

Spring 1995

Good Will Adjustment Games: An Economic and Legal Analysis of Secret Warranty Regulation

Jeff Sovern

Follow this and additional works at: <https://scholarship.law.missouri.edu/mlr>



Part of the [Law Commons](#)

Recommended Citation

Jeff Sovern, *Good Will Adjustment Games: An Economic and Legal Analysis of Secret Warranty Regulation*, 60 MO. L. REV. (1995)

Available at: <https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

This Article is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Missouri Law Review by an authorized editor of University of Missouri School of Law Scholarship Repository. For more information, please contact bassettcw@missouri.edu.

Good Will Adjustment Games: An Economic and Legal Analysis of Secret Warranty Regulation

by Jeff Sovrn*

TABLE OF CONTENTS

I.	Introduction	325
II.	How Secret Warranties Work	328
III.	Should Secret Warranties Be Regulated?	336
	A. An Economic Analysis of Secret Warranty Regulation	337
	1. Will Regulation of Secret Warranties Cause Manufacturers to Stop Offering Secret Warranties?	337
	2. Other Costs of Secret Warranty Regulation	345
	3. Would Consumers Be Worse Off if Manufacturers Stopped Providing Good Will Adjustments?	347
	4. Is Government Regulation Desirable?	353
	5. A Kaldor-Hicks Analysis	362
	B. Fairness Justifications	364
IV.	The Regulatory Background of Secret Warranties	367
	A. Federal Automobile Safety Legislation	368
	B. The Federal Trade Commission Act	370
	1. The FTC Secret Warranty Cases	372
	2. Do Secret Warranties, Without More, Violate the FTC Act?	376
	3. Do Secret Warranties, Together With Misrepresentations, Violate the FTC Act?	386
	4. Do Manufacturers Violate the FTC Act by Failing to Disclose the Existence of the Defects Which Inspire Secret Warranties?	386
	C. State Deceptive Trade Practices Acts	387
	D. State Secret Warranty Statutes	391

* Professor of Law, St. John's University School of Law. A.B., J.D., Columbia University. The author thanks St. John's University School of Law for its research support. The author also acknowledges the help of Charles S. Bobis, John Hennigan, Mary L. Lyndon, Albert J. Rosenthal, Norman Silber, and John Corwin though the author is solely responsible for errors.

E.	Warranty Statutes	392
F.	Miscellaneous Cases	398
V.	How Should Secret Warranties Be Regulated?	400
A.	Should the Federal Government or the States Regulate Secret Warranties?	400
B.	How Should Secret Warranties Be Defined?	404
C.	What Type of Notice Should Be Required?	407
1.	Notice at the Time of Purchase	407
2.	Notice at the Time a Secret Warranty Program is Adopted	409
D.	Should Manufacturers Have to Reimburse Those Who Have Already Paid for Repairs?	413
VI.	Conclusion	414

I. INTRODUCTION

Everyone knows that manufacturers normally repair defects that turn up while a warranty is in effect. But what about defects that surface after the warranty expires? When something you've bought—perhaps a car—breaks down after the warranty has run, do you ask the manufacturer to repair it for free? If not, you may be paying for repairs unnecessarily. Some manufacturers, especially automobile manufacturers, provide repairs without charge when the identical defect turns up in many units of the products they make, even though the repairs are not covered by a warranty. The manufacturer might do so to retain the good will of the customer, in the hope that the customer will continue to buy the manufacturer's products. Many manufacturers who offer these "good will adjustments" strive to keep them confidential, so that few will request them.¹ Hence consumer advocates call good will adjustments by another name: "secret warranties."² Secret warranty programs, which have existed for at least twenty years,³ are

1. Manufacturers also call good will adjustments by other names: policy adjustments, special adjustment programs and post-warranty adjustment programs.

2. One example comes from the testimony of Clarence M. Ditlow, Executive Director, Center for Auto Safety ("CAS"), during *Joint Hearings Before the N.Y. Assembly Committee on Consumer Affairs and Protection and Senate Committee on Consumer Protection* (Dec. 4, 1989) [hereinafter, *N.Y. Hearings*]:

GM's secret warranty on power steering failure on 1980-88 front-wheel-drive cars alone affects up to 16 million vehicles. Center for Auto Safety estimates a minimum of 15% of these cars will have failures that will require replacement of the rack and pinion assembly at a cost of about \$500. Although Center for Auto Safety pressured GM to acknowledge the secret warranty, GM refused to notify owners and its latest press release failed to name the models affected. As a result, Center for Auto Safety is inundated with complaints from consumers about power steering failure who have never heard of the secret warranty. By the time many consumers learn of this secret warranty, the 5 year/50,000 limit has often expired. Even though these consumers first experience symptoms of the defect before the limit, they didn't take it in for repair because it was relatively minor. By concealing the defect, GM managed to get consumers over the limit.

Throughout this Article, references will be made to allegations of secret warranties reported elsewhere. Sometimes manufacturers deny that they are in fact conducting such programs. *See, e.g., infra* note 26. The author cannot verify claims that particular secret warranties programs have existed or not; consequently references to allegations of particular secret warranty programs here should not be construed to mean that the allegations are true.

3. JONATHAN A. SHELDON, *UNFAIR AND DECEPTIVE ACTS AND PRACTICES* 226 (3d ed. 1992). Secret warranties are referred to, though not by that name, in William

enormous in scope: nearly every car on the road is said to be subject to one of the more than 500 secret warranties supposedly operating at any given time,⁴ while one expert estimates that the ten largest known secret warranty programs have covered 30 million automobiles and \$3 billion in repairs.⁵

Troubled by the fact that some consumers obtain free repairs while others who are equally needy do not, a number of consumer groups have sought to make the repairs available to all consumers. These consumer organizations have attempted to publicize secret warranties,⁶ and have met with some success: publication of one list of secret warranties generated more than 20,000 consumer inquiries and helped numerous car owners obtain relief.⁷

But consumer groups have been frustrated by the difficulty of learning about secret warranties. While federal legislation requires automobile manufacturers to file with the Department of Transportation copies of repair bulletins sent to dealers,⁸ manufacturers allegedly have avoided filing notices of secret warranties by addressing reports of secret warranties not to dealers, but to customer service departments.⁹ Corporate whistleblowers have leaked

C. Whitford, *Law and the Consumer Transaction: A Case Study of the Automobile Warranty*, 1968 WIS. L. REV. 1006, 1037-38.

4. See CLARENCE DITLOW & RAY GOLD, *LITTLE SECRETS OF THE AUTO INDUSTRY* 1 (1994); see also Center for Auto Safety, *Car Makers Secret Warranties Attacked*, 8 LEMON TIMES, No. 4, at 4 (1987), reprinted in CENTER FOR AUTO SAFETY, *SECRET AUTO WARRANTIES* item 5 (1992) (300 warranties). For a 73-page list of secret warranties, see MORTON J. SCHULTZ, *GET YOUR CAR FIXED FREE* 10-83 (1994).

5. See *NY Hearings*, supra note 2 (testimony of Clarence M. Ditlow, Executive Director, Center for Auto Safety) (1987 estimate); CENTER FOR AUTO SAFETY, *REPORT ON SECRET WARRANTIES TO THE FTC* 5 (1987), reprinted in CENTER FOR AUTO SAFETY, *SECRET AUTO WARRANTIES* item 7 (1992). The estimate apparently does not take into account consequential and other damages incurred by consumers, such as towing expenses, expenses caused by the need to arrange alternative transportation, and payments made for repairs to mechanics who erroneously diagnose the problem because they do not know of the secret warranty. See *NY Hearings*, supra note 2 (testimony of Virginia Apuzzo, Deputy Executive Director, New York State Consumer Protection Board).

6. The Center for Auto Safety and Consumers Union have been most active in publicizing secret warranties. Other consumer organizations opposed to secret warranties reportedly include the Consumer Federation of America and Motor Voters. See Laura Polachek & Mark Steinbach, *Secret Warranty Programs*, in NAAG CONSUMER PROTECTION REPORT, Aug. 1991, at 1.

7. See *id.* at 6.

8. See 15 U.S.C. § 1418(a)(1) (1988).

9. See *Is Your Car's Warranty a Secret?*, CONSUMER REP., Apr. 1989, at 214 (reporter reviewed a year's worth of technical bulletins filed with the Secretary of Transportation—about 3200—without finding report of good will adjustments).

allegations of some secret warranty programs,¹⁰ and consumer advocates have discovered others by carefully comparing government records with reports from consumers,¹¹ but it is likely that other good will adjustment programs have remained confidential.

Consumer groups have lobbied for protective legislation. That effort has borne fruit in California, Connecticut, Virginia, and Wisconsin, all of which have enacted statutes governing secret warranties. In the early 1980's the Federal Trade Commission commenced two proceedings in an effort to take the secrecy out of secret warranties, but the Commission seems to have lost interest in secret warranty regulation. As a result, in most of the country today, secret warranty programs are largely unfettered by governmental controls.

The purpose of this Article is to discuss whether secret warranties should be regulated, and if so, how. Part II of the Article reviews what is known about the working of secret warranty programs. Part III discusses the economics of secret warranties, consumer psychology, and the policies which militate in favor of and against regulation of secret warranties. Part IV explores the laws applicable to secret warranties. Finally, part V attempts to determine what type of regulation might be most effective.

10. *See id.* ("A whistleblower made public 41 secret warranties . . ."). *See also* Diana T. Kurylko, *Center for Auto Safety Shares Nissan's Internal Repair Documents*, *AUTOMOTIVE NEWS*, July 9, 1990, at 8 ("The Center for Auto Safety has released documents it obtained from whistleblowers that alleged Nissan Motor Corp. spent \$15.5 million in a six-month period on free repairs for consumers who protested about parts no longer covered by warranties."); Laura Sagolla, *Car Trouble*, *COMMON CAUSE MAG.*, Jan-Feb. 1991, at 7-8.

11. CAS has discovered some secret warranty programs by comparing automobile manufacturer service bulletins, which identify defects in cars, with reports of consumer complaints in which the manufacturer had agreed to pay for the repairs. *See NY Hearings, supra* note 2 (testimony of Virginia Apuzzo, Deputy Executive Director, New York State Consumer Protection Board). That system works only if the Center for Auto Safety has access to the service bulletins—and some are available to the public only after long delays. *See id.* (testimony of Robert Abrams, New York State Attorney General) (1988 survey of 24 auto manufacturers found that only three offered service bulletins to public; fourth has since started doing so). It is obviously also limited to automobiles and to cases in which the manufacturer identifies the defect in its bulletins, and *Consumer Reports* has reported that not all adjustment programs are reported in the bulletins. *See supra* note 9.

II. HOW SECRET WARRANTIES WORK

Any attempt to describe how secret warranties function suffers from a significant disability: Many manufacturers who provide them attempt to conceal their very existence, let alone how they work, and so accounts of their operation may be incomplete. Nevertheless, some information has become public. Most of what is known about secret warranties has to do with automobiles.¹² That may be because secret warranties are more common in automobile sales, given the expense and complexity of motor vehicles, or it may be because the Center for Auto Safety has been particularly vigilant in monitoring good will adjustment programs. In any event, since more information is available about automobile secret warranties, the focus of this Article is on cars.

Because many consumers have their cars serviced by dealers, and because dealers provide information to manufacturers about repairs, auto manufacturers are able to identify widespread problems with the cars they sell.¹³ Manufacturers may respond in a variety of ways to discovery of a common problem showing up in cars after expiration of the warranty. At one extreme, they may choose to do nothing. At the other extreme, they may initiate a recall campaign, and indeed, if the problem relates to safety or certain

12. Automobiles are not the only product subject to secret warranties. *See, e.g.,* Warren Brown, *Are Consumers Left Out By 'Secret Warranties'? In Most States, Manufacturers Aren't Required to Notify Public When Protection Is Extended*, WASH. POST, Sept. 22, 1991, at H1 (telephone company reported to have secret warranty program for cordless telephones); *Follow-up*, CONSUMER REP., Sept. 1993, at 558 (manufacturer said to notify its servicers but not customers that it will replace at reduced rate compressors in refrigerators that failed after warranty expired but before compressors normally fail). In addition, many manufacturers provide refunds to dissatisfied consumers who communicate their dissatisfaction to the manufacturer, even though the product's labelling does not indicate that the manufacturer has such a policy. *See* C. L. Kendall & Frederick A. Russ, *Warranty and Complaint Policies: An Opportunity for Marketing Management*, 39 J. MKTG. 36, 39 (Apr. 1975) (when complaint letters were written to companies many of whose products did not carry written warranty, one study found that 70% responded satisfactorily with offers of refund or merchandise and another found 68% responded in same way; no significant difference found between those who put warranties on products and those who did not).

13. *See infra* notes 86-87 and accompanying text. According to one trade organization, these problems need not involve part failures: "Such mundane items as wind noise or rattles may be the subject of a [good will adjustment] program." *Hearings Before Conn. General Law Committee* (Jan. 30, 1990) [hereinafter, *Conn. Hearings*] (statement of Automobile Importers of America, Inc.).
<https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

emissions, federal law requires a recall.¹⁴ An intermediate choice is to provide a secret warranty program.¹⁵

From the manufacturer's perspective, secret warranties offer advantages over both doing nothing and a recall, at least in some circumstances. While doing nothing is the cheapest course in the short term, in the longer run refusing to act may cost the manufacturer sales. Many consumers expect a car to run without significant repairs long after the warranty has expired, and if those expectations are frustrated, the consumer may "exit," that is, stop buying the manufacturer's products.¹⁶ By contrast, if the manufacturer agrees to repair a consumer's car after the warranty has run, the consumer is likely to perceive the manufacturer as generously providing free repairs,¹⁷ making the consumer more likely to buy from the manufacturer again and to praise the car to others.¹⁸ Indeed, manufacturers claim that they sometimes decide to

14. See *infra* notes 138-42 and accompanying text. A manufacturer which chooses to notify its customers that it will provide free repairs upon request, even when it is not required to do so, may choose to call its program something other than a recall. For example, one manufacturer characterized such a program as a "special customer-care program." See *Toyota to Fix Brake-Pedal Fault on 380,000 Camry Models*, AUTOMOTIVE NEWS, May 9, 1988, at 8.

15. Other choices exist as well. For example, a manufacturer could send its dealers a service bulletin in which it describes the problem and its solution. While consumers would still pay for the repairs, the amount of time needed to diagnose the problem and devise a solution should be reduced if the mechanic is aware of the bulletin, and that should lower the cost of repairs. Alternatively, the manufacturer could notify divisional technical personnel instead of dealers. In deciding whether to commence a secret warranty program, manufacturers may take into account such considerations as the expected lifetime of the particular part or system which has failed and how long after the expiration of the warranty the failure occurs. See Whitford, *supra* note 3, at 1037.

16. See generally ALBERT HIRSCHMAN, EXIT, VOICE, AND LOYALTY (1970).

17. See *Is Your Car's Warranty a Secret?*, *supra* note 9, at 214.

18. See Claes Fornell, *Corporate Consumer Affairs Departments: Retrospect and Prospect*, in THE FRONTIER OF RESEARCH IN THE CONSUMER INTEREST 595, 612 (E. Scott Maynes & American Council on Consumer Interests eds., 1988) ("Empirical evidence also demonstrates that a *satisfied*, complaining consumer becomes more loyal and will generate positive word-of-mouth about the firm to other consumers."); Whitford, *supra* note 3, at 1016 (Car manufacturers "are keenly aware that a satisfied new car purchaser will not only become a proponent of his make among his friends but will also be more likely to purchase the same make for his next new car."). On the importance of word-of-mouth, see John Arndt, *Word of Mouth Advertising and Informal Communication*, in RISK TAKING AND INFORMATION HANDLING IN CONSUMER BEHAVIOR 188, 238 (Donald F. Cox ed., 1967) (Based on shaky empirical data, the author concludes "word of mouth emerges as one of the most important, possibly *the* most important source of information for the consumer. . . . Word of

pay for repairs to parts that are not defective, in the interests of maintaining customer good will.¹⁹

Though secret warranties are more expensive in the short run than doing nothing, they are still cheaper than recalls, and are less likely to damage a manufacturer's reputation for quality.²⁰ A manufacturer which recalls a car must notify both the government and its customers of that fact, at least in certain circumstances.²¹ The notification process itself can be expensive, and obviously more consumers are likely to bring their cars in for repairs under a recall program than under a secret warranty program. Moreover, media reports of a recall may cause some would-be car buyers to conclude that the manufacturer does not make its cars very well and that they would do better to purchase a different car.²²

mouth is particularly important in situations of uncertainty and when much is at stake for the consumer."). Auto manufacturers are in fact somewhat successful at building brand loyalty. One survey conducted in 1976 found that the vehicle purchased most recently by 60.9% of the car buyers responding was of a brand they had previously bought. ARTHUR YOUNG & CO., WARRANTIES RULES CONSUMER BASELINE STUDY 29 (1979).

19. See Anthony Giorgianni, *Automakers Don't Inform Owners of All Free Repairs; Car Owners Don't Always Learn About Free Repairs*, HARTFORD COURANT, May 2, 1992, at E3 (Automakers say "many factors can play a role in the decision whether to cover the cost of a repair, including how well the vehicle was maintained and the number of complaints about the problem."). See also Whitford, *supra* note 3, at 1028 (Manufacturers sometimes provide free repairs for good will "even though it is clear that there was no manufacturing defect.").

20. For example, estimates of the cost of one proposed recall range from \$300 million to \$1 billion. See Andrew E. Serwer, *GM Gets Tough With Its Critics*, FORTUNE, May 31, 1993, at 90, 96. The costs of recalls are so great that some companies have sought recall insurance. See *Recalls: Legal and Corporate Responses to FDA, CPSC, NHTSA, and Product Liability Considerations*, 39 BUS. LAW. 757, 760-61 (1984) (Andrew S. Krulwich stated, "recall insurance varies from covering solely the administrative costs of the recall to covering loss of profits and advertising expenses for repairing a tarnished image.").

21. See 15 U.S.C. §§ 1411, 1413 (1988).

22. A wealth of studies on the effects of recalls has yielded sometimes-conflicting results. Some have found that the effect depends on the severity of the recall. See, e.g., Steven M. Crafton et al., *Testing the Impact of Recalls on the Demand for Automobiles*, 19 ECON. INQUIRY 694, 702 (1981) ("Severe recalls were found to influence adversely sales of the models recalled. Recalls of lesser severity had no significant impact on sales."); Paul Slovic et al., *Perception of Risk From Automobile Safety Defects*, 19 ACCIDENT ANALYSIS & PREVENTION 262-63 (1987) (study finds that safety recalls reduce likelihood of future purchase of car which is subject of recall, but that likelihood of decision not to buy car in future depends on how dangerous the defect is). Compare Robert J. Reilly & George E. Hoffer, *Will Retarding the*

Recalls can also have ramifications for product liability suits: when a company recalls its cars, consumers who have been injured by the defect which triggered the recall may realize for the first time that their injury was caused by a defect, thus prompting them to bring a suit they might not otherwise have brought.²³ Additionally, in some jurisdictions the recall letter may be used to help consumers prove their cases.²⁴ Though injury is less likely to be a concern in the types of defects which are candidates for secret warranties, since manufacturers are required to recall unsafe cars and may not substitute secret warranties for such a recall, the impact of product liability litigation cannot be discounted altogether.²⁵

Information Flow on Automobile Recalls Affect Consumer Demand?, 21 ECON. INQUIRY 444, 447 (1983) ("severe recalls have an adverse impact on the growth rate of the car lines recalled") with George E. Hoffer & A. James Wynne, *Consumer Responses to Auto Recalls*, 9 J. CONSUMER AFFAIRS 212, 217 (1975) ("recalls were not a significant determinant of market share for most makes in the subcompact market"). At least one study found a significant impact. See Gregg Jarrell & Sam Peltzman, *The Impact of Product Recalls on the Wealth of Sellers*, 93 J. POL. ECON. 512 (1985) (study finds that automobile recall causes price of seller's stock to decline in value). Jarrell and Peltzman's methodology is criticized in George E. Hoffer et al., *The Impact of Product Recalls on the Wealth of Sellers: A Re-examination*, 96 J. POL. ECON. 663, 669 (1988) ("little significant evidence remains indicating that securities markets penalize shareholders for an automotive recall by driving down share prices"). On the other hand, some consumers might respond to a recall order by concluding that the manufacturer was quick to acknowledge and correct problems, and therefore that they should buy its cars. Cf. David L. Ramp, *The Impact of Recall Campaigns on Products Liability*, 44 INS. COUNSEL J. 83, 84 (Jan. 1977) ("Manufacturers are realizing that recall is not as harmful to the corporate image as once believed, and are increasingly accepted by the public."); Teresa M. Schwartz & Robert S. Adler, *Product Recalls: A Remedy in Need of Repair*, 34 CASE W. RES. L. REV. 401, 417 (1984) ("While manufacturers may overestimate the adverse impact of recall-related publicity, this concern nevertheless deters them from reporting defects and undertaking voluntary recalls.") (footnote deleted).

23. See Stephen J. Werber, *Automobile Recall Campaigns: Proposals For Legislative and Judicial Responses*, 56 J. URBAN L. 1083, 1087 (1979) ("A recall campaign virtually automatically results in the filing of actions involving the subject vehicle . . ."); *Recalls*, *supra* note 20, at 772; Ramp, *supra* note 22, at 84.

24. See generally *Recalls*, *supra* note 20, at 764-65; Cary Stewart Sklaren, *The Effect of Current NHTSA Regulations and Enforcement Policy on Products Liability in the Motor Vehicle Industry*, 21 TORTS & INS. L.J. 464, 472 (1986); W. Terrell Wingfield, Jr., Comment, *Recall Letters as Evidence of a Defect in an Automobile*, 29 MERCER L. REV. 611 (1978).

25. Car manufacturers are required by federal law to recall cars which suffer a safety defect, so secret warranties are not an option for dealing with safety defects. See *infra* notes 138-43 and accompanying text. But if the issue of whether a recall is

Manufacturers have been known to go to considerable lengths to preserve the advantages of secret warranties. For example, according to an article in *Consumer Reports*, after a whistleblower had disclosed the existence of forty-one secret warranties allegedly run by one manufacturer, a spokesperson for that manufacturer maintained "We have no secret warranties."²⁶ Another

required is a close one, conceivably a manufacturer might consider a secret warranty instead of a recall, in which case the matters discussed in the text might be a consideration.

26. *Is Your Car's Warranty a Secret?*, *supra* note 9, at 214. The article reports on a memo dated March 11, 1987 from a Toyota regional customer-relations manager addressed to "all Toyota Customer Relations Managers and Service Managers" which recommended free repairs as a "good will gesture" for engine warmup problems on 1985-87 Toyota Corollas with automatic transmissions. The Toyota spokesperson did acknowledge to *Consumer Reports* that "repairs are sometimes paid for on a case-by-case basis in the interest of customer satisfaction." *Id.* According to one newspaper report, a Toyota spokesperson has acknowledged that it is providing reimbursement for out-of-warranty repair claims, but the spokesperson also denied that the company had a secret warranty. "We do not have a secret warranty," he said. "We make a case-by-case determination under our customer satisfaction policy whether to reimburse for a repair that occurs beyond the normal warranty." John E. Peterson, *Toyota Will Bend on Warranty, If You Ask*, THE DETROIT NEWS, Aug. 26, 1988, at 1A. Toyota has characterized the secret warranty memo as fraudulent. *See, e.g.*, Warren Brown, *Toyota Denies Existence of Secret Warranty Program*, WASH. POST, Sept. 3, 1988, at C2; Geoff Sundstrom, *Secret-Warranty Letter a Fraud, Toyota Says*, AUTOMOTIVE NEWS, Oct. 31, 1988, at 60; *see also* Letter from William MacLeod, Director FTC Bureau of Consumer Protection to Clarence L. Ditlow III 7-8 (May 24, 1989) [hereinafter MacLeod Letter] ("It appears that Toyota's guidelines provide for *ad hoc* good will adjustments and not across the board 'secret warranties.'"). Copies of the alleged list of 41 defects which are the subject of Toyota secret warranties are available from the Center for Auto Safety. *See also* Sagolla, *supra* note 10. (After Toyota and Nissan whistleblowers released documents showing secret warranties, the two automakers denied that they provided secret warranties); SHELDON, *supra* note 3, at 226 ("Manufacturers, moreover, will often deny the existence of these secret warranties or describe them as merely 'good will' or 'customer relations' gestures."); *Group Says Nissan Used Secret Warranties*, AUTOMOTIVE NEWS, July 2, 1990, at 8 ("Center for Auto Safety alleges Nissan uses secret warranties based on internal Nissan documents. A Nissan spokesman denied the charges and said the company's willingness to repair some defects without charge was misinterpreted as a secret warranty."); John E. Peterson, *'Good Will' Costs Nissan*, THE DETROIT NEWS, July 4, 1990, at 13A, 14A (Nissan officials charge that allegations that Nissan provides secret warranties come from disgruntled ex-employees. Nissan spokesperson reported to say that the firm's "good will" in repairing some defects free of charge is misinterpreted as a secret warranty. Center for Auto Safety alleged to have received documents from former Nissan U.S. Director of Consumer Support and Nissan's U.S. Director of Engineering, including memo from Nissan Service Chief to Nissan Financial

representative went even further, remarking, "there is no such thing as a secret warranty."²⁷ Some manufacturers insist that all they do is authorize dealers to make free repairs on a case-by-case basis.²⁸ On occasion, automobile manufacturers have not notified all their dealers, or even any dealers, of their secret warranties.²⁹ Though some of the disagreement between sellers and consumer groups may stem from a split over exactly what constitutes a secret warranty,³⁰ the dispute also seems to reflect a genuine difference over

Vice-President acknowledging that company's good will expenses "are directly related to specific product problems." Documents also show payments by Nissan to its dealers for "good will repairs" of over \$15 million in six-month period); Kathy Jackson, *Watchdogs Say Ford Fixing Cars in Canada Under Secret Warranty; Company Considers Fuel Pump Repairs to be Good Will*, AUTOMOTIVE NEWS, June 10, 1991, at 2 (Canadian Automobile Protective Association charges Ford has secret warranty program to repair fuel pumps and has provided repairs in 35 percent of cases reviewed by organization. Ford of Canada spokesman quoted as saying "we wouldn't risk the good will of our customers by running secret warranties," but acknowledges that good will assistance plan has been in effect for eight years and that repairs provided based on how well a dealer presents the customer's argument. Ford dealers said to use good will forms that they submit to the factory at their discretion.); Abe Plotkin, *Connecticut Shoots Down Secret Warranty With Law*, AUTOMOTIVE NEWS, Feb. 25, 1991, at 15 (Ford Motor Co. regional governmental relations manager quoted as saying Ford does not "engage in secret warranties"); Irene G. Keeney, *Some Dealers Pro-Rating Subaru Repair*, TIMES UNION, Dec. 31, 1989, at D1 (dealer states that it is authorized to provide repairs under secret warranty, but manufacturer denies existence of secret warranty and maintains that dealer is providing repairs on its own account); DITLOW & GOLD, *supra* note 4, at 16 ("Auto makers often try to disguise secret warranties as good will adjustments to avoid their disclosure.").

27. See Marc Silver, *The Out-Of-Warranty Blues*, U.S. NEWS & WORLD REP., Oct. 30, 1989, at 74 (quoting Toyota spokesperson, who was also quoted as saying "sometimes a dealer will decide to do repairs because he values a customer. . . . In other cases, the regional office reviews the case and makes a decision. Adjustments are made in the interest of customer satisfaction.").

28. See *supra* note 26.

29. See YVONNE W. ROSMARIN, SALES OF GOODS AND SERVICES 116 n.120.17 (Supp. 1991); SHELDON, *supra* note 3, at 226 ("Generally the manufacturer issues a bulletin to regional offices, and sometimes to dealers . . ."). See also *Letters: More Money Saved*, 53 CONSUMER REP. 193 (1988) (reader reports that dealer denied knowledge of secret warranty reported in *Consumer Reports* but that reader was able to obtain relief from Buick in Flint, Mich.).

30. For example, in one situation a manufacturer acknowledged that it had notified dealers but not customers that it would replace defective tires under certain circumstances, but denied that it was providing a secret warranty, apparently because, in the manufacturer's view, notification of dealers was enough to prevent the program from constituting a secret warranty. See United Press International, *GM Replacing Tires On Some 1985 and 1986 Models* (Dec. 12, 1986). See also James M. Tarbox,

whether manufacturers are providing at least some free repairs to all who seek them, or only to selected consumers on a case-by-case basis.

As noted above, in the eyes of some consumer groups, a chief problem with secret warranties is that they are not available to all consumers. According to one report, only about ten percent of car owners eligible for secret warranties succeed in obtaining them.³¹ How do manufacturers decide who gets free repairs? Often the manufacturer lets the dealer decide.³² One commentator, writing in 1968, observed that the most important consideration seems to be whether providing free repairs will enhance the seller's good will.³³ Whether a seller values a customer's good will can depend on the seller's guess as to whether the consumer will buy new cars again and how hard the consumer bargains on price.³⁴ The seller may also take into account whether the owner seems to maintain the car properly.³⁵

Even if a seller wishes to retain the good will of a particular customer, the seller may not repair the problem for free unless the seller believes that failure to make the repair would cause the consumer to buy elsewhere in the future. Thus, some manufacturers provide the free repairs only for the most aggressive and persistent customers.³⁶ As an extreme example, one

Ford Truck Paint Woes Protested Consumer Advocates Demand Investigation, ST. PAUL PIONEER PRESS DISPATCH, June 23, 1992, at C3 (quoting Ford Motor Co. representative as saying, "[a] secret warranty is characterized by a time and/or mileage limitation."); Jan A. Zverina, United Press International, *GM to Provide Free Engine Replacement* (Jan. 24, 1986) (GM claimed it was not providing secret warranty when it had notified dealers but not customers because customers can obtain information by contacting dealer or GM).

31. Peterson, *supra* note 26, at 13A (attributing statement to Center for Auto Safety).

32. See Polachek & Steinbach, *supra* note 6, at 1, 2.

33. Whitford, *supra* note 3, at 1038.

34. See Whitford, *supra* note 3, at 1043-44 ("An owner who bargains hard on the price is not as profitable a customer to the dealer, and he also is likely to consider price the most important factor in deciding from which dealer to buy his next car."). Professor Whitford suggests that buyers who pay more for a car or who buy regularly from the same dealer are in fact paying for the extra warranty coverage provision through good will adjustments. *Id.* at 1067. But it is not clear that owners who pay more are in fact the recipients of good will adjustments.

