that the current interpretation deprives consumers of the benefits and protections of the Act and its Rules when they purchase a home.

Cohen argued that the current interpretation is counter to the legislative history, intent, and language of the Act. The Act defines "consumer product" as "any personal property. . . which is normally used for personal, family, or household purposes (including any such property intended to be attached to or installed in any real property without regard to whether it is so attached or installed). (15 U.S.C. 2301(1)) Cohen asserted that building materials fall within the category of personal property intended to be attached to or installed in any real property. Cohen also cited the House Committee's discussion of the definition as support for the proposition that Congress intended that items that were to become part of realty were to be covered by Magnuson-Moss as "consumer products."[21]

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[19] NAIMA at 3.

[20] NRF at 2.

[21] "There are many products which fall within this definition [tangible personal property normally used for personal, family, or household purposes] which are also used for other than personal, family, or household purposes . . . . Under concepts of property law, fixtures such as hot water heaters and air conditioners when incorporated into a dwelling become a part of the real

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The Commission is not persuaded by these arguments. The Commission's analysis starts with the statute. The Commission believes that there are three conclusions that can be drawn based on the language used in the statutory definition of "consumer product." First, the definition assumes the traditional legal distinction between real property and personal property. Second, it clearly places "personal" property within the scope of the Act's coverage. Third, through the drafters' choice of language, the definition obviously stops short of sweeping within the scope of the Act's coverage *all* property, real and personal. In this connection, the legislative history includes the following instructive colloquy, which was part of the floor debate on the legislation by Congressmen Broyhill and Moss, two members of the Conference Committee and of the House Committee responsible for the Act:[22]

> Mr. Broyhill of North Carolina. I would like to address a question to Mr. Staggers or Mr. Moss concerning the definition of "consumer product" in Section 101(1) of the bill. Would a house be in the definition of consumer product?
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> Mr. Moss. A house would not fall within the definition of consumer product since a house is not quite "tangible personal property."
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> Mr. Broyhill of North Carolina. If a warranty applied to component parts of a home such as dry wall, plumbing, heating and air conditioning, would these items be in the definition of "consumer product"?
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> Mr. Moss. The definition of consumer product in Section 101 includes "tangible personal property which is distributed in commerce and which is normally used for personal, family or household purposes--including any such property intended to be attached to or installed in any real property." This definition would apply to any separate equipment such as heating and air conditioning systems which are sold with a new home. However, such a definition would not apply to items such as dry walls, pipes, or wiring which are not separate items of equipment but are rather integral components of a home.

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[21](...continued)
property. It is intended that the provisions of Title I continue to apply to such products regardless of how they are classified." H.R. Rep. No. 93-1107, 93rd Cong., 2d Sess., (1974) reprinted in 1974 U.S.C.C.A.N. 7702, at 7716-7717.

[22] Congressional Record, Vol. 120, No. 139 (September 17, 1974) p. H9316.

The Commission believes that the Interpretations embody the same practical rationale as that espoused by the Act's sponsor in the above-quoted exchange. The Interpretations draw the line, apparently contemplated by the language of the statute, to separate personalty (covered by the Act) and realty (not covered) in a manner that is clear and workable, and that is consistent with the intent of Congress, to the extent it can be determined. Thus, after having reconsidered this issue, the Commission adheres to the view that its original interpretation is correct and should be retained as written: Structural components of a new home such as lumber, dry wall, pipes or electrical conduit or wiring are not considered separate items of equipment and are not considered consumer products within the meaning of Section 101 of the Act. Insulation is another item that is a structural component of a new home and thus would not be a consumer product. These items are not *functionally* separate from the realty. In contrast, such items would be "consumer products" and within the scope of the Act were they purchased either separately or in combination to improve, repair, replace or otherwise modify an existing structure. This distinction holds true regardless of whether the consumer purchased the items for new home construction directly from a retail supplier.

b. Coverage of export items. In its comment, NCLC asked the Commission to reconsider whether its warranty regulations should apply to goods exported to foreign countries. In Section 700.1(i) of its Interpretations, the Commission stated that, although the Act arguably applies to products exported to foreign jurisdictions:

> the public interest would not be served by the use of Commission resources to enforce the Act with respect to such products. Moreover, the legislative intent to apply the requirements of the Act to such products is not sufficiently clear to justify such an extraordinary result.

No evidence has been submitted to the Commission that would justify changing its stated position. The Commission's enforcement responsibilities have expanded since adoption of the Interpretations in 1976, spreading scarce law enforcement resources further. Therefore, the Commission has decided to retain Section 700.1(i) remain as written.

c. Warrantor's decision as final. Section 700.8 prohibits the warrantor from indicating in any warranty or service contract that the decision of the warrantor, service contractor, or any designated third party is final or binding in any dispute involving the warranty or service contract. NCLC expressed the fear that a warrantor who is also the seller could circumvent this prohibition by placing such a restriction in a document other than the warranty or service contract and, therefore, suggested that the Commission reword this section in order to bar such a possibility. No evidence has been provided, however, to indicate that this hypothetical situation occurs, or that it occurs with a frequency that would merit the expenditure of Commission resources necessary to make the wording change. Absent such evidence, the Commission has decided to retain Section 700.8 unchanged.

d. Tying arrangements. Section 700.10 sets out the Commission's interpretations regarding the use of tying arrangements in connection with warranties. Among other things, Section 700.10 prohibits conditioning the continued validity of a warranty on the use of authorized repair service for non-warranty service and maintenance. NCLC recommended that the Commission amend Section 700.10 to prohibit used car warranties which provide for a percentage (*e.g.*, 25 percent) of parts and labor costs provided the repair is done by the dealer or a place of the dealer's choosing. According to NCLC, these warranties allegedly are for a short term, often 30-days or 1,000 miles. NCLC stated that these warranties are common among "low-end" used car dealers and alleges that the warranties harm consumers because they provide little value and that the consumer has little control over the prices charged for the repair. Since the consumer is paying 75 percent of the repair cost under the warranty, the consumer may actually lose money by using the warranty to obtain repairs, according to NCLC.

The Commission has determined not to incorporate the change NCLC proposed into the Interpretations for two reasons. First, a drafting change probably is not necessary to accomplish what NCLC advocated, since such warranties already likely violate Section 102(c) of the Act. Section 102(c) prohibits arrangements that condition warranty coverage on the use of an article or service identified by brand, trade, or corporate name unless that article or service is provided without charge to the consumer. 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. Second, the Commission notes that, although consumers may have little control over the prices charged for repairs under such warranties, they do have a choice of whether to use the warranty. Many states have enacted legislation requiring auto servicers to give estimates on any repair to be done. These estimates allow the consumer to shop for the best price. If the consumer realizes that having a repair done under the warranty may actually cost more than having the repair done by an independent servicer, the consumer can go elsewhere for the work. For these reasons, the Commission has decided to retain Section 700.10 as written.

