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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
CLEVELAND REGIONAL OFFICE

COMMISSION AUTHORIZED

April 7, 1989

The Honorable Rodney T. Berry
House Judiciary Committee
House of Delegates
West Virginia Legislature
State Capitol
Charleston, West Virginia 25305

Dear Delegate Berry:

The staff of the Federal Trade Commission's Cleveland Regional Office and Bureau of Competition are pleased to respond to your letter of March 1, 1989, requesting our comments on House Bill 2297.[1] This bill would prohibit the business of automobile brokering. If passed, it may reduce competition and increase the prices paid by West Virginia consumers for new and used cars. We believe that consumers will be best served if competition in the sale of automobiles in West Virginia is not restricted unnecessarily.

The proposed legislation makes a change in West Virginia law that is likely to prohibit innovative forms of competition in automobile sales.[2] The bill provides that it is unlawful to be a broker and specifies criminal penalties for violation. "Broker" is defined to include anyone other than a licensed dealer, a distributor or their employees, or the owner of the automobile. The prohibition includes any form of arranging or offering to arrange the sale of a motor vehicle for any consideration.[3] Thus, the legislation would prohibit the

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

2 SB 2297 amends Article 6 of the West Virginia Code by adding a new section: 174-6-1a (Unlawful to be a broker; definition; criminal penalties).

3 Obviously, what constitutes consideration is a matter for the courts to decide.

practices of credit unions and buying clubs that assist consumers in locating a licensed automobile dealer willing to sell at a substantial discount.[4]

INTEREST AND EXPERIENCE OF THE FEDERAL TRADE COMMISSION.

Our interest in this legislation stems from the Commission's mandate to enforce the consumer protection and antitrust laws of the United States. The Federal Trade Commission is charged with promoting competition and protecting consumers from unfair competition and unfair and deceptive practices.[5] In fulfilling this mandate, the staff of the Federal Trade Commission often submits comments, upon request, to federal, state, and local governmental bodies to help assess the competitive and consumer welfare implications of pending policy issues. In enforcing the Federal Trade Commission Act, the Commission staff has gained substantial experience in analyzing the impact of various restraints on competition (both by private action and through government intervention) and the costs and benefits to consumers of these restraints.

Moreover, during recent years, this agency has been actively involved in issues relating to the retail automobile market. In 1984, for example, the Commission issued the Used Motor Vehicle Trade Regulation Rule ("Used Car 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.[6] The Commission has also recently ruled that automobile dealers

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[4] In such cases the sales transaction is completely between the consumer and the car dealer, with the credit union or buying club simply acting as a broker. Credit unions that sponsor such sales allow automobile dealers to use their parking lots to display new or used cars and then invite credit union members to attend. Credit unions thus not only assist their members in the purchase of automobiles, but get an opportunity to offer financing for any automobile purchased at the sale. Some credit unions receive finder's fees for organizing the sales.

[5] 15 U.S.C. § 45.

[6] 16 C.F.R. § 455 (1988).

in the Detroit area violated the antitrust laws by agreeing to limit their hours of operation and has settled similar allegations involving Cleveland area automobile dealers.[7] The Commission staff has also conducted economic research concerning automobile marketing.[8]

In addition, the Commission staff has commented on the costs and benefits of legislation similar to that at issue in West Virginia. For instance, the staff recently voiced concern that proposed legislation in Michigan[9] and in Illinois[10] prohibiting automobile brokering would reduce competition and increase the prices that consumers pay for automobiles. During the past two years, the staff has submitted comments to other states on issues similar to those raised by H.B. 2297.[11] In each case we concluded that the legislative initiative could have resulted in raising the prices that consumers paid for new and used cars.

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[7] Detroit Auto Dealers Ass'n, Inc., FTC Docket 9189 (February 22, 1989); Cleveland Automobile Dealers Ass'n, C-3247 (March 2, 1989).

[8] The Commission's Bureau of Economics completed a study concluding that state laws restricting the number of automobile dealers in an area increase costs to car buyers of this country by as much as $3 billion each year. Robert P. Rogers, *The Effect of State Entry Regulation on Retail Automobile Markets*, Federal Trade Commission, Bureau of Economics Staff Report (January 1986).

[9] Comments of the Cleveland Regional Office and Bureau of Economics staffs of the Federal Trade Commission on Michigan House Bill 4390 by Mark Kindt, Director, Cleveland Regional Office (September 29, 1988). The bill did not pass. However, the Michigan bill did not include "auction dealers, persons employed by a licensed new vehicle dealer, used vehicle dealer, or used vehicle parts dealer" in the definition of "broker."

[10] Comments of the Chicago Regional Office and Bureau of Competition staffs of the Federal Trade Commission on Illinois Senate Bill 1978 by C. Steven Baker, Director, Chicago Regional Office (March 21, 1989). The governor vetoed the bill.

[11] See letter from the FTC staff to the Florida Senate (March 29, 1988); letter from the FTC staff to the South Carolina House of Representatives (March 21, 1988); letter from Jeffrey I. Zuckerman, Director, FTC Bureau of Competition, to William P. TeWinkle, Wisconsin State Senate (February 19, 1988); letter from the FTC staff to the California State Assembly (January 29, 1987); letter from the FTC staff to the Governor of Texas (June 1, 1987).

AUTOMOBILE MARKETING METHODS.

Several innovative methods are available to steer consumers to licensed automobile dealers willing to sell at a discount. For instance, credit unions often sponsor automobile sales (by licensed dealers) on their premises. Credit unions encourage these sales because they give the credit unions an opportunity to offer automobile financing. Since cars are sold in volume, the credit unions can obtain substantial savings for their members.