35. See Polachek & Steinbach, *supra* note 6, at 1, 2-3; Ed Henry, "Goodwill" Warranties for High-Mileage Cars, *KIPLINGER'S PERS. FIN. MAG.* (Nov. 1994) (quoting auto manufacturer representative: "If you have a transmission failure and its obvious the car has been abused, you'd probably be told no; but if you had a nice, clean vehicle and the transmission failed, and it was 5,000 to 10,000 miles out of warranty, it would most likely be covered within a goodwill adjustment.").

36. SHELDON, *supra* note 3, at 226 ("Secret warranties benefit only those

<https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

government official has reported a case in which a consumer succeeded in obtaining a \$2,000 settlement from a manufacturer within a week after the consumer subpoenaed the manufacturer's secret customer relations guidelines.³⁷ Manufacturers probably reason that consumers who are not unhappy enough to complain vociferously will not desert them for other sellers.³⁸ In any event, some observers have suggested that it may be necessary to create a nuisance to obtain the benefits of the warranty.³⁹

When manufacturers decide to institute good will adjustment programs, they sometimes impose limiting conditions. Some of these conditions may be designed to insure that the specific problem was in fact caused by a

consumers who complain loudly and persistently enough, and to the right party."); JACK GILLIS, *THE CAR BOOK* 92 (1992) (free repairs formerly "reserved for customers who made a big fuss"); *Is Your Car's Warranty a Secret?*, *supra* note 9, at 214 ("Only car owners who complain long and loudly to the right person get reimbursed for repairs."); Silver, *supra* note 27, at 74 ("Those who benefit [from secret warranties] usually are those who complain the loudest. You certainly will not cut your repair bill if you dutifully reach for a pen and write out a check rather than make your displeasure known."); *NY Hearings*, *supra* note 2 (testimony of New York State Automobile Association) (secret warranty programs "frequently are triggered only when consumers complain vociferously"); Gordon Martin, *Guide to Concours D'Elegance Events in Northern California*, *SAN FRANCISCO CHRON.*, Apr. 18, 1991, at C13 ("On occasion, the customer has to complain loud and long before the 'secret warranty' goes into effect."); John E. Peterson, *Toyota Will Bend on Warranty, If You Ask*, *THE DETROIT NEWS*, Aug. 26, 1988, at 1A, 8A ("A customer 'generally has to complain about paying' for a component on the 'high frequency of repair' list to be reimbursed [Toyota spokesperson] Daly acknowledged. 'A dealer might point out to him that a component shouldn't have failed and offer to seek reimbursement from Toyota, but in most cases it would be up to the customer to request it.'). Cf. Ralph Vartabedian, *Your Wheels: Imported Cars Have Problems Too*, *LOS ANGELES TIMES*, Jan. 16, 1992, at E6 (consumer who complained of problem covered under secret warranty to dealer while warranty in effect was not provided with free repairs).

37. *NY Hearings*, *supra* note 2 (testimony of Virginia Apuzzo, Deputy Executive Director, New York State Consumer Protection Board) (the consumer had learned of the existence of the guidelines from a former employee).

38. Cf. Whitford, *supra* note 3, at 1045 ("An aggressive owner is more likely to obtain a warranty repair. . . . Aggressive owners more often convey the impression that a denial of a warranty repair will have a substantial harmful effect on their feelings of good will towards the dealer and manufacturer.").

39. See ROSMARIN, *supra* note 29, at 115; SHELDON, *supra* note 3, at 227; See also Ralph Vartabedian, *Your Wheels: Fuel Pump Fails to Deliver the Needed Power*, *LOS ANGELES TIMES*, Aug. 30, 1990, at E8 (consumer may be able to receive benefits of secret warranty on car older than cut-off, if consumer complained before car was too old, but consumer "undoubtedly will have to make a lot of noise complaining and . . . almost certainly will have to haggle with a . . . factory representative").

manufacturing defect rather than customer neglect. The programs generally run for a limited time.⁴⁰ Consumers who learn of the program after the deadline for obtaining repairs are usually out of luck, even if they complained to the dealer while the program was in effect.⁴¹ Not all cars are included in the program; manufacturers sometimes establish cutoffs based on mileage.⁴² Manufacturers typically assume only the actual cost of repair and will not compensate consumers for consequential damages.⁴³ Sometimes manufacturers do not pay the full cost of repairs.⁴⁴

III. SHOULD SECRET WARRANTIES BE REGULATED?

Those who seek the regulation of secret warranties usually argue for a rule that would accomplish two goals: First, good will adjustments should be offered to all purchasers of the cars which might suffer from the defect, and second, notice of the adjustments should be provided to eligible purchasers.⁴⁵ The justifications for these goals are typically rooted in both economics and a sense of fairness. The economics-based rationale stems from the fact that those who do not know about the good will adjustments not only end up paying for the repair itself, but may incur other expenses because of the collateral damage which may be caused by an unrepaired defect.⁴⁶ In addition, the inequality of treatment—some consumers are able to obtain free repairs while others are not—strikes critics as unfair. Advocates for secret

40. See ROSMARIN, *supra* note 29, at 114.

41. ROSMARIN, *supra* note 29, at 114; SHELDON, *supra* note 3, at 226 ("[C]onsumers who complain of the problem during the secret warranty period, but are not sufficiently aggressive or complain to a dealer uninformed of the policy, are denied coverage when they later learn of it after the period/mileage cutoff.").

42. See Polachek & Steinbach, *supra* note 6, at 1-2 ("Typically . . . repairs will be made or reimbursed only when the vehicle owner reports the problem within a designated time period, such as the first 5 years or 50,000 miles. Some secret warranties, however, have extended for the life of the car."); ROSMARIN, *supra* note 29, at 114; SHELDON, *supra* note 3, at 226.

43. ROSMARIN, *supra* note 29, at 114; SHELDON, *supra* note 3, at 226.

44. See, e.g., Silver, *supra* note 27, at 74 (manufacturer offered to assume half the repair bill for particular problem).

45. See, e.g., *Conn. Hearings*, *supra* note 13 (testimony of Clarine Riddle, Attorney General of the State of Connecticut) ("Notification to the consumer personally is crucial to the concept before you today. I urge the Committee to consider requiring the manufacturers to mail the notice . . . directly to the consumer.").

46. See, e.g., DITLOW & GOLD, *supra* note 4, at 17-19. Automobile owners use independent mechanics, rather than dealers, about 80% of the time. See Julie E. Halpert, *Who Will Fix Tomorrow's Cars?*, N.Y. TIMES, Nov. 7, 1993, at F4.

warranty regulation seldom go beyond these points. This section explores these and other arguments concerning the regulation of secret warranties.

A. An Economic Analysis of Secret Warranty Regulation

This section discusses the economics of rules which would prohibit manufacturers from offering good will adjustments unless they made the repairs without charge for all affected consumers and notified those consumers of the availability of the free repairs. The section argues, first, that under such a regimen of regulation manufacturers would continue to offer good will adjustments, though they might offer fewer than they do at present. Second, the Article contends in this section that as all automobile purchasers pay a portion of the costs of the secret warranties that benefit only a few, most consumers would be better off if manufacturers provided good will adjustments to all buyers or none, even if fewer good will adjustments were provided.

The section also argues that the market cannot resolve this matter optimally, in part because the obscurity of secret warranties prevents consumers from taking them into account when making purchasing decisions. Hence, this section concludes that government intervention is necessary to correct the market failure.

1. Will Regulation of Secret Warranties Cause Manufacturers to Stop Offering Secret Warranties?

Industry representatives,⁴⁷ commentators,⁴⁸ government officials,⁴⁹

47. See, e.g., *NY Hearings, supra* note 2 (testimony of Automobile Importers of America, Inc.) ("government regulation of adjustment programs, if it raises the overall cost or legal risk of offering assistance, will act as a strong disincentive to any action"); *id.* (testimony of Toyota Motor Sales, U.S.A., Inc.) ("increased costs of compliance with [government] regulation would divert manufacturer resources from direct customer satisfaction efforts and discourage manufacturers from offering new programs"); *Conn. Hearings, supra* note 13 (statement of Stephen F. Gabriel, Executive Vice President, Connecticut Automotive Trades Association) ("Our ultimate concern is that any proposed legislation affecting warranty adjustment programs not be so inflexible as to deter manufacturers from taking responsive measures which might otherwise have been implemented.").

48. See, e.g., Keith E. Crain, *"Secret Warranties" Are Better Than None*, AUTOMOTIVE NEWS, July 16, 1990, at 12 (arguing that if automakers are required to offer good will adjustments to all consumers, automakers will stop making adjustments; "the net result would be far worse for the consumer than if we permit exceptional remedies from time to time").

49. See, e.g., Sagolla, *supra* note 10, at 7 (FTC Bureau of Consumer Protection

and even a consumer advocate⁵⁰ have argued that if secret warranties are regulated, sellers might offer fewer good will adjustments, if indeed they offer any at all. They contend that manufacturers might conclude that the benefits of providing secret warranties—increased sales attributable to customer good will—would be outweighed by the costs of providing them—the expense of complying with whatever regulation is imposed, plus the costs currently associated with secret warranties.

The history of consumer protection suggests that argument should not be taken at face value. Proposals designed to aid consumers often elicit predictions of similar setbacks for consumers, and the predictions have sometimes proved fanciful. Thus, some forecast that sellers would stop warranting goods if Congress passed the Magnuson-Moss Warranty Act,⁵¹ and obviously sellers still furnish warranties.⁵²

employee Lydia Parnes was reported to state that "[i]f car makers are required to disclose secret warranties, they will be less likely to offer them, thus hurting consumers." Bureau of Consumer Protection Director William MacLeod was quoted as saying "requiring . . . disclosures [of secret warranties] would also raise the cost of each adjustment program, as reimbursements go to more beneficiaries. We would expect manufacturers to offer fewer programs unless consumers are willing to pay for the increased costs."); 33 PROCEEDINGS OF THE CONN. GEN. ASSEMBLY, HOUSE, part 4, at 1316-17 (1990) (remarks of Rep. Farr) ("What this bill does is it says to a manufacturer, if you have a small defect and the cost of giving notice is high, just don't repair it. If you have a manufactured automobile and it's got a defective light in the glove compartment and it's going to cost \$5 or \$10 to fix that and you decided it was obviously a mistake in manufacturing and you told your dealers to go ahead and fix it, it's only \$10, but now we pass a bill and it's going to cost you \$25 or \$15 to give this notice. Any dealer is going to—any manufacturer is simply not going to give the notice.").

50. See *World News*, AUTO WEEK, Apr. 24, 1989, at 9 (Consumer advocate and author Sal Fariello reported to say that requiring car makers to provide free repairs for all owners under secret warranties "will only force all manufacturers to indiscriminately shut the door to all consumers who request special out-of-warranty assistance.").

51. See *Emerging Issues Under the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act*, 45 A.B.A. ANTITRUST L.J. 72, 74 (1976) (remarks of Joan Z. Bernstein, formerly Acting Director, FTC Bureau of Consumer Protection). The Magnuson-Moss Warranty Act is codified at 15 U.S.C. §§ 2301-2312 (1988). See also Robert J. Banta, *Negotiability in Consumer Sales—The Need for Further Study*, 53 NEB. L. REV. 195, 196-97 (1974) ("Many banking and financial institutions argue that if they were subject to consumer defenses, consumer credit might vanish or become so expensive as to be prohibitive.").

52. Similarly, estimates of the costs of air bags by auto manufacturers have proved to be wildly inflated. See, e.g., Daniel D. Cutler, *The Continuing Struggle for Automotive Safety*, 15 SETON HALL LEGIS. J. 453, 463 n.65 (1991) (car manufacturers

Indeed, some empirical evidence suggests that manufacturers would not stop providing free repairs if the repairs were regulated. For example, after Connecticut passed a statute regulating good will adjustments, Ford continued to make adjustments and simply complied with the statute.⁵³ Ford reportedly continued to abide by the terms of a 1980 consent decree it entered into with the FTC, requiring notice of good will adjustments to Ford customers, years after the decree expired by its terms.⁵⁴

If good will adjustments are regulated, manufacturers should continue to provide the adjustments if they conclude that it is in their best interests to do so.⁵⁵ What manufacturers perceive as being in their best interests should, in

estimated airbags would cost consumers \$1,100).

53. Giorgianni, *supra* note 19, at E3 (since the Connecticut law became effective in 1990, Ford has provided Connecticut officials with copies of owner notifications for four adjustments). Ford also continued to institute good will adjustment programs after it entered into a consent order with the FTC obliging it to notify its customers when it created such programs. See Letter from Clarence M. Ditlow III, Dan Howell and Daniel Oliver, FTC Chair (Sept. 9, 1987) reprinted in CENTER FOR AUTO SAFETY, SECRET AUTO WARRANTIES item 6 (1992) (six programs in eight months). On the other hand, CAS has charged that Ford has conducted a secret warranty program without notifying consumers. Ford denied that it was providing secret warranties and stated that it was getting in touch with affected consumers. See Doron P. Levin, *When It Pays to Complain: Detroit's 'Secret Warranties'*, N.Y. TIMES, June 23, 1992, at D1.

54. See Levin, *supra* note 53, at D7; Polachek & Steinbach, *supra* note 6, at 6; see also *Conn. Hearings*, *supra* note 13 (testimony of Alice Cantwell, Regional Manager of Governmental Relations for Ford Motor Co.) (Ford continues to notify consumers of good will adjustments even after expiration of FTC consent decree "because we believe in doing so is in the best interest of the consumer and ultimately in Ford's best interest to serve and keep customers happy"). Similarly, General Motors claimed recently that it provided notice by mail to owners in more than 90% of its "field actions for non-safety and customer satisfaction problems . . ." *Id.* (Letter from R. J. Bugno, General Motors General Director of Service Operations, (Jan. 30, 1990.)). The consent decree is reported at *In re Ford Motor Co.*, 96 F.T.C. 362 (1980).

55. Cf. *Conn. Hearings*, *supra* note 13 (Letter from R.J. Bugno, General Motors General Director of Service Operations (Jan. 30, 1990)) ("It is simply not in General Motors' short or long term interest to withhold information about [good will adjustment] programs from our customers. Any 'savings' that might result from a company's effort to withhold from its customers information about its own remedial programs are very likely to be more than offset by the diminished customer loyalty that results from dissatisfaction associated with the problem."); Linda Welling, *A Theory of Voluntary Recalls and Product Liability*, 57 S. ECON. J. 1092, 1093 (1991) ("[T]he firm has some discretion in determining whether the benefits of a recall, measured by the reaction of current and future consumers to an admission that some

turn, depend on a calculus of several variables, which takes into account the cost of compliance, including the cost of providing notice and repairs, and the cost of not providing the adjustments.

What is the cost to manufacturers of not providing adjustments? If the manufacturers respond to regulation by refusing to make any free repairs on widespread problems, they will certainly incur the irritation of the consumers who complain to them (call them "complainers"). In addition, the manufacturers will also generate ill will among some number of consumers who do not complain to them ("non-complainers"). Studies show that many consumers who discover that a product is defective do not complain to sellers or manufacturers;⁵⁶ some of these, in the parlance of social scientists, "exit" and purchase products made by others in the future.⁵⁷

part of its product line is substandard, outweigh the costs. . . . Depending upon the conditions of demand, a firm which maintains a reputation for recalling defective products is able to obtain expected profits in excess of those available when consumers bear all of the risk attached to uncertainty over product liability.").

56. See Arthur Best & Alan R. Andreasen, *Consumer Response to Unsatisfactory Purchases: A Survey of Perceiving Defects, Voicing Complaints, and Obtaining Redress*, 11 LAW & SOC'Y REV. 701, 712, 716 (1977) (Of those who perceived problems with cars they purchased, 41.8% took no action while 46.8% complained to the seller; nonprice problems about cars were voiced 57.1% of the time.); Kenneth McNeil et al., *Market Discrimination Against the Poor and the Impact of Consumer Disclosure Laws: The Used Car Industry*, 13 LAW & SOC'Y REV. 695, 715 (1979) (study which examined the behavior of those who bought used cars from a dealer found that when a defect manifested in the car in the first three months of purchase, nearly 40% of the consumers did not report the problem to the dealer); Rex H. Warland et al., *Dissatisfied Consumers: Who Gets Upset and Who Takes Action*, 9 J. CONSUMER AFF. 148, 152 (1975) (Of 458 dissatisfied consumers of various goods and services, 49% either did nothing or took only such steps as complaining to family or friends or resolving not to purchase product in the future, rather than complaining to seller.); *Improving the New Products Equation*, THE NIELSEN RESEARCHER, No. 1, at 2, 12-13 (1974) ("A national study of consumer reactions to product defects revealed that . . . 69% [of the consumers] took no *direct action* whatsoever.") (emphasis in original). But see H. Laurence Ross & Neil O. Littlefield, *Complaint as a Problem-Solving Mechanism*, 12 LAW & SOC'Y REV. 199, 205 (1978) (middle class consumers of single appliance dealer, who might have been more responsive to complaints than other sellers, generally complained to seller when they experienced problems). Another study found that 25% of the car buyers who experience difficulty in obtaining warranty repairs do not pursue the matter further; in other words, 25% of those who do complain stop at the first rebuff. See Whitford, *supra* note 3, at 1021 n.44.

57. See Best & Andreasen, *supra* note 56, at 711 (survey found that 5.7% of disappointed car buyers exit without complaining to seller); Warland et al., *supra* note 56, at 152 (In survey of consumer to determine how they respond to product

Consumer research also shows that some consumers are less willing to complain about problems which are not manifest.⁵⁸ That is to say, some consumers seem more comfortable complaining to sellers about problems that are easy to demonstrate, such as a product that was never furnished, than about problems that are harder to prove and whose very existence is more susceptible to the exercise of judgment, such as whether the product is sufficiently durable.⁵⁹ It may be that these consumers feel uneasy about complaining when they face a possibility of a rebuff. Intuition suggests such consumers will hesitate to complain when they know that the good is no longer covered by a warranty, though they may nevertheless feel that the product has not performed adequately.⁶⁰ Thus, refusal to repair will probably cost the seller some unknown number of repeat sales to those who do not complain.

One advantage of secret warranty programs, from a manufacturer's point of view, is that they permit manufacturers to target many of the customers who are most angry about a defect, and thus offer the greatest return, in good will, per repair. Manufacturers who provide free repairs for all their customers retain the good will of non-complainers, but to do so they probably pay for repairs for some customers who have not noticed the defect,⁶¹ or who do not hold it against the manufacturer, and whose faith in the company has not been shaken. Such manufacturers end up paying for repairs which do not

disappointments, 6% did not complain about problem but stopped shopping at the store or changed stores, and 5% resolved not to purchase the offending product or service in future but did not complain.). For a theoretical discussion of how consumers choose between exit and voicing their concerns, *see generally* Hirschman, *supra* note 16; *see also* H. Keith Hunt, *Consumer Satisfaction Dissatisfaction and Complaining Behavior*, 47 J. SOCIAL ISSUES 107 (1991).

58. *See* Best & Andreasen, *supra* note 56, at 719.

59. *See* Best and Andreasen, *supra* note 56, at 719, 724.

60. Some consumers may complain because they do not realize that their warranty has expired. One survey found that 31% of the respondents, when asked how long their auto warranty was, answered incorrectly, and that another 4% did not know. Whitford, *supra* note 3, at 1055. On the other hand, the survey respondents do not appear to have been given a warranty to check their answers; in real life, some consumers who thought their repairs were covered by a warranty might review the warranty before bringing the car in for work. In addition, some of those who thought their warranty had a different term than it had in actuality may have thought it had a shorter term than it did. *See also* ARTHUR YOUNG & CO., *supra* note 18, at 79-81 (88.4% of car buyers responding to survey said their cars carried warranties claimed to know duration of warranty, but answers to questions about length of warranty suggested that some did not in fact know the duration of their warranties.).

61. Some problems simply escape detection, *see* Best & Andreason, *supra* note 56, at 703, or do not surface in every car.

necessarily enhance their good will, and so, from the manufacturer's point of view, the money may not have been well-spent. At a minimum, the cost of retaining the good will of the unidentified non-complainers who would otherwise exit is much higher than the cost of retaining the good will of the complainers. On the other hand, if manufacturers are barred by statute from spending money on some customers without also repairing the cars of others, the calculus is very different. In order to retain the good will of any customers who are angry about the defect, including the complainers, the manufacturers must repair the cars of all.

For example, assume that a particular model, of which 1000 cars were sold, contains a defect that appears after the warranty expires, and that 300 of the purchasers complain to the manufacturer and seek a good will adjustment. Also, assume that the manufacturer believes that all the complainers will exit if the defect is not repaired and that an additional 100, of the 700 non-complainers who bought the car, will exit because of the flaw, though the manufacturer cannot identify them. Finally, assume that the manufacturer believes no one who is angry about the flaw and who receives a free repair will exit. As things stand now, absent regulation, if the manufacturer initiates a secret warranty program limited to complainers, it will retain the good will of the 300 complainers, and lose the repeat business of 100 of the remaining 700. The cost of reclaiming those 100 disappointed non-complainers is the cost of notifying all of the 700 non-complainers and agreeing to repair all of their cars. In fact, probably not all the 700 would seek free repairs even if they were notified that they could obtain them, but assume for the sake of argument that all 700 would. Thus, for every non-complaining customer the manufacturer keeps, it pays for seven repairs. A manufacturer, faced with the choice of losing the 100 or keeping them at the expense of repairing 700 cars, might choose to lose the 100.

However, regulation that prohibits fixing some without fixing all changes the economics. Because the manufacturer could not repair the cars of the complaining 300 without also fixing the cars of the other 700, the value to the manufacturer of fixing the cars of the 600 who do not care is retaining 400 consumers. A manufacturer who would not repair 700 cars to retain the good will of 100 people might repair 1,000 cars to retain the good will of 400.⁶² Whether the manufacturer would pay to fix the 1,000 to retain the 400 still depends on a multitude of variables, including the cost of the repairs and the

62. Cf. Polachek & Steinbach, *supra* note 6, at 8 (arguing that manufacturers would continue to offer good will adjustments even after regulation because of "increasingly competitive auto marketplace to retain customer satisfaction. Manufacturers can ill afford to stand by while large numbers of buyers of particular models experience widespread, common problems resulting from flaws in manufacture or design.").

cost of complying with any notice rules.⁶³ However, as this hypothetical illustrates, the economics of good will adjustments is not so clear-cut as some have suggested.

In addition, the economics depend very much on what the manufacturer believes consumers will do. For example, not all consumers who learn of the availability of free repairs will necessarily seek them.⁶⁴ Many consumers

63. See *infra* notes 286-307 and accompanying text for a discussion of notice rules.

64. Compare *NY Hearings, supra* note 2 (testimony of Travis B. Plunkett, New York Public Interest Research Group, Inc.) (Ford provided notices to owners of problems and "whole world" did not claim free repairs. "These programs cover a defined number of cars manufactured within specific production dates. Owners are not compensated unless their cars have the appropriate serial numbers. Often, Ford will notify buyers that a particular defect, such as poor quality leather, could potentially cause damage to occur, such as cracked leather upholstery. Repairs are not made unless the damage actually exists.") with Silver, *supra* note 27, at 75 (quoting Chrysler spokesperson as saying "Experience teaches you that when you say to the world, 'We'll fix it,' the whole world will come in for the repairs whether they have the problem or not. That's human nature.") and *NY Hearings, supra* note 2 (testimony of Automobile Importers of America, Inc.) (Mandatory notice to all cars in class of good will adjustment program "would result in more vehicle owners seeking the remedy than actually have the problem, causing a much higher cost of repairing the vehicles and eventually a much higher cost of new vehicles."). The problem is similar to moral hazard, under which people who are insured seek payments for damages which would not have occurred but for the existence of the insurance. See generally John M. Marshall, *Moral Hazard*, 66 AM. ECON. REV. 880 (1976) (defining moral hazard as "any misallocation of resources which results when risks are insured with normal insurance contracts and only with such contracts"); Mark V. Pauly, *The Economics of Moral Hazard*, 58 AM. ECON. REV. 531 (1968); Mark V. Pauly, *Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection*, 88 Q.J. ECON. 44 (1974); Isaac Ehrlich & Gary S. Becker, *Market Insurance, Self-Insurance, and Self-Protection*, 80 J. POL. ECON. 623 (1972). See also Robert E. Wilkes & James B. Wilcox, *Consumer Perceptions of Product Warranties and Their Implications for Retail Strategy*, 4 J. BUS. RESEARCH 35, 39 (1976) (63.8% of consumers in study agreed that "sometimes consumers make claims for service or repair for a product even though they are not honestly entitled to do so by the guarantee"). But moral hazard is unlikely to present much difficulty with secret warranties. The defects which prompt secret warranties are significant enough to cause owners to complain vociferously to manufacturers. That being so, trained mechanics should be able to identify most defects covered by secret warranties from a description of the symptoms, and so relatively little time should be required to determine whether a particular problem, real or imagined, is in fact covered under a particular secret warranty. To use the example above, a determination of whether leather upholstery has cracked does not take very long, even for an untrained mechanic. Owners who have not suffered from cracked upholstery are not likely to take the time to bring their

who have been notified of recalls in the past have elected not to bring their cars in to be corrected.⁶⁵ Recalls may not provide the best evidence of how consumers will respond to notice of good will adjustments, however. Recalls often involve defects which may not be of concern to a particular motorist, for example, and so the motorist may not bother to seek the repair. Thus, car owners who do not have children may not take the time to respond to a notice

cars in for repairs of upholstery under a program in which only cracks are repaired. In effect, the burden of taking the car to the dealer functions as the equivalent of a co-payment, a classic method of reducing moral hazard. See Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests* 69 VA. L. REV. 1387, 1446-47 (1983) ("Moral hazard seems unlikely to exist in warranty markets. . . . Even broad consumer warranties enjoy a form of coinsurance. Consumer durables are bought for use, and buyers seldom keep spares. Moreover, firms require many warranted repairs to be made off the consumer's premises. Consequently, product breakdown imposes substantial costs on consumers in lost use even when firms fulfill their warranty obligations."). Sellers can also reduce losses from moral hazard by instructing owners, in any notice of good will adjustments, not to bring their cars in for adjustments unless the particular symptoms attributable to the defect which is the subject of the adjustment have manifested.

65. See, e.g., Glen D. Nager, Note, *Auto Recalls and the Pursuit of Safety: A Commonsense Approach*, 33 STAN. L. REV. 301, 305 n.23 (1981) ("Administration statistics indicated that return rates for recalls from 1966 to 1974 averaged 75% when the manufacturer paid for repairs."); Bob Tamarkin, *Recalls—The Costs Soar*, FORBES, July 10, 1978, at 79 ("Owner response to a recall notice varies sharply: a brake recall may draw an 80% response, a seat belt repair only 30%."); Schwartz & Adler, *supra* note 22, at 406 (owner response rates to recalls average around 50%). When queried, owners provide various explanations for their failure to respond to a recall. Among the reasons given: lack of notice, inadequate notice (such as letters which did not explain the safety risks clearly enough to impress the reader), time or inconvenience involved in responding to the recall, and a perception that the risk of danger is low. See *id.* at 421-24; see also *Why You Don't Respond to Recalls*, CONSUMER REP. Jan. 1981, at 46 (when *Consumer Reports* asked its readers why they did not respond to recalls, the replies fell into four rough categories: too much trouble, lack of incentive (in particular, that the danger seemed remote or irrelevant), doubts about whether the dealer will repair the defect properly without causing additional problems, and some consumers reported that they were able to solve the problem themselves); George E. Hoffer et al., *When Recalls Matter: Factors Affecting Owner Response to Automotive Recalls*, 28 J. CONSUMER AFFAIRS 96, 103-04 (1994) (study finds that owners more likely to respond to recalls of newer cars, domestic cars, and when defect is more severe; study also found that the number of cars recalled and the issuance of a press release announcing the recall when car owners were already notified by direct mail did not have a significant impact on owner response to the recalls).

of a defect that is dangerous only to children;⁶⁶ similarly, some drivers may not care enough about the environment to have even free repairs performed on their car when the sole purpose of the repairs is to reduce emissions. On the other hand, unlike some recalls, secret warranties are triggered by consumer complaints, and are significant enough problems to cause some consumers aggressively to seek correction of the problem. Consequently, it may be that consumers who learn they can obtain free repairs under a good will adjustment program will want those repairs in greater numbers than has been the case with safety and emission recalls.

In addition, the manufacturer's belief as to the circumstances in which consumers will exit is critical. For example, if the manufacturer anticipates that consumers will exit whether or not the manufacturer provides free repairs, the manufacturer has little to gain in good will from making the adjustment.⁶⁷ Similarly, if the manufacturer believes that consumers will buy the manufacturer's product again regardless of whether the manufacturer provides free repairs, good will adjustments do not benefit the manufacturer. However, if either of these situations existed, the manufacturer would not in any event offer a secret warranty, even in the absence of regulation.

2. Other Costs of Secret Warranty Regulation

If secret warranties were regulated, what other costs would be imposed on society? Though manufacturers can be expected to care primarily about the costs they bear when they offer good will adjustments, in fact they do not incur all the costs of good will adjustments. Consumers obviously bear the cost of bringing their cars to a dealer for repair.⁶⁸ But since many consumers would normally seek the repair anyway—after all, part of the reason the manufacturer offers the good will adjustment is because consumers have noticed the defect and want it repaired—this cost may be a wash.

66. For example, in 1992, Ford recalled 654,000 Ford Taurus and Mercury Sable station wagons because it discovered that a child could lock itself in an area of the tailgate and suffocate. *See Recalls*, CONSUMER REP., Aug. 1992, at 542. Owners who rarely, if ever, have children in their cars could rationally conclude that bringing their cars in to have the problem corrected would be a waste of time.

67. Conceivably, the manufacturer might offer free repairs even to loud complainers it expects to exit in the hope that these consumers will be placated and not generate adverse publicity. But some such consumers voice their critical comments anyway, as manufacturers know, and so this may not be a successful strategy.

68. *Cf. Nager, supra* note 65, at 306 ("Recalls require owners to bring their cars to the dealer to obtain service. Demands on the owners' time must be counted as a social cost of recall since in the absence of recall the time would be available for other productive or leisure activity.").

Another potential cost imposed by any regulation of good will adjustments requiring notice stems from the "boy who cried wolf syndrome." If consumers receive too many notices of free repairs, they may regard them as unimportant and not respond to safety recalls, which can be of critical significance.⁶⁹ Given, however, that any individual automobile is the subject of few, if any, good will adjustments at present, and that regulation is likely to diminish the number of good will adjustments offered, rather than increase it, this concern seems far-fetched.