2. 16 CFR 701: Disclosure of Terms and Conditions (Rule 701).

a. "On the face of the warranty" requirement. Two commenters (AAMA and AIAM) suggested that the Commission modify the requirement in Section 701.3(a)(7) that limitations on the duration of implied warranties be "disclosed on the face of the warranty." In the case of multi-page warranty documents, Section 701.1(i)(1) of the Rule defines "face of the warranty" to mean "the page on which the warranty text begins." The commenters stated that this restriction constrains the warrantor's ability to make the warranty document more user-friendly. They maintain that a warranty booklet is more difficult for consumers to read when the limitations come before complete descriptions of all warranty coverage. These commenters suggest that Section 701.3(a)(7) be modified to permit the limitations to appear anywhere within the text of the warranty, provided that the limitations are displayed prominently, clearly and conspicuously.

The Commission believes that 701.3(a)(7) should be retained without change. One of the problems that led to passage of the Magnuson-Moss Warranty Act was that warrantors frequently gave warranties which at first appeared to offer very expansive coverage, which was in fact severely eroded by provisions buried farther on in the document limiting coverage of the written warranty, or of the implied warranties of merchantability or fitness for a particular purpose. Such warranties were deceptive, since they could mislead consumers into thinking that coverage is greater than it actually is. Protection of the consumer's implied warranty rights is the bedrock of the Magnuson-Moss Warranty Act regulatory scheme. Accordingly, it is essential that any limitation on these rights be disclosed up-front and not buried elsewhere in a multi-page document. The Commission has been provided with no evidence that would compel revision of this core provision of Rule 701.

b. Value thresholds. Two commenters[23] suggested that the Commission should modify 701.3(a) and 702.3 to increase the threshold for products subject to the rules in order to account for the impact of inflation. The AAMA suggested that the threshold be raised from $15 to $25, and also suggested that the Commission report to Congress, recommending that the corresponding value thresholds in the statute itself also be adjusted (15 U.S.C. 2302(e) and 2303(d)).[24] The Commission, however, believes that the dollar thresholds set out in the rules and in the statute remain appropriate. The statute and the rules were drafted to be flexible. There is no requirement that a company offer a written warranty. Therefore, a company that sells a product costing less than $15 is under no obligation to give a written warranty. The costs of compliance are minimal for those products that cost under $15 -- *i.e.*, principally a prohibition against warranty tying arrangements and a requirement that the warranty be labeled either "limited" or "full."

Furthermore, the Commission believes that consumers might be deprived of important protections if the threshold for rule coverage were to be raised to $25. Although many warrantors voluntarily would continue to disclose fully the terms and conditions of the warranty, others might choose not to do so since the legal obligation would no longer be present. It is true that, if a low-cost product were to malfunction, some consumers might choose to simply throw it

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[23] AAMA at 3; NAIMA at 5.

[24] Section 102(e) of the Act provides that all written warranties on consumer products costing $5 or more will be subject to the provisions of Section 102. This threshold serves two purposes: First, it insures that any warrantor giving a written warranty on a consumer product costing $5 or more may not condition the warranty on the consumer's use of a specific brand or trade name of product or service (15 U.S.C. 2302(c)). Second, this section sets a floor for the written warranties to be covered by the Commission rules which were to be promulgated under the Act. Those rules could set the threshold higher than $5, but could not lower the threshold to encompass all products. In addition, Section 103(d) provides that only those warranties on products costing $10 or more must adhere to the labeling requirements of Section 103 (*i.e.*, labeling the warranty either "limited" or "full.")

away and purchase another. However, not all consumers view products costing $15 - $25 as disposable. Some consumers might choose to assert their warranty rights in getting the product repaired or replaced.[25] Therefore, the Commission has decided that the threshold values for coverage by the statute and the rules shall remain unchanged.

c. *Use of owner registration cards.* One commenter[26] recommended that Section 701.4[27] should be eliminated due to perceived conflict with the Commission's interpretations in 16 CFR 700.7(b) regarding the use of owner registration cards in connection with a *full* warranty, and with the intent of Section 104(b)(1) of the Act.[28] NARDA stated the view that retaining 701.4 would allow manufacturers to continue "raiding" retailer customer lists under the guise of "warranty card registration." NARDA opined that such customer information can be used by manufacturers to compete directly with the retailer in offering service contracts and other products. NARDA did not oppose that manufacturers be allowed to collect demographic and similar market information on consumers, but urged that they should not be allowed to do so under the premise of conditioning warranty coverage on the furnishing of that information.

A second commenter (NCLC) suggested that 700.7(c) should be clarified to prohibit return instructions for registration cards that imply that returning the card is necessary in order to

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[25] This position has some support from the 1984 Warranty Consumer Follow-Up Study, ("Warranty Rules Consumer Follow-Up : Evaluation Study Final Report" (1984), at ES-4. ["Warranty Study"]), in which over 30 percent of the respondents felt that it was important to see the warranty for products costing as little as $15.

[26] NARDA at 1-2.

[27] Section 701.4 requires a warrantor to disclose in the warranty if an owner or warranty registration card is a condition precedent to warranty coverage. The section also requires the warrantor to disclose that the return of the card is not necessary for warranty coverage if the return of such a card reasonably appears to be a condition precedent to warranty coverage and performance, but is not such a condition.

[28] Section 104(b)(1) of the Act prohibits a warrantor that offers a "full" warranty (*i.e.*, one that meets the minimum standard of coverage set out in Section 104(a)) from imposing on the consumer any duty other than notification in order to obtain warranty service. Section 700.7 of the Interpretations cover the use of warranty registration cards as a condition precedent to perform obligations under a full warranty and whether the use of such cards constitutes an "unreasonable duty" in violation of Section 104(b)(1). The Interpretations state that the use of such cards constitute an "unreasonable duty" when their return is a condition precedent to warranty performance and coverage under a full warranty. However, warrantors may suggest the use of such cards as one possible means of proof of the purchase date of the product. In addition, sellers can use these cards to obtain information from purchasers at the time of sale on behalf of the warrantor.

obtain warranty coverage. NCLC cites language such as "Return this card to ensure warranty registration" as misleading because consumers are led to believe that registration is necessary to obtain coverage.

The Commission is aware that warrantors commonly request that purchasers return owner or warranty registration cards in order to obtain marketing and demographic information. The required return of such owner registration cards is prohibited as an "unreasonable duty" *only* when the warrantor gives a full warranty; requiring return of such cards is permitted under a *limited* warranty as long as the warrantor discloses in the warranty that the consumer must return the card in order to get coverage. However, no evidence submitted to the Commission identified specific situations where the return of such a card is a condition precedent for warranty coverage, or how often this occurs, if at all. Nor has any evidence been provided that consumers actually are being misled by the language used on owner registration cards. The record, therefore, contains no indication that such language is inherently deceptive or misleading and as such should be banned. (Of course, particular language or instructions could still be challenged as deceptive or unfair under Section 5 of the FTC Act (15 U.S.C. § 45)).