Fleet dealers, such as Hertz and Avis, are a principal source of automobiles for sales conducted on credit union premises. The fleet dealers are seeking a means of selling their used rental cars. Low overhead sales offered in conjunction with credit unions enable fleet dealers to turn over their inventories efficiently. It is possible that this process will, in turn, enable rental agencies to charge consumers lower prices when renting automobiles.

Credit union fleet sales save consumers substantial amounts in their used car purchases. For example, in 1986, credit unions surveyed by the Illinois Credit Union League estimated that consumers paid an average of $1,118 less for a used car at a credit-union-sponsored fleet sale than those consumers would have paid to a "conventional" used car dealer.[12] The Michigan Credit Union League estimated that consumers purchasing cars at its members' sales pay an average of $900 less per vehicle.[13]

Another marketing development that provides consumers with an opportunity to obtain substantial savings in the purchase of new cars is the emergence of automobile buying clubs and referral services. These services generally charge an annual membership fee and arrange new car purchases for members at guaranteed prices with participating dealers. An August 1988 survey of six automobile buying services by *Changing Times* magazine concluded that customers purchasing cars through these services would have realized substantial savings on each purchase no matter which service was picked.[14]

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[12] The Illinois Credit Union League surveyed the nearly 1,000 Illinois consumers who purchased used fleet vehicles at special sales conducted by credit unions in conjunction with National Car Rental during the last six months of 1988. Of those surveyed, 80% reported that the used car price was "good or excellent" and 87.5% reported that the purchased car's performance was "good" or "excellent."

[13] The Michigan Credit Union League asked its members to fill out a survey which asked how much credit union customers saved at the sales.

[14] "Taking the Hassle out of Car-Buying," *Changing Times*, August 1988, at 37.

Our understanding is that Amway Corporation, for example, offers a program through which its distributors and their customers may purchase new cars from licensed dealers for a maximum of $150 over the factory invoice price. According to Amway, these discount sales are available through independent Amway distributors to persons paying a suggested annual fee of $24.95. The Amway Auto Network is currently available in thirty states, the District of Columbia and the United States Virgin Islands.[15] This type of program appears to offer consumers substantial benefits.

PROHIBITIONS ON "BROKERING" AUTOMOBILE SALES.

H.B. 2297 would prohibit credit unions, buying clubs, or the like from acting as "brokers" in sales of new or used automobiles,[16] and thus would ban the practices described above. It is difficult to see how this change will benefit consumers or competition.[17] We have no reports of significant or

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[15] The American Automobile Association also works with selected automobile dealers throughout the country to provide its members with opportunities to purchase new motor vehicles at substantial discounts. *Changing Times, supra,* at 35-38.

[16] The definition of "broker" encompasses anyone who is compensated for being involved in a car sales transaction and who is not a licensed dealer or the dealer's employee, a distributor or distributor's employee, or the owner of the car being sold. Brokers, as defined in the Bill, may not sell new cars or used cars. W. Va. Code § 17A-6-1a.

The definition of "broker" is so broad that an attorney who becomes involved in the sale of a client's car and receives legal fees for his assistance could arguably be acting illegally as a broker.

[17] The purpose of H.B. 2297's prohibition of automobile brokering may be to protect dealer's investments in showrooms, lots, and other items necessary for the car dealer business from "free-riding" by other sellers. This rationale would apparently be based upon the assumption that a significant number of car buyers choose their preferred cars at a full service dealer's showroom and then purchase that car from a low overhead automobile broker. This "free-riding" may be a serious concern, especially regarding the sale of new cars, but prohibition of automobile brokering by the state might not be the optimal response. Private contractual restraints between dealers and manufacturers might be able to resolve the problem. These restraints, if properly drafted, would not necessarily raise serious antitrust concerns. Moreover, many of the automobiles sold through brokers are used vehicles. To the extent that buyers are concerned with characteristics unique to each used car, such as mileage, age, and general condition, free-riding would be less of a problem.

extensive fraud or deception that has injured consumers who participate in these discount sales programs, and current law may already provide meaningful protection to the public. For instance, automobile sales are covered by the West Virginia Consumer Credit and Protection Act,[18] and the Commission's Used Car Rule helps protect consumers' warranty rights when purchasing used cars.[19] In addition, all automobile dealers in West Virginia must be licensed by the State.[20] H.B. 2297 does not appear to provide benefits to the public that are not already available under current law.

On the other hand, the anti-brokering amendments in H.B. 2297 appear likely to injure West Virginia consumers by restricting competition in the new and used car markets. Such a restriction may in turn result in higher prices for consumers. Preventing credit unions, buying clubs and referral services from offering consumers cost-saving methods of purchasing new and used automobiles does not benefit consumers. Rather, consumers would be deprived of the potentially substantial savings that they could obtain through these alternative automobile purchase programs.

CONCLUSION.

The proposed bill would restrict the ability of licensed car dealers to conduct automobile sales through credit unions or buying clubs and to employ other innovative marketing techniques that result in substantial savings to consumers. We believe that the provisions of HB 2297 are not likely to benefit consumers or competition. Instead, this legislation may limit competition among automobile dealers and increase the prices that consumers pay for automobiles.

We appreciate the opportunity to comment.

Sincerely,

Mark D. Kindt
Director
Cleveland Regional Office

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18 W. Va. Code § 46-A-6-102 (1988).

19 *Supra* note 5.

20 W. Va. Code § 17-A-6-3(a) (1988). Although we recognize this specific potential benefit of licensing, we express no opinion on whether the licensing requirement provides overall benefits to consumers exceeding the overall costs of licensing.