Finally, any regulatory scheme normally requires enforcement, and enforcement may add to the cost of regulating good will adjustments. But experts seem to agree that the enforcement of secret warranty regulation would not be difficult,⁷⁰ implying that the cost will not be great, and existing filings required by law should make enforcement even cheaper.⁷¹ In short, the costs of secret warranty regulation—other than those imposed on manufacturers—do not seem significant, and so probably need not be taken into account in determining whether secret warranties should be regulated.⁷²

69. See *NY Hearings*, *supra* note 2 (testimony of Automobile Importers of America, Inc.) ("Repeated notices . . . would . . . undercut the response to recall notices which might well cover more serious problems."); *Cf. Nager*, *supra* note 65, at 306 n.23 (If recall and notice announcements are to be taken seriously by the consumer, they must not be overused. Repeated notices or recalls might have a chilling effect on the rate at which consumers return defective cars, causing an increase in the harm from accidents to the extent that recalls for serious hazards are ignored.).

70. See *Conn. Hearings*, *supra* note 13 (testimony of Clarine Riddle, Attorney General of the State of Connecticut) (predicting that enforcement of Connecticut law would not be difficult); *id.* (testimony of Timothy West, Director of the Fraud Division of the Department of Consumer Protection) (enforcement would not be difficult because manufacturers could be required to report information to state about repeated problems and repairs).

71. See *supra* note 9 and accompanying text.

72. Other potential costs of disclosure, which do not appear to be worthy of serious consideration in connection with secret warranties, have been mentioned in various sources. Moral hazard is discussed *supra* in note 64. Some opponents of secret warranty regulation have argued that notices of good will adjustments might impair consumer confidence in automobiles. See *NY Hearings*, *supra* note 2 (testimony of Automobile Importers of America, Inc.) ("Repeated notices . . . would undercut the overall level of consumer confidence . . ."); Polachek & Steinbach, *supra* note 6, at 4 ("Manufacturers also contend that if they were forced to disclose all widespread flaws in their cars, customer confidence in their product would be undermined. For example, assume that a component has a failure rate of ten percent. An auto maker who wanted to compensate customers who experienced the problem would have to notify all owners of the affected model. But in that case, ninety percent of the owners would have their confidence in the product undermined without reason."). Consumer confidence seems far more likely to be harmed by defects in cars

3. Would Consumers Be Worse Off if Manufacturers Stopped Providing Good Will Adjustments?

While the existing statutes have not eliminated good will adjustments, and while it may sometimes be in a manufacturer's best interests to offer good will adjustments even under a regimen of regulation, it is in fact impossible to determine, based on publicly-available information, whether some manufacturers have decided against instituting good will adjustment programs because of existing regulation of those programs. While no manufacturer has proclaimed that it eschewed a good will adjustment program because of regulation, such a claim is unlikely, given that it would necessarily require acknowledging an uncorrected defect; manufacturers are understandably reluctant to advertise the defects in their automobiles. Moreover, it is possible that more expensive regulation, such as extension of Connecticut-like legislation to the entire country or even many more states, would increase the cost of good will adjustments to the point where manufacturers would provide them less frequently.

Accordingly, while good will adjustments probably would survive regulation, it is nevertheless the case that government regulation might reduce the number of good will adjustments. Some commentators, including at least one consumer advocate, have argued that secret warranty programs therefore should not be regulated.⁷³ Their theory is that even absent regulation, secret warranties benefit those consumers who are fortunate enough (or aggressive enough) to obtain the free repairs; half a loaf, or even a few slices of bread, is better than none.

which the manufacturer refuses to fix than by notices of defects which the manufacturer agrees to fix without charge. Former Federal Trade Commission Chair Miller has argued that regulation of secret warranties will reduce experimentation because manufacturers will not want to take a chance on being ordered to pay for substantial repairs. *See* 42 TRADE REG. & ANTITRUST RPTR. (BNA) 234 (Jan. 28, 1982). That, too, misses the mark. Manufacturers could simply decline to undertake an expensive good will adjustment program. In addition, any disincentive to experimentation undoubtedly comes from the fear of producing a defective product, not the fear of being ordered to correct the defect if the manufacturer corrects the defect for some of its customers.

Commentators on the provision of information to consumers generally have noted that some consumers might misinterpret the information provided. *See* Howard Beales et al., *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 534 (1981). It should be possible, however, to draft notices of good will adjustments in such a way as to minimize the likelihood of consumer confusion. Thus, though the observation is important in other contexts, it does not appear significant here.

73. *See supra* notes 47-50 and accompanying text.

Implicit in that argument is an assumption that consumers as a group benefit when some consumers, but not others, receive free repairs. That assumption is questionable. In fact, a system in which either all purchasers of a particular good or no purchasers have access to free repairs may be better for consumers as a whole than a system in which only aggressive or lucky consumers obtain free repairs.

When competition is perfect, sellers recover their costs plus a reasonable profit. While the automobile industry might not be characterized by perfect competition, and indeed sellers do not always recover their costs, it is reasonable to assume that prices to consumers, on average, bear a significant relationship to costs. If that is so, sellers should recover much or all of the cost of providing future good will adjustments in their selling prices.⁷⁴ They should estimate the cost of providing good will adjustments and take that estimate into account in establishing the selling price. Because manufacturers

74. Cf. David A. Rice, *Products Quality Laws and The Economics of Federalism* 65 B.U. L. REV. 1, 5 n.7 (1985) ("Warranty and other claims costs are a cost of goods sold and must be recovered through the sale of goods. The calculus necessarily involves estimation regardless of the type of warranty accounting system that is employed."); Mark Geistfeld, Note, *Imperfect Information, the Pricing Mechanism, and Products Liability*, 88 COLUM. L. REV. 1057, 1062-63 (1988) ("The price charged for a product must cover not only its manufacturing and distribution costs, but also the cost of those product-related risks for which the manufacturer is liable. This latter cost is roughly equivalent to a product liability insurance premium paid by the consumer. The amount of the premium for each product risk is determined by the expected cost of the risk plus its administrative costs.") (footnote omitted). The exact proportion of an increase in manufacturing costs that is passed on to consumers in the form of an increase in price is determined by the shape of the supply and demand curves. See generally Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361 (1991); cf. *Center for Auto Safety v. Peck*, 751 F.2d 1336, 1352 n.11 (D.C. Cir. 1985) ("Because automobile manufacturers seek to make money, and because their industry is a highly competitive one, it is reasonable to assure that they will view cost savings as an opportunity to compete for profitable business by lowering their prices, or will be forced to follow the lead of those who do"); ROBERT W. CRANDALL ET AL., *REGULATING THE AUTOMOBILE* 40-41 (1986) (Authors constructed a model to calculate how much of the costs of automobile regulation is passed on to consumers. They conclude "roughly two-thirds of regulatory costs appear to be passed on to consumers with a one-year lag One cannot reject the hypothesis that eventually the price of cars reflects the full estimated costs of regulation. "). *In re International Harvester Co.*, 104 F.T.C. 949, 1065 (1984) ("More information may generally be helpful to consumers, but all such information can be produced only by incurring costs that are ultimately born as higher prices by those same consumers.").

have decades of experience with secret warranties, and can control whether they are offered at all, manufacturers' estimates should be fairly accurate.⁷⁵

Consequently, the average consumer, when purchasing an automobile, bears some portion of the expense of providing secret warranties. As a result, the vast majority of consumers end up paying for a benefit they do not receive; namely, providing free repairs for the most aggressive consumers.⁷⁶ If most consumers pay for secret warranties without gaining anything from them, they would be better off if automakers did not provide secret warranties at all. Hence, most consumers would be better off under a system in which manufacturers must provide good will adjustments to all or none, even if that meant fewer good will adjustments were provided.

Of course, if good will adjustments were eliminated, the consumers who now obtain free repairs would lose benefits whose cost is spread over a much larger group. Alternatively, if all consumers were provided with good will adjustments, all consumers would have to pay the full cost of the adjustments they receive at the time they purchase their car. The people who now obtain the benefits of secret warranties might be disappointed if that were to occur, but as it is difficult to articulate with a principled justification for their continued receipt of benefits for which others pay, that does not seem a tragic outcome.⁷⁷

Which would be better for consumers as a whole, if manufacturers provided good will adjustments to all, or to none? Though it is unnecessary to decide that question to determine whether secret warranties should be regulated, the question is nevertheless of interest. Assuming that consumers end up paying for the good will adjustments, or perhaps more accurately, the manufacturer's prediction of what future good will adjustments will cost, that

75. Cf. Geistfeld, *supra* note 74, at 1064 ("In general, the manufacturer is the party best able to make accurate estimates of product risks, and each estimate directly translates into a price that the consumer pays for the risk involved.") (footnote omitted).

76. See Whitford, *supra* note 3, at 1066-67 (writing about out-of-warranty repairs decided on a case-by-case basis rather than through a secret warranty program: "Although the dealers and manufacturers might argue that these policy adjustments are in the nature of gifts, the expense of making policy adjustments must be met out of the dealers' and manufacturers' income, and that income is principally derived from the sale of new cars. Accordingly . . . all owners in some sense help pay for policy adjustments that are generally available only to a few.").

77. Some might argue that the fact that those who complain the most also receive the free repairs operates as a sort of self-selecting rationing, insuring that those who care the most obtain free repairs, and thus, that those who care less must pay for them or forego them. Some might see this as efficient. But it is not demonstrable that those who are loudest care the most, only that they are loudest. Others might not have the time and resources needed to travel back and forth to the dealer to complain.

raises the question of whether good will adjustments are worth as much to consumers as they cost.⁷⁸

No empirical evidence is publicly available to answer that question. The closest analogous product consumers can purchase is extended warranties, or, as they are also known, service contracts. Some consumers purchase extended warranties and others do not,⁷⁹ as the consumers who purchase the extended warranties already should receive the benefits of good will adjustments, they might not wish to pay for the additional protection. On the other hand, if manufacturers assumed the cost of providing good will adjustments to all, that might reduce the cost of providing service contracts.⁸⁰ Ironically, one of the staunchest supporters of regulation of secret warranties, Consumers Union, routinely urges its readers not to purchase extended warranties.⁸¹

But comparing consumer demand for service contracts to consumer demand for secret warranties may be misleading; the two are not the same. Under secret warranty programs, manufacturers typically pay for repairs to correct a defect shared by many of the manufacturer's cars; often the problem is one of design. Under extended warranty programs, however, the manufacturer agrees to pay for all repairs, whether they are caused by widespread problems or problems specific to the particular car, subject perhaps to a deductible. The real issue is whether consumers want to pay in advance

78. Cf. Ian Ayres & F. Clayton Miller, "I'll Sell it to You at Cost:" *Legal Methods to Promote Retail Markup Disclosure*, 84 NW. U. L. REV. 1047, 1076 (1990) ("Requiring . . . disclosure when the costs of communicating are higher than the value of the information to consumers would force retailers to provide a service whose value is less than its costs.")

79. Consumers may decide against extended warranties for a variety of reasons. Some evidence suggests that consumers are more likely to be dissatisfied with automobile warranty repairs than with repairs of other products under warranties. See Michael Pertschuk, *Consumer Automobile Problems*, 11 U.C.C.L.J. 145, 146-47 (1978) (FTC study shows that "25 percent of those who had warranty problems with motor vehicles were dissatisfied with the final result, compared to only 8 percent for all other products." Various reasons were given: Consumer phone calls were not returned and appointments were canceled without notice; parts were not available for extended periods; and consumers were obliged to return to dealers repeatedly). Ultimately, the problems with automobile warranty repairs culminated in state lemon laws, under which consumers have a right to a new car or a refund after a specified number of repairs. See generally DEE PRIDGEN, CONSUMER PROTECTION AND THE LAW, ch. 15 (1991).

80. More completely, it might lower the cost of extended warranties and raise the price of the car by a like amount.

81. See, e.g., *To Deal or not to Deal*, CONSUMER REP., Apr. 1993, at 207 ("Extended warranties . . . are more costly. They are not worth their price . . ."). See also Center for Automobile Safety, *Warranties and Consumer Rights*, 8 LEMON TIMES No. 3 & 4 at 41 (1987) (service contracts "a bad buy").

for repairs of defects which surface in many units of the particular model, but not necessarily all defects in the specific car, given that the decision of whether to initiate a good will adjustment program is entirely in the discretion of the manufacturer.

Consumers as a whole should value open disclosure of good will adjustments if the good will adjustments lower the total of the expected costs of purchasing, maintaining, and operating the automobile.⁸² That is to say, if manufacturers provide good will adjustments and raise their prices accordingly, consumers should still value the good will adjustments if they reduce the operating and maintenance costs down the road enough so that consumers overall save money.

Will that be the case? Car dealers are notorious for charging more for repairs than independent mechanics,⁸³ consequently, it is easy to imagine that the cost to consumers of paying in advance for good will adjustments might be greater than the cost of paying others to perform the same repairs at the time they are needed. But the price dealers charge consumers for repairs probably is not the best figure to use in calculating the costs of good will adjustments. Manufacturers rarely pay dealers as much for repairs as consumers do,⁸⁴ and the repairs provided under secret warranties are paid for by manufacturers, not consumers, in the first instance.

82. Cf. Charles W. Smithson & Christopher R. Thomas, *Measuring the Cost to Consumers of Product Defects: The Value of "Lemon Insurance,"* 31 J. LAW & ECON. 485, 486 (1988) (using a similar approach to determine value of lemon laws for automobiles). Smithson & Thomas point out that consumers value lemon laws more for larger cars. *Id.* at 502. Perhaps consumer valuation of secret warranties also varies according to the car.

83. See, e.g., MARK ESKELSON, WHAT AUTO MECHANICS DON'T WANT YOU TO KNOW 59 (1993).

84. See Polachek & Steinbach, *supra* note 6, at 5 n.3 (Auto dealers generally charge customers a higher labor rate for non-warranty work than [sic] they are allowed to charge the manufacturer for warranty work."); Whitford, *supra* note 3, at 1020 ("[A] dealer usually receives less for warranty work than he would charge a paying service customer for the same work. Indeed, many dealers believe that the flat rates for some labor operations are so stringent that they inevitably absorb a loss on such warranty work, and some dealers believe their hourly labor rate is so low that they absorb a loss on almost all warranty work."); ESKELSON, *supra* note 83, at 61; FEDERAL TRADE COMMISSION, REPORT ON AUTOMOBILE WARRANTIES 54-65 (1970). Cf. Kronon Motor Sales v. Ford Motor Co., 41 F.3d 338 (7th Cir. 1994) (Dealer unsuccessfully sued manufacturer to recover difference between what manufacturer pays dealer for warranty work and what dealer charges customers; difference alleged to be nearly \$700,000 over four years for dealer.). *But see* ME. REV. STAT. ANN. tit. 10 § 1176 (West Supp. 1994) (manufacturer must reimburse dealer for warranty work "at the retail rate customarily charged by that" dealer).

In addition, there are reasons to believe that auto manufacturers, or dealers working under their direction, as is the case with secret warranty repairs, possess special characteristics which ought to make them more efficient than independent mechanics in providing those repairs. Dealership mechanics are typically better trained and more highly specialized than independent mechanics.⁸⁵ But even apart from that, dealership mechanics are apt to have advantages over other mechanics in effecting secret warranty repairs. As noted above, each car manufacturer receives and analyzes reports of repairs from its dealers around the country.⁸⁶ These reports may enable the manufacturer to identify a potential defect in a system which would not be apparent to a mechanic who sees many fewer cars of a particular model. Given that the manufacturer's concern is not just with one car, as might be true of an independent mechanic, but with many cars (and perhaps with cars yet to be produced), the manufacturer has a greater incentive to devote resources to determining how the defect can be cured. As one General Motors representative put it, GM's product monitoring system is "expected to identify [problem] situations early and provide General Motors with a sufficient amount of detailed feedback to fashion the appropriate corrective action in the shortest time possible."⁸⁷

In the end, the manufacturer may be able to tell its dealers how to identify and fix the problem. That information should help dealers solve the problem more quickly and cheaply than an independent mechanic, who must

85. See ESKELDSO, *supra* note 83, at 59 ("Dealership mechanics are usually specialists in one repair area of one brand of vehicles Because they have access to factory training and technical assistance that is not usually available to mechanics working in independent shops, they are usually more knowledgeable concerning the types of vehicles they work on.").

86. See *Conn. Hearings*, *supra* note 13 (statement of Stephen F. Gabriel, Executive Vice President, Connecticut Automotive Trades Association) ("Information relative to repairs performed under warranty is forwarded by each dealer to his respective manufacturer. This statistical information forms the basis of the manufacturers' analysis of vehicle performance, repair frequencies of various vehicle parts and projected failure rates of such parts. Additionally, unusual patterns of parts failure detected by a dealership service department will be routinely noted to the manufacturer."); *Id.* (Letter from R.J. Bugno, General Director, Service Operations, General Motors to General Law Committee, (Jan. 30, 1990)) ("General Motors monitors the performance of its products in a wide variety of ways The monitoring process continues after the public sale of vehicles begins, with the ongoing assistance of nearly 10,000 General Motors dealers who provide service to the purchasers and lessees of our vehicles.").

87. *Conn. Hearings*, *supra* note 13 (Letter from R.J. Bugno, General Director, Service Operations, General Motors to General Law Committee, (Jan. 30, 1990)).

first diagnose the problem and then devise her own solution.⁸⁸ Dealers who perform the same repair on many cars should also benefit from practice; there may even be economies of scale in effecting some repairs. In fact, it appears that mechanics as a group are not very successful in fixing cars; one study of 5,000 cars inspected at a Department of Transportation diagnostic center in Huntsville, Alabama, for example, found that twenty-four percent of all repairs to the cars were unnecessary and one-third of the money spent on repairs was devoted to unneeded work.⁸⁹ Another study found that more than a third of the consumers who had had their cars repaired within the previous year found the repairs unsatisfactory.⁹⁰ While dealers' mechanics also make mistakes,⁹¹ common sense suggests that they are less likely to do so when making repairs pursuant to a good will adjustment program, under which they have special information, than are independent mechanics who are not so well informed.

4. Is Government Regulation Desirable?

The foregoing analysis suggests that consumers as a whole should desire notice of good will adjustment programs, but does not by itself indicate why government intervention is required. That is to say, the above discussion does not explain why the market does not reach an optimal resolution of the matter.

88. Cf. *Conn Hearings*, *supra* note 13 (Letter from R.J. Bugno, General Director, Service Operations, General Motors to General Law Committee, (Jan. 30, 1990)) (GM's "dealers are supported by a large network of field personnel . . . including people experienced in engineering, quality and reliability and service-related functions, all of whom make on-site contact with dealers. In addition, a nation-wide direct-access telephone system is made available to dealership technicians. This system provides dealer service technicians with helpful technical insights and diagnostic assistance."); Ralph Vartabedian, *Your Wheels*, L.A. TIMES, Dec. 13, 1990, at E15 ("If a dealer is 'unfamiliar' with a problem, he can refer to the [service] bulletins [provided by manufacturers] and find whether the engineers in Detroit or Tokyo have information that will save him time and the motorist money."); Mary L. Lyndon, *Secrecy and Innovation In Tort Law and Regulation*, 23 N.M. L. REV. 1, 14 ("There is general agreement among economists that secrecy as such is costly. It encourages wasteful duplication and lack of coordination.").

89. See Pertschuk, *supra* note 79, at 152. See also ESKELDSO, *supra* note 83, at 6 ("Rapidly changing technology is making most mechanics' skills obsolete. According to the California Bureau of Automotive Repair, which licenses mechanics for the state's smog inspection program, 70% of the mechanics being tested are not able to expertly diagnose and repair late-model vehicles.").

90. See Best & Andreasen, *supra* note 56, at 705-06. For extensive discussion of problems with auto repairs, see generally ESKELDSO, *supra* note 83.

91. For discussion of problems with dealer repairs under warranty, see Whitford, *supra* note 3, at 1032-35, 1040.

One of the mainstays of economic analysis is that properly functioning markets should allocate resources appropriately.⁹² In theory, if consumers value good will adjustments more than it costs manufacturers to supply them, manufacturers will in fact produce the adjustments. If consumers do not value good will adjustments as much as adjustments cost, they should not have to pay for them, and regulation that forces consumers to do so will lead to inefficiencies. In the absence of a market failure, if the market does not supply consumers with good will adjustments, then the analysis in the preceding section may simply be wrong.

Has there been a market failure? Market forces could conceivably resolve secret warranty issues in one of two ways: There could be a separate market in a form of warranty or insurance that protects only against the type of defects covered by secret warranty programs; or the market for new cars could take into account the type of support manufacturers provide for after-warranty defects, just as that market takes into account other auto characteristics, such as price and gasoline mileage. In fact, it appears that market forces are not resolving the matter optimally.

There is no separate market in "good will adjustment insurance." To be sure, manufacturers sell extended warranties, but extended warranties cover other types of defects as well, and thus are more expensive than would be some sort of good will adjustment insurance, assuming such insurance were available.

What would happen if manufacturers were to offer a form of good will adjustment insurance? Any answer must be founded on sheer speculation, but it beggars the imagination to suggest that many consumers would be enthusiastic about secret warranty programs as they currently exist; it seems far-fetched to suggest that consumers would be willing to pay for a program under which, when many cars of a particular model developed a problem after the warranty expired, those who complained to the right people loudly enough would obtain free repairs, at the manufacturer's discretion.

It is less obvious how consumers would respond if the repairs were offered to all who purchased the insurance, though the fact that the decision on whether to institute a particular repair program at all is up to the manufacturer would undoubtedly diminish interest. But, of course, manufacturers would not offer good will adjustment insurance as a separate product. From the manufacturer's point of view, that would defeat the purpose of making good will adjustments. Those who purchased the insurance would feel entitled to the adjustment; therefore providing the repairs would not enhance the seller's reputation. Similarly, if the manufacturer chose not to pay for the repair for those who did not buy the insurance, its good will

92. See generally Peter Asch, *Automobile Safety: Is Government Regulation Really Our Savior?*, 3 YALE J. ON REG. 383, 387 (1986).

would suffer, even though the consumer did not purchase the insurance. In short, not only is there now no market in good will adjustment insurance, but such a market is not likely to come into existence.

Another way the market could resolve the problem is through the market for new cars. When making purchasing decisions, buyers of new cars could decide how much they valued good will adjustments vis-a-vis other features and price, and could purchase cars manufactured by companies which provided more adjustments, if that was their preference. But few consumers can do that because few consumers are aware of secret warranties.⁹³ Because most companies are not open about providing good will adjustments, very few consumers are in a position to form a conclusion about which manufacturers provide more after-warranty support. While consumers can form conclusions about the durability of particular models, and in fact *Consumer Reports* annually publishes the results of its surveys on durability, providing interested consumers with access to durability information,⁹⁴ durability does not correlate directly with secret warranties. Some cars which fare quite well in durability ratings are nevertheless the subject of secret warranties.⁹⁵ The situation is a variant of George A. Akerlof's famous lemons model: Akerlof wrote that when buyers cannot distinguish between high-quality and low-quality goods, sellers have an incentive to market poor quality merchandise.⁹⁶ Manufacturers who sell to those who do not know about goodwill adjustment programs have an incentive not to supply those programs.

If consumers cannot take secret warranties into account in making purchasing decisions, the market cannot be expected to reach an optimal equilibrium.⁹⁷ A number of economists have argued that when consumers possess imperfect information, sellers will have disproportionate market power;⁹⁸ empirical studies seem to confirm that insight.⁹⁹ Accordingly, the

93. See, e.g., *Conn. Hearings*, *supra* note 13 (testimony of Timothy West, Director of the Fraud Division of the Department of Consumer Protection) ("the general public does not recognize that these secret warranties are in effect").

94. The information appears in the April issue of each year. For reasons why the *Consumer Reports* data may not be entirely reliable, see ROBERT W. CRANDALL ET AL., *REGULATING THE AUTOMOBILE* 150 (1986).

95. For example, the April 1989 issue of *Consumer Reports* contained both an article listing various secret warranties ("Cars With Secret Warranties") and Frequency of Repair Records for numerous makes. Some of the cars listed as having been the subject of secret warranties rated highly in the durability ratings.

96. George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

97. See Asch, *supra* note 92, at 387 ("The qualification that markets in question must function properly is important . . . , gross consumer ignorance of particular risks may justify government intervention.").

98. See Steve Salop, *Information and Market Structure: Information and* Published by University of Missouri School of Law Scholarship Repository, 1995

traditional "let the market do it" argument does not justify resisting governmental intervention.

Even if information about good will adjustments were readily available before purchase, it is doubtful that the market would function properly. Many consumers probably are not equipped to take good will adjustments into account in making decisions to buy cars. A number of studies have demonstrated that many consumers do little "shopping around" for purchases, even for major purchases like cars.¹⁰⁰ One survey conducted in 1976 found

Monopolistic Competition, 66 AM. ECON. REV. 240 (1976) ("if information is costly, each small firm obtains market power, and the equilibrium (if one exists) is characterized by prices above competitive levels . . ."); William N. Eskridge, *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1112, n.96 (1984); Phillip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311 (1970); Charles Stuart, *Consumer Protection in Markets With Informationally Weak Buyers*, 12 BELL J. ECON. 562 (1981). *But see* Leon Courville & Warren H. Hausman, *Warranty Scope and Reliability Under Imperfect Information and Alternative Market Structures*, 52 J. BUS. 361, 373 (1979) ("inaccurate information does not imply poor market results" based on an economic model that makes the questionable assumption that consumers maximize perceived expected utility).

99. For example, a number of studies have found that increased comparison shopping by consumers leads to lower market prices. *See, e.g.*, D. Grant Devine & Bruce W. Marion, *The Influence of Consumer Price Information on Retail Pricing and Consumer Behavior*, 61 AM. J. AGRIC. ECON. 228 (1979); Vicki A. McCracken et al., *The Impact of Comparative Food Price Information on Consumers and Grocery Retailers: Some Preliminary Findings of a Field Experiment*, 16 J. CONSUMER AFFAIRS 224 (1982); Kenneth McNeil et al., *supra* note 56, at 708-09; J. Edward Russo et al., *An Effective Display of Unit Price Information*, J. MKTG., Apr. 1975, at 11. *See also* E. Thomas Sullivan & Brian A. Marks, *The FTC's Deceptive Advertising Policy: A Legal and Economic Analysis*, 64 OR. L. REV. 593, 620 (1986) ("The courts, the Commission, and legal commentators have recognized that the lack of product information leads to market imperfections, abuse and reduced consumer welfare.").

100. *See, e.g.*, Brian T. Ratchford, *The Economics of Information: The Views of a Marketing Economist*, in THE FRONTIER OF RESEARCH IN THE CONSUMER INTEREST 265, 267 (E. Scott Maynes & American Council on Consumer Interests eds., 1988) ("consumers search little, even for expensive items such as cars"); James N. Morgan, *Consumer Choice is More Than Search*, in THE FRONTIER OF RESEARCH IN THE CONSUMER INTEREST 277, 278 (E. Scott Maynes & American Council on Consumer Interests eds., 1988) (studies show that consumers exhibit "even in major purchases, a startling lack of deliberation, of specification of qualities, of consideration of brands, or of visiting of stores, and not even a substantial span of time from thinking of buying to purchase . . . the overwhelming finding in search of an explanation is the casual purchase-without-choice, even for cars"); Howard Beales et al., *Consumer* <https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

that more than a third of car buyers considered only one or two brands before buying a car while the average car purchaser considered only 3.5 brands and made 3.1 dealer visits.¹⁰¹ Other studies have found that consumers can

Search and Public Policy, 8 J. CONSUMER RES. 11, 11, 17 (1981) ("[C]onsumers engage in very little overt search for information, even for expensive products such as major appliances and furniture. . . . [S]ome buyers purchase a house after exploring only a few alternatives."); D. HEMPEL, SEARCH BEHAVIOR AND INFORMATION UTILIZATION IN THE HOME BUYING PROCESS IN MARKETING INVOLVEMENT IN SOCIETY AND THE ECONOMY 241, 243 (P. McDonald ed., 1969) (1969 Fall Conf. Procs. Am. Marketing Ass'n) (study of homebuyers in high-income Connecticut communities found that about one-third actually visited fewer than six homes with the intent of considering them for purchase; median number of houses visited with the intent of considering for purchase was four); Michael L. Ray & Donald A. Dunn, *Local Consumer Information Systems for Services: The Market for Information and Its Effect on the Market*, in THE EFFECT OF INFORMATION ON CONSUMER AND MARKET BEHAVIOR 92, 94 (A. Mitchell ed., 1978) (median number of houses seen by a homebuyer is about two or three and many people buy the first house they see); Norris, *Processes and Objectives of House Purchasing in the New London Area*, in 1 CONSUMER BEHAVIOR: THE DYNAMICS OF CONSUMER REACTION 25, 26-27 (L. Clarke ed., 1954) (author of study of homebuyers in tight Connecticut market, after finding that median number of houses entered was six and median number of houses seriously considered was one, characterized househunting of many consumers as "lethargic and casual"); Eskridge, *supra* note 98, at 1113-14 (many consumers do little shopping for mortgages); DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND VETERANS' ADMINISTRATION, MORTGAGE SETTLEMENT COSTS 2-3 (1972), *reprinted* in REAL ESTATE SETTLEMENT COSTS, FHA MORTGAGE FORECLOSURES, HOUSING ABANDONMENT, AND SITE SELECTION POLICIES: HEARINGS ON H.R. 13337 BEFORE THE SUBCOM. ON HOUSING OF THE COMM. ON BANKING AND CURRENCY, 92nd Cong. 1st Sess. 735, 738-39 (1972) ("The buyer seldom decides who will provide settlement services for him. If there is a choice, he usually depends upon advice of the broker, escrow agent, seller, or settlement attorney."). *But see* Joseph W. Newman & Bradley D. Lockman, *Measuring Prepurchase Information Seeking*, 2 J. CONSUMER RES. 216 (1975) (concluding that some studies of consumer search behavior underestimate the amount of search by consumers).

101. *See* ARTHUR YOUNG & CO., *supra* note 18, at 31. According to the study only 13.3% thought about six or more brands. Of the car purchasers who responded to the survey, 80.6% visited a dealer between one and four times before buying. Another study conducted in January and February of 1977 under the auspices of *Newsweek Magazine*, was published in two volumes, BUYERS OF NEW DOMESTIC CARS 1977, [hereinafter DOMESTIC CARS] and BUYERS OF NEW IMPORTED CARS 1977 [hereinafter IMPORTED CARS]. More than 7,000 purchasers of domestic autos and nearly 6,000 owners of imported vehicles were surveyed. The study found that more than 40% of consumers visited only one dealer that sold the make of car they ultimately purchased, that the median number of such dealers visited was 2 and the mean number was 2.4 for domestic purchases and 2.1 for imported cars. DOMESTIC

become overloaded with too much information¹⁰² and that many respond to

CARS, *supra* at Table 13; IMPORTED CARS, *supra* at Table 13. More than 40% of the domestic car buyers did not consider another make. DOMESTIC CARS, *supra* at Table 15, while nearly a third of the foreign car buyers did not, IMPORTED CARS, *supra* at Table 15. Nearly half of the domestic purchasers did not even visit a dealer who sold one make other than the one purchased; nearly 40% of the imported car buyers did not visit a rival manufacturer's dealer either. DOMESTIC CARS, *supra*, at Table 16; IMPORTED CARS, *supra* at Table 16.

