USED CAR DEALERS' DUTY TO DISCLOSE MAJOR KNOWN DEFECTS

In spring 1982, Congress blocked adoption of the Used Car Rule proposed by the Federal Trade Commission. The rule would have required that a used automobile dealer provide a written list of major defects which the dealer knew existed in a car offered for sale. This Comment will examine the rule, the reasons for its proposal by the FTC, and the objections which led to its eventual congressional veto. This Comment suggests that the traditional fraud cause of action be expanded to include nondisclosure of major defects by used automobile dealers.

INTRODUCTION

On May 26, 1982, Congress vetoed[1] the proposed Federal Trade Commission (FTC) Used Car Rule.[2] The rule would have required used car dealers to place informational stickers in windows of used autos.[3] These stickers would have disclosed certain "major" mechanical defects the dealer knew existed in the car and would have explained the relevant warranty provisions accompanying the sale. The FTC adopted the rule after extensive research and compromise.[4] The congressional veto was the prod-

1. 128 CONG.REC. 2856-83 (daily ed. May 26, 1982). The disapproval was authorized under the Federal Trade Commission Improvement Act of 1980, 15 U.S.C. § 57a-1 (Supp. IV 1980). The FTC Used Car Rule was the first rule challenged under the legislative veto provision of the Act. This veto provision was itself later challenged and ruled unconstitutional; however, the constitutionality of the legislative veto provision and therefore the effectiveness of the FTC Used Car Rule are uncertain due to a pending appeal. Consumers Union of United States, Inc. v. FTC, 691 F.2d 575, 577 (D.C. Cir. 1982), *petition for cert. filed*, United States Senate v. FTC, 51 U.S.L.W. 3470 (U.S. Dec. 6, 1982) (No. 82-935); United States House of Representatives v. FTC, 51 U.S.L.W. 3511 (U.S. Dec. 20, 1982) (No. 82-1044).

2. FTC Used Car Rule, 46 Fed. Reg. 41,359-68 (1981) (was to be codified at 16 C.F.R. pt. 455) (proposed Aug. 14, 1981).

3. *Id.* at 41,360-65.

4. *See* H.R. REP. No. 417, 97th Cong., 1st Sess. 5-16 (1981) (statement of Patricia P. Bailey, Commissioner, Federal Trade Commission).

uct of cursory congressional review[5] and dealer association lobby misinterpretation of the rule.

This Comment reviews the reasons underlying the FTC's adoption of the Used Car Rule and attempts to answer the objections which led to its congressional veto. Several problems confront the purchaser of a used automobile: for example, "as is" sales, which negate implied warranties and a remedy in contract, are prevalent in the used auto industry. Further, although dealers are usually familiar with the condition of the cars they offer, the average buyer lacks the mechanical skill to detect many defects. This knowledge disparity unfairly places a serious economic risk upon the "as is" used auto purchaser. A statute similar to the FTC rule, requiring that dealers disclose major known defects, would best solve this problem. Yet, the recent veto demonstrates that such enactment may be politically difficult.[6] Negligence law currently requires that dealers disclose "dangerous defects" they know exist in cars they offer for sale. An analogous disclosure duty can be found in several states' requirements that realty vendors disclose facts materially affecting a property's value which the seller knows exist and the purchaser cannot readily detect. This Comment suggests that this expansion of disclosure responsibility be applied to used car dealers through a fraud cause of action.

THE FTC USED CAR RULE

FTC Studies and Proposals Preceding the Rule

Extensive research and several proposals preceded the FTC's adoption of the Used Car Rule. In 1975, under congressional mandate,[7] the FTC initiated rulemaking proceedings concerning used auto warranty provisions and practices. The rulemaking committee held public hearings in six major cities during 1976 and 1977.[8]

5. The House waived the normal three-day post-proposal "layover" and limited debate to one-fifth the normal time provided. 128 CONG. REC. 2856-83 (daily ed. May 26, 1982); *see also* 127 CONG. REC. 14,889-90 (daily ed. Dec. 9, 1981).

6. Wisconsin, however, has enacted similar requirements through administrative regulation. Wisconsin section MVD 24 requires dealers to inspect each vehicle before sale, using "reasonable diligence" in a "walk-around and interior inspection, under-hood inspection, under-vehicle inspection and test drive." The types of defects the dealer is required to disclose are limited to those expensive to repair. WIS. ADMIN. CODE § MVD 24.03(5)(a) (1974).

7. 15 U.S.C. § 2309(b) (1976).

