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UNITED STATES OF AMERICA  
FEDERAL TRADE COMMISSION  
CLEVELAND REGIONAL OFFICE

COMMISSION AUTHORIZED

September 28, 1988

V880055

The Honorable Dick Posthumus  
The Senate  
State of Michigan  
State Capitol  
Lansing, Michigan 48913

Dear Senator Posthumus:

The staff of the Federal Trade Commission is pleased to respond to your invitation to comment on the Senate substitute for House Bill 4390 (S-6).<sup>1</sup> This bill would amend Section 248 of the Michigan Vehicle Code to prohibit the business of automobile brokering. We believe that the proposed prohibition of auto brokering is likely to limit competition and injure consumers.

I. Federal Trade Commission Experience

The FTC is an independent regulatory agency responsible for fostering competition and safeguarding the interests of consumers. The staff of the FTC, upon request by federal, state and local governmental bodies, regularly analyzes legislative and regulatory proposals to identify provisions that may impair competition or increase costs without offering offsetting benefits to consumers. Section 5 of the Federal Trade Commission Act<sup>2</sup> prohibits unfair methods of competition and unfair or deceptive acts or practices. By enforcing this statute, the staff has gained substantial experience in analyzing the effects of various trade restraints, and the costs and benefits of such restraints to consumers.

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<sup>1</sup> These comments are the views of the staff of the Cleveland Regional Office and the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner.

<sup>2</sup> 15 U.S.C. Sec. 45.

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Moreover, during recent years, this agency has been actively involved in issues relating to the retail market for automobiles. In 1984, the Commission issued the Used Motor Vehicle Trade Regulation Rule in an effort to educate consumers about their warranty rights and to prevent the injury that can be caused by oral misrepresentation in used car transactions.<sup>3</sup> More recently, a study by the FTC's Bureau of Economics concluded that entry laws restricting the number of automobile dealers in an area may increase costs to car buyers in this country by as much as \$3 billion each year.<sup>4</sup> Finally, during the last two years, the staff has submitted comments to other states on issues somewhat similar to those raised by this bill.<sup>5</sup>

## II. Amendments to Section 248 Restrain Competition

The proposed amendments to section 248 prohibit the brokering of automobiles within the state of Michigan by limiting the sale of new automobiles to licensed auctioneers and new car dealers.<sup>6</sup> The purpose of these amendments is to protect dealers with substantial investment in physical plants and facilities from competition by brokers with little investment in facilities.<sup>7</sup> We believe that the amendments could reduce competition, retard innovation, and injure consumers by

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<sup>3</sup> 16 C.F.R. Sec. 455.

<sup>4</sup> R. Rogers, Effect of State Entry Regulations on Retail Automobile Markets, Federal Trade Commission, Bureau of Economics Staff Report (1986).

<sup>5</sup> See letter from the FTC staff to The Honorable Gwen Margolis, Florida Senate (March 29, 1988); letter from the FTC staff to The Honorable David C. Waldrop, Jr., South Carolina House of Representatives (March 21, 1988); letter from the FTC staff to The Honorable Richard Katz, California State Assembly (January 29, 1988); letter from the FTC staff to The Honorable William P. Clements, Governor of Texas (June 1, 1987); letter from the FTC staff to The Honorable Woods Bowman, Illinois House of Representatives (April 24, 1987).

<sup>6</sup> Section 4 of the bill defines "broker" as "a person who for a consideration negotiates or attempts to negotiate the sale, exchange, or purchase of a vehicle of a type required to be titled under this act, to which he or she does not have title or other legal interest, and who does not display vehicles for sale."

<sup>7</sup> M. Delong, An Analysis of HB 4390 (S-6) Prepared for the Michigan Senate's Republican Majority (June 10, 1988).

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entrenching one group of business owners at the expense of new entrants.

As a threshold matter, restrictions on brokering might be reasonable if a significant number of car buyers are identifying the particular cars they want to buy by taking advantage of the facilities and services offered by full-service dealers but then purchasing their cars through low-overhead automobile brokers. Restrictions on such practices, however, need not be imposed by the state. Contractual non-price provisions between dealers and manufacturers could address the problem. These provisions, if properly drafted, should not raise antitrust concerns.<sup>8</sup> State regulation, therefore, would not be required.