Some evidence suggests that consumers would be better off if they engaged in more search when purchasing cars. For example, one study concluded "on average, automobile brands are far from equal in value even within size classes, and . . . consumers stand to gain a great deal from acquiring information and making optimal choices." See Brian T. Ratchford & Manoj K. Agarwal, *The Value of Information on Automobile Characteristics*, 1979 EDUCATOR'S CONFERENCE PROCEEDINGS 200, 203 (Neil Beckwith et al. eds., 1979). The study concluded that the expected incremental gain even from obtaining information on a fifth car as opposed to only four, was substantially in excess of the cost of obtaining that information.

102. Though some of the information overload studies have been criticized, the bulk of the research indicates that consumer decision-making does degrade when consumers are provided with too much information. See, e.g., Kevin L. Keller & Richard Staelin, *Effects of Quality and Quantity of Information of Decision Effectiveness*, 14 J. CONSUMER RES. 200, 211 (1987); John C. Bergstrom & John R. Stoll, *An Analysis of Information Overload with Implications for Survey Design Research*, 12 LEISURE SCIENCES 265 (1990); Naresh K. Malhotra, *Information Load and Consumer Decision Making*, 8 J. CONSUMER RES. 419 (1982). Early studies included Jacob Jacoby et al., *Brand Choice Behavior as a Function of Information Load: Replication and Extension*, 1 J. CONSUMER RES. 33 (1974); and Jacob Jacoby et al., *Brand Choice Behavior as a Function of Information Load*, 11 J. MARKETING RES. 63 (1974). The Jacoby studies were criticized by a number of articles, some of which argued that the data did not support the reported conclusions. See, e.g., Naresh K. Malhotra, *Reflections on the Information Overload Paradigm in Consumer Decision Making*, 10 J. CONSUMER RES. 436 (1984) (suggesting that information overload occurs but that the Jacoby studies did not prove it); J. Edward Russo, *More Information is Better: A Reevaluation of Jacoby, Speller & Kohn*, 1 J. CONSUMER RES. 68 (1974); John D. Summers, *Less Information Better?*, 11 J. MARKETING RES. 467 (1974); William L. Wilkie, *Analysis of Effects of Information Load*, 11 J. MARKETING RES. 462 (1974). Jacoby responded in Jacob Jacoby, *Constructive Criticism and Programmatic Research: Reply to Russo*, 2 J. CONSUMER RES. 154 (1975); and Jacob Jacoby, *Information Load and Decision Quality: Some Contested Issues*, 14 J. MARKETING RES. 569 (1977). Studies suggesting that additional information does not impair decision-making—though possibly the load tested was too small—include Debra L. Scammon, *"Information Load" and Consumers*, 4 J. CONSUMER RES. 148 (1977); Naresh K. Malhotra et al., *The Information Overload Controversy: An Alternative Viewpoint*, 46 J. MARKETING 27 (1982); and Thomas E. Muller, *Buyer Response to Variations in Product Information Load*, 69 J. APPLIED

information overload by not attending to all the information with which they are presented;¹⁰³ in essence, consumers focus on some features but not others. Still other studies have shown that when making decisions, consumers tend to focus on exciting, "vivid" information rather than on less interesting, drier information.¹⁰⁴ Given the welter of information which is available to buyers about cars, the emotional response much of it elicits, and the difficulty in evaluating much of the available information, it is easy to imagine that after-warranty repairs which may never be needed would not get much attention.¹⁰⁵

PSYCH. 300 (1984). These last studies have been criticized. See Jacob Jacoby, *Perspectives on Information Overload*, 10 J. CONSUMER RES. 432 (1984). Keller & Staelin are in turn criticized in Robert J. Meyer & Eric J. Johnson, *Information Overload and the Nonrobustness of Linear Models: A Comment on Keller and Staelin*, 15 J. CONSUMER RES. 498 (1989). Kevin L. Keller & Richard Staelin responded in *Assessing Biases in Measuring Decision Effectiveness and Information Overload*, 15 J. CONSUMER RES. 504 (1989).

103. See David M. Grether et al., *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277 (1986); Jacoby, *Perspectives on Information Overload*, *supra* note 102; Allan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 660-61 (1979) ("Evaluating terms is more costly than evaluating prices or search characteristics such as color, size or fit; some comparison shoppers in consequence may devote little time to examining terms.").

104. See RICHARD E. NISBETT & LEE ROSS, HUMAN INFERENCES: STRATEGIES AND SHORTCOMINGS OF SOCIAL JUDGMENT 45 (1980); Eskridge, *supra* note 98, at 1117; Jonathan Shedler & Melvin Manis, *Can the Availability Heuristic Explain Vividness Effects?*, 51 J. PERSONALITY & SOC. PSYCHOL. 26 (1986); Marie G. Wilson et al., *Information Competition and Vividness Effects in On-Line Judgments*, 44 ORGANIZATIONAL BEHAVIOR & HUMAN DECISION PROCESSES 132 (1989).

105. The amount of printed information designed to assist car buyers provides some hint of how much is available in making purchase decisions. For example, car buyers can consult automobile books, like GILLIS, THE CAR BOOK, *supra* note 36 (updated annually; the 1992 edition runs 160 pages and has chapters on safety, fuel economy, maintenance, warranties, insurance, tires, buying strategies, among other things); consumer magazines, like *Consumer Reports* (one issue each year is devoted to cars and most other issues rate at least a few cars); automobile specialty magazines, like *Car and Driver*; buyer's price guides; car columns in local newspapers; and advertising brochures prepared by car manufacturers. Visiting show rooms and taking test drives can also be overwhelming for some.

It is impossible to know the extent to which consumers would absorb and use information about secret warranties, if that information were made available at the time of purchase. The closest analogy is warranty information, but as warranties are considerably more important than after-warranty support information, the extent to which consumers use information about warranties in making purchase decision is not

Some scholars have argued against intervention in markets even when consumers lack perfect information. Professors Schwartz and Wilde have argued that in many markets governmental regulation of warranties will be unnecessary as long as a certain number of consumers shop for warranties.¹⁰⁶ According to their theory, because sellers cannot distinguish between those who shop for warranties and those who do not, sellers who wish to attract the business of those who shop for warranties will offer favorable warranty terms to all shoppers. Thus, all shoppers obtain favorable warranty terms, and those who do not actively shop for warranties are protected by those who do. On that theory, it should not much matter if some consumers lack the ability to focus on secret warranties when purchasing cars as long as some do.

But that theory does not seem to speak to the market failure pertaining to secret warranties.¹⁰⁷ Secret warranties do not present a situation where interested consumers protect others who are not interested. First, many sellers make some attempt to distinguish between those who care about good will adjustments and those who do not; they simply do not offer good will

a reliable guide as to consumer interest in secret warranties. Some empirical data on consumer use of motor vehicle warranty information in purchasing decisions is available. One study found that fewer than seven percent of motor vehicle buyers rated the terms of the warranty offered among the five most important factors in their purchase decision. See DOMESTIC CARS, and IMPORTED CARS, *supra* note 101, at Table 33-1. But another study found that many car buyers claim awareness of the detail of the warranties provided with the cars they purchased. See ARTHUR YOUNG & CO., *supra* note 18, at 55 (78.2% of respondents who had bought cars asserted that they knew details of the warranty). But as only 36.8% had actually read the warranty before purchase, *see id.* at 58, the claims of awareness may be inflated. In addition, it is not clear how representative the study's respondents were of the population as a whole. Respondents were called upon to mail their answers back to those conducting the survey, and thus the respondents were probably more interested in consumer matters and better informed than the general population. *See id.* at 12. Thus, they may also have been more careful about reading warranties. *See also* Wilkes & Wilcox, *supra* note 64, at 39 (91.5% of respondents in survey agreed that "consumers are not likely to check a product's guarantee very well until after the product has been bought and some problem arises"); William C. Whitford, *Strict Products Liability and the Automobile Industry: Much Ado About Nothing*, 1968 WIS. L. REV. 83, at 152-53 (concluding that consumers do not seem interested in absorbing warranty information).

106. *See* Schwartz & Wilde, *Imperfect Information in Markets*, *supra* note 64; *see also* Schwartz & Wilde, *Intervening on the Basis of Imperfect Information*, *supra* note 103.

107. This is not to suggest that the authors intended their theory to apply to secret warranties. Rather, they dealt with conventional warranties.

adjustments to all buyers and thus the Schwartz-Wilde model does not apply.¹⁰⁸

Second, it is unlikely that there are enough consumers who are interested in secret warranties at the time of purchase to cause auto makers to compete on that basis. As Professors Schwartz and Wilde note, "[e]valuating terms is more costly than evaluating prices or search characteristics such as color, size or fit; some comparison shoppers in consequence may devote little time to examining terms."¹⁰⁹ Secret warranties seem even less likely than most terms to draw the attention of comparison shoppers: If consumers are not generally aware of secret warranties, it is unlikely that many are choosing among different cars on the basis of good will adjustments. Even those manufacturers, like Ford, which provide superior after-warranty support do not seem to advertise the fact; that suggests that they believe that consumers do not make buying judgments on the basis of good will adjustments until they have been the beneficiary of such adjustments. Alternatively, manufacturers may believe that disclosing the existence of after-warranty support may detract from other marketing efforts, either by obscuring more persuasive appeals or

108. Professors Schwartz and Wilde comment that their model will not apply if sellers can discriminate among consumers:

When firms competed for the business of comparison shoppers, nonsearchers necessarily were benefitted. But if firms discriminate among customers on the basis of knowledge or sophistication, this pecuniary externality would vanish: firms would exploit nonsearchers by charging them higher prices or providing them with lower quality products and services than would be offered to comparison shoppers.

Schwartz & Wilde, *Imperfect Information in Markets*, *supra* note 64, at 662-63.

109. Schwartz & Wilde, *Intervening on the Basis of Imperfect Information*, *supra* note 103, at 660-61. The authors also state:

A market can be considered monopolistic for any term used by all or almost all firms if (1) the market is not price competitive; and (2) the term at issue appears in arcane legal language and fine or otherwise inconspicuous print If the market is price competitive but the second criterion is met, a monopolistic outcome for any term should be presumed to occur if a substantial portion . . . of the comparison shoppers are not term conscious.

Id. at 661 (footnotes omitted). Secret warranties, of course, are even less conspicuous than anything buried in fine print. See also Richard Craswell, *The Identification of Unfair Acts and Practices by the Federal Trade Commission*, 1981 Wis. L. REV. 107, 133 ("It would be a rare (and exceptionally industrious) consumer who could imagine all the undesirable things a seller might do, and then compare competing offers to see which undesirable acts each seller has promised not to commit. Unless enough consumers are willing and able to make such comparisons, however, the market provides very little incentive for sellers to improve their contracts to offer the optimal bundle of post-purchase rights.").

by reminding consumers of something manufacturers would rather they forget; namely, that cars break down after the warranty expires.

5. A Kaldor-Hicks Analysis

It thus appears that consumers would be better off if manufacturers offered good will adjustments to all consumers or none, and that, as the market cannot attain that result acting alone, government intervention is desirable. But would such a result be efficient? Economists sometimes use an approach known as Kaldor-Hicks to measure whether a particular outcome is efficient.¹¹⁰ Under Kaldor-Hicks efficiency, a transaction or regulation is considered efficient if it produces an outcome in which the winner gains more than the loser loses, so that the outcome produces a net increase in wealth. For example, if A values a particular book at three dollars, and B at seven dollars, and A sells the book to B for six dollars, that is an efficient outcome. A is better off by three dollars, because A has received six dollars for a book worth half that to A, while B's position has improved by one dollar, because B paid only six dollars for something worth seven dollars to B. By parity of reasoning, an outcome under which the law required A to surrender the book to B at no charge would also be efficient, because A would have lost something worth three dollars, and B would have gained something worth seven, for a net gain in wealth of four dollars.¹¹¹ Under the Kaldor-Hicks approach, it is not necessary for the winner actually to compensate the loser; rather, as long as the winner could in theory have compensated the loser and still have something left over, the solution is considered efficient.¹¹²

Kaldor-Hicks is obviously a long way from a perfect guide to formulating legal rules, and it is subject to criticism on various grounds.¹¹³ Still, it is

110. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 14 (4th ed. 1992) ("When an economist says that free trade or competition or the control of pollution or some other policy or state of the world is efficient, nine times out of ten he means Kaldor-Hicks efficient, as shall this book."). For a comparison of Kaldor-Hicks efficiency with other measures of efficiency, see JULES L. COLEMAN, *MARKETS, MORALS AND THE LAW* 84-132 (1988).

111. The example assumes that A does not resent the law. If A does, the result may not be efficient. For example, if A were willing to pay five dollars to join a group to repeal the law, then the law would not produce optimal results. The example also assumes that there are no transaction costs, so that no money is expended effecting the transfer of the book.

112. For discussion of Kaldor-Hicks efficiency, see DAVID W. BARNES & LYNN A. STOUT, *CASES AND MATERIALS ON LAW AND ECONOMICS* 16-20 (1992); POSNER, *supra* note 110, at 13-16; Coleman, *supra* note 110, at 84-132.

113. Some of the criticisms are discussed in the sources referred to *supra* in note 112. See also Richard S. Markovits, *A Constructive Critique of the Traditional*

interesting to examine whether the regulation of secret warranties is Kaldor-Hicks efficient.

Suppose that a particular model of car suffers from a defect and the manufacturer determines that it will provide a good will adjustment program to those who complain to dealers. Assume that the repairs will cost the manufacturer fifty dollars per car. If the manufacturer is rational, it must believe that its gains in good will from repairing the cars it chooses to include in the program equal or exceed fifty dollars per car, so that it at least breaks even on the transaction. The manufacturer probably assumes that its gains in good will from repairing cars excluded from the program would be less than fifty dollars per car, because otherwise a rational manufacturer would include those cars in the program as well (assuming, for the moment, no transaction costs). That will often be a reasonable assumption, because some consumers who do not complain will not suffer from the problem, or may not notice it, or may not hold it against the manufacturer. But other consumers probably will encounter the problem and some may even be sufficiently troubled by it that they will decide not to buy the manufacturer's products again. Consequently, it is reasonable to assume also that the manufacturer would experience some gain in good will if it offered free repairs to those not included in the program, though perhaps not so large a gain per consumer as with those who are included.

Assume that the manufacturer would average a gain in good will of five dollars per car of those excluded from the program.¹¹⁴ If the manufacturer decided to extend its program to all purchasers of its cars, it would also face some expense in notifying them and perhaps incur other transaction costs as well. Assume these costs average two dollars per consumer. As a result, the net cost to the manufacturer of notifying non-complaining motorists of its program and then repairing their cars is forty-seven dollars per car. That is arrived at by adding the fifty dollars in repair costs to the two dollars in notice costs, and subtracting the five dollars gained in good will.

Now look at the situation from the point of view of the motorist. As a practical matter, it might cost consumers considerably more than fifty dollars to obtain the repair from a source other than the manufacturer, given the

Definition and Use of the Concept of "The Effect of a Choice On Allocative (Economic) Efficiency:" Why the Kaldor-Hicks Test, the Coase Theorem and Virtually All Law-and-Economics Welfare Arguments Are Wrong, 1993 U. ILL. L. REV. 485.

114. This assumes also that the announcement of an adjustment program will not cause the seller to lose any good will. As discussed above, announcements of recalls may cause a loss in good will. See *supra* note 22 and accompanying text. On the other hand, it may be that a voluntary adjustment, which is not required for safety or emission-related reasons, can be presented in a way to avoid any loss to the seller's good will.

diagnostic problems and other problems other repairers are likely to experience, as discussed above, but assume that the repairs are worth only fifty dollars to consumers. If the net gain to non-complaining motorists is fifty dollars, and the net loss to the manufacturer is forty-seven dollars, then requiring manufacturers to provide free repairs is Kaldor-Hicks efficient. Such a requirement would produce a net increase in the wealth of society of three dollars per repair, assuming no other costs. In fact, as long as the increase in the manufacturer's good will exceeds the cost of notice and other transaction costs, disclosure of the existence of secret warranties will be Kaldor-Hicks efficient. If the assumption that repairs are worth no more to consumers than they cost manufacturers is relaxed, so that the value of the repairs to consumers reflects the likelihood that they would have to pay more than the manufacturer pays to accomplish the repairs, it becomes even more likely that requiring manufacturers to provide free repairs is Kaldor-Hicks efficient. While that is not a sufficient condition for forced disclosure or regulation, it does militate in favor of forced disclosure.

In sum, regulation of secret warranties is desirable from the standpoint of economics. The market cannot reach an optimal allocation of resources without government intervention. The Article now turns to other policy arguments concerning good will adjustments.

B. *Fairness Justifications*

The argument most frequently made by supporters of secret warranty legislation is that less aggressive consumers are deprived of a benefit afforded the more aggressive, and this seems unfair. For example, one government official has commented, "We don't think a prerequisite to getting a defective part or a failed part repaired in your \$15,000 car should be some type of confrontation with either the service manager or a general manager."¹¹⁵ This implicates one of the traditional themes of consumer law: protecting those who do not or cannot protect themselves. That idea finds expression in numerous ways in consumer protection rules: For example, legally-mandated cooling off periods are designed to afford consumers a chance to reconsider certain purchases away from high-pressure sellers;¹¹⁶ the FTC Act has historically been used to help the vulnerable;¹¹⁷ and the unconscionability

115. *Conn. Hearings*, *supra* note 13 (testimony of Timothy West, Director of the Fraud Division of the Department of Consumer Protection).

116. *See generally*, DEE PRIDGEN, CONSUMER CREDIT AND THE LAW § 15.01 (1990).

117. *See generally*, Elizabeth H. Dole, *Cost-Benefit Analysis Versus Protecting the Vulnerable: The FTC's Special Interest Groups*, 9 ANTI-TRUST L. & ECON. REV. 15 (1977). *See also* Federal Trade Comm'n v. Sterling Drugs, Inc., 317 F.2d 669,

doctrine is most likely to be brought into play when one of the participants to an agreement is lacking in bargaining power.¹¹⁸ Requiring manufacturers to afford the ignorant the same benefits they provide the more knowledgeable fits neatly into this tradition.

Secret warranties also lend themselves to other forms of discrimination. Because dealers and district representatives frequently have the discretion to decide whether individual consumers will receive free repairs or not under good will adjustment programs, they can exercise that discretion in favor of preferred groups. Although no empirical research is publicly available to show that certain groups are or are not more likely to receive good will adjustments than others, it does appear that white males receive better treatment from car dealers than females and African-Americans, at least on some matters,¹¹⁹ and that the poor pay more, both for used cars and for repairs to those cars.¹²⁰ Thus, Ian Ayres' recent study of automobile dealerships in Chicago found that dealers charged white women markups that

674 (2d Cir. 1963), in which appears the following famous quote reflecting the attitude toward consumers of those who applied the FTC Act, at least until 1983:

The general public has been defined as 'that vast multitude which includes the ignorant, and unthinking and the credulous, who, in making purchases, do not stop to analyze but too often are governed by appearances and general impressions.' The average purchaser has been variously characterized as not 'thinking straight,' subject to 'impressions,' uneducated, and grossly misinformed; he is influenced by prejudice and superstition; and he wishfully believes in miracles, allegedly the result of progress in science

....

(quoting 1 CALLMAN, UNFAIR COMPETITION AND TRADEMARKS § 19.2(a)(1), at 341-44 (1950)). Though the FTC has purportedly abandoned that standard, in favor of the "consumer acting reasonably in the circumstances," see FTC Policy Statement on Deception, contained in Letter from James C. Miller III (then-FTC Chair) to Senator Bob Packwood (Oct. 14, 1983), [hereinafter FTC Policy Statement], the quote does demonstrate an approach which has animated much FTC action.

118. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) ("Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power.").

119. See Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 827-842 (1991).

120. See McNeil et al., *supra* note 56, at 709-12. Although this study took into account sales by private sellers as well as by dealers, the same patterns were found in both markets; that is to say, dealers charged more for the same cars to the poor and the poor were obliged to pay more for repairs for the same cars. That retailers charge the poor more for goods has long been established. See generally, DAVID CAPLOVITZ, THE POOR PAY MORE: CONSUMER PRACTICES OF LOW-INCOME FAMILIES (1967).

were forty percent higher than the markups charged white men; that African-American men were obliged to pay markups twice those of white men; and that female African-Americans had to pay markups three times larger than those paid by white males.¹²¹

The study also found that consumers were subject to varying kinds of nonprice discrimination, depending on their race and gender. African-American men were less likely to be offered a test-drive,¹²² while African-American women were more likely to be asked certain questions than other potential purchasers.¹²³ Sellers tended to steer customers to salespeople of the same race and gender as the customer.¹²⁴

Another study explored what happened when consumers complained to dealers after having bought used cars which developed problems during the first three months after the sale. The study found that the seller was more likely to pay for repair costs when the consumer had a higher income than when the consumer was poor, even taking into account product characteristics, such as the age of the car.¹²⁵

Though the reasons for the different treatment remain unclear,¹²⁶ it is certainly plausible that dealers who accord preferential treatment to white males in some respects will do so in other respects as well. If good will adjustments are provided in a racially discriminatory fashion, that alone should justify legislative and regulatory intervention.¹²⁷

Even if sellers do not deliberately discriminate against certain groups, the method chosen to ration good will adjustments—waiting until a consumer seeks redress from the seller—is likely to deprive minority groups and those with lower incomes of the free repairs. Studies show that African-Americans and those of lower socio-economic status are less likely to perceive problems

121. Ayres, *supra* note 119, at 819.

122. Ayres, *supra* note 119, at 834-35.

123. *E.g.*, Are you married? What is your occupation? Ayres, *supra* note 119, at 834.

124. Ayers, *supra* note 119, at 833. Professor Ayres found that sellers did not treat different groups differently in all respects. Sellers did not steer different consumers to cars of different cost, for example. *Id.* at 833-34.

125. *See* McNeil et al., *supra* note 56, at 715-17.

126. Professor Ayres speculates that the different treatment is rooted less in animus towards certain consumers than in dealer estimates as to which group will yield the most revenue for the dealer, but calls for further study to discover the reasons. Ayres, *supra* note 119, at 841-57.

127. It might be that civil rights statutes would bar such discrimination. But that would require proof that free repairs were offered on a biased fashion, proof that might be difficult to obtain. It might also be preferable to have a statute applying clearly to secret warranties.

with the products they purchase and less likely to voice those problems, once perceived, to the seller.¹²⁸

A final fairness argument turns on the secrecy in secret warranties. Because so much about secret warranties is kept obscure, policy makers are unable to obtain enough information to formulate rules. For example, given the amount of information available to the public, it is impossible to determine such basic questions as how much secret warranties cost, whether certain groups obtain a disproportionate share of secret warranties, or even how many secret warranties have existed. The burden of proof on the issue of whether or not secret warranties should be regulated ought to rest on those who possess the relevant information and are keeping it confidential: automobile manufacturers.

In sum, from the perspective of both economics and simple fairness, and given the information currently available, it appears desirable to regulate secret warranties. The article now explores the extent to which existing laws accomplish this goal.

IV. THE REGULATORY BACKGROUND OF SECRET WARRANTIES

The key issues of law concerning secret warranties revolve around manufacturers' obligations to people to whom free repairs are not offered. May a manufacturer, without violating the law, provide free repairs to some consumers without notifying others who suffer from the same problem that they too can obtain help? If so, may the manufacturer deny repair assistance to some who actively seek it while giving it to others? Must the manufacturer reimburse consumers who paid for the repairs? The answers are not yet clear.

The leading federal statute governing recalls for automotive safety problems—the National Traffic and Motor Vehicle Safety Act¹²⁹—does not normally apply to secret warranty programs. Indeed, in most of the country, no law specifically and clearly regulates secret warranties. The Federal Trade Commission, acting under the Federal Trade Commission Act,¹³⁰ has in the past commenced cases against automobile manufacturers operating secret warranty programs,¹³¹ though the FTC's interest in secret warranties has waned since 1980, as discussed below. Most states, at least arguably, have the

128. See Best & Andreasen, *supra* note 56, at 707, 723; Ross & Littlefield, *supra* note 56, at 203; Warland et al., *supra* note 56, at 160 (consumers who are upset by product failures but take no action are less well-off and less educated than those who take action).

129. 15 U.S.C. §§ 1381-1431 (1988).

130. 15 U.S.C. §§ 41-77 (1988).

131. See *In re Ford Motor Co.*, 96 F.T.C. 362 (1980) (consent order); *In re Chrysler Corp.*, 96 F.T.C. 134 (1980) (consent order).

power to regulate secret warranties under their existing "Little FTC" Acts,¹³² though there are no reported cases in which state authorities have sought to do so.¹³³ Only California, Connecticut, Wisconsin, and Virginia have passed legislation designed to afford their citizens uniform access to goodwill adjustments.¹³⁴ In addition, two commentators have suggested that secret warranties might help make out a claim for breach of an implied warranty under the Uniform Commercial Code ("UCC").¹³⁵

This Article now takes up this regulatory background. It first touches upon the federal recall statute, then explores the rules which arguably prohibit secret warranties, and finally turns to warranty claims.

A. Federal Automobile Safety Legislation

Until 1966, federal law imposed virtually no quality or safety standards on automobile manufacturers. Any legal obligations to produce safe or well-made cars came from state product liability law.¹³⁶ Relatively few cars were recalled and what recalls there were bore a distinct resemblance to the

132. See *infra* notes 214-25 and accompanying text.

133. It is impossible to know how many secret warranties have been disclosed as the result of private negotiations between auto manufacturers and regulatory agencies or public interest groups. Two settlements, however, have generated some publicity. One is the result of a case filed against Ford by the Illinois Attorney General. See *Ford Agrees to Disclose Existence of Post-Warranty Repair Programs In Illinois*, ANTI-TRUST & TRADE REG. RPTR. (BNA), July 2, 1981, at D-1-2. In addition, the Center for Auto Safety and the Center for Law in the Public Interest filed a class action suit against Toyota stemming from a secret warranty program allegedly instituted by Toyota. According to two reports (one published by CAS and the other co-authored by a CAS employee), Toyota settled the suit by agreeing to notify past and present owners and lessees of the 400,000 cars which might suffer from the defect; repair cars which developed the problem within one year of the settlement; reimburse owners who had already incurred expenses repairing the problem, including expenses for substitute transportation; pay up to \$835,000 to a Consumer Support and Education Fund; and pay \$250,000 in attorneys' fees. The estimated cost of the settlement is \$100 million. See Polachek & Steinbach, *supra* note 6, at 3; Center for Auto Safety, *CAS 100 Million Toyota Class Action Settled*, 10 LEMON TIMES No. 2 at 1, 2 (1989). See also Helen Kahn, *Toyota Suit Has Boon for Consumer*, AUTOMOTIVE NEWS, Mar. 13, 1989, at 1 (noting that Toyota denied liability).

134. See CONN. GEN. STAT. § 42-227 (West 1993); VA. CODE ANN. ch. 17.6 §§ 59.1-207.34 to 59.1-207.39 (Michie 1992); CAL. CIV. §§ 1795.90-1795.93 (Deering 1994); WIS. STAT. ANN. § 218.017 (West 1994).

135. See ROSMARIN, *supra* note 29, at 126-27 (Supp. 1992); SHELDON, *supra* note 3, at 226. See *infra* notes 240-59 and accompanying text.

136. See Joan Claybrook & David Bollier, *The Hidden Benefits of Regulation: Disclosing the Auto Safety Payoff*, 3 YALE J. ON REG. 87, 103 (1985).

secret warranty programs of today: Manufacturers rarely publicized recalls and were lax about notifying customers of either the problems or risks which prompted the recalls.¹³⁷

Then Congress passed the National Traffic and Motor Vehicle Safety Act of 1966.¹³⁸ That statute focuses on preventing traffic accidents and, when accidents do occur, reducing deaths and injuries from them.¹³⁹ The Act requires manufacturers to recall automobiles which fail "to conform to applicable Federal motor vehicle safety standards, or contain[] a defect which relates to motor vehicle safety"¹⁴⁰ Manufacturers who learn of defects which render cars unsafe are obliged to mail notice of the facts to owners and to cure the problem without charging the owners.¹⁴¹ The National Highway Traffic Safety Administration can also direct a manufacturer to conduct a recall.¹⁴²

137. *See id.* at 104 (8.7 million cars were recalled from 1960 through 1966 for possible safety defects, compared with more than 100 million from 1966 through 1983); Mark Levinson, *Footnote, Recalls: Tracing Them Back to the Turn of the Century*, DUNN'S REV., Jan. 1979, at 117 ("[T]he so-called 'silent recalls' of the early part of the century were infrequent, carried out by companies when and how they saw fit." Levinson cites the Automotive Information Council for the fact that the first recall involved the 1903 Model K Packard: the manufacturer notified dealers that the car's drive shaft tended to pop out of its housing.). *See also* Robert W. Irvin, *Making Good, After Their Fashion*, THE NATION, July 24, 1972, at 46 (Pre-1966 recalls "were often handled informally and haphazardly; sometimes the deficiency was made good when a car was brought in for service, and the owner was never the wiser.").

138. 15 U.S.C. §§ 1381-1431 (1988). Other federal statutes govern the safety of other products. *See, e.g.*, the Consumer Product Safety Act, 15 U.S.C. §§ 2051-2083 (1988). For discussion of the effectiveness of the Consumer Product Safety Commission, *see* W. Kip Viscusi, *Consumer Behavior and the Safety Effects of Product Safety Regulation*, 28 J.L. & ECON. 527 (1985).

139. 15 U.S.C. §§ 1381-1431 (1988).

140. 15 U.S.C. § 1400 (1988). In determining whether a vehicle contains a defect, courts have stated a willingness to take cost into account. *See* United States v. General Motors Corp., 518 F.2d 420, 436 (D.C. Cir. 1975).

141. 15 U.S.C. §§ 1411, 1413 (1988); 49 C.F.R. § 577.7 (1993).