8. Hearings were held in Boston, Cleveland, Dallas, Los Angeles, San Francisco and Washington, D.C. Most witnesses were either dealers, representatives from dealer organizations, state or local government officials, or legal aid attorneys; relative few consumers testified. Interviewers included Commission staff members, dealer representatives and consumer group members. The final transcript contained 8,232 pages. BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE

The Commission sanctioned several research reports[9] and received 1,681 additional comments from interested parties.[10]

The committee's 1978 report[11] stated the industry's major consumer abuses[12] were dealer misrepresentation and non-disclosure regarding the dealer's post-sale warranty responsibilities,[13] and mechanical condition at time of sale.[14] The staff recommended a rule[15] requiring dealers to: (1) inspect cars for mechanical defects; (2) disclose defects and estimate resultant repair costs; (3) list previous owners and known repairs; and (4) explain warranty provisions in writing.

The FTC rejected this proposal,[16] as well as a subsequent rule which would have established "voluntary inspections."[17] Meanwhile, Congress expressly discouraged the FTC from imposing mandatory used auto warranties or inspections.[18] In the fall of 1981, six years after rulemaking proceedings were authorized, the Commission finally adopted the "known defects rule" which Con-

---

COMMISSION, SALE OF USED MOTOR VEHICLES, FINAL STAFF REPORT TO THE FEDERAL TRADE COMMISSION AND PROPOSED TRADE REGULATION RULE (Sept. 1978) [hereinafter cited as FINAL STAFF REPORT].

9. *See id.* at 19-37. These reports include: CENTER FOR PUBLIC ADMINISTRATION, AN INVESTIGATION OF THE RETAIL USED MOTOR VEHICLE MARKET; AN EVALUATION OF DISCLOSURE AND REGULATION; NATIONAL ANALYSTS, INC., REPORT ON A SURVEY OF BUYERS OF USED CARS; SURVEY RESEARCH LABORATORY, BELIEFS AND EXPERIENCES OF DISSATISFIED PURCHASERS OF USED MOTOR VEHICLES (1976); AUTOMOBILE CLUB OF MISSOURI, STUDY REGARDING THE CONDITION OF VEHICLES PURCHASED AS USED CARS (1977); CALIFORNIA STATE AUTOMOBILE ASS'N, STUDY REGARDING THE CONDITION OF VEHICLES PURCHASED AS USED CARS (1977); CALIFORNIA PUBLIC INTEREST RESEARCH GROUP, A CALPIRG STUDY: PRACTICES IN THE USED MOTOR VEHICLE INDUSTRY (1977).

10. These comments included letters from consumers, state and local law enforcement officials, legal aid attorneys, consumer groups, dealer associations, rental and leasing associations, members of Congress and other federal agencies. H.R. REP. NO. 417, *supra* note 4, at 7.

11. FINAL STAFF REPORT, *supra* note 8.

12. The staff contended that many of these practices violated the Federal Trade Commission Act § 5, 15 U.S.C. § 45 (1976), which prohibits unfair competitive practices. FINAL STAFF REPORT, *supra* note 8, at 2.

13. FINAL STAFF REPORT, *supra* note 8, at 8-9, 248-91.

14. *Id.* at 6-7, 38-71.

15. *Id.* at app. F.

16. H.R. REP. NO. 417, *supra* note 4, at 8.

17. The proposed rule would not have required dealer inspection; however, should dealers choose to inspect, they would be obligated to disclose the results of such inspection. In her congressional testimony, FTC Commissioner Bailey stated that the Commission rejected this rule because it wished to avoid any "inspection" requirements in a used auto rule. *Id.*

18. H.R. REP. NO. 181, 96th Cong., 1st Sess. 46 (1979).

gress eventually defeated.[19]

The proposed FTC rule would have prohibited affirmative misrepresentation by dealers, while requiring dealer disclosure regarding warranty provisions and certain known defects.[20] The rule was designed to enhance consumer knowledge regarding a used automobile's mechanical condition and warranty coverage. The rule would have given the FTC a cause of action against a dealer who affirmatively misrepresented defects or warranty provisions.[21] Dealers would also have been required to place informational stickers in windows of used autos.[22] The stickers would (1) warn buyers that oral warranties were often unenforceable,[23] (2) advise buyers that they may and should seek third party (professional) mechanical inspection before purchase, (3) provide warranty terms and explain effects of "as is" sales clauses,[24] and (4) list major defects known to the dealer. The rule provided a $10,000 maximum fine for a single violation.[25]

Objections to the FTC Rule

The greatest opposition came from auto dealer associations.[26] The dealers contended that the rule's requirements were excessive and would increase used car prices and shift sales.

Dealers specifically objected to the defect disclosure require-

19. The Commission stated that its authorities for adopting this regulation were the Magnuson-Moss Warranty Act, 15 U.S.C. § 2309(b) (1976), and the Federal Trade Commission Act § 5, 15 U.S.C. § 45 (1976).