In sum, in the absence of specific evidence that these cards are being misused by warrantors and/or that the language used is inherently deceptive or misleading, the Commission believes that Sections 701.4 and 700.7 should remain unchanged.

3. 16 CFR 702: Pre-Sale Availability (Rule 702).

a. Should the Rule be Rescinded? The NRF proposed that Rule 702 no longer serves the purpose for which it was intended and that it should be rescinded. Section 102(b)(1)(A) of the Magnuson-Moss Warranty Act[29] directs the Commission to promulgate rules requiring that the terms of any written warranty be made available to the consumer prior to sale. Because the Act specifically requires a pre-sale availability rule, the NRF recommended that the Commission report to Congress that the rule is no longer necessary to ensure that consumers are informed about warranties and request that Congress repeal Section 102(b)(1)(A) of the Act.

The NRF asserted that consumers no longer need Rule 702 in order to obtain information about warranties since a variety of sources exist for consumers to educate themselves about consumer issues in general, including warranties. To buttress this argument, the NRF cited an anecdotal survey conducted by three of its members indicating that consumers rarely request warranty information from retailers.[30] The NRF also cited the Commission's 1984 Warranty

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[29] 15 U.S.C. § 2302(b)(1)(A).

[30] The NRF also cites the Commission's statement in its 1987 amendment of Rule 702 that "consumers rarely consult warranty binders." (NRF at 2, citing 52 FR 7569, 7569 (March 12, 1987). However, the Commission notes that it made this statement in the context of explaining (continued...)

Study as further support for rescinding the rule. According to NRF, that study indicated that the primary reason consumers did not ask retailers for warranty information was that they already knew all they needed to know about the warranty for the particular product they were buying.[31] The NRF reasoned that since few consumers request warranty information from retailers, most consumers are aware of warranties. Therefore, according to NRF, the Commission is imposing unnecessary costs on retailers to maintain product warranties on hand and up to date.

The Commission believes that NRF is misguided in its interpretation of the Warranty Study results. The Commission believes that the Warranty Study is more a measure of the importance of warranties in making a purchase decision on certain products rather than the importance to consumers of pre-sale availability of warranty information generally on all products. The study shows that warranties were considered in the purchase decision for 54.2 percent of the products for which buyers comparison shopped.[32] In 40 percent of those cases, consumers reported having information about the warranty prior to purchasing the product. Of those 40 percent, 23.1 percent said that they received at least some of that information from reading the warranty.[33] The study goes on to state:

> Most consumers [who did not read warranties before buying] did not believe pre-purchase warranty reading was important ***in that particular instance***. . . . While very few consumers appear to engage in serious warranty reading, ***most feel that it is important to see the written warranty before buying -- only 11.8 percent of***

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[30](...continued)
why the specific detailed methods of compliance were not needed and why detailed regulatory requirements were unnecessary. While the statement is useful in explaining why more flexible methods are necessary to provide warranty information, Commission believes that it would be incorrect to infer from that statement that it is unnecessary to ensure that warranty information is available.

[31] Warranty Study at 57.

[32] The Warranty Study implies that one reason many consumers do not read warranties before buying a product is because they rarely experience problems with the products they purchase and, those who do, had few problems in obtaining satisfactory repairs under the warranty. (Warranty Study at ES-3)

[33] Warranty Study at ES-2. The Warranty Study also indicates that more people apparently learn about warranties from salespersons and newspaper or magazine articles than from an actual reading of the document. However, more people will seek out warranty information on high-priced goods. (Warranty Study at 50)

the respondents believed that it was never important to see the warranty before buying. [emphasis added][34]

If most consumers believe that it is important to see the warranty before buying in some instances, the Commission believes that it would not be in the public interest to recommend legislative action that would permit rescission of Rule 702. Certainly, before recommending that such a drastic step be taken, the Commission would require more up-to-date factual evidence countering the results of the 1984 Warranty Study regarding the importance to consumers of having warranty information available before the sale.

The Commission believes that Rule 702 continues to serve the purpose for which it was intended: to ensure that full and accurate warranty information is available prior to sale when consumers want it. In some instances and with respect to some purchases, consumers might be satisfied with general information about a warranty that can be gleaned from other sources such as advertising or a salesperson's oral presentation. Nonetheless, the warranty survey indicates that, in a substantial number of instances, such information will not satisfy consumers' needs. Because a warranty is a legally enforceable document that defines the respective rights and obligations of the purchaser and the warrantor, a summary description of the warranty, derived from advertising or from a salesman's oral representations, may or may not completely and accurately convey material terms of coverage. Such alternative sources of information are an inadequate substitute for the actual text of the warranty.

Furthermore, the 1987 amendment to Rule 702 gave retailers a great deal of flexibility in how to comply with the rule and alleviated much of the burden imposed by the original rule. The Commission believes that this flexibility has made compliance costs minimal. Anecdotal information provided by the NRF for three members regarding compliance costs does not provide an adequate basis to conclude that compliance costs outweigh benefits and that Congress should repeal the Act's requirements for a rule on pre-sale availability of warranty information.

b. Posting requirement. NARDA recommends that the Commission should amend Section 702.3(a) to eliminate the requirement that retailers post signs notifying customers where actual copies of the warranties may be obtained.[35] NARDA maintains that since the rule was adopted in 1975, compliance with the posting requirement has ebbed to the point where few retailers comply. However, despite the alleged non-compliance, NARDA believes that there has been no corresponding decrease in information made available to consumers. NARDA recommends that the rule should be amended to eliminate the posting requirement and simply

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[34] Warranty Study at ES-4.

[35] Section 702.3(a) requires the retailer to either display the actual product warranty in close proximity to the product, or to furnish it upon request. If the retailer chooses to furnish it on request, the retailer must place signs in prominent locations advising buyers that copies of warranties are available upon request.

require retailers to make warranty information available upon request.[36] NARDA believes that this modification would cause no consumer harm and would eliminate compliance costs for those retailers who do attempt to comply with the requirement.