142. *See* 15 U.S.C. § 1412 (1988); 49 C.F.R. §§ 501.2, 577.1 to 577.9 (1994). *See generally* Sklare, *supra* note 24, at 470-73; Stephen J. Werber, *Automobile Recall Campaigns: Proposals for Legislative and Judicial Responses*, 56 J. URBAN L. 1083, 1084 (1979). For varying views on NHTSA and its effectiveness, *see* Claybrook & Bollier, *supra* note 136; Asch, *supra* note 92 (critiquing Claybrook & Bollier); Jerry L. Mashaw & David L. Harfst, *Regulation and Legal Culture: The Case of Motor Vehicle Safety*, 4 YALE J. ON REG. 257 (1987); Schwartz & Adler, *supra* note 22, at 403-26; Daniel D. Cutler, Note, *The Continuing Struggle for Automotive Safety*, 15 SETON HALL LEG. J. 453 (1991).

The Traffic and Vehicle Safety Act does not apply to non-safety-related defects. Consequently, it does not help motorists who wish to claim the benefits of secret warranties. On the other hand, it is sometimes difficult to determine whether a particular defect sufficiently affects safety to mandate a recall.¹⁴³ Conceivably, in a close case in which a manufacturer decided that a recall was not required, but chose instead to institute a secret warranty program, the Traffic and Vehicle Safety Act might offer some leverage to consumers or those arguing on their behalf. However, the argument in such a situation would not be that the manufacturer had misbehaved by creating a secret warranty program, but rather that it had misbehaved by not ordering a recall under the federal statute.¹⁴⁴

B. *The Federal Trade Commission Act*

Strong arguments can be made that secret warranty programs violate the Federal Trade Commission Act. The Federal Trade Commission was sufficiently persuaded of this view that it commenced proceedings against two major automakers, proceedings that ultimately terminated in consent decrees in 1980.¹⁴⁵ Since 1980, the FTC has not acted against secret warranties,¹⁴⁶

143. See Sklaren, *supra* note 24, at 471 ("Often, the question of whether or not to recall is quite close, for example, as to whether an alleged defect is 'safety related,' or as to what is the appropriate repair . . ."). CAS has suggested that "manufacturers have conducted secret warranties for some defects that, prior to 1981, would probably have been the subject of safety recalls . . ." CENTER FOR AUTO SAFETY, REPORT ON SECRET WARRANTIES TO THE FTC (1987), reprinted in CENTER FOR AUTO SAFETY, SECRET AUTO WARRANTIES, item 6 (1992). Cf. Warren Brown, *Toyota to pay \$250,000 to Settle Complaint*, WASH. POST, Apr. 26, 1994, at C3 (Manufacturer and NHTSA settled NHTSA complaint about defective fuel tank. NHTSA representative reportedly stated that manufacturer changed design in newer models and fixed old tanks only for customers who complained. CAS charged secret warranty. Manufacturer claimed it cooperated with NHTSA and did not provide misleading or incomplete information.).

144. Federal law may also require a manufacturer to recall cars if a substantial number of the cars violate air pollution prevention regulations. See 42 U.S.C. § 7541 (1988). That obviously is of little aid to a consumer attempting to obtain repairs for a problem unrelated to emissions.

145. See *In re Ford Motor Co.*, 96 F.T.C. 362 (1980); *In re Chrysler Corp.*, 96 F.T.C. 134 (1980).

146. See Sagolla, *supra* note 10 (Reagan administration did not initiate secret warranty cases); Jim Henry, *N.Y. Seeks End to Secret Warranties*, AUTOMOTIVE NEWS, Dec. 11, 1989, at 15 (quoting New York State Attorney General Robert Abrams that federal government has not pursued secret warranties); *NY Hearings, supra* note 2 (testimony of Clarence M. Ditlow, Executive Director, Center for Auto Safety) ("When the Reagan Administration took control of the FTC in 1981, the Commission dropped

because it shares the view, criticized above, that secret warranties may not injure consumers¹⁴⁷ and perhaps also because of its diminished resources.¹⁴⁸ That does not mean, however, that the FTC lacks the legal authority to play a role in the area, if it chooses to do so.

The Federal Trade Commission Act proscribes unfair and deceptive trade practices.¹⁴⁹ In its two secret warranty cases, the FTC charged that the

its efforts to expose secret warranties.").

147. For relatively recent expressions of the FTC view of secret warranties, see William MacLeod, director of the FTC's Bureau of Consumer Protection, *quoted in Is Your Car's Warranty a Secret?*, *supra* note 9, at 215 ("There is a real question as to whether 'secret' warranties help or hurt consumers. If we make adjustment policies more expensive, then fewer companies will offer them. It won't help consumers if automakers do away with goodwill adjustments altogether."). See also Karen Riley, *FTC to Get Complaints on Ford's Truck Paint*, WASH. TIMES, June 23, 1992, at C1 (quoting Gary Laden, FTC Assistant Director of Marketing) ("If the company is voluntarily doing something extra than they normally have to do, then what's the problem? They're just being a nice guy."). Silver, *supra* note 27, at 73 (FTC Bureau of Consumer Protection Director William MacLeod reported to say that FTC would only intervene in a secret warranty case if the FTC believed a manufacturer had intentionally concealed a serious defect that would have caused a purchaser not to buy the car if they had known about the defect at the time of the purchase or if the manufacturer knew of a minor defect that would cause major problems if not repaired, such as a sudden loss of oil that would damage the engine); Ann J. Woolley, *Little-Known GM Warranty Fixed Some Cars*, MIAMI HERALD, Mar. 16, 1983, at B6 (reporting that FTC attorney Richard Gateley said secret warranties are not illegal, but commented "I'm not saying whether it's fair, the law isn't always fair."). Cf. MacLeod Letter, *supra* note 26, at 2 ("if an automobile manufacturer knows or should know that the owners of its cars need to engage in unusual maintenance procedures, or if the manufacturer has information that a significant number of its vehicles have a hidden defect that will lead to costly, unexpected, premature component failures, it may be a violation of Section 5 of the Federal Trade Commission if the manufacturer fails to disclose that information to affected purchasers"). Earlier FTC officials had a different view. See *FTC Challenges Ford Motors Handling of 'Piston Scuffing' Defect in Autos*, ANTITRUST & TRADE REG. RPTR. (BNA), Jan. 19, 1978, at A-10-11.

148. For discussion of the reduction in FTC resources, see *The Report of the American Bar Association Section of Antitrust Law Special Committee to Study the Role of the FTC*, section IX, *reprinted in* MARKETING AND ADVERTISING REGULATION THE FEDERAL TRADE COMMISSION IN THE 1990S 412, 437-38 (Patrick Murphy & William L. Wilkie eds., 1990). But see William L. MacLeod, *Kirkpatrick II: A View From Inside the Commission*, *id.* at 51-54 (arguing that despite budget cuts, FTC is as active as in the past in issuing complaints and orders).

149. See 15 U.S.C. § 45(a)(1) (1988) ("Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."). See also 15 U.S.C. § 52(b) (1988) ("The dissemination or the causing to be disseminated of any false advertisement . . . shall

programs at issue were "unfair or deceptive,"¹⁵⁰ thus permitting the inference that secret warranties are only unfair, or that they are only deceptive, or even that they are both unfair and deceptive. It appears that the programs might in fact violate both prongs of the statute.

There are three main arguments that secret warranties are unfair or deceptive.¹⁵¹ The first approach—and probably the hardest to support—is that it violates the FTC Act for a manufacturer, as a matter of policy, to provide free repairs to some consumers without making those repairs available to others who experience the same problem.

The second theory depends on whether the dealer has made certain statements to consumers who are denied free repairs. If the dealer tells some customers, say, that nothing can be done for them when in fact the dealer can, in its discretion, provide free repairs, then it should be fairly easy to establish deception. But obviously not every dealer makes such statements.

The third approach depends not so much on the existence of a secret warranty program, but on the fact that the cars suffer a significant defect. As discussed below, it is by now fairly well established that the FTC has the power to order the recall of a defective product, even after the warranty has expired. Thus, in many situations in which an automaker institutes a good will adjustment program, the FTC will have the power to order a recall, not necessarily because of the secret warranty program, but because of the same defect which triggered the secret warranty program. This Article now reviews the FTC secret warranty cases, and then explores each of these arguments in turn.

1. The FTC Secret Warranty Cases

In the first secret warranty case to be resolved, the FTC charged that certain Chrysler cars were rusting prematurely.¹⁵² In the second case, the complaint alleged that some Ford engines suffered from "piston scuffing."¹⁵³ Both manufacturers allegedly provided special aid to complaining customers: Chrysler provided free replacement fenders or paid installation costs, or both,

be an unfair or deceptive act or practice in or affecting commerce . . ."); 15 U.S.C. § 55(a)(1) (1988) ("The term 'false advertisement' means an advertisement, other than labeling, which is misleading in a material respect.").

150. The complaints in the cases charged the respondents with having committed an "unfair or deceptive act or practice." See *Chrysler Corp.*, 96 F.T.C. at 135; *Ford Motor Co.*, 96 F.T.C. at 365.

151. See generally Polacheck & Steinbach, *supra* note 6, at 3-4.

152. See *Chrysler Corp.*, 96 F.T.C. at 135.

153. *Ford Motor Co.*, 96 F.T.C. at 363. "Piston scuffing" means that pistons were rubbing improperly against cylinder walls.

while Ford initiated a program to compensate injured buyers.¹⁵⁴ Still, the complaints alleged, most affected consumers were unable to take advantage of the manufacturers' largesse, in Chrysler's case because they did not know of the program, and in Ford's because either they did not know that compensation was available, or they were not eligible for compensation because of model year or mileage limitations on the program, or dealers simply did not implement the program. The complaints charged that the failure to disclose the existence of the adjustment programs to owners of the relevant cars "may cause [them] substantial economic harm" and consequently was unfair or deceptive.¹⁵⁵ The complaints also claimed that the manufacturers had violated the FTC Act in other respects,¹⁵⁶ and the complaint against Ford alleged generally that Ford's practices had "the capacity and tendency to mislead" the public.¹⁵⁷

In its settlement, Chrysler denied that it had violated the law, while the FTC maintained that "it had reason to believe that the respondent had violated the said [FTC] Act."¹⁵⁸ Chrysler agreed to give notice of its adjustment program by mail to certain car owners, replace the affected fenders of owners who contacted Chrysler, and reimburse owners who had paid for the repairs themselves.

154. After discovering the problem, Ford also modified its engine design.

155. *Chrysler Corp.*, 96 F.T.C. at 135; *Ford Motor Co.*, 96 F.T.C. at 365.

156. The *Chrysler* complaint also alleged that Chrysler had known of the defect for some time and that its failure to disclose to owners of affected cars that the problem existed had caused these owners "substantial economic harm due to their inability to avoid or prevent premature rust." This failure to disclose the existence of the defect was said to be unfair or deceptive. *Chrysler Corp.*, 96 F.T.C. at 135.

Ford's concealment of its adjustment program was also allegedly unfair to prospective purchasers because they would not have access to facts likely to affect their purchase decision. Wholly apart from the failure to disclose the existence of the secret warranty program, the Commission alleged that Ford had committed an unfair or deceptive practice by not notifying prospective purchasers and owners of Ford vehicles that its cars suffered from piston scuffing. Prospective purchasers were again said to be injured because they were not told of facts which would probably have an impact on their purchase decision; with respect to those who already owned Fords, the complaint charged that the failure to disclose "may cause them substantial economic harm due to inability on their part to avoid or prevent substantial damage to the engines of their vehicles." *Ford Motor Co.*, 96 F.T.C. at 365. The complaint also took Ford to task for representing, through its advertising, either directly or impliedly, that its automobiles were durable even though the piston scuffing had impaired the durability of its cars. *Id.* at 364.

157. *Ford Motor Co.*, 96 F.T.C. at 365.

158. *Chrysler Corp.*, 96 F.T.C. at 136.

The *Ford* settlement agreement also contains a statement noting that Ford did not concede that it had violated the law. In contrast with the *Chrysler* settlement, the *Ford* agreement did not report a Commission determination that it had reason to believe that Ford had violated the FTC Act. That may not be very significant, however: Not only had the FTC issued the complaint described above, indicating that it had determined that if the facts were as alleged, Ford had violated the FTC Act, but also Ford agreed to much more stringent terms than did Chrysler. In fact, in complying with the settlement, Ford is reported to have sent notices to more than eleven million consumers and to have spent millions on free repairs.¹⁵⁹

Under the settlement, Ford agreed to mail owners of affected cars notice of any good will adjustment programs Ford might institute during the next eight years.¹⁶⁰ Ford further promised to reimburse owners of cars who had already paid for repairs for the piston scuffing. The settlement obliged Ford to insert in its warranty booklets a statement to the effect that it sometimes pays for repairs under adjustment programs and to maintain a toll-free number which consumers could call to learn about specific adjustment programs. Similar notices were to go to those who had bought Ford cars during the two preceding model years. Advertisements to be placed by Ford in various publications and displays for dealer showrooms were also to explain the adjustment programs.¹⁶¹

159. Silver, *supra* note 27, at 73.

160. Under part IV (A) of the consent decree, Ford agreed to notify by mail affected owners of "adjustment programs." Adjustment programs are defined in part I (7) as follows:

"Adjustment program" refers to extended policy programs . . . under which respondent undertakes, on a uniform basis and with eligibility defined in terms of specified time-in-service and/or specified mileage limits and/or specified other terms beyond those stated in respondent's applicable warranty or warranties, to pay for all or any part of the cost of repairing, or to reimburse owners for all or any part of the cost of repairing, any engine or transmission condition, or any condition other than an engine or transmission condition that may substantially affect vehicle durability, reliability or performance, other than service provided under a safety or emission-related recall campaign. This term does not include ad hoc adjustments made by respondent on a case-by-case basis and not pursuant to a general commitment to pay for specified services.

Then-Commissioner Robert Pitofsky concurred in the decision to accept the consent order, but noted with concern that the agreement did not require direct mail notice to owners that their cars suffered from problems that were not the subject of good will adjustment programs. He observed that direct mail notification can be expensive.

161. Ford also agreed to provide copies of its Technical Service Bulletins to consumers upon request, and many of the notices described in the text were also to

<https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

Normally, settlements provide little support for the legal propositions that could have been litigated had the cases proceeded to judgment. But FTC consent orders are somewhat more authoritative than conventional settlements. For one thing, courts have a long record of deference to FTC decisions.¹⁶² Consequently, to the extent that the *Ford* and *Chrysler* cases reflect Commission views, they are likely to provide significant guidance as to what the law is, or at least was, at the time the orders were adopted. In addition, when the FTC issues a complaint—an act which precedes or coincides with the filing of the consent order—the FTC has determined that the offending practice violates federal law.¹⁶³ The *Ford* and *Chrysler* complaints both alleged that secret warranty programs were unfair or deceptive, and in *Chrysler*, the Commission explicitly reported a determination that it had reason to believe that Chrysler had violated the FTC Act.¹⁶⁴

refer to the existence of the Technical Service Bulletins.

162. See, e.g., *Federal Trade Comm'n v. Mary Carter Paint Co.*, 382 U.S. 46, 48-49 (1965); *Federal Trade Comm'n v. Colgate-Palmolive Co.*, 380 U.S. 374, 385 (1965) ("[T]he Commission's judgment is to be given great weight by reviewing courts."); *Kraft, Inc. v. Federal Trade Commission*, 970 F.2d 311, 316-18 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 1254 (1993); *Simeon Management Corp. v. Federal Trade Comm'n*, 579 F.2d 1137, 1142 (9th Cir. 1978) ("[T]he FTC has accumulated much expertise. We are not to lightly set aside agency action based on the exercise of such accumulated expertise merely because, were we trying the matter anew, we might reach a different result. We are not to set aside the Commission's action unless it is apparent that it is unsupported by substantial evidence or is arbitrary, capricious, an abuse of discretion or otherwise not in accordance with the law.") (citations omitted). See generally Jeff Sovern, *Private Actions Under the Deceptive Trade Practices Acts: Reconsidering the FTC Act as Rule Model*, 52 OHIO ST. L.J. 437, 443 (1991) (explaining why the FTC has taken the lead in shaping the definition of deception); *Developments in the Law, Deceptive Advertising*, 80 HARV. L. REV. 1005, 1039 (1967) ("[R]ecent judicial opinions yield the Commission very broad discretion on all of the critical issues."); Candace L. Oxendale, Comment, *The FTC and Deceptive Trade Practices: A Reasonable Standard?*, 35 EMORY L.J. 683, 685 (1986) ("the appellate courts, mindful of the presumed expertise of the Commissioners in the field of trade regulation, have applied a very deferential standard of review to FTC determinations"); Belinda Welti, Note, *The Need for a Statutory Definition of "Deceptive" Advertising*, 19 NEW ENG. L. REV. 127 (1983) ("Reviewing courts defer to FTC findings of deceptive advertising."). *But cf.* Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661, 678 (1977) (former FTC Commissioner criticizes judicial deference to FTC).

163. See SHELDON, *supra* note 3, at 101-02.

164. This is not to suggest that FTC consent orders are equivalent to binding judicial precedents, see generally Stephanie W. Kanwit, 1 FEDERAL TRADE COMMISSION § 12.06, at 12-19 (1992) ("The courts and FTC have construed consent orders as contracts rather than as binding judicial precedent, reasoning that any other

The Supreme Court has given special consideration to FTC consent orders. In *Federal Trade Commission v. Mandel Brothers*, the Court wrote that an FTC interpretation of a statute "is entitled to great weight . . . even though it was applied in cases settled by consent rather than in litigation."¹⁶⁵ However, *Mandel* is arguably distinguishable: Not only was the statute involved not the FTC Act, but the interpretation was contemporaneous with enactment of the statute and had been consistently adhered to in more than 100 cases. Still, a worthless interpretation should not become significant just because it is repeated in numerous consent decrees and was written shortly after the statute interpreted was enacted. In any event, the determinations made by the FTC in the *Ford* and *Chrysler* cases should be accorded respectful consideration in deciding whether secret warranties violate the FTC Act, even though the FTC has since ignored the issue.

2. Do Secret Warranties, Without More, Violate the FTC Act?

In addition to the FTC determinations in secret warranty litigation, the standards generally applied by the FTC support the conclusion that secret warranty programs, without more, violate the FTC Act. Taking unfairness first, the FTC formerly used three criteria to determine if a practice was unfair:

- (1) Whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise—whether, in other words, it is within at least the penumbra of some common-law, statutory, or other established concept of unfairness;
- (2) whether it is immoral, unethical, oppressive, or unscrupulous;
- (3) whether it causes substantial injury to consumers . . .¹⁶⁶

interpretation would hamper the consent settlement process."), but only that they shed considerable light on how the FTC Act should be interpreted.

165. 359 U.S. 385 (1959). *Id.* at 391. See also *People ex rel Hartigan v. Maclean Hunter Pub. Corp.*, 457 N.E.2d 480, 487 n.1 (1983) ("consent orders are not authoritative as adjudications, but they are not without precedential value").

166. See, e.g., 29 Fed. Reg. 8324, 8355 (1964). See also *Federal Trade Comm'n v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244-45 n.5 (1972). On unfairness under the FTC Act generally, see Craswell, *supra* note 110; Ernest Gellhorn, *Trading Stamps, S & H, and the FTC's Unfairness Doctrine*, 1983 DUKE L.J. 903; Neil W. Averitt, *The Meaning of "Unfair Acts or Practices" in Section 5 of the Federal Trade Commission Act*, 70 GEO. L.J. 225 (1981); David A. Rice, *Consumer Unfairness at the FTC: Misadventures in Law and Economics*, 52 GEO. WASH. L. REV. 1, 4 (1983).

In 1980, the Commission issued a Policy Statement which shifted the focus of unfairness away from morality and more towards an economics-oriented approach similar to cost-benefit analysis.¹⁶⁷ The Policy Statement stated that the consumer injury prong was the most important of the three criteria, and could by itself warrant a finding of unfairness.¹⁶⁸ The Policy Statement also refined the consumer injury prong, a refinement which was in turn codified by Congress in 1994. The 1994 statute barred the FTC from outlawing a practice for reasons of unfairness, "unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."¹⁶⁹ It is no coincidence that statute parallels the Policy Statement; the Senate Committee Reports makes clear that the statute is intended to embrace existing law and preserve the authority of FTC unfairness precedents.¹⁷⁰

Do secret warranties cause consumers substantial injury? The FTC's complaint in *Ford* alleged that the failure to disclose the existence of the secret warranty program caused consumers "substantial economic harm."¹⁷¹ The Policy Statement also notes that "[i]n most cases a substantial injury involves monetary harm . . ."¹⁷² The FTC has in the past used its unfairness

167. Letter from Michael Pertschuk et al., to Senators Ford and Danforth (Dec. 17, 1980) [hereinafter Pertschuk Letter]. The Policy Statement is discussed in PRIDGEN, *supra* note 79, at ch.9.

168. The Policy Statement in fact indicates that the Commission will not rely on the unethical or unscrupulous prong as an independent basis for a finding of unfairness.

169. Pub. L. No. 103-312 (1994), 15 U.S.C.A. § 45(n) (West Supp. 1995).

170. See S. REP. NO. 103-30, 103d Cong., 2d Sess. §§ 12-13 (1994), *reprinted in* 1994 U.S.C.C.A.N. (103 Stat.) 1776, 1787-88:

This section is intended to codify . . . the principles of the [Policy Statement]. Since the FTC's policy statement itself is based on the FTC's decided cases and rules, this section codifies existing law. The incorporation of these criteria should enable the FTC to proceed in its development of the law of unfairness with a firm grounding in the precedents decided under this authority, and consistent with the approach of the FTC and the courts in the past. The Committee believes that this codification is necessary in order to provide the FTC, its staff, regulated business, and reviewing courts greater guidance on the meaning of unfairness and to prevent a future FTC from abandoning the principles of the [Policy Statement].

171. See *supra* note 155 and accompanying text.

172. Pertschuk Letter, *supra* note 167, at 5. Even small injuries may meet the standard if many consumers suffer the injury. See also S. REP. NO. 103-130, 103d Cong., 2d Sess. §13 (1994), *reprinted in* 1994 U.S.C.C.A.N. (103 Stat.) 1776, 1788; *In re Orkin Exterminating Co.*, 108 F.T.C. 263, 362 (1986) ("We are not concerned

power, and thus presumably found serious economic injury, when sellers did not disclose information which would help consumers care properly for their automobiles and clothing.¹⁷³ Notice of good will adjustments seems to fall into that category as well. It is not an obstacle that the injury caused by secret warranty programs arguably occurs after purchase of the product:¹⁷⁴ the FTC has banned a variety of post-purchase practices.¹⁷⁵

The second part of the test is whether the injury was one that consumers could not reasonably have avoided. It is difficult to see how consumers who are unaware of good will adjustment programs could reasonably have avoided the injury caused by the programs. Consumers who do not know of the

with trivial or merely speculative harms, but an injury may be substantial if it does a small harm to a large number of people. Over \$7.5 million in increased renewal revenue in an approximately four year period at the unjustified expense of consumers, is not insubstantial.") (footnotes omitted), *aff'd*, 849 F.2d 1354, 1366 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989). See also *Averitt*, *supra* note 166, at 246.

173. See, e.g., Trade Regulation Rules, 16 C.F.R. § 423 (1994) (Care Labeling Rule requires clothing to bear permanent labels on how to care for garment, such as "cold water wash only"), explained at Care Labeling of Textile Wearing Apparel, Statement of Basis and Purpose, 36 Fed. Reg. 23,883-23,889 (1971) ("It is unduly oppressive and unfair to consumers to withhold information essential to the ordinary use of a product" because many consumers experience "substantial economic loss because of erroneous assumptions about care of clothes"); 16 C.F.R. § 306 (1994), explained in Posting of Minimum Octane Numbers of Gasoline Dispensing Pumps, Statement of Basis and Purpose, 36 Fed. Reg. 23,871, 23,877 (1971) (Rule requiring posting of standardized octane ratings of gasoline to prevent confused consumers from buying more expensive gasoline with higher octane than necessary; rule based on both unfairness and deception power). See generally PRIDGEN, *supra* note 79, § 9.05[2].

174. To the extent that consumers pay for secret warranty programs at the time of purchase and do not receive a benefit for that payment, they have arguably been injured at the time of payment. Yet it is probably fair to say that an even greater injury occurs after purchase when the consumer incurs additional expense to correct a problem, or simply lives with a defect, which would have been corrected had the consumer known of the good will adjustment program.

175. See, e.g., *Orkin Exterminating Co.*, 108 F.T.C. at 341-42 (exterminating company contracted for lifetime pest control at particular rate and later sought to raise rates; practice ruled unfair); *In re Spiegel, Inc.*, 86 F.T.C. 425, 437 (1975) (practice of mail order company of suing consumer in company's home state rather than consumer's home state unfair), *aff'd in pertinent part*, 540 F.2d 287 (7th Cir. 1976); *In re All-State Indus. Inc.*, 75 F.T.C. 465, 490 (1969) (practice found unfair when seller did not disclose to consumers that it routinely assigned consumer credit contracts to third party, thus immunizing third party from most consumer claims and defenses and obligating consumer to pay under holder in due course doctrine, even when seller did not perform), *aff'd*, 423 F.2d 423 (4th Cir.), *cert. denied*, 400 U.S. 828 (1970).

availability of free repairs cannot be expected to seek them; they end up either enduring a defect or paying for its correction.

*In re Orkin Manufacturing Co.*¹⁷⁶ is instructive. Orkin had entered into "lifetime" contracts at fixed rates with some of its customers, but sought to raise its rates some years later when inflation impaired the profitability of the contracts. Some customers complained. In an effort to preserve the good will and business of complaining customers, Orkin responded to complaints by rolling back the price increase if the customer could establish that it had relied on Orkin's promise that the fee would not change.¹⁷⁷ Orkin generally charged the higher price to customers who did not complain. The FTC found that non-complaining customers could not reasonably have mitigated the injury they suffered,¹⁷⁸ even though the customers had a writing which indicated that Orkin had violated their rights.¹⁷⁹ Consumers have no such writing when secret warranties are involved and thus are even less able to protect themselves.¹⁸⁰

176. 108 F.T.C. 263 (1986), *aff'd*, 849 F.2d 1354, 1366 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989).

177. *Id.* at 286-90, 367.

178. *Id.* at 366-68.

179. The Eleventh Circuit, in affirming, noted that "consumer information is central to this prong of the unfairness inquiry" *Orkin Exterminating Co. v. Federal Trade Comm'n*, 849 F.2d 1354, 1366 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989).

180. In *In re International Harvester*, 104 F.T.C. 949 (1984) the Commission offered some guidance on when it believed the unfairness power should be used to require disclosure. The Commission wrote:

In most cases it is appropriate to limit mandatory disclosure to those core aspects of a transaction that virtually all consumers would consider essential to an informed decision. These are the same basic characteristics discussed above in connection with common-law merchantability: (1) information bearing on fitness for intended use

Id. at 1062 (footnote omitted).

Probably nearly all consumers who had experienced a problem with their car would regard it as essential to their decision of whom should repair the problem that the dealer would provide free repairs. And the availability of free repairs of a defect at least arguably bears on the fitness of the car for its intended use. In 1981, then-FTC official (and now-professor) Richard Craswell offered the following synthesis of FTC unfairness decisions governing non-disclosures:

[T]he Commission's decisions suggest that the failure to disclose information . . . will be unfair if: (1) consumers currently lack the information in question; (2) consumers would choose differently if they had the information, thus facing sellers with a different set of demand curves; and (3) the benefits of better consumer decisions and improved seller performance are not outweighed by the costs of supplying the information.

The third part of the unfairness test is whether the injury is outweighed by any countervailing benefits. The FTC restated this part of its policy statement as whether the conduct is harmful "in its net effects."¹⁸¹ As discussed above in part III, secret warranties meet that test.

If secret warranties are unfair, are they also deceptive? Secret warranty programs do not fit in well with traditional deception cases. Generally, conduct is found deceptive under the FTC Act because a seller has caused or permitted the consumer to believe that the consumer is getting more than is in fact provided. Secret warranties present precisely the reverse scenario. With secret warranties, consumers actually could receive more than the manufacturer promised, but because they do not know about the available benefits, they are misled into thinking the benefits are not available and so do not seek them. Nevertheless, although it is more difficult to show a violation of the deception prong of the FTC Act than the standards for unfairness, secret warranties probably violate the deception prong as well.

The standards for deception have also changed in recent years, or at least the way those standards are expressed has changed. Since 1983, the FTC has seen conduct as deceptive "if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment."¹⁸² The misconduct must also be material.¹⁸³

Craswell, *supra* note 166, at 123. Secret warranties meet those criteria.

181. See *International Harvester Co.*, 104 F.T.C. at 1061 ("In analyzing an omission this part of the unfairness analysis requires us to balance against the risks of injury the costs of notification and the costs of determining what the prevailing consumer misconceptions actually are."). Cf. *In re Southwest Sunsites, Inc.*, 785 F.2d 1431 (9th Cir.) ("There can be no benefit to society from the dissemination of misrepresentations that induce consumers to continue making payments that they might very well have terminated if they had not been misinformed."), *cert. denied*, 479 U.S. 828 (1986). See also S. REP. NO. 103-130, 103d Cong., 2d Sess. §13 (1994), *reprinted in* 1994 U.S.C.C.A.N. (103 Stat.) 1776, 1788.

182. FTC Policy Statement on Deception at 5 contained in Letter from James C. Miller, III (then FTC Chair) to Senator Bob Packwood (Oct. 14, 1983). See generally *Southwest Sunsites, Inc. v. Federal Trade Comm'n*, 785 F.2d 1431 (9th Cir.), *cert. denied*, 479 U.S. 828 (1986); Carol T. Crawford, *Unfairness and Deception Policy at the FTC: Clarifying the Commission's Role and Rules*, 54 ANTITRUST L.J. 303 (1985); William W. Jacobs, *Consumer Litigation and Its Relationship to the Federal Trade Commission's "Unfairness" and "Deception" Standards*, 16 U. TOL. L. REV. 903 (1985); Jack E. Karns, *The Federal Trade Commission's Evolving Deception Policy*, 22 U. RICH. L. REV. 399 (1988); Roger E. Schechter, *The Death of the Gullible Consumer: Towards a More Sensible Definition of Deception at the FTC*, 1989 ILL. L. REV. 571; E. Thomas Sullivan & Brian A. Marks, *The FTC's Deceptive Advertising Policy: A Legal and Economic Analysis*, 64 OR. L. REV. 593 (1986); *The FTC and Deceptive Trade Practices: A Reasonable Standard?* 35 EMORY L.J. 683 (1986); Dale Pollak & Bruce Teichner, Comment, *The Federal Trade Commission's Deception*

Little else is required: the FTC need not show that the manufacturer has made a false statement;¹⁸⁴ or that the manufacturer intended to deceive anyone;¹⁸⁵ or that anyone was in fact deceived¹⁸⁶ or injured.¹⁸⁷

The FTC secret warranty cases were commenced and settled under the earlier standard: Acts were considered deceptive in 1980 if they had a capacity or tendency to deceive the ignorant, unthinking, and credulous consumer.¹⁸⁸ The *Ford* complaint echoed some of this language. It alleged that Ford's practices had "the capacity and tendency to mislead members of the consuming public . . ."¹⁸⁹ Nevertheless, whether or not the change in standards matters in some situations, it probably does not matter in this one: If secret warranties are objectionable, they should deceive consumers acting reasonably in the circumstances just the same as consumers who are ignorant, unthinking and credulous.

