DOCUMENT NO. 11/4/72 PD

OFFICE OF POLICY DEVELOPMENT

STAFFING MEMORANDUM

DATE: 2/1/83 ACTION/CONCURRENCE/COMMENT DUE BY: 2/10/83

SUBJECT: FTC Activity

	ACTION	FYI
HARPER	☐	☐
PORTER	☐	☒
BARR	☐	☒
BLEDSOE	☐	☐
BOGGS	☐	☐
BRADLEY	☐	☐
CARLESON	☐	☐
DENEND	☐	☐
FAIRBANKS	☐	☐
FERRARA	☐	☐
GALEBACH	☐	☐
GARFINKEL	☐	☐
GUNN	☐	☐
B. LEONARD	☐	☐
LI	☐	☐
MONTOYA	☐	☐
ROCK	☐	☐
ROPER	☐	☐
SMITH	☐	☐
UHLMANN	☒	☐
ADMINISTRATION	☐	☐

	ACTION	FYI
DRUG POLICY	☐	☐
TURNER	☐	☐
D. LEONARD	☐	☐
OFFICE OF POLICY INFORMATION		
HOPKINS	☐	☐
PROPERTY REVIEW BOARD	☐	☐
OTHER		
_____	☐	☐
_____	☐	☐
_____	☐	☐
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_____	☐	☐
_____	☐	☐

REMARKS:

Ed Meese asked that you have Mike Uhlmann staff out this dispute, isolate the issues, and summarize the opposing positions. He will then meet with SUBURH if it appears to be appropriate.

Please return this tracking sheet with your response

Edwin L. Harper
Assistant to the President
for Policy Development

THE WHITE HOUSE
WASHINGTON

Ed Harper,

Ed Meese asked that you have someone staff out this dispute, isolate the issues, and summarize the opposing positions. He will then meet with SUBURH if it appears to be appropriate.

Jim Jukins

444 South Flower Street
Suite 2620
Los Angeles, California 90017
213/622-1000
Public Relations & Public Affairs

December 28, 1982

The Honorable Edwin Meese III
Counsellor to the President
The White House
Washington, D.C. 20006

The Hannaford Company, Inc.

Dear Ed:

I greatly appreciate the careful attention you gave my September 14 letter and the fact that you pursued this matter with the FTC staff. Ironically, the information that the staff furnished to you underscores, in part, the concerns I had expressed.

You correctly note that the preferred procedure is for problems to be handled on a case-by-case basis, rather than by rulemaking, if such problems are "not endemic to an industry." You may not have been advised that the problems which are the subject of FTC activity here are actually common to the industry. The FTC, to date, has filed administrative complaints relating to non-disclosure of "secret warranties" and "hidden defects" against General Motors, Ford, Honda, Chrysler, Volkswagen, and American Motors corporation. In fact, the primary reason for my approaching you concerning this matter is that the problem is industry-wide.

The position of the FTC staff described in your letter would permit the imposition of liability for non-disclosure where there exists a "significant" number of vehicles with a "hidden defect," resulting in "costly," "unexpected," "premature" failures. These words are so general as to provide no practical guidance to the industry. To date, the FTC staff has refused to define them; nor have its actions provided standards to govern future conduct. For example, the FTC recently brought an action against Ford that related to alleged piston scuffing and cracked engine blocks. The action was brought although the staff estimated that these conditions occurred in well under one percent of Ford vehicles. Is such a low failure rate still sufficiently "significant" to trigger obligations under the FTC Act? The automobile industry does not really know. Similarly, ETC staff meetings with industry groups (such as the Automobile Importers association meeting noted in your letter) have not yielded helpful specific information which would eliminate the industry's confusion.

The basic problem for the industry is that the FTC is developing a new theory that will have general application, yet it is proceeding on a case-by-case basis rather than rulemaking. The result is that the industry cannot determine what is expected of it.

Predictably, the FTC staff position is that it is merely applying well-established law, claiming its actions are based upon a 40-year old legal standard. The staff's position, while perhaps technically correct, is disingenuous. The legal standard is that "unfair" or "deceptive" acts or practices are unlawful. Yet, these words provide no meaningful guidance to the industry. This standard, over the years, traditionally has been applied to a different factual context. A violation for failure to disclose has normally involved either express statements by a seller that omit important facts and hence are untruthful or deceptive, or conduct that gives rise to well-organized implied representations that are untruthful and deceive the purchaser by failure to expressly disclose factual information. In its current "hidden defect" activities, however, the FTC is contending that the mere offering for sale of a product is an implied representation that all of the product's parts will last a certain period of time beyond the express warranty period and that, if this is not so, the seller has a duty to disclose this negative characteristic. This is a major extension and novel application of the failure-to-disclose principle and an application which would be contrary to the customary practice in all industries of not affirmatively disclosing negative features of one's product.