Several organizations have embraced automobile brokering as an innovative and cost effective way of buying and selling automobiles. For example, Amway Auto Network sells options which consumers may exercise to purchase General Motors, Ford or Chrysler automobiles at prices guaranteed not to exceed \$150 over factory invoice price. According to Amway Corporation, this option costs \$24.95 a year, and may be exercised at any of more than one hundred (100) automobile dealers in Michigan. It also is available in more than twenty-five (25) other states and the District of Columbia. The American Automobile Association works with selected automobile dealers throughout the country to provide its members with opportunities to purchase new motor vehicles at substantial discounts.<sup>9</sup> Any remuneration could make AAA an automobile broker subject to penalties for violating amended Section 248. This is true even though AAA will have done nothing more than undertake the haggling over price that intimidates many car buyers. Limiting or discouraging these methods is likely to affect consumers adversely.

Some trade associations believe that the amendments to Section 248 could also restrain competition in the used car market.<sup>10</sup> The usual practice of fleet owners, such as Hertz and Avis, is to hold used car sales on credit union property or in shopping center parking lots. These sales entail low overhead, and fleet owners frequently pass along substantial savings to

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<sup>8</sup> For example, manufacturers might restrict distribution of the product to places with point of sale expertise and with the capability of providing detailed information.

<sup>9</sup> Taking the Hassle out of Car-Buying, Changing Times (Aug. 1988), at 35-38.

<sup>10</sup> News Releases from the Car and Truck Rental and Leasing Association of Michigan (CARTRALA) (August 1988) and the Michigan Credit Union League (August 1988).

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consumers. The Michigan Credit Union League estimates that consumers purchasing cars at these sales pay an average of \$900 less per vehicle than would be paid at a "conventional" used car dealer. For arranging these sales, credit unions are compensated directly through payment of a fee by the fleet owner, or indirectly through the interest charges they receive for financing the sale of these automobiles. Under amended Section 248, credit unions could be unlawfully engaged in the brokering of automobiles. Further, the Michigan Credit Union League estimates that a significant portion of the fleet sales sponsored by member credit unions are held in or near small communities where few car-buying alternatives are available. This practice promotes competition in the used car market.

Fleet sales may also benefit consumers in the car rental market. The rental price of an automobile depends in part on the the rental agency's ability to dispose of that car efficiently once it reaches a specified mileage. Amended section 248 might hinder the ability of fleet owners to sell their inventories and therefore may tend to increase the cost of car rentals.

Moreover, cars purchased at fleet sales typically carry a 12-month or 12,000 mile power train warranty, while many other used cars carry only a 90-day warranty or none at all. This additional warranty coverage itself has a value to the consumer of several hundred dollars based on the cost of a comparable service contract.<sup>11</sup> Established automobile dealers may benefit from these warranties. Hertz, for example, contracts with a network of dealers to provide warranty service on cars it sells. According to Hertz officials, a buyer phones a toll-free number, gets the name of the nearest dealer-service facility, and takes the vehicle to that dealer. Automobile dealers with a substantial investment in physical plants including service facilities can receive an indirect benefit from these fleet sales.

### III. Conclusion

The automobile industry is dynamic, with an increasing number of dealers offering a greater variety of sales and service choices to consumers. Automobile brokering is a sales innovation that increases consumer choices. The proposed amendments to section 248 could prevent consumers from benefiting from this innovation and protect established automobile dealers from

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<sup>11</sup> Because the used car market suffers from information problems, the cost of getting this coverage on most used cars is extremely high. Rental fleets keep well-documented maintenance histories of their vehicles, and, as a result, the cost of warranty coverage is lower than for most other used car dealers.

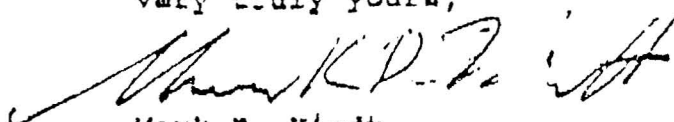
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competition. The likely net effect of prohibiting brokering will be to reduce consumer choices and increase automobile prices.

We appreciate this opportunity to provide our views on the competitive effects of HB 4390 and urge you to reconsider the proposed amendments to Section 248. We would be happy to provide further information at your request.

Very truly yours,



Mark D. Kindt  
Director  
Cleveland Regional Office