Secret warranties are deceptive when considered in juxtaposition to the written warranty provided car buyers. A consumer who examined her warranty and saw that the manufacturer is not under a legal obligation to

Enforcement Policy, 35 DEPAUL L. REV. 125 (1985).

183. FTC Policy Statement, *supra* note 182.

184. Even literally true statements may be ruled deceptive. *See, e.g.*, *Bockenstette v. Federal Trade Comm'n*, 134 F.2d 369, 371 (10th Cir. 1943) ("Words and sentences may be literally and technically true and yet be framed in such a setting as to mislead or deceive."); *Removatron Int'l Corp.*, 5 TRADE REG. REP. (CCH) ¶ 22,619 (1988); *Thompson Medical Co.*, 104 F.T.C. 648, 788 (1984).

185. *See* Federal Trade Comm'n v. *Sterling Drugs, Inc.*, 317 F.2d 669, 674 (2d Cir. 1963) ("proof of intention to deceive is not requisite to a finding of violation of the statute"); *see also* Federal Trade Comm'n v. *Algoma Lumber*, 291 U.S. 67 (1934); Schulman, *Little F.T.C. Act: The Neglected Alternative*, 9 J. MARSHALL J. OF PRAC. & PROC. 351, 361 (1976).

186. *See* *Montgomery Ward & Co. v. Federal Trade Comm'n*, 379 F.2d 666, 670 (7th Cir. 1967); *Resort Car Rental Sys. v. Federal Trade Comm'n*, 518 F.2d 962, 964 (9th Cir.), *cert. denied*, 423 U.S. 827 (1975).

187. *See* Federal Trade Comm'n v. *Raladam Corp.*, 316 U.S. 149, 152 (1942); *Sterling Drugs, Inc.*, 317 F.2d at 674; *Charles of the Ritz Distrib. Corp. v. Federal Trade Comm'n*, 143 F.2d 676, 680 (2d Cir. 1944).

188. *See, e.g.*, *Sterling Drug, Inc.*, 317 F.2d at 674. For discussion of the earlier standard, see the authorities cited *supra* note 182.

189. *Ford Motor Co.*, 96 F.T.C. at 365. Paragraph 15 of the complaint reads: The use by respondent of the aforesaid acts and practices has had, and now has, the capacity and tendency to mislead members of the consuming public who are purchasing or who have purchased substantial quantities of motor vehicles equipped with the engines described in Paragraph Five.

provide free repairs after the warranty expires could reasonably conclude that asking the manufacturer for such repairs will be fruitless.¹⁹⁰

In a sense, the warranty acts as a half-truth because it creates the illusion that the manufacturer will provide only the services identified in the warranty, and no more. It is well-established that half-truths can be deceptive under the FTC Act.¹⁹¹ For example, a baker's truthful advertisement that its bread contained "only 46 calories per slice" was ruled deceptive because it created the impression that the bread was a special diet food, when the reality was that the bread had been sliced more thinly than other breads.¹⁹² More recently,

190. To reduce the likelihood of such confusion, the consent decree that the FTC entered into with Ford required Ford to state in various publications furnished to buyers of Fords that Ford sometimes pays for repairs after the warranty has expired. *Ford Motor Co.*, 96 F.T.C. at 369. For a theoretical discussion of the type of inference described in the text, see Richard Craswell, *Interpreting Deceptive Advertising*, 65 B.U. L. REV. 658, 670-72 (1985). The FTC's power over deceptive statements is not limited to express statements but extends also to implications. See, e.g., *In re Litton Indus.*, 97 F.T.C. 1, 76-77 n.12 (1981) ("It is well-established principle of advertising law . . . that advertisers be held responsible for implied, as well as express, misrepresentations . . ."). See also *Thompson Medical Co.*, 104 F.T.C. at 802-03 (ad for Aspercreme which stated that Aspercreme contained "non-aspirin pain reliever" nevertheless held to imply that Aspercreme contained aspirin when surveys showed significant number of consumers thought it did, apparently because of product's name); *In re Bristol-Myers Co.*, 102 F.T.C. 21, 320 (1983), *aff'd*, 738 F.2d 554 (2d Cir. 1984), *cert. denied*, 469 U.S. 1189 (1985); *Aronberg v. Federal Trade Comm'n*, 132 F.2d 165, 167 (7th Cir. 1942) ("The ultimate impression upon the mind of the reader arises from the sum total of not only what is said but also of all that is reasonably implied."). See generally Ivan L. Preston, *The Federal Trade Commission's Identification of Implications As Constituting Deceptive Advertising*, 57 CINCINNATI L. REV. 1243 (1989). Some limits exist to the FTC's willingness to infer representations from statements by merchants. The FTC has written that the implication must be a reasonable interpretation of the merchant's statement to be sanctionable. See FTC Policy Regarding Advertising Substantiation, appearing as Appendix to *Thompson Medical Co.*, 104 F.T.C. at 839-40; *In re National Dynamics Corp.*, 82 F.T.C. 488, 524 (1973). In some cases, the FTC requires extrinsic evidence, such as survey evidence, to establish that a substantial number of consumers do in fact, draw the erroneous inference from the material. See *Thompson Medical Co.*, 104 F.T.C. at 789. It appears that secret warranties should satisfy these tests. Numerous consumers—indeed probably most consumers—have been misled into thinking that sellers will not repair their defective products for free once the warranty has expired; how else to explain the fact that so many consumers pay for repairs when they could obtain them without charge?

191. See, e.g., *International Harvester Co.*, 104 F.T.C. at 1057 ("it can be deceptive to tell only half the truth, and to omit the rest").

192. See *National Bakers Servs., Inc. v. Federal Trade Comm'n*, 329 F.2d 365, 367 (7th Cir. 1964).

a cheese-manufacturer's truthful advertisement that each slice of its cheese was made from five ounces of milk or had five ounces of milk was found deceptive when thirty percent of the calcium in the milk was lost during processing, in light of the fact that the ads also accurately noted the importance of calcium in the development of bones.¹⁹³

In addition, secret warranties are arguably deceptive as "pure omissions." This is a harder argument to sustain than the half-truth argument, in part because the FTC has retreated from the pure omission doctrine in recent years. In the past, the FTC concluded that when a manufacturer does not correct a consumer's normal, but erroneous, expectations about a product, the manufacturer can be found to have behaved deceptively.¹⁹⁴ For example, the FTC determined that many people purchasing funeral services mistakenly believe that the law requires embalming and, for cremation, caskets.¹⁹⁵ Consequently, the FTC views the failure of funeral directors to correct these misconceptions as deceptive, even though the funeral directors themselves did nothing to foster the confusion.¹⁹⁶

The FTC's retreat from the pure omission doctrine came in 1984 in the *International Harvester* case.¹⁹⁷ In *Harvester* the FTC stated that it "does not treat pure omissions as deceptive" and that "pure omissions are not appropriately characterized as deceptive or reached through deception analysis . . ."¹⁹⁸ The Commission identified two reasons for this decision. First, it noted that individual consumers might have preconceptions about many issues, and "it would be both impractical and very costly to require corrective information on all such points."¹⁹⁹ Second, the Commission observed that "pure omissions do not presumptively or generally reflect a deliberate act on

193. *See* Kraft, Inc. v. Federal Trade Comm'n, 970 F.2d 311 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 1254 (1993).

194. *See* Statement of Basis and Purpose, Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8,324, 8,352 (1964) ("The principle crystallized in [cases] is that Section 5 [of the FTC Act] forbids sellers to exploit the normal expectations of consumers in order to deceive just as it forbids sellers to create false expectations by affirmative acts."). *See generally* PRIDGEN, *supra* note 79, § 10.07; Preston, *supra* note 190, at 1277-81.

195. *See* Trade Regulation Rule, Funeral Industry Practices, 47 Fed. Reg. 42,260, 42,274-77 (1982).

196. *See* 16 C.F.R. § 453.3(a)(1)(ii), (b)(2) (1994).

197. 104 F.T.C. 949 (1984). Though the FTC found that *Harvester* had not engaged in deception, it concluded that *Harvester* had violated the unfairness prong of the FTC Act. At least one observer has expressed skepticism about how much of an impact *Harvester* will in fact have on pure omissions. *See* PRIDGEN, *supra* note 79, § 10.07[1] at 10-29 to 10-30.

198. *International Harvester*, 104 F.T.C. at 1059-60.

199. *Id.* at 1059.

the part of the seller²⁰⁰ Nevertheless, the FTC noted that a seller might commit a deceptive practice if the seller remained silent "under circumstances that constituted an implied but false representation," and that such an implied representation could be based on "ordinary consumer expectations as to the irreducible minimum performance standards of a particular class of goods."²⁰¹ By analogy, the FTC could, if it wished to, determine that when a seller supplies a written warranty but is silent about post-warranty repairs, the seller makes an implied, but false, representation that it will not provide post-warranty repairs, in light of the ordinary consumer expectation that a seller will perform its repair obligations under the warranty, and no more.

Failure to disclose the availability of good will adjustments also appears to satisfy the materiality requirement for deception. The FTC defines something as material if it is "likely to affect consumers' conduct or decision with regard to a product."²⁰² In its 1983 Policy Statement on Deception, the Commission noted that "[m]aterial information may affect conduct other than the decision to purchase a product."²⁰³ The Statement gave as an example *In re Volkswagen of America, Inc.*,²⁰⁴ in which the Commission alleged that providing incorrect instructions for installation of oil filters was material. The Statement also observed that information concerning durability, performance, warranties, or quality are likely to be material.²⁰⁵ If consumers knew about good will adjustments, they would undoubtedly seek free repairs in greater

200. *Id.*

201. *Id.* at 1058. See also *In re Figgie Int'l, Inc.*, 107 F.T.C. 313, 379 (1986). Cf. Thomas J. Holdych, *Standards for Establishing Deceptive Conduct Under State Deceptive Trade Practices that Impose Punitive Penalties*, 73 OR. L. REV. 235, 294 (1994) (arguing that sellers should have obligation to disclose under state deceptive trade practices statutes "when an information source knows or has reason to know that disclosure of a fact would correct a mistake about a basic assumption upon which the other party is operating in entering into a transaction [or] when an information source knows or has reason to know that there is a high probability that a buyer is ignorant of a fact that the buyer subjectively believes is material to the transaction and the information source can provide information about the fact efficiently and at a lower cost than the buyer.").

202. *International Harvester Co.*, 104 F.T.C. at 1056. See also *Southwest Sunsites, Inc.*, 105 F.T.C. at 149.

203. FTC Policy Statement, *supra* note 182, at 16 n.45.

204. 99 F.T.C. 446 (1982). The case terminated in a consent decree in which Volkswagen agreed, among other things, to mail to owners of affected cars corrected instructions on how to install oil filters and to reimburse certain owners whose cars had suffered oil leaks as a result of improper oil filter installation. *Id.* at 451-52.

205. FTC Policy Statement, *supra* note 182, at 18.

numbers; it thus seems fairly clear that concealing the availability of free repairs has an impact on consumer behavior and so qualifies as material.

Does all of this prevent a manufacturer from repairing even one consumer's car after the warranty has expired without falling afoul of the Federal Trade Commission Act? Not in light of the public interest requirement. The FTC may bring only proceedings which "would be to the interest of the public"²⁰⁶ That statutory restraint, together with budgetary restrictions²⁰⁷ and concerns about political realities²⁰⁸ are likely

206. 15 U.S.C. § 45(b) (1988). *See generally* PRIDGEN, *supra* note 79, at § 8.03; PETER C. WARD, FEDERAL TRADE COMMISSION: LAW, PRACTICE AND PROCEDURE, § 3.03 (1993); John D. French, *The Federal Trade Commission and the Public Interest*, 49 MINN. L. REV. 539 (1965); Marshall A. Leaffer & Michael H. Lipson, *Consumer Actions Against Unfair or Deceptive Acts or Practices: The Private Uses of Federal Trade Commission Jurisprudence*, 48 GEO. WASH. L. REV. 521, 525 n.23 (1980) (suggesting public interest limitations "encourag[e] restraint in case selection"). Courts generally do not make an independent determination of whether a particular action is within the public interest. *See id.*; *Slough v. Federal Trade Comm'n*, 396 F.2d 870, 872 (5th Cir.), *cert. denied*, 393 U.S. 980 (1968) (determination of public interest "is essentially one for the Commission and will only be reversed on a showing of an abuse of discretion"); *Guziak v. Federal Trade Comm'n*, 361 F.2d 700, 704 (8th Cir. 1966), *cert. denied*, 385 U.S. 1007 (1967); *Federal Trade Comm'n v. Rhodes Pharmacal Co.*, 191 F.2d 744, 747 (7th Cir. 1951); *Ford Motor Co. v. Federal Trade Comm'n*, 120 F.2d 175, 182 (6th Cir.), *cert. denied*, 314 U.S. 668 (1941).

207. *See Sovern, supra* note 162, at 442 ("Because the FTC lacks the staff to pursue many significant improprieties, it is unlikely to expend its scarce resources on trivial deceptions."); Leaffer & Lipson, *supra* note 205, at 554 ("The FTC must select cases carefully because of scarce budgetary resources."); William A. Lovett, *State Deceptive Trade Practice Legislation*, 46 TUL. L. REV. 724, 729 n.10 (1972) (the FTC "is modestly staffed [and] far removed from most local communities").

208. On occasion, Congress has curtailed the FTC's power when the legislature feared the FTC would regulate matters best left untouched. *See, e.g.*, Federal Trade Commission Improvements Act of 1980, Pub. L. No. 96-252, § 11, 94 Stat. 374, 378-79 (1980) (*amending* 15 U.S.C. § 57a) (withdrawing power to regulate children's advertising). *See also* William J. Baer, *At the Turning Point: The Commission in 1978 in MARKETING AND ADVERTISING REGULATION; THE FEDERAL TRADE COMMISSION IN THE 1990s* 94, 98 (Patrick E. Murphy & William L. Wilkie eds., 1990):

In brief, Congress, which had remained strongly supportive of the agency until 1978, began to show increasing hostility towards the Commission's activist agenda and to consider a broad range of proposals to restrict the agency's authority. The proposed restrictions included: (1) limiting the FTC's jurisdiction over unfair, as opposed to deceptive, acts and practices; (2) terminating the FTC's rule making proceedings involving children's advertising, used cars, and procedures for private organization standard-setting; (3) allowing one house of Congress to veto any trade

to deter even the most aggressive FTC Commissioners from acting with respect to good will adjustments, except when the manufacturer actually institutes a secret warranty program.

3. Do Secret Warranties, Together With Misrepresentations, Violate the FTC Act?

Even if the FTC were to conclude, contrary to its past views and the discussion above, that secret warranties do not, in and of themselves, violate the FTC Act, it is possible that a particular secret warranty program will be accompanied by conduct that will fall afoul of the statute. If, for example, a dealer tells a complaining consumer that nothing can be done, when the dealer has the discretion to fix the car without charging the customer, the dealer has acted deceptively.²⁰⁹ It is well established that oral statements can violate the FTC Act. The classic *Holland Furnace* case provides a good example.²¹⁰ A Holland Furnace representative would reportedly appear at a consumer's home, claim to work for a governmental agency, and tell the consumers that their existing furnace was defective, not repairable, and likely to cause fires. Not surprisingly, such misrepresentations sometimes resulted in sales. The Court of Appeals upheld the FTC's order banning such conduct.

But relying on accompanying conduct to prevent secret warranties is unsatisfactory. For one thing, a particular secret warranty program may not be accompanied by such conduct. In addition, when oral statements are at issue, proof becomes more difficult. Finally, it is the manufacturer who initiates secret warranty programs, not the dealer. Yet it is the dealer whose conduct is considered troublesome under this approach. If the goal is to eliminate secret warranties, focusing on the associated conduct of the dealer, rather than the institution of the secret warranty itself, may not be productive.

4. Do Manufacturers Violate the FTC Act by Failing to Disclose the Existence of the Defects Which Inspire Secret Warranties?

Whether or not a product is the subject of a secret warranty, if the FTC concludes that a product is defective it may seek a recall. As one observer

regulation rule that the Commission might promulgate; (4) requiring dismissal of pending litigation against the cereal industry and the agricultural cooperatives; and (5) imposing new limits on the FTC's subpoena authority.

209. See Polachek & Steinbach, *supra* note 6, at 1, 5.

210. *Holland Furnace Co. v. Federal Trade Comm'n*, 295 F.2d 302 (7th Cir. 1961).

commented, the "Commission has developed a sort of FTC common law of recalls and defect theory."²¹¹ The FTC has reached consent orders with a number of auto manufacturers requiring the manufacturers to notify customers of certain defects in their cars, repair the defects, and reimburse owners who had previously had the repairs made.²¹² Because secret warranty programs are commenced only when a defect is present, the FTC could use the existence of a secret warranty program as a signal that such a recall is needed. Thus, even if the FTC concludes that secret warranty programs are not *per se* unfair or deceptive, it still might act because of the defect which triggered the secret warranty program.

C. State Deceptive Trade Practices Acts

Because the courts have not recognized a private cause of action for violation of the FTC Act,²¹³ a decision by the FTC not to regulate secret

211. *Recalls*, *supra* note 20, at 773 (remarks of Nancy L. Buc).

212. See *In re American Honda Motor Co.*, 99 F.T.C. 305 (1982) (premature fender rusting); *In re Ford Motor Co.*, 96 F.T.C. 362 (1980) (piston scuffing); *In re Chrysler Corp.*, 96 F.T.C. 134 (1980) (premature rusting); *In re Saab-Scania of America, Inc.*, 107 F.T.C. 410 (1986) (paint condition). See also *In re Volkswagen of America, Inc.*, 110 F.T.C. 392 (1988) (respondent agreed to establish arbitration procedure under aegis of Better Business Bureau to resolve claims by individual owners of damage caused by excessive oil consumption by certain of respondent's cars and to advertise existence of program); *In re General Motors Corp.*, 102 F.T.C. 1741 (1983) (respondent agreed to establish arbitration program under aegis of Better Business Bureau to resolve various claims of defects by individual owners); *In re Chrysler Corp.*, 99 F.T.C. 347 (1982) (respondent allegedly misrepresented type of oil filter suitable for cars and agreed to notify owners of problem; separate statement of Commissioner Pertschuk expressed dismay that Commission did not do more to protect consumers who have suffered damages).

213. See *Bott v. Holiday Universal, Inc.*, 1976-2 Trade Cas. (CCH) ¶ 60,973 (D.C. Cir. 1976); *Holloway v. Bristol-Meyers Corp.*, 485 F.2d 986, 988 (D.C. Cir. 1973); *Carlson v. Coca-Cola Co.*, 483 F.2d 279, 280 (9th Cir. 1973); cf. *Pan American World Airways, Inc. v. United States*, 371 U.S. 296, 306 (1963) (dicta: statute based on FTC Act does not "embrace a remedy for private wrongs but [is] only a means of vindicating the public interest"). But see *Guernsey v. Rich Plan of the Midwest*, 408 F. Supp. 582, 588-89 (N.D. Ind. 1976) (private right of action exists when FTC had previously entered cease and desist order against defendant's parent corporation). See generally Steven W. Gard, *Purpose and Promise Unfulfilled: A Different View of Private Enforcement Under the Federal Trade Commission Act*, 70 NW. U. L. REV. 274 (1975) (arguing for private cause of action); Alan J. Bentkofsky, Note, *Private Judicial Remedies for False and Misleading Advertising*, 25 SYRACUSE L. REV. 747 (1974) (same); Steven Naclerio, *The Federal District Court as Small Claims Tribunal: An Argument Against the Holding in Guernsey v. Rich Plan*, 5 HOFSTRA L. REV. 345

warranties ends the matter, at least insofar as the FTC Act is concerned. But the states have stepped in to fill the gap. Every state has enacted a statute which permits a public agency to proceed against manufacturers who engage in deceptive practices, and nearly all states permit consumers to bring claims as well.²¹⁴ Though different states frame the requirements for a successful claim under these "little FTC" acts differently, most courts rely heavily on federal interpretations of the FTC Act in interpreting their own legislation;²¹⁵

(1977) (opposing private claims); Comment, *Private Enforcement and Rulemaking Under the Federal Trade Commission Act: Expansion of FTC Responsibility*, 69 NW. U. L. REV. 462 (1974) (same). A decision by the FTC not to commence a case is not subject to judicial review. See Arthur Best, *Controlling False Advertising: A Comparative Study of Public Regulation, Industry Self-Policing, and Private Litigation*, 20 GA. L. REV. 1, 16 (1985) ("The Federal Trade Commission has almost total independence in deciding to commence cases. Consumers and competition may request that the FTC begin investigations or prosecutions, but an FTC decision to reject these suggestions is not reviewable.") (citations omitted). Cf. Heckler v. Chaney, 470 U.S. 821 (1985) (Food and Drug Administration decision not to bring proceeding not reviewable unless statute so provides).

214. See, e.g., ALA. CODE §§ 8-19-1 to -15 (1993); ALASKA STAT. § 45.50.471 (1986); ARIZ. REV. STAT. ANN. § 44-1522 (1994); ARK. CODE ANN. § 4-88-106 (Michie 1991); CAL. BUS. & PROF. CODE §§ 17200, 17500 (West 1987); CAL. CIV. CODE § 1770 (West 1985 & Supp. 1995); CONN. GEN. STAT. § 42-110b (West 1992); DEL. CODE ANN. tit. 6, §§ 2513, 2532 (Supp. 1994); D.C. CODE ANN. § 28-3904 (1991 & Supp. 1991); FLA. STAT. ANN. § 501.204 (West Supp. 1995); GA. CODE ANN. § 10-1-393, 106-1203 (Harrison 1994); HAW. REV. STAT. § 481A-3 (1985); IDAHO CODE § 48-603 (Supp. 1994); 121 ILL. COMP. STAT. ANN. 1/2 para. 312 (Smith-Hurd 1993); IOWA CODE § 714.16 (1993); KAN. STAT. ANN. § 50-626 (Supp. 1993); KY. REV. STAT. ANN. § 367.170 (Michie/Bobbs-Merrill 1987); ME. REV. STAT. ANN. tit. 10, § 1212 (West 1980); MINN. STAT. ANN. § 325D.44(1) (West Supp. 1995); MISS. CODE ANN. § 75-24-5 (Supp. 1994); MONT. CODE ANN. § 30-14-103 (1993); NEB. REV. STAT. §§ 59-1602 (1993), 87-302 (1994); N.H. REV. STAT. ANN. § 358-A:2 (1984 & Supp. 1994); N.M. STAT. ANN. § 57-12-2(c) (Michie Supp. 1994); N.Y. GEN. BUS. LAW §§ 349, 350 (McKinney 1988); N.Y. EXEC. LAW § 63.12 (McKinney 1993); N.D. CENT. CODE § 51-15-02 (1989); OHIO REV. CODE ANN. § 1345.02 (Anderson 1993); OR. REV. STAT. § 646.608 (1993); PA. STAT. ANN. tit. 73, § 201-2 (1993); S.C. CODE ANN. § 39-5-20(b) (Law. Co-Op 1985); S.D. CODIFIED LAWS ANN. § 37-24-6 (1994); TENN. CODE ANN. § 47-18-104 (Supp. 1994); TEX. BUS. & COM. CODE ANN. § 17.46 (West 1987 & Supp. 1995); UTAH CODE ANN. § 13-11-4 (1992); VT. STAT. ANN. tit. 9, § 2453 (1993); VA. CODE ANN. § 59.1-200 (Michie Supp. 1994); WASH. REV. CODE ANN. § 19.86.020 (West 1989); WIS. STAT. ANN. § 100.20 (West 1988 & Supp. 1989); WYO. STAT. § 40-12-105 (1993).

215. Some "little FTC" acts refer specifically to interpretations of the F.T.C. Act. See, e.g., MONT. CODE ANN. § 30-14-104(1) (1993) ("in construing [the deceptive trade practices act] due consideration and weight shall be given to the interpretations of the federal trade commission and the federal courts relating to section 5(a)(1) of the <https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

indeed, one state even accords FTC consent orders precedential value.²¹⁶ Accordingly, if, as argued above, secret warranties violate the federal FTC Act, they most likely fall afoul of the state deceptive trade practices acts as well.²¹⁷ The "little FTC" acts of some states do not ban unfair practices, but

Federal Trade Commission Act"); W. VA. CODE § 46A-6-101(1) (1992) ("[T]he purpose of this article is to complement the body of federal law governing . . . unfair, deceptive and fraudulent acts or practices It is the intent of the legislature that, in construing this article, the courts be guided by the interpretation given by the federal courts to the various federal statutes dealing with the same of similar matters."). See also ALA. CODE § 8-19-6 (1993); ALASKA STAT. § 45.50.545 (1986); ARIZ. REV. STAT. ANN. § 44-1522 (1994); CONN. GEN. STAT. ANN. § 42-110b(b) (West 1992); FLA. STAT. ANN. § 501.204(2) (West Supp. 1995); GA. CODE ANN. § 10-1-391(b) (Harrison 1994); HAW. REV. STAT. § 480-2(b) (Supp. 1992); IDAHO CODE § 48-618 (1977); 212 ILL. COMP. STAT. ANN. 1/2 para. 262 (Smith-Hurd 1993); ME. REV. STAT. ANN. tit. 5, § 207(1) (West 1989); MD. CODE ANN. [Transportation] § 13-105 (1990); MASS. GEN. LAWS ANN. ch. 93A, § 2(b) (West 1994); N.H. REV. STAT. ANN. § 358-A:13 (1984); N.M. STAT. ANN. § 57-12-4 (Michie 1987); R.I. GEN. LAWS § 6-13.1-3 (1992); S.C. CODE ANN. § 17.46(c)(1) (Law Co-Op); VT. STAT. ANN. tit. 9, § 2453 (1993); WASH. REV. CODE ANN. § 19.86.920 (West 1989). Cases according some weight to interpretations of the F.T.C. Act when construing "little FTC" acts include *In re Scrimpscher*, 17 B.R. 999, 1015 (Bankr. N.D.N.Y. 1982) (applying New York law); *Guste v. Demars*, 330 So. 2d 123, 125 (La. Ct. App. 1976); *People v. Colorado State Christian College*, 346 N.Y.S.2d 482, 487-89 (N.Y. Sup. Ct. 1973); *Marshall v. Miller*, 276 S.E.2d 397, 399 (N.C. 1981); *Hardy v. Toler*, 218 S.E.2d 342, 345 (N.C. 1975); *Commonwealth ex rel. Zimmerman v. Nickel*, 26 Pa. D. & C. 3d 115, 120 (C.P. Mercer Cty. 1983); *Wesware, Inc. v. State*, 488 S.W.2d 844, 848 (Tex. Civ. App. 1972). See generally Leaffer & Lipson, *supra* note 206, at 532 ("[S]tate courts applying these statutes increasingly have adopted the standards of 'unfairness' and 'deception' that have been developed and used by the F.T.C., and approved by the federal courts."); SHELDON, *supra* note 3, at 99 (many "courts show great deference to F.T.C. decisions"); Jack E. Karns, *State Regulation of Deceptive Trade Practices Under "Little F.T.C. Acts": Should Federal Standards Control?* 94 DICK. L. REV. 373 (1990). But see Russel J. Boehner, Note, *Consumer Protection Statutes and the Common Law: Is the Imposition of Double or Treble Damage Awards "Unfair" to the Businessman?* 15 SUFFOLK U. L. REV. 1157, 1177-78 (1981) ("The significant differences between the state statutes and their federal counterpart greatly diminish the value of F.T.C. decisions as a guide on the state level.").

216. See *State v O'Neill Investigations, Inc.*, 609 P.2d 520, 529 (Alaska 1980) ("adjudications which are resolved by consent decree constitute an administrative interpretation of the Federal Trade Commission Act which have clear precedential value"). See also Idaho Consumer Protection Regulations, Reg. 3,4,2 ("It is an unfair or deceptive act or practice for any seller to engage in trade or commerce if in so doing the seller or the seller's goods or services fail to comply with: . . . Any Federal Trade Commission Consent Decree in which the seller is a party to the decree . . .").

217. See SHELDON, *supra* note 3, at 226 ("a strong argument can be made that the

only deceptive trade practices.²¹⁸ In such states, obviously, those arguing that secret warranties violate state law are limited to arguments of deception. But even in those states the FTC consent decrees may be useful because the FTC complaints indicate that the secret warranty programs at issue in those cases were "unfair or deceptive."

Connecticut and Virginia have provided by statute that secret warranty plans violate their "little FTC" acts.²¹⁹ It is by now fairly well-established that in fashioning the law, courts can look to statutes enacted in other jurisdictions as persuasive authority. Thus, in *Trammel v. United States*,²²⁰ the Supreme Court looked to the privilege rules of the states, as enacted in statutes, to conclude that the privilege against adverse spousal testimony should no longer be recognized in the federal courts under the Federal Rules of Evidence.²²¹ Consequently, courts may, in addition to relying on FTC precedents, employ the Connecticut and Virginia enactments in interpreting their own state statutes. To be sure, courts cannot ignore the normal rules of statutory interpretation that the text of the statute and its legislative history are of paramount importance, but where statutes are as open-ended as deceptive trade practices acts often are, and are intended to apply to a variety of transactions to prevent consumer frauds, it makes sense to construe them in light of the interpretations of other states.

Though no cases have been reported involving challenges to secret warranties under "little FTC" acts, there are a number of analogous cases. The troublesome aspect of secret warranties, it will be recalled, is that a merchant does not disclose to consumers an available benefit. In several cases, courts have found such conduct deceptive. In *Aetna Casualty & Surety Co. v. Martin Surgical Supply Co.*,²²² an insurer was held to have violated the Texas Deceptive Trade Practices—Consumer Protection Act when the insurer, knowing that Martin had been sued, did not disclose to Martin that Martin was covered for the lawsuit under an insurance policy that the insurer had sold to another. Because Martin had not known of the coverage, it had retained its own attorney to defend in the litigation. Similarly, another court ruled that Pennsylvania's "little FTC" act requires landlords to notify tenants of certain

practice of secret warranties is a UDAP violation"). ROSMARIN, *supra* note 29, at 115.