Another matter that needs to be addressed in connection with this novel theory is how liability imposed for post-warranty problems can be made consistent with provisions of the Magnuson-Moss act and the laws of most states that permit manufacturers or warrantors of consumer products to limit their liability if they clearly state these limitations (for example, 12 months or 12,000 miles). In fact, the Magnuson-Moss act states in Section 102 (b) (2) that the Act does not authorize the FTC to require that a consumer product or any of its components be warranted.

Since the FTC's theory is novel, and has an across-the-board impact on the motor vehicle industry, the most effective and proper way for the FTC to proceed is by rulemaking. By doing so, the FTC would be able to establish and make known -- either by Trade Practice Guide or by Trade Regulation Rule -- the standards that would apply uniformly to the industry, after an opportunity for input from interested parties. Proceeding in this way will also benefit the FTC, which has limited financial and personnel resources.

We are pleased that the FTC staff has indicated that its future activities will be "scrutinized from a cost/benefit basis." Such an analysis is particularly appropriate here where the staff previously recognized the monetary importance to the consumer of the standard to be applied. Thus, the staff reported in the Federal Trade Commission Automobile Policy Session (April 17, 1978), at page 13, that: "A legal standard which is 'too high' will raise the cost of the car's beyond what consumers want or is socially desirable." While the staff's concern with cost/benefit analysis would appear to reflect Chairman Miller's views, it does not appear as though it is shared by a majority of the Commissioners.

The FTC actions to date appear to run counter to the cost/benefit theories. As you know, a specialized segment of the automobile industry has emerged within the past several years. This segment provides consumers who desire to receive warranty-type coverage after the expiration of their manufacturer's warranty with service contracts which extend coverage to as long as five years after the date of purchase of an automobile. By separating the automobile from its service contract, the industry has been able to respond to the consumer demand that car prices be at the lowest level possible while, at the same time, offering those consumers who desire increased protection the ability to obtain it at an increased cost. If the FTC will require manufacturers to take certain actions post-warranty, the possibility of such actions must be considered by the manufacturers when pricing their vehicles, thereby increasing the cost of the basic automobile to all purchasers. This is what the above mentioned staff report wanted to avoid.

Finally, the fact that "only a relatively modest portion" of Commission resources are devoted to product information activities provides little comfort to the industry. A "modest portion" of the pending $60,000,000 FTC budget can still be a lot of money. Also considerable are the legal and other expenses incurred by individual companies in the industry in defense of investigations or complaints. This defense cost, of course, will ultimately be passed on to the consumer in the form of higher motor vehicle prices.

Thus, industry concerns remain. I have heard them summarized well by Harvey Lamm, president of Subaru of America, and would like to request an opportunity to call on you with him in mid-January to discuss this industry problem.

Sincerely,

Peter D. Hannaford
Chairman of the Board

PDH:ss

6 November 1982

Dear Pete:

Thank you for your letter of 14 September and for the summary of the Federal Trade Commission (FTC) automotive issues that we discussed. I contacted the FTC staff to learn more about the automobile defects portion of their "product information" program. I understand that Harold Aronson of your office, on behalf of the Japanese importer, Subaru, had previously spoken with Fred McChesney, FTC Associate Director for Policy and Evaluation, about this same issue.

As you know, with the exception of its enforcement of model year designations and the advertising of EPA fuel efficiency disclosures, the FTC has no regulations specifically governing the automobile manufacturers of all consumer products. The automotive matters you mention are not the result of new regulations, but rather are specific investigations that have been handled on a case by case basis, as problems arose. That, of course, is the traditional and judicially preferred administrative approach for handling problems that are not endemic to an industry.

As I understand it, the FTC staff has taken the following position: If a manufacturer

(a) knows or should know that owners of its cars need to engage in unusual maintenance procedures in order to keep the cars in good condition; or,

(b) has information that a significant number of its automobiles have a hidden defect that will lead to costly, unexpected, premature component failures,

then it may be a violation of the FTC Act to withhold that information from affected purchasers. Whether the full Commission decides to take enforcement action depends on

a number of considerations, including the manufacturer's response to the problem and whether the benefits of disclosure outweigh the costs. The FTC actions you have referred to are based on a legal standard that the Commission has relied on for more than forty years: its authority under Section 5 of the FTC Act to prohibit deceptive material omissions of fact. Such a violation is not based on state warranty law of the Commission's warranty authority under the Magnuson-Moss Act. (I understand that similar actions have been brought by state attorneys general under "little FTC Acts".)