The Commission has been concerned about the non-compliance with the Rule 702 that NARDA alleges is commonplace. As a result, the Commission has brought several actions against major retailers in recent years for failing to comply with the rule's requirements.[37] These actions place all retailers on notice that they risk Commission action by ignoring their compliance responsibilities under Rule 702. If NARDA is correct that there is widespread non-compliance with the posting requirements of Rule 702, such non-compliance would not support eliminating the requirement as much as it would support an argument for increased enforcement activity.[38]

NARDA does not offer any empirical evidence regarding the compliance costs of posting signs regarding the availability of warranty information. When the Commission amended Rule 702 in 1987, it substituted the posting requirement for the requirement in the original rule that specified the particular methods by which retailers should make the warranty information available (*e.g.*, by the use of a binder). At that time, the evidence available to the Commission indicated that the cost of posting signs is relatively low. The Commission concluded that, on balance, this low compliance cost was substantially outweighed by the potential benefit of raising consumer awareness about their ability to obtain warranty information. The Commission has seen no evidence which would challenge this conclusion and, therefore, has determined that Section 702.3(a) be retained unchanged.

c. Plain language warranties. One commenter (NCLC) suggested that the Commission amend Section 702.3 to require the display of "key points" of warranties, especially on big-ticket items.[39] NCLC also suggested that the Commission consider creating model "plain-language" warranty forms as a guide on how to write warranties that can be easily understood.

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[36] NARDA at 2-3.

[37] See, *e.g.*, Circuit City Stores, Inc., FTC Docket No. C-3389 (1992); Nobody Beats the Wiz, FTC Docket No. C-3329 (1991); The Good Guys, FTC Docket No. C-3388 (1992); Sears, Roebuck & Co., FTC Docket No. C-3529 (1994); Montgomery Ward & Co., FTC Docket No. C-3528 (1994); and R.H. Macy & Co., Inc., FTC Docket No. C-3115 (1994). In addition, the Commission brought an action against a mail order company which included charges that the company had violated Rule 702. See, Advance Watch Co., Civil Action No. 94 CV601 78AA (E.D. Mich. 1994).

[38] Interestingly, the NRF recognized the Commission's commitment to enforcing Rule 702 and asked the Commission to "reexamine its enforcement priorities in this area." (NRF at 2).

[39] Section 702.3 is the core section of Rule 702 that sets out the duties of the seller and the warrantor in making warranty information available prior to sale.

The Commission believes that market forces already drive many warrantors and retailers to promote the key points of their warranties, in print and broadcast media as well as in point-of-sale promotional pieces. In fact, because of this competition, the Commission issued its Guides for the Advertising of Warranties and Guarantees to ensure that consumers are not misled into thinking that the "key points" mentioned constitute all material terms of coverage. The Guides require a statement directing consumers to where they can obtain full details of the warranty. Given the apparent healthy competition in promoting warranties, the Commission sees no basis for government intervention to impose such a "key points" disclosure requirement. With regard to creating model "plain-language" warranty forms, the Commission believes that the examples and guidance set out in the FTC business education publications, A Businessperson's Guide to Federal Warranty Law and Writing Readable Warranties, are sufficient to assist those who want to make their warranties readable.[40]

4. 16 CFR 239: Warranty Guides

One commenter (AIAM) suggested that the Commission amend the Warranty Guides to eliminate the requirement that an advertisement mentioning a warranty also include a statement of where the consumer can find complete details about the warranty. The AIAM believed that, at least for automobiles, the statement "See your dealer for details" is a "statement of the obvious and accordingly unnecessary."

The Commission does not believe the disclosure of such information is unnecessary. The message intended is not just that the dealer or other retailer has the warranty; that much is obvious. What may not be obvious is the remainder of the message: that prospective purchasers have a right to read the warranty, if they desire, before purchasing. Because the aspects of warranty coverage touted in an advertisement may not necessarily provide a complete understanding of a warranty's overall coverage, the Commission believes that it is important to alert consumers that the actual warranty text is available for review, to obtain an accurate and complete understanding of the coverage. Accordingly, the Commission has determined to retain the Warranty Guides unchanged.

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[40] These publications as well as other consumer and business education brochures and other materials are available online in the *FTC Consumer Publications* and *FTC Business Publications* sections of the FTC's Home Page, located at http://www.ftc.gov/ftc/news.htm.

C. ANALYSIS OF COMMENTS ON RULE 703.

Thirteen (13) organizations submitted comments in response to the April 2, 1997 *Federal Register* notice.[41] The comments generally reflected strong support for the Rule 703 and indicated that the Rule is achieving the objectives it was fashioned to achieve -- *i.e.*, to encourage the fair and expeditious handling of consumer disputes through the use of informal dispute settlement mechanisms.[42] Commenters pointed to the importance of Rule 703 in serving as a standard for IDSMs in general (particularly in the absence of any other standards from private or government organizations) and, more specifically, in providing a benchmark for the state lemon law IDSMs.[43] Commenters noted that, for those 45 states that incorporate Rule 703 into their lemon laws or reference the Rule in these laws, [44] Rule 703 provides either the sole standard or a critical part of the standards that are used to determine the threshold acceptability of a dispute resolution program in accordance with state law prior resort requirements.[45] Commenters believed that the minimum standards set out in Rule 703 were developed with forethought and

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[41] The thirteen commenters are: (1) American Automobile Manufacturers Association ("AAMA"); (2) Association of International Automobile Manufacturers, Inc. ("AIAM"); (3) California Arbitration Review Program ("California"); (4) The CIT Group ("CIT"); (5) Consumers for Auto Reliability and Safety Foundation ("CARS"); (6) Council of Better Business Bureaus, Inc. ("BBB"); (7) Jay R. Drick, Esq. ("Drick"); (8) Manufactured Housing Institute ("MHI"); (9) Frank E. McLaughlin ("McLaughlin"); (10) National Association of Consumer Advocates ("NACA"); (11) National Consumer Law Center, Inc. ("NCLC"); (12) P.R. Nowicki & Company ("Nowicki"); and (13) Donald Lee Rome, Esq., Robinson & Cole ("Rome").

[42] AAMA at 1; AIAM at 1; BBB at 1-2; California at 1; CARS at 2; McLaughlin at 2-3; NACA at 1; NCLC at 1; Nowicki at 2. Although not expressly endorsing retention of the present regulatory regime, three other commenters (CIT, MHI, and Rome) supported such retention by implication in suggesting modifications to the Rule which they believed would provide greater consumer protections or would reduce burdens on firms subject to the regulations. CIT, MHI, and Rome. Only one commenter (Drick) recommended that Rule 703 be rescinded, stating that the Rule serves no useful purpose since few if any programs actually operate under Rule 703. Drick at 2.

[43] AAMA at 1; BBB at 2.

[44] Many state lemon laws prohibit consumers from pursuing a state lemon law action in court unless the consumer first attempts to resolve the claim through the manufacturer's IDSM, *if* it complies with Rule 703.