218. See, e.g., N.Y. GEN. BUS. LAW § 349 (McKinney 1988 & Supp. 1995).

219. See CONN. GEN. STAT. § 42-227(h) (West Supp. 1994); VA. CODE ANN. § 59.1-207.38 (Michie 1991).

220. 445 U.S. 40 (1980).

221. See also *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375 (1970) (The Court relied on federal and state wrongful death statutes to create new claim in wrongful death). See generally HARRY W. JONES ET AL., LEGAL METHOD CASES AND TEXT MATERIALS 594-736 (1980).

222. 689 S.W.2d 263 (Tex. Ct. App. 1985).

tenant rights if the failure to provide notice might mislead or confuse the consumer.²²³ In still another case, a plaintiff was held to state a cause of action under Oregon's Unlawful Trade Practices Act when the plaintiff had alleged that the defendant had sold her a car without disclosing that the defendant had previously advertised it—and later advertised it again—for \$800 less than the plaintiff had paid.²²⁴ Finally, another case ruled that a lender's practice of encouraging customers to refinance existing loans without disclosing to them that taking out a new loan would be even more advantageous violated a "little FTC" act.²²⁵

D. State Secret Warranty Statutes

California, Connecticut, Virginia, and Wisconsin all have similar statutes governing good will adjustments.²²⁶ The statutes require manufacturers to notify owners of eligible autos of the existence of any good will adjustment program and of the terms of the program. The notice must be sent by mail within ninety days of the adoption of the adjustment program.²²⁷ Manufacturers must also reimburse those who have previously obtained the repairs on their own.²²⁸ If a consumer seeks a repair which is covered by an adjustment program from a dealer, the dealer must disclose to the consumer that the adjustment program exists.²²⁹ Except in Connecticut, manufacturers are also required to inform dealers of the adjustment programs.²³⁰ When consumers purchase a new car, manufacturers or dealers must tell them, as a

223. *Commonwealth v. Monumental Properties, Inc.*, 329 A.2d 812, 829-30 (Pa. 1974) (court remanded for further proceedings under the standard it articulated).

224. *Sanders v. Francis*, 561 P.2d 1003 (Or. 1977).

225. *In re Milbourne*, 108 B.R. 522,537-39 (Bankr. E.D. Pa. 1989) (applying Pennsylvania law).

226. See CAL. CIV. CODE §§ 1795.90-1795.93 (West Supp. 1995); CONN. GEN. STAT. § 42-227 (West 1992 & Supp. 1994); VA. CODE ANN. § 59.1-207.34 to 59.1-207.39 (Michie 1991); WIS. STAT. ANN. § 218.01(7) (West 1994).

227. CAL. CIV. CODE § 1795.92(a) (West Supp. 1995); CONN. GEN. STAT. § 42-227(c) (West 1992); VA. CODE ANN. § 59.1-207.35 (Michie 1991); WIS. STAT. ANN. § 218.01(7)(2) (West 1994).

228. CAL. CIV. CODE § 1795.92(d) (West Supp. 1995); CONN. GEN. STAT. § 42-227(f)(g) (West 1992); VA. CODE ANN. § 59.1-207.37 (Michie 1991); WIS. STAT. ANN. § 218.01(7)(3) (West 1994).

229. CAL. CIV. CODE § 1795.91(b) (West Supp. 1995); CONN. GEN. STAT. § 42-227(e) (West 1992); VA. CODE ANN. § 59.1-207.36 (Michie 1991); WIS. STAT. ANN. § 218.01(7)(2)(b) (West 1994).

230. CAL. CIV. CODE § 1795.92(c) (West Supp. 1995); VA. CODE ANN. § 59.1-207.35 (Michie 1991); WIS. STAT. ANN. § 218.01(7)(2) (West 1994).

general matter, that the manufacturer sometimes offers good will adjustment programs.²³¹

The statutes define adjustment programs to exclude *ad hoc* adjustments made on a case-by-case basis.²³² Adjustment programs are also limited to conditions "that may substantially affect vehicle durability, reliability or performance . . ." ²³³ Violation of the Wisconsin statute is punishable by an award of double damages and attorney's fees, while infringers of the Connecticut and Virginia statutes are subject to the remedies of the state "little FTC" acts.²³⁴ The California statute does not contain an enforcement mechanism, an omission which has already drawn criticism.²³⁵

E. Warranty Statutes

Consumer warranties are governed by an amalgam of state and federal law. The traditional rules, based largely on the common law, are found in the UCC. Under the UCC, sellers may make express warranties²³⁶ and, unless disclaimed, implied warranties.²³⁷ The federal Magnuson-Moss Warranty

231. CAL. CIV. CODE § 1795.91(a) (West Supp. 1995); CONN. GEN. STAT. § 42-227(d) (West 1992); VA. CODE ANN. § 59.1-207.36 (Michie 1991) (not limited to new car purchasers); WIS. STAT. ANN. § 218.017(2) (West 1994).

232. CAL. CIV. CODE § 1795.90(d) (West Supp. 1995); CONN. GEN. STAT. § 42-227(a)(4) (West 1992); VA. CODE ANN. § 59.1-207.34 (Michie 1991); WIS. STAT. ANN. § 218.017(1)(a) (West 1994).

233. CAL. CIV. CODE § 1795.90(d) (West Supp. 1995); CONN. GEN. STAT. § 42-227(a)(4) (West 1992); VA. CODE ANN. § 59.1-207.34 (Michie 1991); WIS. STAT. ANN. § 218.017(1)(a) (West 1994).

234. CONN. GEN. STAT. § 42-227(g) (West 1993); VA. CODE ANN. § 59.1-207.38 (Michie 1991); WIS. STAT. ANN. § 218.017(4) (West 1994).

235. See Ralph Vartabedian, *Owners Not In On Secret Warranties*, L.A. TIMES, Apr. 22, 1994, at E6; Center for Auto Safety, *California's Weak Secret Warranty Law*, 14 LEMON TIMES No. 1 & 2, at 1 (1994). As originally introduced, the California bill provided that violations of the bill would constitute an unfair or deceptive trade practice; injured consumers could recover treble damages plus attorney's fees; and the Attorney General could seek enforcement of the provisions. See Cal. S. Bill No. 486, § 1797.92 (Feb. 25, 1993). During the legislative process, Toyota Motor Sales, USA apparently objected to these enforcement provisions. See Report of the Senate Com. on Judiciary on SB 486, at 6-7 (1993-94 Regular Session) ("Toyota believes that the enforcement of warranty adjustment law should be left to public and private litigants via the state's unfair competition act."). The provision was dropped during the legislative process.

236. See U.C.C. § 2-313 (1990).

237. See U.C.C. § 2-314 (1990) (implied warranty of merchantability); *id.* § 2-315 (implied warranty of particular purpose); and *id.* § 2-316 (disclaimer of https://scholarship.law.missouri.edu/mlr/vol60/iss2/2

Act²³⁸ provides that sellers of consumer products who provide written warranties may not disclaim the implied warranties, though they may limit the "duration" of the implied warranties "to the duration of a written warranty of reasonable duration" provided the limitation is conscionable.²³⁹ Because many, if not most, manufacturers of consumer goods wish to make a written warranty, they also make implied warranties for at least some period, under the lash of Magnuson-Moss, and, of course, some manufacturers who do not provide written warranties still make implied warranties.

Two commentators, Yvonne W. Rosmarin and Jonathan Sheldon, both writing in publications of the National Consumer Law Center, have urged that the existence of a secret warranty program supports a claim for breach of the implied warranty of merchantability.²⁴⁰ If the product is found to be defective before the implied warranty has expired, the consumer should not need the secret warranty program to establish an entitlement to free repairs: The consumer has a right to repairs under the warranty during the warranty period upon the showing of a defect. If, on the other hand, the warranty has expired, the consumer will not ordinarily be entitled to free repairs. Ms. Rosmarin has suggested, however, that the existence of a secret warranty program implies a "widespread pattern of defects," making a limit to the

warranties).

238. 15 U.S.C. §§ 2301-2312 (1988). On the Magnuson-Moss Act generally, see, in addition to the authorities cited below, Michael B. Bixby, *Judicial Interpretation of the Magnuson-Moss Warranty Act*, 22 AM. BUS. L.J. 125 (1984); Barkley Clark & Michael J. Davis, *Beefing Up Product Warranties: A New Dimension in Consumer Protection*, 23 KAN. L. REV. 567 (1975); Paul A. Lester, *The Magnuson-Moss Warranty Act: The Courts Begin to Talk*, 16 U.C.C.L.J. 119 (1983); Michael A. Schmitt & Susan D. Kovac, *Magnuson-Moss vs. State Protective Consumer Legislation: the Validity of a Stricter State Standard of Warranty Protection*, 30 ARK. L. REV. 21 (1976); Christopher Smith, *The Magnuson-Moss Warranty Act: Turning the Tables on Caveat Emptor*, 13 CAL. W. L. REV. 391 (1977); Ronald L. Lipinski, Note, *Consumer Product Warranties—The F.T.C. Steps In*, 9 J. MARSHALL J. PRAC. & PROC. 887 (1976).

239. Section 108(b), (c) of the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act of 1980, 15 U.S.C. § 2308 (1988) provides:

(b) . . . implied warranties may be limited in duration to the duration of a written warranty of reasonable duration, if such limitation is conscionable and is set forth in clear and unmistakable language and prominently displayed on the face of the warranty.

(c) A disclaimer, modification, or limitation made in violation of this section shall be ineffective for purposes of this title and State law.

240. See ROSMARIN, *supra* note 29, at 126-27; SHELDON, *supra* note 3, at 226.

duration of the implied warranties unconscionable and thus invalid under the Magnuson-Moss Warranty Act.²⁴¹

The circumstances under which a limit to the duration of an implied warranty is unconscionable under the Magnuson-Moss Act are unclear. Indeed, even the concept of the duration of an implied warranty is so vague as to have been accorded a variety of different meanings.²⁴² Neither the legislative history²⁴³ nor the FTC regulations²⁴⁴ shed much light on the problem.

Only three reported cases explore the Magnuson-Moss conscionability limitation. All three involve automobiles. Two of the cases seem to focus primarily on the length of the warranty actually provided. In one, *Hahn v. Ford Motor Co.*,²⁴⁵ the court upheld a twelve-month, 12,000 mile warranty

241. ROSMARIN, *supra* note 29, at 127.

242. For varying judicial interpretations, see Max E. Klinger, *The Concept of Warranty Duration: A Tangled Web*, 89 DICK. L. REV. 935, 936, 966 (1985) (concluding that Magnuson-Moss duration language refers to time for discovery of breaches of the implied warranties, as opposed to, say, length of time in which consumer can sue for breach). See also CURTIS R. REITZ, CONSUMER PRODUCT WARRANTIES UNDER FEDERAL AND STATE LAWS 82 (2d ed. 1987) (some language of Magnuson-Moss is "most perplexing"); Kathleen F. Brickey, *The Magnuson-Moss Act—An Analysis of the Efficacy of Federal Warranty Regulation as a Consumer Protection Tool*, 18 SANTA CLARA L. REV. 73, 101-09 (1978); David B. Saxe & David I. Blejwas, *The Federal Warranty Act: Progress and Pitfalls*, 22 N.Y.L. SCH. L. REV. 1, 20-21 (1976). Implied warranties are not normally thought of as having a duration. Rather, if a product is defective at the instant in which it is transferred to the buyer, the warranty has been breached, even though the defect may not become apparent until some later date. Professor Reitz discusses some possible interpretations of the language of the statute in his treatise. REITZ, *supra* at 82-95.

243. For example, the relevant section of the House Committee Report merely paraphrases the statute. See H. REP. NO. 1107, 93rd Cong., 2d Sess. 21 (1974) reprinted in 1974 U.S.C.C.A.N. 7702, 7722; See also S. CONF. REP. 1408, 93rd Cong. 2d Sess. 3 (1974) reprinted in 1974 U.S.C.C.A.N. 7755, 7757-58. One key member of Congress commented "[f]rankly, I have trouble with the whole section. I don't know precisely what it attempts to have done, and I am one of the authors of the bill, frankly." *Consumer Warranty Protection: Hearings on H.R. 6313, H.R. 6314, H.R. 261, H.R. 4809, H.R. 5037, H.R. 10673 (and similar and identical bills) Before the Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce*, 92d Cong., 1st Sess. 187 (1971) (remark of Rep. Eckhardt). The legislative history on the meaning of duration of an implied warranty is discussed in Klinger, *supra* note 242, at 951-53.

244. 16 C.F.R. § 701.4(a)(7) (1994) requires only that warrantors state limitations on the duration of implied warranties, together with a text that some states may not allow such limitations, so that the limitation may not apply to the particular consumer.

245. 434 N.E.2d 943 (Ind. Ct. App. 1982). See generally Bixby, *supra* note 238, <https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

limitation against challenge under Magnuson-Moss without much discussion of the meaning of the Magnuson-Moss conscionability limit. The warranties in the second case, *Bush v. American Motors Sales Corp.*,²⁴⁶ also were limited to twelve months or 12,000 miles. On a motion to dismiss, the court ruled the limitation conscionable as a matter of law. The *Bush* court did not explain its decision beyond citing three other cases which it said had found similar warranties to be reasonable and conscionable. None of the cases cited by the court in *Bush* as support for the proposition that the warranty passed muster under Magnuson-Moss refers to the Magnuson-Moss Act. Although all three of the cases cited in *Bush* involved twelve-month warranties, in only one did a party challenge a warranty on the ground that it was not reasonable and conscionable, and that challenge was made under the UCC.²⁴⁷ Nothing in the other two cases indicates that the litigants had argued that a warranty was unconscionable; indeed, the word unconscionable is not even mentioned in the decisions. Rather, both opinions seem to take as a given that a warranty does not extend beyond its terms.²⁴⁸

Carlson v. General Motors Corp.,²⁴⁹ took a different approach. Some of the warranties at issue in *Carlson* were limited to two years or 24,000 miles while others lasted three years or 50,000 miles. Defects in the engines of many of the cars allegedly surfaced only after the warranties had expired. The district court granted defendant's motion to dismiss, ruling as a matter of law that the limitations were reasonable and conscionable.²⁵⁰ The court of

at 144-45.

246. 575 F. Supp. 1581 (D. Colo. 1984).

247. *Broe v. Oneonta Sales Co.*, 420 N.Y.S.2d 436, 437-38 (N.Y. Sup. Ct. 1978). *Broe* is also discussed *infra*, note 262.

248. See *Henderson v. General Motors Corp.*, 262 S.E.2d 238, 239 (Ga. Ct. App. 1979) ("The evidence on summary judgment shows without contradiction that warranties had expired prior to the sale of the car to appellant. Thus, even if the warranties were transferable to appellant, recovery will not lie under an implied warranty theory."); *Christopher v. Larson Ford Sales, Inc.*, 557 P.2d 1009, 1013 (Utah 1976) ("[T]he important point is that the warranty was limited to 12 months or 12,000 miles, whichever occurred first. The indisputable fact and the insuperable obstacle to defendant's recovery against Condor, is that it had purchased the vehicle two years previously.").

249. 883 F.2d 287 (4th Cir. 1989).

250. From the wording of the statute, quoted *supra* note 239, it appears that the duration of the implied warranties may be limited to the length of a *written* warranty, if the duration of the *written* warranty is reasonable and the limitation of the *implied* warranties is conscionable and meets other requirements of clarity and conspicuousness. Thus, it appears that whether the *implied* warranties (as opposed to the *written* warranty) are of reasonable duration should not be an issue, at least under the plain meaning of the statute.

appeals reversed, holding that the question of conscionability could not be decided on the pleadings, but required a more developed record.

The *Carlson* court regarded as irrelevant decisions finding shorter warranties to be conscionable, since, the court noted, "each case necessarily turns on variable evidence of the 'commercial setting' in which challenged disclaimers were imposed."²⁵¹ The court then explored ways in which the warranty limit could have been unconscionable.²⁵² The complaint had alleged that because the defendant had more bargaining power than the plaintiff and there was not significant competition over warranties in the automotive industry, the plaintiff had no choice but to accept the defendant's warranty terms. The plaintiff also alleged that the defendant had known of the defect in its engines but did not warn consumers of the likelihood of engine failure. The court of appeals ruled that those allegations, if proven, could establish that the limits to the defendant's warranties were unconscionable.

Neither the *Bush* approach nor the *Carlson* approach is particularly helpful to those challenging secret warranties. Car warranties are, if anything, longer today than they were when the *Bush* court held a warranty of one year or more conscionable as a matter of law. According to one recent report, no auto warranty is shorter than two years while most are three years or longer.²⁵³

251. *Carlson*, 883 F.2d at 293 n.8.

252. The *Carlson* court seemed to assume that conscionability as used in the Magnuson-Moss Act has the same meaning as it does in the Uniform Commercial Code ("UCC"). See also Klinger, *supra* note 242, at 966. Section 2-302(1) (1990) of the UCC provides:

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of an unconscionable clause as to avoid any unconscionable result.

Id.

Given that at the time the Magnuson-Moss Act was enacted, portions of the UCC had been enacted in every state in the country, and that § 2-302 and the unconscionability doctrine had spawned a large amount of discussion in cases, scholarly articles, treatises, and law schools, Congress must have known that the word it was using had a meaning, albeit a disputed meaning, in commercial law, the field Congress was regulating. It thus seems plausible that Congress intended the word conscionability to bring with it the baggage it had acquired since being incorporated into the UCC.

253. See GILLIS, *supra* note 36, at 95-96. According to Gillis, only Porsche, Suzuki Soft Tops, and Volkswagen provided basic warranties as short as two years. The longest basic warranty was five years, provided by Chrysler on certain of its models. Powertrain warranties and corrosion warranties tended to run even longer. <https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

While the *Carlson* approach offers greater flexibility, it too has significant drawbacks for someone trying to argue that an automobile durational limitation is unconscionable. It is probably no longer fair to say that auto manufacturers do not compete on the basis of warranty. There is some variation in length of warranties, and at least one manufacturer, Chrysler, has run an extensive campaign to publicize the terms of its warranty.²⁵⁴ It may be that courts will be receptive to the argument that many consumers are inattentive to car warranties, and so even when manufacturers provide varying degrees of warranty protection, consumers will not adequately protect themselves, but other courts surely will not see that as suggesting unconscionability.²⁵⁵ In addition, one apparently key allegation in *Carlson* was that the defendant knew at the time it sold the cars of the likelihood of catastrophic engine failures.²⁵⁶ Many, perhaps most, secret warranty programs involve defects about which the manufacturer did not know at the time it sold the cars.²⁵⁷

Consequently, those challenging durational limitations on the theory that the existence of a secret warranty program renders the limit unconscionable may have difficulty fitting their cases within any of the relevant precedents. That difficulty may not prove insurmountable—it may be that courts will, on reflection, choose a third approach to the problem—but it does not bode well for the success of such challenges.

Even if a court finds that a durational limit is unconscionable, that still will help only a limited class of consumers. At most, given the statute of limitations on implied warranty claims, such a decision would extend the period in which one could sue on the implied warranties to four years from

254. Indeed, in truth auto manufacturers competed on the basis of warranty at the time *Carlson* was decided. See Schwartz & Wilde, *supra* note 103, at 667 ("The [auto] industry . . . began to compete extensively on warranty coverage in the 1960's, and continues to compete in this area today."); see also Clark & Davis, *supra* note 238, at 568.

255. See *supra* note 105.

256. *Carlson*, 883 F.2d at 294. The court wrote:

Perhaps, most significantly, plaintiffs also alleged that GM knew of inherent defects in its diesel engines—but failed to warn its customers of the consequential likelihood of "catastrophic failures." . . . The claim is, of course, that GM imposed its durational limitations on the operation of implied warranties in the course of bargaining tainted by the "concealment of relevant facts", that, *ipso facto*, plaintiffs had no "meaningful choice" when they accepted the limitations; and that the disclaimers themselves were therefore unconscionable as a matter of law

Id.

257. But see *Ford Motor Co.*, 96 F.T.C. at 365 (complaint alleges that manufacturer knew of defects at time of sale). See *supra* note 156.

the date tender of the good is made,²⁵⁸ as some automobiles are already warranted for four years or more, and most are warranted for at least three years,²⁵⁹ even when a court is persuaded by the argument it will not help in many cases.

F. Miscellaneous Cases

Bennett v. Matt Gay Chevrolet Oldsmobile, Inc.,²⁶⁰ mentioned secret warranties. After plaintiffs complained of steering problems, the manufacturer and dealer made repairs. It was not clear whether those repairs were made under the warranty or after the warranty expired, as a good will adjustment. In addition, after the warranty ran, the manufacturer and dealer installed a new power steering unit. The dealer had purchased the unit from an independent parts supplier; unbeknownst to the manufacturer, the unit contained parts which were not designed to fit the model year of plaintiff's car. One of the plaintiffs lost control of the car and was injured in the ensuing accident. The court denied the manufacturer's motion for summary judgment on plaintiffs' negligence and breach of warranty counts, noting that the manufacturer had known that the original steering mechanism was defective and that the manufacturer had provided a secret warranty to correct the defect. The court concluded its opinion by stating that "an issue remains for the jury to determine if [the manufacturer] was negligent or breached its warranty to plaintiffs and if so, whether the installation of the replacement part in question was foreseeable and thus whether . . . negligence or breach [of warranty] by [the manufacturer] was the proximate cause of plaintiffs' injuries."²⁶¹

It is hard to know what significance to attribute to *Bennett*. Most likely, the court used the existence of a secret warranty program only as an acknowledgement by the manufacturer that a part was defective. Alternatively, *Bennett* may speak to the liability of a manufacturer who negligently repairs a car even when the manufacturer is under no duty to make the repair.

But *Bennett* is also susceptible to a broader, if less plausible, interpretation. The case could be read to imply a rule that manufacturers who provide secret warranties are liable to those who are injured if the part covered by the secret warranty proves defective. That rule would be justifiable on policy grounds, for many of the same reasons discussed in Part III above,

258. See U.C.C. § 2-725 (1990) which provides that the statute of limitations for breach of a contract for sale is four years after the cause of action has accrued and that a breach of warranty occurs when tender of delivery is made.

259. See *supra* note 253 and accompanying text.

260. 408 S.E.2d 111 (Ga. Ct. App. 1991).

261. *Id.* at 115.

though it is harder to support as an extension of traditional product liability common law. Certainly the notion that a warranty extends for a longer period than its terms provide seems peculiar, absent unconscionability or a similar rationale. Negligence (in failing to provide notice or properly made repairs without charge to consumers, who later suffer personal injury from the defect, when the manufacturer knows of the defect and is providing free repairs to others) seems a more defensible argument, though it would be impracticable for individual secret warranty plaintiffs to prove negligence in most cases, given the expense of doing so. Even under this broader interpretation, *Bennett* could be limited to cases in which the manufacturer unsuccessfully attempts to correct the problem before the warranty expires. Such an interpretation will not provide much assistance to consumers seeking the aid of secret warranties after a warranty has expired.²⁶²

262. Two other reported cases have discussed secret warranties but did little to advance the state of the law of that subject. In *Broe v. Oneonta Sales Co.*, 420 N.Y.S.2d 436 (N.Y. Sup. Ct. 1978), plaintiff sued an auto manufacturer for breach of warranty after the warranty had expired. Plaintiff supported his claim by filing with the court a newspaper clipping that stated that some manufacturers provided secret warranties. The court, noting that "there is nothing to indicate that any secret warranties existed here or, if so, the nature and extent of them, or more important, that plaintiff knew and relied upon them and is entitled to the benefit of them," granted summary judgment to the defendant. *Id.* at 437-438. The court thus implied that a consumer could sue on a secret warranty only if the consumer knew of and relied on the secret warranty. As that reliance, to be material, would have to come at the time of purchase, and as even manufacturers typically do not know that they will offer a secret warranty with a new car at the time of purchase, the effect of such a rule would be to deny consumers an action on secret warranties. The court probably did not fully understand the nature of secret warranties.

An unpublished opinion, *K & B Lincoln Mercury, Inc. v. Polen*, No. 9-151, 1983 WL 6221 (Ohio Ct. App. Apr. 8, 1983), also explored good will adjustments. The manufacturer offered to pay for part of an out-of-warranty repair on the consumer's car. When the consumer refused to pay for the remainder of the work, the dealership which had repaired the car sued the consumer, and the consumer sued the manufacturer. The trial court held that the manufacturer's offer to pay for part of the work extended the warranty as to that repair, obliging the manufacturer to assume its full cost. On appeal, that portion of the decision was reversed. The appellate court ruled that the manufacturer's offer to pay part of the repair bill did not create any obligation to pay for the rest. Nothing in the opinion suggests that the offer to pay was part of a larger program directed at the defect in question; that is to say, it does not appear from the decision that the offer to pay was part of a secret warranty program. As the opinion is technically unpublished, its precedential value may be limited.

V. HOW SHOULD SECRET WARRANTIES BE REGULATED?

Part III of this Article argues that secret warranties should be regulated. Part IV demonstrates that while secret warranties seem to violate existing, vaguely-worded, rules governing consumer transactions, those rules have not, with rare exceptions, been used to prohibit secret warranty programs. This section explores what, if anything, should be done to further the regulation of secret warranties.

One possible choice—to do nothing—seems unsatisfactory. The existing statutes have not been effective in preventing car manufacturers from operating secret warranty programs. In 1992, for example, the Center for Auto Safety claimed to have discovered a new secret warranty involving a defect allegedly affecting more than four million vehicles and costing more than one billion dollars to correct.²⁶³ Of course, it cannot be determined how many secret warranty programs remain undiscovered. In addition, it is desirable to have clear and specific rules regulating secret warranties so that consumers and manufacturers alike can readily identify their rights and obligations, and then conform their conduct to the requirements of law at as low a cost as possible.

A variety of issues involving secret warranty regulation will now be considered in turn. Among them: Are secret warranties best regulated at the state or federal level? Under what circumstances should a manufacturer's adjustment program be regulated, or, to put it another way, how many cars must a manufacturer repair for free before it can properly be said that it has instituted a secret warranty? What type of notice should a manufacturer have to give to consumers that free repairs are available? When a manufacturer institutes a good will adjustment program, should it be obliged to reimburse customers who have previously obtained the repairs on their own?

A. Should the Federal Government or the States Regulate Secret Warranties?

Assuming that regulation is desirable, one critical issue is what level of government ought to be involved. Though the federal government—specifically, the FTC—blazed the trail on secret warranties, more recently the states have led the way, as has happened in a variety of areas in consumer

263. See Center for Auto Safety, *Annual Report*, 13 LEMON TIMES, No. 4 at 1, 2 (1993) ("1992 saw CAS uncover one of the biggest secret warranties in history—peeling paint on over 4 million 1985-92 Ford F-series pickups that Ford officials estimated could cost \$1 billion to repair. For owners that complained loudly, Ford had authorized free repainting at a cost of \$1,000 per truck.").

protection.²⁶⁴ For several reasons, national regulation seems preferable to state regulation. First, to the extent that state laws differ, they may increase the expense of complying with the applicable rules. For example, if state A requires that a company give notice by advertising and state B by direct mail, the company may, in order to meet the requirements of state A, incur unneeded expense by advertising in publications which are distributed in both states. At least one industry representative has expressed concern about the administrative burden of complying with the secret warranty rules of different states.²⁶⁵

A second problem with leaving secret warranty regulation to the states is that if some states enact secret warranty legislation while others do not—as has already happened—some car buyers will continue to bear the costs of free repairs for other car buyers. Assume that manufacturers comply with secret warranty legislation, and that, as argued above, the expense of secret warranty programs is ultimately borne in large measure by car buyers in the form of increased purchase prices.²⁶⁶ If some states require auto makers to notify their citizens of the possibility of free repairs, the citizens of those states will probably obtain more free repairs than those who live elsewhere.²⁶⁷ But the residents of all states will share equally in the cost of the repairs, at least in the short run. Consequently, car buyers in some states will end up subsidizing

264. See *supra* notes 152-61 and accompanying text. See also REPORT OF THE A.B.A. SECTION OF ANTITRUST LAW SPECIAL COMMITTEE TO STUDY THE ROLE OF THE FEDERAL TRADE COMMISSION, reprinted in *MARKETING AND ADVERTISING REGULATION; THE FEDERAL TRADE COMMISSION IN THE 1990s* 412, 421 (1990) ("The state attorneys general have responded to the perceived slackening of FTC enforcement with vigorous advertising programs of their own.").

265. See *Conn. Hearings, supra* note 13 (testimony of Alice Cantwell, Ford Motor Co. Regional Manager of Governmental Relations) (opposing state regulation because Ford notification is nationwide and reporting to state officials would create additional administrative burdens).

266. See *supra* notes 74-76 and accompanying text.

267. One externality of secret warranty legislation is that it helps consumers in other states obtain the free repairs as well. Once a manufacturer notifies the residents of one state of the possibility of obtaining free repairs, some citizens of other states will hear of the good will adjustments through word of mouth or media coverage. The likelihood, however, is that fewer people outside the enacting state will learn of the good will adjustment than those inside the state, and so the problem of some car buyers subsidizing the repairs of others will continue.

repairs received in disproportionate numbers by car buyers in other states.²⁶⁸ That seems undesirable.²⁶⁹

The states are in fact locked in a game similar to the Prisoner's Dilemma with each other on secret warranties.²⁷⁰ Because the citizens of states enacting secret warranty legislation reap nearly all of the benefits of the statute while bearing only a small portion of the increase in costs, states have an economic reason to pass such statutes, just as each prisoner has an incentive to cooperate so as to receive a lesser sentence while imposing a greater one on the other prisoner. Every time a state passes a secret warranty statute, it increases the cost of providing good will adjustments. At some point, however, when enough states have enacted secret warranty statutes, the cost of offering secret warranties increases enough to have a greater impact on the manufacturer's decision as to whether to offer a secret warranty at all. Conceivably, in some instances, the greater cost will be enough to cause the manufacturer not to offer a good will adjustment that it otherwise would have. Just as each prisoner is better off if he is the only prisoner to confess, each

268. Cf. Rice, *supra* note 74, at 2 ("Significant state-to-state differences in laws governing product quality and performance claims do exist . . . [and] the conditions produce a market system transfer of a subsidy from consumers in less protective states to purchasers in more protective jurisdictions."). In addition, as Professor Rice has also pointed out, "the cost burden borne by residents of less protective states will increase as more jurisdictions enact protective laws." *Id.* at 49.