The FTC staff informs me that the Commission is aware that dealers and manufacturers occasionally arrange ad hoc adjustments for various problems, outside of the warranty period, as a means of maintaining customer relations and goodwill. The FTC does not discourage those adjustments. In fact, the Commission's staff has worked with some automobile manufacturers to develop dispute resolution programs. The instance you refer to as the FTC prohibiting a "secret warranty," was, in all likelihood, a case in which a manufacturer allegedly knew it was producing a systematically defective product (a fact which it could have been required by Section 5 to disclose to all affected purchasers). According to the Commission staff, in that case the manufacturer allegedly chose to conceal the existence of the problem from some injured individuals while simultaneously providing reimbursements to others.

I am told that the Commission is keenly aware of the marketplace consequences of discouraging voluntary resolution of individual customer problems and that there are no "secret warranty" cases pending before it. Moreover, any further such actions or settlement agreements will be scrutinized from a cost benefit basis to ensure that they do not place unwarranted burdens on the market.

Finally, I understand that only a relatively modest portion of the Commission's resources are devoted to product information matters and that only part of that budget is devoted to investigating automotive matters. In order to facilitate understanding of this program, the FTC staff meets with industry members (most recently the Automobile Importers Association) and other groups to explain its product information cases and the requirements of Section 5 of the FTC Act.

Your concern is appreciated, and I hope this clears up any misunderstanding you may have had.

With best personal wishes,

Sincerely,

EDWIN MEESE III
Counsellor to the President

Mr. Peter D. Hannaford
The Hannaford Company, Inc.
Suite 207
905 Sixteenth Street, N.W.
Washington, D.C. 20006

cc: Ed Meese

EM:FTC:SK:vml--

Mr. Peter Hannaford
905 Sixteenth Street, N.W.
Suite 207
Washington, D.C. 20006

Dear Peter,

Thank you for your September 14 letter and summary of the Federal Trade Commission (FTC) automotive issues that we discussed. I contacted the FTC staff to learn more about the automobile defects portion of their "product information" program. I understand that Harold Aronson of your office, on behalf of the Japanese importer, Subaru, had previously spoken with Fred McChesney, FTC Associate Director for Policy and Evaluation, about this same issue.

As you know, with the exception of its enforcement of model year designations and the advertising of EPA fuel efficiency disclosures, the FTC has no regulations specifically governing the automobile industry. The industry is subject to the same laws as are the manufacturers of all consumer products. The automotive matters you mention are not the result of new regulations, but rather are specific investigations that have been handled on a case by case basis, as problems arose. This, of course, is the traditional and judicially preferred administrative approach for handling problems that are not endemic to an industry.

As I understand it, the FTC staff has taken the following position: If a manufacturer

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I am told that the Commission is keenly aware of the marketplace consequences of discouraging voluntary resolution of individual customer problems and that there are no "secret warranty" cases pending before it. ~~I am assured,~~ Moreover, ~~that~~ any further such actions or settlement agreements will be scrutinized from a cost benefit basis to ensure that they do not place unwarranted burdens on the market.

Finally, I understand that only a relatively modest portion of the Commission's resources are devoted to product information matters and that only part of that budget is devoted to investigating automotive matters. In order to facilitate understanding of this program, the FTC staff meets with industry members (most recently the Automobile Importers Association) and other groups to explain its product information cases and the requirements of Section 5 of the FTC Act.

I ~~hope that this answers the questions raised in your letter.~~

Sincerely,

Edwin Meese, III
Counselor to the President

Federal Trade Commission

Office of Congressional Relations
Washington, D.C. 20580

October 27, 1982

Ms. Sally Kelley
Director of Agency Liaison
Presidential Correspondence
The White House
Room 91
Washington, D.C. 20500

Dear Ms. Kelley:

The draft letter you requested for Mr. Meese's signature is enclosed. It responds to the September 14, 1982 letter and enclosure sent to Mr. Meese by Mr. Peter D. Hannaford.