[45] BBB at 2.

have withstood the test of time and usage.[46] As one commenter put it, "Rule 703 is an integral part of a wide-ranging system of informal dispute resolution procedures . . . [which] functions smoothly and provides quick, inexpensive and informal dispute resolution."[47]

Commenters cautioned the Commission that rescinding the Rule would create significant problems for consumers and manufacturers because of the impact such action would have on the functioning of state lemon laws.[48] Rescission would create a vacuum in the 45 states that reference Rule 703 in their lemon laws, thus requiring massive efforts to alter existing state laws and reconfigure auto maker programs.[49] The uniformity in dispute resolution programs which Rule 703 promotes would be lost, to the detriment of consumers, warrantors, IDSMs, and state governments.[50]

Commenters generally did not think that compliance with the Rule was particularly burdensome or costly. The AAMA estimated that its three member companies pay the independent suppliers that administer their IDSMs an estimated $10 million, in addition to corporate staff support or related filing, recordkeeping or administrative costs.[51] However, other commenters noted that, except for the annual audit and specific record keeping requirements in Rule 703, most of the costs involved are the administrative costs that would be associated with the operation of any dispute resolution program.[52] The only IDSM to submit a comment was the BBB which operates the BBB AUTOLINE program. The BBB estimated that the annual costs of Rule 703's audit and record keeping requirements were less than $100,000 for the entire

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[46] McLaughlin at 2; Nowicki at 2.

[47] AIAM at 1.

[48] AIAM at 1; McLaughlin at 2-3; Nowicki at 2. As mentioned, many state lemon laws require consumers to resort to a manufacturer's IDSM before pursuing a legal remedy in court. However, the consumer is required to do so *only if* the IDSM complies with Rule 703.

[49] AIAM at 1; Nowicki at 2.

[50] McLaughlin at 2.

[51] AAMA at 2-3. Another report indicated that GM alone spent $8.4 million in 1994 on its BBB AUTOLINE program. Leslie Marable, "Better Business Bureaus Are A Bust," *Money*, October 1995, p. 108, cited in Nowicki at 5, fn. 5.

[52] BBB at 3; California at 2. CARS noted that any discussion of cost burdens by the manufacturers should be viewed with skepticism since most have opted not to offer Rule 703 programs and thus they are not in a position to calculate any additional costs that a 703 program would cause them to incur. CARS at 6, 7.

AUTOLINE program.[53] California stated that manufacturers have indicated that IDSM programs are a cost effective way to avoid expensive litigation and that they would continue to use these programs for warranty disputes even if not required to do so by state lemon laws.[54]

Based on its review of the comments and on its experience with the evolving area of alternative dispute resolution, the Commission has decided to retain Rule 703 unchanged. Although most commenters supported retention of Rule 703, they also recommended certain modifications that they believed would benefit consumers or reduce the burden on warrantors and IDSMs. These recommendations fall into four major categories: (1) certification or other oversight of IDSM compliance; (2) mandatory pre-dispute arbitration clauses; (3) increasing the time limit for rendering a decision from 40 days to 60 days; (4) encouraging a mediation approach to dispute resolution; and (5) other suggested modifications (*e.g.*, allowing electronic storage of records and changing the nature of the required statistical compilations).

1. Certification and oversight of IDSMs. Commenters generally expressed the view that a need exists for stronger government oversight both on the federal and state levels and for increased funding to monitor IDSM and warrantor operations to ensure that their procedures comply with Rule 703.[55] However, commenters did not suggest how such increased oversight or monitoring could, as a practical matter, be achieved given the voluntary nature of the Rule. As noted, the Rule applies only to warrantors who "give or offer to give a written warranty which incorporates an informal dispute settlement mechanism,"[56] but few warrantors incorporate an IDSM into their warranties -- *i.e.*, few include a prior resort requirement in their warranties. Therefore, there are few IDSMs that come within the ambit of the Rule's existing monitoring

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[53] BBB at 3. The AAMA estimated that the annual aggregate cost for its three members to conduct the annual audits is about $160,000. AAMA at 3. (One of the three members of AAMA is General Motors, which uses the BBB AUTOLINE as its dispute resolution mechanism; thus, there may be some duplication between the BBB figures and the AAMA figures.)

[54] California at 2.

[55] CARS at 3; McLaughlin at 3-4; Nowicki at 4-5. One suggestion was to use the model of California and Florida where manufacturers pay between 25-28 cents on each car sale to fund the state lemon law programs, including the annual review of IDSM operations. Nowicki at 5. Another commenter suggested that increased warrantor and IDSM compliance might be achieved at a lower cost by establishing a voluntary offenders program similar to the Funeral Rule Offenders Program ("FROP"), which is used in conjunction with law enforcement actions under the Commission's Funeral Rule, 16 CFR Part 453. McLaughlin at 4.

[56] 16 CFR 703.1(d).

requirement (in Section 703.7), which mandates an annual audit for compliance with the Rule.[57] The comments do not support radically revising the Rule to mandate use of IDSMs across the board, regardless of whether a warrantor incorporates an IDSM into its warranty.

Despite the fact that the Rule seldom comes into play in the manner originally contemplated (*i.e.*, by inclusion of prior resort requirements in warranties), the Rule now serves as an essential reference point for state lemon laws. Specifically, many state lemon laws, paralleling Section 110(a)(3) of the Warranty Act, prohibit the consumer from pursuing any state lemon law rights in court unless the consumer first seeks a resolution of the claim to the manufacturer's (or a state-operated) IDSM.[58] Those statutes also provide that the consumer is required to use the manufacturer's IDSM *only* if it complies with the FTC's standards set out in Rule 703. Thus, in effect, these states incorporate Rule 703 into their lemon laws.[59] A threshold question for many state lemon law suits is whether the IDSM complies with Rule 703 and thus whether the consumer must use that IDSM or may proceed directly to a court action.

The problem of determining compliance is not a new one.[60] The auto manufacturers recommended nationwide certification of IDSM compliance with Rule 703, possibly through a neutral third-party organization, that would preempt state certification standards.[61] The manufacturers argued that a federal certification program would be an incentive to warrantors to set up Rule 703 IDSMs because, among other benefits, it would eliminate the uncertainty of conflicting state certification standards and the risk of litigation over the issue of whether a mechanism complies with Rule 703.[62] Manufacturers further argued that not only does the lack of a national certification program lead to economic inefficiencies, but it also harms consumers by

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[57] Nonetheless, the manufacturer IDSMs continue to submit annual audits to the FTC on a voluntary basis.

[58] "Lemon laws" entitle the consumer to obtain a replacement or a refund for a defective new car if the warrantor is unable to repair the car after a reasonable number of repair attempts.

[59] Some state lemon laws require that the IDSM comply with additional state standards in addition to complying with the Rule 703 provisions. For example, approximately ten states (CA, CT, FL, GA, IA, NJ, NY, OH, OR, WI) require manufacturer IDSMs to maintain state-specific records in addition to the recordkeeping requirements in Rule 703.

[60] In 1988, the auto manufacturers petitioned the Commission to initiate a rulemaking proceeding to amend Rule 703, proposing, among other things, that the Commission institute a national certification program for IDSMs in order to determine whether a specified warrantor or IDSM complies with Rule 703's standards.

[61] *See, generally,* AAMA and AIAM.