269. Conceivably, car manufacturers could respond to secret warranty legislation by adding a surcharge to the cost of cars sold in the enacting state, to recover the cost of complying with the statute. At least one commentator has argued that a variety of factors militate against adjustments in prices to reflect the different costs of different rules enacted by different states. See Rice, *supra* note 74, at 5-8. In addition, such a surcharge, in the short run, also shifts the cost of repairs from the car owners who receive the repairs—who bought some years ago—to other car buyers—who buy today and in the future. In the longer run that problem should take care of itself, as manufacturers include the costs of secret warranties under the new legislation in the purchase price of cars.

270. In that classic game, two accomplices, call them A and B, are arrested in the commission of a crime. The prosecutor tells A that if A testifies against B, while B remains silent, A will go free, while B is sentenced to fifteen years. Another prosecutor makes an identical offer to B in a different room. Each is told that if neither A nor B cooperates, both will get two years, but if both cooperate, each will be sentenced to five years. Both prisoners would be better off if neither cooperated, but each has an incentive to cooperate to protect himself from the other. The logical move for each prisoner is to make a deal with the authorities, unless A and B are able to agree with each other—and trust each other—that neither will cooperate. For discussion of the prisoner's dilemma, see, e.g., BARNES & STOUT, *supra* note 112, at 33-34; CHARLES J. GOETZ, CASES AND MATERIALS ON LAW AND ECONOMICS 8-19 (1984).

state is better off if other states do not enact secret warranty legislation so that manufacturers never reach the point at which the cost of complying with secret warranty legislation renders it uneconomic to institute free repair programs.²⁷¹

These problems can be avoided if either Congress or the FTC intervene. Congress, however, seems unlikely to act with respect to secret warranties any time soon. Though Congress has enacted a variety of statutes governing automobiles,²⁷² it has not yet turned its attention to secret warranties, and may never do so.

The FTC seems a more likely candidate for action at the federal level. To be sure, the FTC has during the last decade eschewed a role in secret warranty regulation, and its officials have expressed the view that secret warranties should not be regulated.²⁷³ But the change in presidential administrations might bring a similar change in the outlook of the FTC, and the FTC has intervened in secret warranties before.

The FTC could act with respect to secret warranties in a variety of ways. It could, as it did in 1980, litigate, either seeking cease and desist orders through administrative adjudications, perhaps again with the goal of reaching settlement agreements with auto manufacturers, or it could file in federal court for injunctive relief.²⁷⁴ The FTC could promulgate a trade regulation rule enforceable through civil penalties and consumer redress actions.²⁷⁵

271. The discussion assumes that consumers in states lacking secret warranty legislation receive fewer free repairs than do those in states which do have legislation. This is likely to be so, even if the media publicizes the fact of a secret warranty in news accounts, since the media probably would not provide as widespread notice as would a direct mail campaign, for example.

272. *See, e.g.*, National Traffic and Motor Vehicle Safety Act, 15 U.S.C. §§ 1381-1431 (1988); Motor Vehicle Information and Cost Savings Act, 15 U.S.C. § 1982, *repealed by* Pub. L. No. 103-272, § 7(b), 108 Stat. 1379 (1994).

273. *See supra* notes 146-47 and accompanying text.

274. *See* 15 U.S.C. § 53(b) (1988). *See generally* 1 KANWIT, *supra* note 164, at ch. 10.

275. *See* 15 U.S.C. § 57a(a)(1)(B) (1988). *See generally* 1 KANWIT, *supra* note 164, at ch. 6. In 1994, Congress restricted the FTC's power to promulgate trade regulation rules to circumstances in which the unfair or deceptive acts or practices in question "are prevalent." Such acts or practices are considered prevalent only if the Commission has previously issued cease and desist orders regarding them, or if "other information available to the Commission indicates a widespread pattern of unfair or deceptive acts or practices." Pub. L. No. 103-312, § 5, amending 15 U.S.C. § 57a(b). This prevalence requirement should not pose a problem with secret warranties, given the past consent decrees and the frequent reports of secret warranties in the media and by consumer groups.

Alternatively, the FTC could issue an industry guide²⁷⁶ or an advisory opinion.²⁷⁷ The FTC could also pursue some combination of these activities. Interestingly, the *Ford* secret warranty consent order provided for what would happen if the FTC issued a trade regulation rule or a guide involving the subject of the consent order, implying that the FTC considered the possibility of a secret warranty regulation or guide.²⁷⁸ The relative merits of these different ways of proceeding—which have been discussed extensively elsewhere²⁷⁹—is beyond the scope of this Article. It is enough to note that the FTC has a number of options in choosing how to proceed, if it elects to do so.

B. How Should Secret Warranties Be Defined?

The definition of a secret warranty is critical because only when a manufacturer satisfies that definition will the statute be triggered. For example, suppose a manufacturer chooses to pay for repairs to a system which has failed in a single car after the warranty has expired. Assume that no other reports of failures of that system have been received. No one proposes to require a manufacturer who repairs one car to notify all other purchasers of its cars of the availability of free repairs. Consequently, any definition of good will adjustments should exclude such single repairs. On the other hand, if the manufacturer frequently assumes the cost of repairs to other cars which have suffered the same system failure, at some point the manufacturer will have made so many repairs that it can fairly be said that the manufacturer has adopted a good will adjustment policy. Any definition should embrace such a situation.

This point—that the definition should focus on the number of repairs provided by the manufacturer—was overlooked by the drafters of the four secret warranty statutes and the *Ford* consent decree, which all define adjustment programs similarly. Connecticut's statute, for example, provides that an adjustment program is "any program or policy that expands or extends the consumer's warranty beyond its stated limit or under which a manufacturer offers to pay for all or any part of the cost of repairing, or to reimburse consumers for all or any part of the cost of repairing, any condition that may substantially affect vehicle durability, reliability or performance"¹¹²⁸⁰

276. See 15 U.S.C. § 57a(a)(1)(A) (1988).

277. 16 C.F.R. § 1.1 (1994).

278. *Ford Motor Co.*, 96 F.T.C. at 375.

279. See, e.g., Report of the A.B.A., *supra* note 264, at 426-32; 1 KANWIT, *supra* note 164, § 6.02.

280. CONN. GEN. STAT. § 42-227(a)(4) (West 1993). See also CAL. CIV. CODE § 1795.90(d) (West Supp. 1995); WIS. STAT. ANN. § 218.017(1)(a) (West 1994).

The definitions also exclude repairs made under a safety or emission-related recall campaign, and "adjustments made by a manufacturer on a case by case basis."²⁸¹

A problem has arisen under the Connecticut definition. The Center for Auto Safety has charged that one manufacturer has attempted to evade the Connecticut statute by erroneously characterizing its repairs as performed on a case-by-case basis.²⁸² The manufacturer's position seems to be that the statute applies only if the manufacturer automatically provides free repairs to all complaining consumers, and that it does not apply to the situation in which the manufacturer evaluates each claim separately, granting some and denying others. The statute could also be interpreted as being triggered by a decision to provide repairs to some, unstated number of consumers who meet certain criteria, even though free repairs are denied to other consumers who do not meet those criteria. Though this latter interpretation seems more defensible

Virginia's statute is similar except that it fails to make explicit that the law does not apply to repairs made under written warranties. Rather, it requires adjustment programs to be "extended policy programs," which is presumably intended to refer to extensions of express warranties. See VA. CODE ANN. § 59.1-207.34 (Michie 1991). The *Ford* consent order definition is quoted *supra* in note 160.

281. See CAL. CIV. CODE § 1795.90(d) (West Supp. 1995); CONN. GEN. STAT. § 42-227 (West 1992 & Supp. 1994); VA. CODE ANN. § 59.1-207.34 (Michie 1991); WIS. STAT. ANN. § 218.017(1)(a) (West 1994).

282. See, e.g., *World News This Week*, AUTOWEEK, Feb. 3, 1992, at 3 (CAS charges that Honda is attempting to evade Connecticut's secret warranty law by labeling repair as "goodwill adjustment" in dealer bulletins.); Anthony Giorgianni, *A Whispered Promise to Pay? Honda Accused of Violating State Law on Secret Warranties*, HARTFORD COURANT, Jan. 16, 1992, at A16 (CAS charges Honda notified dealers it would pay certain repair costs but did not tell Connecticut car owners in violation of Connecticut law; Honda asserts it is not required to notify car owners because repairs are made on case-by-case basis. CAS claims that repairs are being provided free to all who request them. HONDA Sept. 21, 1991 bulletin to service managers quoted as saying "Any repair performed after warranty expiration may be eligible for goodwill consideration by the District Sales Manager."); Giorgianni, *supra* note 19, at E3 ("Automakers can circumvent the [Connecticut] law, however, by issuing 'good-will adjustments' instead of warranty extensions. In good-will adjustments, the manufacturers notify dealers they will pay to correct defects and related damage, but on a case-by-case basis, with the final decision usually resting with the dealer or the manufacturer's zone representative. Connecticut's hidden warranty disclosure law does not require automakers to notify vehicle owners about good-will adjustments. But critics, including the CAS, say such notification should be required because manufacturers often don't apply such adjustments case by case but give them to everyone who complains.").

as a matter of statutory interpretation, and certainly as a matter of policy, the manufacturer's interpretation is not beyond the pale.²⁸³

A preferable definition, and one that would avoid the problem with the Connecticut statute, would have a trigger based on the number of repairs or percentage of cars sold receiving free or reduced cost repairs provided by the manufacturer. When the manufacturer exceeded the threshold of, say, the lower of 200 free or reduced cost repairs of the same defect, or free or reduced cost repairs of the same defect provided to ten percent of the cars of a particular year and model, the manufacturer would be required to comply with the statute. The figures 200 and ten percent are completely arbitrary. The goal is to select numbers which imply that so many cars suffer from this problem that it would be productive for society to require the manufacturer to notify all or many owners of such cars of the availability of free repairs; 200 and ten percent may or may not be those numbers. Obviously, little point would be served in requiring manufacturers to incur expenses notifying consumers that they can obtain free repairs for a condition from which their car does not suffer.²⁸⁴

A final point related to the definition of a good will adjustment concerns the value of the repairs. It may be that a manufacturer would choose to institute a hidden warranty program for an extremely inexpensive repair. For example, the manufacturer might, as a matter of course, always replace a missing screw if the repairer noticed its absence, even if a consumer who might have brought the car in for an unrelated repair had not noticed the absence of the screw. The manufacturer should not be required to comply

283. The manufacturer's interpretation would reduce the statute to one that provided that when a manufacturer decided to repair the cars of all who complain about a specific defect, the manufacturer must also notify those who do not complain. That would make the statute considerably less significant: a manufacturer could avoid complying with it simply by electing to make repairs on a case by case basis.

284. See *Conn. Hearings, supra* note 13 (statement of Automobile Importers of America, Inc.):

One major difficulty is the determination of what characteristics of vehicles merit a wide-ranging offer of assistance. For a problem that manifests itself in less than one percent of a vehicle class or a characteristic that one in 10,000 owners may observe, complying with extensive notice and repair obligation [sic] would be a waste of time and money.

Another difficulty is defining how many instances of assistance constitute an "adjustment program." If a manufacturer repairs five cars on an *ad hoc* basis, does an "adjustment program" exist?

See also Werber, *supra* note 23, at 1085 ("Ford was once required to recall 200,000 trucks to find a single vehicle with a wheel related safety defect."); Bob Tamarkin, *Recalls—The Costs Soar*, FORBES, July 10, 1978, at 79 ("Not every recalled car is defective. The defect rate on recalls has generally ranged from 20% to 35%.")

with notice requirements as to such repairs. Consequently, any secret warranty statute should have a minimum threshold for the value to the customer of the repairs before the statute is triggered.²⁸⁵

C. *What Type of Notice Should Be Required?*

Once a decision is made to regulate secret warranties, notice is probably the thorniest issue. It has great potential for increasing the cost of providing adjustments to the point where manufacturers choose not to offer adjustment programs. Better quality notice increases the cost of adjustment programs two ways. First, it is itself more expensive. And second, because better quality notice results in more affected consumers learning of the availability of free repairs, it increases the number of consumers who may seek repairs. On the other hand, notice is obviously critical to helping consumers obtain free repairs.

1. Notice at the Time of Purchase

The four secret warranty statutes require a variety of notices. When a consumer purchases a car, the statutes require the manufacturer to notify the consumer that the manufacturer sometimes offers post-warranty adjustment programs.²⁸⁶ The *Ford* consent order contained a similar requirement.²⁸⁷

285. Because the focus of this article has been on automobiles, it has not been necessary to consider whether the product which is the subject of the secret warranty should also have a minimum price before the manufacturer should be required to notify consumers of the availability of free repairs. But some products other than cars have been the subject of secret warranties, *see supra* note 12, and so legislation could conceivably be drafted which would be applicable to goods other than cars. If so, the statute should specify that it does not apply unless the good sells for more than some minimum amount large enough to justify the cost of providing notice.

286. *See* CAL. CIV. CODE § 1795.91(a) (West Supp. 1995) (dealer provides notice; not limited to new car purchasers); CONN. GEN. STAT. § 42-227(d) (1993); VA. CODE ANN. § 59.1-207.36 (Michie 1991) (not limited to new car purchasers); WIS. STAT. ANN. § 218.017(2) (West 1994). Toyota, for example, places the following notice to purchasers in the glove compartment at the time of purchase:

To further demonstrate our commitment to your satisfaction with your Toyota car or truck, there may be times when Toyota will establish a special policy adjustment for your particular vehicle model which will pay for all or part of the repair cost beyond normal warranty coverage. If you should experience a problem or concerns, either within or outside of the warranty period, please follow these procedures in sequence listed for the fastest possible response. STEP 1: CONTACT THE DEALERSHIP CUSTOMER RELATIONS MANAGER, STEP 2: CALL THE TOYOTA

Ironically, though such a notice requirement seems prudent, and was in fact used above to support the argument that secret warranties can be deceptive, this type of notice may not be of much help to consumers, unless steps are taken to increase the likelihood that consumers will read and remember the information. Many car buyers probably do not read through all the documentation they receive when they purchase a new car.²⁸⁸ Even those who read the documents when they first receive the car might be less attentive to matters which are not likely to be useful for years, especially in light of the information overload effect—consumers who buy a new car receive a great deal of printed matter and many do not give full attention to some of it.²⁸⁹ Finally, some consumers who read and attend to the legend surely forget about it over time. This is, after all, a provision that is not helpful until the warranty expires three or more years later.

Nevertheless, it is possible to make this type of notice more helpful. If it were to appear on the cover of the warranty booklet, for example, in a conspicuous typeface or color, consumers would be more likely to notice it,

CUSTOMER ASSISTANCE CENTER (1-800-331-4431).

NY Hearings, *supra* note 2 (testimony of Toyota Motor Sales, U.S.A., Inc.).

287. See *Ford Motor Co.*, 96 F.T.C. at 269. Ford also agreed to maintain a toll-free number for consumers to call to obtain information on adjustment programs, to urge dealers to post information on adjustments in their showrooms and service areas, and to advertise the existence of adjustment programs in various publications, including the "Ford Times."

288. For example, one study determined that some warranties go unread by some consumers because the warranties are too long, too technical, or too legal. See ARTHUR YOUNG & CO., *supra* note 18, at 60. See also Ellen M. Moore & F. Kelly Shuptrine, *Warranties: Continued Readability Problems After the 1975 Magnuson-Moss Warranty Act*, 27 J. CONSUMER AFFAIRS 23, 31-32 (1993) (average auto warranty requires post-graduate reading level). Another study found that 91.5% of the responding consumers agreed that "customers are not likely to check a product's guarantee very well until after the product has been bought and some problem arises." Wilkes & Wilcox, *supra* note 64, at 39. Consumers who see at the beginning of the warranty that it has expired are thus likely never to make it to the statement about post-warranty coverage unless the statement is prominent. In a dramatic illustration of how consumers don't read notices, a bank that was required by law to provide a particular notice to its customers, included with the notice a statement that it would pay \$10 to any customer who mailed in to the bank his or her name and address on a piece of paper bearing the word, "regulation." No one did so. See ALAN SCHWARTZ & ROBERT E. SCOTT, *COMMERCIAL TRANSACTIONS: PRINCIPLES AND POLICIES* 1142 (2d ed. 1991).

289. Cf. Whitford, *supra* note 105, at 152-53 (consumers who had been provided oral explanation of warranty at time of purchase did not perform significantly better when quizzed later on warranty than those who were not given oral explanation). For discussion of information overload, see *supra* notes 102-03 and accompanying text.

read it, and even recall it. If it is thought desirable to provide such a notice, and it does appear useful, steps should be taken to increase the likelihood that consumers will in fact receive the information in a usable way.²⁹⁰ At a minimum, that reduces the problem of deception.

2. Notice at the Time a Secret Warranty Program is Adopted

The four secret warranty statutes all require manufacturers who institute a good will adjustment program so notify owners of eligible automobiles by first class mail within ninety days of adoption of the program.²⁹¹ Under the *Ford* consent order, Ford agreed to provide mail notice of any new good will adjustment programs it started.²⁹²

Mail notice is probably one of the best ways of reaching affected consumers.²⁹³ But it can be very expensive, so expensive that it provides

290. There is always a danger, in highlighting one disclosure, of obscuring others. Cf. Howard Beales et al., *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 534 (1981) ("the information disclosed will act as a signal which channels competition away from some other, more important product attribute"); Henry Weinstock, Comment, *Consumer Warranty Law in California Under the Commercial Code and the Song—Beverly and Magnuson-Moss Warranty Acts*, 26 U.C.L.A. L. REV. 583, 593 (1979) ("We may pity the consumer who is forced to receive voluminous documents all of whose terms are in large colorful print, bold-face type, and capital letters."). Nevertheless, it is difficult to think of some critical information that would be overlooked if this were printed on the cover of the warranty booklet. It is, however, undeniable, that there is an inconsistency between wanting consumers to know of secret warranties, so they can take advantage of them, and not wanting consumers to know of secret warranties so as to avoid distracting consumers from other product characteristics.

291. See CAL. CIV. CODE § 1795.92(a) (West Supp. 1995); CONN. GEN. STAT. § 42-227(c) (West 1992); VA. CODE ANN. § 59.1-207.35 (Michie 1991); WIS. STAT. ANN. § 218.017(2) (West 1994).

292. *Ford Motor Co.*, 96 F.T.C. at 373.

293. A requirement that sellers give notice by mail requires manufacturers to have access to the names and addresses of their customers, but apparently manufacturers do retain that information concerning the initial purchasers of their cars. See *Conn. Hearings*, *supra* note 13 (testimony of Alice Cantwell, Ford Motor Co., Regional Manager of Governmental Relations) (Ford maintains records of first owners of cars; speaking of notifications of recalls of cars still under warranty, she stated "because now of the wonderful computer world and the identification system, consumers are notified very easily"); George E. Hoffer et al., *When Recalls Matter: Factors Affecting Owner Response to Automotive Recalls*, 28 J. CONSUMER AFFAIRS 96, 100 (1994) ("Before initiating a recall campaign, the manufacturer obtains from each state's motor vehicle registration files a list of *current* registered owners of the recalled vehicles.") (emphasis in original).

a significant disincentive to institute an adjustment program.²⁹⁴ One manufacturer sometimes forgoes mail notice, and makes do by telling its dealers of the program, making service bulletins available to public, and sometimes issuing a press release.²⁹⁵ Similarly, in one case involving not secret warranties, but alleged defects in a car, the FTC and a manufacturer negotiated a settlement under which the manufacturer agreed to advertise the availability of an arbitration program and to give direct mail notice only to consumers whose names were supplied to the manufacturer by State Attorneys General.²⁹⁶

Another approach which might be less expensive would be to specify that manufacturers must provide actual notice to some proportion of their affected customers—say seventy-five percent—within a specified period of time and leave to the manufacturers the question of how to attain that result. As manufacturers probably have more experience, through their marketing efforts, at communicating commercial information than government, manufacturers are more likely to come up with the cheapest way to provide notice than government.²⁹⁷ In some cases, manufacturers might prefer to use mail notice, especially when relatively few had purchased the affected cars.²⁹⁸

294. Cf. Beales et al., *supra* note 290, at 522 ("information should not be generated beyond the point at which its marginal benefits equal its marginal costs"); Ayres & Miller, *supra* note 78, at 1076 ("Requiring . . . disclosure when the costs of communicating are higher than the value of the information to consumers would force retailers to provide a service whose value is less than its cost.").

295. *Conn. Hearings*, *supra* note 13 (Letter from R.J. Bugno, General Motors General Director of Service Operations (Jan. 30, 1990)). General Motors also announces the availability of its service bulletins in its owners' manuals, as well as in *People Magazine* and *Reader's Digest*, and prints in its warranty books the telephone number to call to obtain information.

296. *General Motors Corp.*, 102 F.T.C. at 1759, 1762 (consent order).

297. See Beales et al., *supra* note 290, at 522-23:

There is usually an advantage in designing disclosure remedies that leave as large a role as possible to normal market forces, to restrict the market as little as possible. The goal should be not to specify the exact information to be disclosed and the exact manner in which it will be disclosed but to give sellers the proper incentives to make these decisions on their own. This reduces the consequences of a bad decision by the government since it avoids forcing sellers to disclose information in an ineffective manner or to disclose information which, because of a change in circumstances, is no longer desired by consumers. It also increases the effectiveness of the remedy by harnessing sellers' own incentives to develop the most effective ways of informing consumers. Thus, innovation should be encouraged by leaving sellers latitude to experiment.

298. When mail notice is the manufacturer's choice, the manufacturer should be required to provide that notice to all affected consumers, not just to 75%. In addition, <https://scholarship.law.missouri.edu/mlr/vol60/iss2/2>

In other cases, where the cost of mail notice would be prohibitive, some combination of advertising and notice in dealer's showrooms and service centers might be more efficient, especially since word of mouth and news coverage might carry the news to some consumers who did not see the advertising.

One notice issue revolves around independent repair shops. A consumer experiencing a problem with her car before receiving notice that the problem is covered by an adjustment program, will often bring her car to an independent mechanic.²⁹⁹ Repair shops have a disincentive to tell consumers about secret warranties. A mechanic who tells the consumer that the manufacturer would repair the problem for free loses business. Some mechanics might tell the consumer anyway, out of innate honesty or a belief that they will retain the customer's good will over the long run, but many will not.³⁰⁰ Consequently, at the point at which the consumer most needs to know about the secret warranty—when the defect surfaces and the consumer is about to authorize a mechanic to perform the work—the consumer is dealing with someone who will not want to tell him about the existence of secret warranties.

One way to deal with this problem is to oblige manufacturers to maintain toll-free numbers which consumers can call to learn about good will adjustments.³⁰¹ Although the four secret warranty statutes do not provide for 800 numbers, Ford agreed to provide information about adjustment programs on toll-free lines under its FTC consent order.³⁰² But toll-free telephone numbers are not a complete solution either. How likely is it that consumers will remember to call when they have a problem with their car? A better solution is to require independent mechanics to post in a conspicuous location somewhere on their premises a notice that manufacturers do sometimes provide free after-warranty repairs and a suggestion that the consumer call the manufacturer's 800 number to inquire whether the particular condition is the subject of an adjustment. Mechanics will surely not greet this

manufacturers who mail other documents to consumers during the relevant period, such as promotional material, should be obliged to include notice of the good will adjustment in the envelope as well. Some manufacturers even publish proprietary magazines, such as *Chevy Outdoors*.

299. The four state statutes all require that notice be provided within ninety days of the institution of the program, *see supra* note 227 and accompanying text, but the defect surely manifests in some cars during that period.

300. *See* ESKELDSON, *supra* note 83, at 68.

301. *See* Polachek & Steinbach, *supra* note 6, at 7; Center for Auto Safety, *CAS Recommendations for State Secret Warranty Legislation*, 11 LEMON TIMES No. 3, at 4 (1990).

302. *See Ford Motor Co.*, 96 F.T.C. at 371-72.

recommendation with enthusiasm, but it offers the greatest opportunity for providing consumers with notice at the moment when that notice would be most useful.³⁰³

An example of how these notice requirements fit together might be helpful. Suppose a defect occurs in a small proportion of a particular model of a car, say one percent,³⁰⁴ and the defect is one that no owner of a car would allow to go uncorrected. In such a case, a manufacturer that wrote to all the owners of the model would incur a large expense to provide information of use to very few consumers. The manufacturer, facing such an expense for such a small return in good will, might choose instead to forego the good will of the one percent of its customers, perhaps trusting that some will continue to buy its products anyway and some would have exited anyway.³⁰⁵ If consumers could obtain notice of a good will adjustment through calling the toll-free number after seeing the reminder in repair shops, that, together with some advertising, might be enough to reach the bulk of the affected consumers, and still not discourage the manufacturer from offering the good will adjustments.

303. Even this may not be a complete success. As one observer has commented: One drawback to the installation of a toll-free hot line is that consumers would need to call the number every time they bring the car into the shop. Since, in most instances, consumers do not know what is wrong with the car when they bring it into the repair shop, a call to the toll-free line would have to be made after the repair has been completed.

Conn. Hearings, supra note 13 (statement of Clarine Nardi Riddle, Attorney General of the State of Connecticut). But since consumers could describe the symptoms of the problem to the manufacturer over the telephone, very often a good guess could be made as to whether the problem is covered under a good will adjustment program or not.

304. *Cf. Nager, supra* note 65, at 306 n.30 ("In some recall campaigns as few as one percent of the vehicles involved may actually have a safety-related defect, the remainder being recalled only to locate defective vehicles. For instance, Chrysler recalled 1.3 million Dodge Aspens and Plymouth Volares to locate 13,000 that were defective All models or years of a given vehicle may be recalled due to similarity in design or production even though only a small number actually need repair or modification.").

305. *See N.Y. Hearings, supra* note 2 (testimony of Automobile Importers of America, Inc.) ("One crucial problem in dealing with this issue is the determination of what characteristics of vehicles merit a wide-ranging offer of assistance. For a problem that manifests itself in less than one percent of a vehicle class or a characteristic that one in 10,000 owners may observe, complying with a requirement for notice and an offer to repair all vehicles would be a waste of time and money. Legislation requiring notice to all vehicle owners, if any owners were offered an adjustment, would in these circumstances probably mean that no one would be offered anything").

When a consumer seeks repairs for a condition which is the subject of a good will adjustment program, the state secret warranty statutes also require dealers to notify the consumer of the existence of the program.³⁰⁶ Concomitantly, California, Virginia, and Wisconsin require manufacturers promptly to notify dealers of good will adjustment programs.³⁰⁷ Both requirements make sense.

D. Should Manufacturers Have to Reimburse Those Who Have Already Paid for Repairs?

All four state statutes require manufacturers who provide good will adjustments to reimburse consumers who have already paid for repairs, "consistent with the terms and conditions of the program."³⁰⁸ The *Ford* consent order contained a similar reimbursement provision,³⁰⁹ while Chrysler pledged to reimburse owners "for the actual or the usual and customary charges in the owner's trade area, whichever is lower" in its agreement.³¹⁰ Indeed, the arguments for not permitting manufacturers to conceal the existence of adjustment programs militate in favor of reimbursement as well. But reimbursement poses special problems.

Reimbursement risks much greater exposure for manufacturers. When manufacturers adopt a good will adjustment program, they can determine how much they will contribute to repairs. Because they can specify the replacement parts, if any are needed, and can shorten the diagnostic process by providing information to dealers, they can reduce costs. But manufacturers cannot control the cost of repairs already made. In addition, because those repairs were presumably made without the benefit of the manufacturer's diagnostic information, they may be considerably more expensive than the repairs the dealer would have provided. Finally, an offer to reimburse consumers for previously-made repairs creates some possibility for fraud. For example, consumers could collude with repairers to submit inflated bills to manufacturers. This greater exposure, the full extent of which is difficult to

306. See CAL. CIV. CODE § 1795.91(b) (West Supp. 1995); CONN. GEN. STAT. § 42-227(e) (West 1992); VA. CODE ANN. § 59.1-207.36(B) (Michie 1991); WIS. STAT. ANN. § 218.017(2) (West 1994).

307. See CAL. CIV. CODE § 1795.92(c) (West Supp. 1995); VA. CODE ANN. § 59.1-207.36(B) (Michie 1991); WIS. STAT. ANN. § 218.017(2) (West 1994).

308. See CAL. CIV. CODE § 1795.92(d) (West Supp. 1995); CONN. GEN. STAT. § 42-227(f) (West 1992); VA. CODE ANN. § 59.1-207.37 (Michie 1991); WIS. STAT. ANN. § 218.017(3) (West 1994).

309. *Ford Motor Co.*, 96 F.T.C. at 374 (reimbursement to be "adjusted to fit the circumstances, terms and conditions of the particular program in question").

310. *Chrysler Corp.*, 96 F.T.C. at 139.

predict, might discourage manufacturers from offering good will adjustment programs.

One way to cure this problem is to limit the amount the manufacturer must pay. For example, the manufacturer could reimburse consumers only what it has already decided to pay its dealers for providing the same repair. This might be what is meant by the language in the statutes that reimbursement shall be "consistent with the terms and conditions of the [good will adjustment] program."³¹¹

But such a limitation has costs of its own. It may not fully cover the costs incurred by consumers who obtained the repairs before the adjustment program was initiated. Because other consumers are able to obtain the repairs for free, consumers who paid for their own repairs are not put on an equal footing, and that seems troublesome.

In addition, when manufacturers must reimburse consumers at a higher rate than they provide their own dealers, they have an incentive to move quickly to create a good will adjustment program. The longer the manufacturer waits to start an adjustment program, the larger the number of customers who will be due reimbursement at a greater rate than the manufacturer provides its dealers, and so the cost to the manufacturer increases when the manufacturer finally inaugurates a program. It is desirable to provide manufacturers an incentive to start good will adjustment programs as early as possible.

One compromise solution might be to provide for reimbursement at a rate no greater than ten percent higher than the amount the manufacturer pays dealers for performing the repairs. That comes closer to compensating those who paid for the repairs and provides some encouragement to manufacturers to move swiftly to institute good will adjustment programs, but still limits the manufacturer's exposure.

VI. CONCLUSION

This Article has argued that from the standpoint of economics, as well as simple fairness, secret warranties should be regulated. But existing regulation has not been effective. Consequently, new regulatory initiatives are needed. Although most new efforts with respect to secret warranties have occurred at the state level, federal intervention, either through legislation or FTC action, would be preferable. Any regulation should contain provisions providing for notification of affected owners, availability of repairs to all affected owners, and limited reimbursement of those who have already paid for repairs.

311. See CAL. CIV. CODE § 1795.92(d) (West Supp. 1995); CONN. GEN. STAT. § 42-227(f) (West 1992); VA. CODE ANN. § 59.1-207.37 (Michie 1991); WIS. STAT. ANN. § 218.017(3) (West 1994).