Sincerely,

Bryce L. Harlow
Director

Enclosure

T H E W H I T E H O U S E O F F I C E

REFERRAL

SEPTEMBER 27, 1982

TO: FEDERAL TRADE COMMISSION

ACTION REQUESTED:
DRAFT REPLY FOR SIGNATURE OF EDWIN MEESE

DESCRIPTION OF INCOMING:

ID: 099388

MEDIA: LETTER, DATED SEPTEMBER 14, 1982

TO: EDWIN MEESE

FROM: MR. PETER D. HANNAFORD
905 SIXTEENTH STREET, NW
SUITE 207
WASHINGTON DC 20006

SUBJECT: WRITER SENDS A SUMMARY OF THE AUTOMOBILE "SECRET WARRANTY" ISSUE ABOUT WHICH HE DISCUSSED WITH MR. MEESE RECENTLY

PROMPT ACTION IS ESSENTIAL -- IF REQUIRED ACTION HAS NOT BEEN TAKEN WITHIN 9 WORKING DAYS OF RECEIPT, PLEASE TELEPHONE THE UNDERSIGNED AT 456-7486.

RETURN CORRESPONDENCE, WORKSHEET AND COPY OF RESPONSE (OR DRAFT) TO:
AGENCY LIAISON, ROOM 91, THE WHITE HOUSE

SALLY KELLEY
DIRECTOR OF AGENCY LIAISON
PRESIDENTIAL CORRESPONDENCE

905 Sixteenth Street, N.W.
Suite 207
Washington, D.C. 20006
202/638-4600

Public Relations & Public Affairs

September 14, 1982

The Hannaford Company, Inc.

099388

The Honorable
Edwin Meese, III
Counsellor to the President
The White House
Washington, D.C. 20500

Dear Ed,

Enclosed is a summary of the automobile "secret warranty" issue about which we spoke recently. It has affected a number of manufacturers and importers. Beginning in the Carter Administration and continuing to this day, the FTC has applied its theories about "secret warranties" on an ex post facto basis.

Sincerely,

Peter D. Hannaford

PDH:jlw

Enclosure

"HIDDEN DEFECTS" AND "SECRET WARRANTIES"

The Federal Trade Commission is expanding the scope of its regulation of the automobile industry by adopting novel theories about what constitutes a violation of Section 5 of the FTC Act. This section condemns "unfair or deceptive acts or practices." The FTC's position is now that, whenever an automobile manufacturer or importer knows or even should know that a number of failures of an automobile component is likely to occur (a "hidden defect"), this fact must be disclosed to prospective customers regardless of when the failure is expected to occur and regardless of the terms of the automobile's warranty. The FTC also takes the position that an automobile company violates Section 5 if it voluntarily sets up but does not publicly disclose a formal, or even an informal, program under which the company, at its discretion, helps customers with repairs related to the "hidden defect" after the warranty program has expired (a so-called "secret warranty").

To promote its new theories, the FTC has allocated large sums of money and assigned substantial numbers of attorneys and staff to its "hidden defects" and "secret warranty" investigations of and legal actions against companies in the automobile industry. This major FTC effort to expand its regulatory power is contrary to the expressed positions of the Administration and the Congress to reduce government regulation generally and FTC regulation specifically. Moreover, imposing new regulatory burdens on the automobile industry at this time hardly seems appropriate.

The judicially-untested theories that the FTC is promoting appear legally incorrect. The FTC's position on "hidden defects" - that a duty exists to disclose problems that might occur after the warranty period - seems inconsistent with the concept of written warranties of limited duration permitted by state warranty laws and by provisions of the Magnuson - Moss Warranty Act. Further, the automobile companies do not know what is expected of them. The FTC has never announced guidelines establishing when disclosure of "hidden defects" must be made (for example, how many failures must be projected before disclosure is required) or what kind of disclosure is required.

The FTC is imposing its new regulatory scheme in an incorrect fashion. The case-by-case basis used by the FTC results in different, inconsistent burdens being imposed by the FTC on different companies, causing competitive disadvantages to some. Further, liability is imposed retroactively for company decisions that, at the time, were not inconsistent with the FTC's position.

The FTC apparently has never engaged in an analysis of whether the benefit to the consumer of the regulatory scheme the FTC seeks to impose outweighs the cost to the industry and, ultimately, to the consumer.

In this regard, the FTC's attack on "secret warranties" seems particularly counterproductive because it may well discourage automobile companies from voluntarily establishing post-warranty repair assistance programs. Faced with the choice of establishing and publicizing post-warranty programs available to all customers or not having any post-warranty programs at all, the automobile companies may choose to limit their customer assistance to what is required by the warranty and offer no further assistance. Such a decision benefits neither the automobile companies, which lose customer goodwill, nor those automobile owners who would otherwise have obtained post-warranty repair assistance.