[62] AAMA at 2, 5-6; AIAM at 2.

prolonging the dispute settlement process through fostering litigation over the issue of compliance.[63] The manufacturers maintained that non-uniformity in federal and state laws increases costs to warrantors, to IDSMs, and to consumers, thus frustrating the Congressional policy stated in the Warranty Act[64] of encouraging the development of IDSMs.

The Commission recognizes that a uniform certification program could possibly diminish uncertainty as to whether an IDSM complies with Rule 703 and, thus, whether the consumer must use the IDSM before pursuing a court action. Nonetheless, for the reasons stated below, the Commission has decided to reject the suggestion that it institute a national certification program.

First, it is possible that FTC certification would not eliminate an IDSM's alleged non-compliance with Rule 703 as an issue for litigation, but merely shift the focus for consumer litigants to challenge FTC certifications.[65] Such an outcome would not likely curtail the litigation that the manufacturers allege makes final resolution of disputes elusive; in fact, such a certification program might well prolong and further complicate such litigation.

Second, as a general matter, the Commission traditionally has been unwilling to commit its limited law enforcement resources to regulatory schemes that entail licensing or prior approval, such as the certification program recommended by some commenters. The Commission, moreover, would be loathe to take regulatory action likely to exert a chilling effect on competition and on experimentation by IDSMs, warrantors, and state governments in setting up and administering these programs.

Finally, were the Commission to follow some commenters' recommendation to preempt state certification standards through a federal certification program, it could jeopardize the very laws that give force to Rule 703's IDSM standards by incorporating them into state lemon law statutory schemes. For these reasons, the Commission has determined not to undertake a national certification program for IDSMs.

2. Binding arbitration clauses. Two commenters urged that the Rule be amended to permit mandatory binding arbitration clauses in consumer contracts, [66] while comments from two

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[63] AAMA at 2. No data was supplied as to the actual number of cases in which compliance with Rule 703 is litigated.

[64] 15 U.S.C. § 2310(a)(1).

[65] Conceivably, auto manufacturer litigants also might challenge the denial of certification.

[66] MHI and CIT proposed a "streamlined" warranty dispute resolution process when the dispute is related to manufactured homes. Among other characteristics of such a process, MHI (continued...)

consumer advocacy groups (NACA and NCLC) urged the Commission to continue the Rule's current prohibition against binding arbitration.[67] NACA and NCLC pointed to the increased use by corporations of mandatory binding arbitration clauses in standard form contracts with consumers. They expressed the belief that the use of binding arbitration is more favorable to institutional interests than to the consumer and that it provides the corporation with a way to avoid class actions, punitive damage awards, attorney fee awards, discovery, and juries.[68] NACA and NCLC indicated that the use of mandatory binding arbitration clauses is expanding in the securities, credit, and health care industries and expressed the fear that, without the protection of Rule 703 in its current form, warrantors may begin to require mandatory binding arbitration as a precondition of warranty coverage on consumer products.

The Commission examined the legality and the merits of mandatory binding arbitration clauses in written consumer product warranties when it promulgated Rule 703 in 1975. Although several industry representatives at that time had recommended that the Rule allow warrantors to require consumers to submit to binding arbitration, the Commission rejected that view as being contrary to the Congressional intent.

The Commission based this decision on its analysis of the plain language of the Warranty Act. Section 110(a)(3) of the Warranty Act provides that if a warrantor establishes an IDSM that complies with Rule 703 and incorporates that IDSM in its written consumer product warranty, then "[t]he consumer may not commence a civil action (other than a class action) . . . *unless he initially resorts to such procedure*." [Emphasis added.] This language clearly implies that a mechanism's decision cannot be legally binding, because if it were, it would bar later court action. The House Report supports this interpretation by stating that "[a]n adverse decision in any informal dispute settlement proceeding would not be a bar to a civil action on the warranty involved in the proceeding."[69] In summarizing its position at the time Rule 703 was adopted, the Commission stated :

> The Rule does not allow [binding arbitration] for two reasons. First, . . . Congressional intent was that decisions of Section 110 Mechanisms not be legally binding. Second, even if binding Mechanisms were contemplated by Section 110 of the Act, the

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[66](...continued)
recommended that the process allow the decision of the IDSM to be binding on the parties.

[67] *See, generally,* NACA and NCLC. Section 703.5(j) of the Rule states that the informal dispute settlement procedure *cannot* be legally binding on any person.

[68] NACA at 1-2; NCLC at 2-3.

[69] House Report [to accompany H.R. 7917], H. Report, No. 93-1107, 93d Cong., 2d Sess., (1974) at 41.

> Commission is not prepared, at this point in time, to develop guidelines for a system in which consumers would commit themselves, at the time of product purchase, to resolve any difficulties in a binding, but nonjudicial proceeding. *The Commission is not now convinced that any guidelines which it set out could ensure sufficient protection for consumers.* (Emphasis added.)[70]

Based on its analysis, the Commission determined that "reference within the written warranty to any binding, non-judicial remedy is prohibited by the Rule and the Act."[71] The Commission believes that this interpretation continues to be correct.[72] Therefore, the Commission has determined not to amend Section 703.5(j) to allow for binding arbitration. Rule 703 will continue to prohibit warrantors from including binding arbitration clauses in their contracts with consumers that would require consumers to submit warranty disputes to binding arbitration.

3. Increase time limit for rendering a decision from 40 days to 60 days. The BBB recommended that the time limit for rendering a decision be increased from 40 days to 60 days, at least for those dispute resolution programs that provide for oral hearings.[73] The BBB stated that BBB and State experience with arbitration programs indicates that time requirements should be more flexible in order to provide for an arbitration hearing, and notes that several states with state-run programs (*e.g.*, Florida, Connecticut, and Texas) allow for a 60-day time period to render decisions.[74]

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[70] 40 FR 60168, 60210 (1975). The Commission noted, however, that warrantors are not precluded from offering a binding arbitration option to consumers *after* a warranty dispute has arisen. 40 FR 60168, 60211 (1975).

[71] 40 FR 60168, 60211 (1975).

[72] At least one federal district court has upheld the Commission's position that the Warranty Act does not intend for warrantors to include binding arbitration clauses in written warranties on consumer products. *Wilson v. Waverlee Homes, Inc.*, 954 F. Supp. 1530 (M.D. Ala. 1997). The court ruled that a mobile home warrantor could not require consumers to submit their warranty dispute to binding arbitration based on the arbitration clauses in the installment sales and financing contracts between the consumers and the dealer who sold them the mobile home. The court noted that a contrary result would enable warrantors and the retailers selling their products to avoid the requirements of the Warranty Act simply by inserting binding arbitration clauses in sales contracts. *Id.* at 1539-1540.

[73] BBB at 2.

[74] BBB at 2. Twelve states offer consumers the opportunity to use a state-run arbitration (continued...)

The BBB argued that the 40-day time frame set by Rule 703 may work to the detriment of consumers because the BBB is often unable to accommodate consumer requests for delay or postponement of hearings because the Rule requires that disputes be resolved within 40 days. Furthermore, the BBB maintained that the 40-day time period often constrains their efforts to mediate disputes for those consumers who prefer a mediated resolution rather than the more formal arbitration process that Rule 703 sets forth.

When the Rule was promulgated in 1975, the Commission received many comments on its proposal that decisions must be rendered within 40 days. Many consumer commenters believed that 40 days was too long to wait when there is a malfunctioning product, while industry comments generally took the position that the time limit was too short.[75]

The goal of encouraging fair and expeditious informal handling of consumer warranty disputes remains an important step in providing consumers a means to obtain relief for defective products. The Commission's intent in promulgating the requirements set out in Rule 703 was to avoid creating artificial or unnecessary procedural burdens so long as the basic goals of speed, fairness, and independent participation are met.[76] The Commission is concerned that by the time a dispute has ripened to referral to an IDSM the consumer in many cases has already had to contend with a defective product for a protracted period. The Commission is concerned that any period longer than 40 days would, in many cases, serve only to wear down consumers so they will abandon their attempts to obtain redress. In the absence of firmer evidence to the contrary, the Commission believes that the 40-day time period, on balance, is beneficial to consumers most in need of an IDSM remedy. The Commission believes that the 40-day time limit should remain in effect.

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[74](...continued)
program in addition to, or in lieu of, a manufacturer-sponsored IDSM. Although those states require that the manufacturer-sponsored IDSM comply with Rule 703's 40-day requirement, ten of them allow their state-run panels longer than 40 days to render a decision. The time limits for state-run panels in those twelve states are as follows: **40 days**: NJ, NY; **45 days**: HI, ME, MA. The remaining states require decisions within 50-150 days: **50 days**: VT (30 days to hold hearing and 20 days thereafter to render decision); **60 days**: CT, FL; **70 days**: NH (40 days to hold hearing and 30 days thereafter to render decision) and WA (10 days to forward application to Board, 45 days thereafter to hold hearing, and 15 days after hearing to render decision); **150 days**: TX (60 days to render decision after hearing; if process not completed within 150 days of date consumer application and fee received, consumer can go into court); **no stated time limit:** GA.

[75] 40 FR 60168, 60208. Consumer witnesses recommended a time period of 10 to 30 days, while industry recommended a 90-day limit.

[76] 40 FR 60168, 60193.

4. Encourage the use of a mediation approach to settling disputes. Two commenters sounded the theme that warrantors, consumers, and IDSMs need flexibility to fashion dispute resolution procedures using mediation and other forms of alternative dispute resolution mechanisms so disputes can be resolved in an expeditious and cost effective manner.[77] MHI recommended that mediation be allowed in addition to, or in lieu of, arbitration.[78] Donald Rome recommended that the Rule encourage mediation as an approach to facilitate the early resolution of warranty disputes in a manner that would better meet the needs and expectations of consumers than more formal arbitration proceedings.[79]

The Commission supports the use of mediation to achieve a mutually-agreed-upon settlement among the parties to the dispute prior to initiating the more formal arbitration process outlined in the Rule. Indeed, Section 703.5(d) itself implies that there will be ongoing attempts to settle the dispute short of having the decision maker render a decision.

> *If the dispute has not been settled*, the Mechanism shall, as expeditiously as possible, but at least within 40 days of notification of the dispute . . . render a fair decision. [Emphasis added.]

The Commission has made clear, however, that the use of mediation must not impede those consumers who wish to pursue a remedy through other avenues, (*e.g.*, arbitration and litigation). Those avenues must be readily accessible if mediation does not produce a satisfactory resolution of the dispute. In addition, consumers must not be obligated to use mediation *instead* of the Rule 703 arbitration process, nor should they be pressured into accepting a settlement that is unsatisfactory to them. The Commission articulated its position on this subject in 1984 when it granted limited exemptions from Rule 703, for a two-year trial period, to the BBB, the Chrysler Customer Arbitration Board, the Automotive Consumer Action Panel, and the Ford Consumer Appeals Board programs.[80] The exemptions suspended the 40-day time limit and extended the Rule's time limit for arbitration decisions to 60 days in order to allow the programs up to 20 days to pursue mediation prior to conducting arbitration. In granting the exemption, however, the Commission imposed three conditions to ensure that consumers retained control over the speed of the process.

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[77] *See*, Rome; MHI

[78] MHI, Appendix A at 3.

[79] *See, generally,* Rome.

[80] 49 FR 28397 (July 12, 1984) [Approval of Exemption for BBB, Chrysler, and Automotive Consumer Action Panel]; and 50 FR 27936 (July 9, 1985) [Approval of Exemption for Ford Consumer Appeals Board]. These programs did not renew their requests for exemptions after the two-year trial period ended.

(1) The mediation process must be optional. Consumers should not be required to participate in mediation and must be allowed to terminate mediation at any time during the process and still obtain a decision from the IDSM.

(2) As soon as the consumer notifies the IDSM that he or she elects to terminate mediation and begin the arbitration process, the IDSM must render a decision within 40 days of that notification, or within 60 days of the date on which the IDSM first received notification of the dispute, whichever is less.

(3) The above two conditions must be disclosed clearly and conspicuously to the consumer after the mechanism has received notice of the dispute and prior to beginning the arbitration process.

The Commission believed that these conditions would ensure that consumers would not lose any of their protections under Rule 703 for a speedy and fair resolution of their warranty disputes. Consumers would retain control over which approach (mediation and/or arbitration) they wished to use and also would control the speed of the process.

The Commission continues to believe that mediation's informality, flexibility, and emphasis on the particular needs of disputing parties makes it a useful tool in achieving a fair and expeditious resolution of consumer product warranty disputes. However, the Commission does not believe that it is necessary to amend the Rule to specifically encourage the use of mediation since the Rule's provisions already allow for such settlements before a decision is rendered.

5. Other recommendations.

a. Changes in technology. The BBB notes that it is implementing an electronic document management system that will enable all case records and documents to be stored as electronic images. The BBB asks that Rule 703 be updated to specifically provide for storage of records as electronic images.[81]

As the BBB notes, Rule 703's recordkeeping requirements do not mandate the form in which records are stored. There is nothing in the Rule to prohibit the use of electronic storage or any other new technology, as long as the IDSM can meet its obligations under the Rule to allow public inspection and copying of the statistical summaries and other public records, to allow parties to the dispute to access and copy the records relating to the dispute, and to allow an annual audit of the IDSM's operations. It is not the Commission's intention that the Rule be

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[81] BBB at 4.

interpreted to restrict to antiquated technological methods the form or format of records required to be kept under the Rule.

b. Changing the type of required statistical analyses. One commenter (Nowicki) recommends that Section 703.6(e) be abolished.[82] Section 703.6(e) requires the IDSM to maintain certain statistical compilations, including the number and percent of disputes resolved or decided and whether the warrantor has complied; the number of decisions adverse to the consumer; and the number of decisions delayed beyond 40 days and the reasons for the delay. Mr. Nowicki argues that the categories of statistical compilations the mechanism must maintain are "either moot, nebulous, or even worse, misleading and deceptive."

Mr. Nowicki maintains, for example, that the statistical compilations underreport the number of decisions that are not resolved within 40 days because many manufacturer IDSMs assign a new file each time a consumer files a complaint, even if the consumer previously had filed a complaint for the same vehicle and the same problem. Thus, if a consumer was awarded an interim repair and refiles because the repairs did not cure the problem, the refiling is assigned a new case number and triggers a new 40-day time period. Mr. Nowicki believes the statistics would be more meaningful if they tracked the entire process of resolving the consumer's complaint about a particular vehicle, regardless of how many times the consumer refiles. Similarly, he maintains that the statistical compilations understate the level of compliance by warrantors with settlements and decisions and that the category that reports the number of "adverse decisions" under reports the number of consumers who are not awarded the relief they sought (*e.g.*, the consumer is awarded further repairs instead of a replacement).

The Commission appreciates that the statistical compilations required by Section 703.6(e) cannot provide an in-depth picture of the workings of a particular IDSM. However, the statistics were not intended to serve that function. The statistical compilations attempt to provide a basis for minimal review by the interested parties to determine whether the IDSM program is working fairly and expeditiously. Based on that review, a more detailed investigation could then be prompted. In addition, in adopting the recordkeeping requirements, the Commission was mindful that substantial recordkeeping costs might dissuade the establishment of IDSMs. Therefore, the Commission sought to minimize the costs of the recordkeeping burden on the IDSM while ensuring that sufficient information was available to the public to provide a minimal review. The Commission does not believe that there is sufficient record evidence to prompt changes in the statistical compilations required under Section 703.6(e). Accordingly, the Commission has determined to retain Section 703.6(e) unchanged.

D. REGULATORY FLEXIBILITY ACT ANALYSIS.

The Regulatory Flexibility Act provides for analysis of the potential impact on small businesses of Rules proposed by federal agencies. (5 U.S.C. 603, 604). Rules 701 and 702 are

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[82] Nowicki at 3-4.

the only warranty-related matters currently under review that require such an analysis.[83] In 1987, the Commission conducted a Regulatory Flexibility Act analysis of Rule 702 in connection with its amendment of that Rule. See 52 FR 7569. The April 3, 1996 request for comment was the first review of Rule 701 since it was promulgated in 1975 and thus presented the first opportunity to conduct such an analysis for that Rule. Therefore, the April 3 notice included questions to elicit the necessary information.

The Commission believes that a very high percentage of businesses subject to Rule 701 are "small" based on Small Business Administration size standards. Unfortunately, the available data do not provide a precise measurement of the impact Rule 701 has had on small businesses nor the economic impact that would result from leaving the Rule unchanged.

For example, in the regulatory analysis conducted for Rule 702, the Commission's investigation found that nearly all the manufacturers (11,365 companies or 97 percent) and nearly all retailers (952,916 companies or 99.3 percent) affected by Rule 702 were considered "small" using the size standards promulgated by the Small Business Administration. That investigation indicated that, if the companies were compared according to annual receipts, small retailers would represent about 47 percent and small manufacturers about 23 percent of the gross annual receipts in their respective industries.

In 1984, the FTC's Office of Impact Evaluation issued a study evaluating the Impact of the Warranty Rules [Market Facts, Warranty Rules Consumer Follow-Up: Evaluation Study. Final Report, Washington, D.C., July 1984 ("the Study")]. The Study found that some type of warranty was offered for 87 percent of the consumer products surveyed. Of those warranted products, almost 63 percent carried only a manufacturer's warranty, about 12 percent were warranted only by the retailer, and about 13 percent were covered by both a manufacturer's and a retailer's warranty. Thus, the costs of Rule 701 would appear to fall principally on manufacturers, since those entities are more likely to provide a written warranty. However, it is unknown how many of those manufacturers or retailers who give written warranties are also small entities.

Much of the burden imposed on business by Rule 701 is statutorily imposed. Section 102 of the Magnuson-Moss Warranty Act, 15 U.S.C. 2301 et seq., requires warrantors who use written warranties to disclose fully and conspicuously the terms and conditions of the warranty. The Act lists a number of items that may be included in any rules requiring disclosure that the Commission might prescribe, and, in Rule 701, the Commission tracked those items. Nonetheless, in promulgating the Rule, the Commission attempted to comply with the

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[83] Rule 703 does not require a Regulatory Flexibility Act analysis because the only entities affected by the requirements of Rule 703 are those warrantors and IDSMs who purport to follow Rule 703 standards (the auto manufacturers and their IDSM programs). Currently, none of those entities fall within the definition of "small" based on Small Business Administration size standards. Therefore, Rule 703 does not appear to have a significant effect on a substantial number of small entities.

Congressional mandate in Section 102 of the Act while minimizing the economic impact on affected businesses. For example, the Commission limited the disclosure requirements to warranties on consumer products actually costing the consumer more than $15.00. Furthermore, the Commission exempted “seal of approval” programs from providing the disclosures on the actual seal.

The comments provided some indication that the Commission succeeded in drafting the Rule so as not to make it unduly burdensome to business. The comments from AAMA and NAIMA indicate that Rule 701 is not unreasonably costly to warrantors. These two commenters indicated that the system is working well. The AAMA stated that the current system is working well and is not unreasonably costly to warrantors: the Rules are workable and understood by industry and that there is no evidence that the adequacy of warranty disclosure nor that the legal sufficiency of the warranties given is a major source of complaints, nor is there evidence that customers are unaware of their warranty rights. The AAMA stated "As presently structured, these Rules are workable and effective, and permit warrantor compliance without unreasonable expense."[84]

The NAIMA echoed AAMA’s opinion. NAIMA indicated that the costs of the warranty regulations are not imposed upon businesses by government, but rather are voluntarily assumed by companies that choose to offer written warranties. As such, NAIMA states that "any cost incurred by a firm would be calculated into a business decision to offer a warranty or guarantee and should not be weighed as a factor to eliminate or diminish the requirement."[85]

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[84] AAMA at 2.

[85] NAIMA at 3.

The other commenters were silent as to the effects of Rule 701 on small businesses. Therefore, based on the information available, the Commission has determined that, to the extent that Rule 701's requirements are not Congressionally mandated, the current version of Rule 701 does not unduly burden small businesses.

List of Subjects in 16 CFR Parts 239, 700, 701, 702, and 703.
Warranties, advertising, dispute resolution, trade practices.

Authority: 15 U.S.C. 41-58.

By direction of the Commission.

Donald S. Clark
Secretary