20. FTC Used Car Rule, 46 Fed. Reg. 41,328 (1981).

21. Such action is presumably within the Commission's authority under the Federal Trade Commission Act § 5(b), 15 U.S.C. § 45 (1976).

22. FTC Used Car Rule, 46 Fed. Reg. 41,359-62 (1981).

23. The Commission had found that, oftentimes, dealers orally reassure buyers that the dealer would repair cars which subsequently develop mechanical problems despite written warranty waivers. Purchasers appeared unaware of the distinction between oral and written promises. *See infra* text accompanying notes 60-61.

24. The Commission found, "[t]he record demonstrates conclusively that many motor vehicle purchasers are unaware, at the time of sale, of the true nature and extent of their responsibility for repairs after the sale has been consummated." FINAL STAFF REPORT, *supra* note 8, at 261 (studies showed between 25-59 percent of "as is" purchasers were unaware of the effect of such a waiver).

25. FTC Used Car Rule, 46 Fed. Reg. 41,344 (1981).

26. *See Hearing on H. Con. Res. 254 & 256 Before Subcomm. on Commerce, Tourism, and Transportation of the Comm. on Energy and Commerce*, 97th Cong., 2d Sess. (1982) (statement of Thomas Green, Executive Director of Legislative Affairs, National Automobile Dealers Association (NADA), and statement of Joseph Eikenburg, President Emeritus, National Independent Auto Dealers Association) [hereinafter cited as *Hearing on H. Con. Res. 254 & 256*]. NADA is one of the five largest association political action committee contributors to 1982 congressional campaigns. Of the approximately $950,000 contributed, $40,750 went to members of the Committee on Energy and Commerce. *Running the the PACs*, TIME, Oct. 25, 1982, at 20, 21.

ment.[27] The proposed sticker listed fifty-two possible "major defects."[28] The rule required dealers to list any of these problems they knew existed.[29] The rule imputed to the dealer or his agent such knowledge if he had "obtained facts or information about the condition of a vehicle which would lead a reasonable person, under the circumstances, to conclude that the car contained one or more of the fifty-two defects listed."[30] Dealer associations contended the "knowledge" definition was vague and imposed constructive knowledge upon dealers.[31] They warned that the rule would effectively require dealers to inspect thoroughly all used autos sold.[32] Additionally, they claimed those dealers aware of mechanical problems would further be required to investigate the specific listed defect that caused the problem.[33] The associations contended these inspections would increase used car prices by as much as $100 per car.[34]

The dealers' interpretation was too broad and inconsistent with the rule's language. The rule stated: "You are not required to inspect . . . ."[35] Studies and practical sense indicate most dealers are familiar with their cars' mechanical conditions.[36] Admittedly, actual knowledge is difficult to prove, particularly in the fraud area. Yet such difficulty has not prohibited "actual knowledge" components in other statutes.[37] Nevertheless, the FTC rule ex-

27. 128 CONG. REC. H2856-83 (daily ed. May 26, 1982).
28. FTC Used Car Rule, 46 Fed. Reg. 41,361 (1981).
29. *Id.* at 41,366.
30. *Id.* at 41,362.
31. *Hearing on H. Con. Res. 254 & 256, supra* note 26 (statement of Thomas Green).
32. *Id.*
33. *Id.* (statement of Thomas Green). Congressional opponents also feared that the sticker's partial disclosure would lull the consumer into a false sense of security. That is, consumers would presume that the *listed* defects were the car's only mechanical problems. 128 CONG. REC. H2859 (daily ed. May 26, 1982) (statement of Rep. Lent). Yet, the sticker face read: "The defects must be disclosed if known . . . . However, there may be defects that are unknown to the dealer. If nothing is listed, the car is not necessarily free of defects." FTC Used Car Rule, 46 Fed. Reg. 41,360 (1981).
34. *Hearing on H. Con. Res. 254 & 256, supra* note 26 (statement of Joseph Eikenburg); *see also infra* text accompanying notes 42-43.
35. FTC Used Car Rule, 46 Fed. Reg. 41,366 (1981).
36. FINAL STAFF REPORT, *supra* note 8, at 71-75, 81-83.
37. *See, e.g.*, 15 U.S.C. § 1824(5) (1976) (requiring horseshow management to disqualify any horse which the management knows is sore); 15 U.S.C. § 1411(1) (1976) (requiring that an auto manufacturer who "obtains knowledge that any motor vehicle . . . manufactured by him contains [safety] defect[s]" must inform the FTC and the auto's owners, purchasers and dealers); 7 U.S.C. § 2044(b)(6) (1976)

pressly limited dealer responsibility to "obtained facts and information" and required the FTC to prove such actual knowledge.[38] This language, coupled with statements by FTC Commissioner Patricia Bailey,[39] indicate that the intent of the rule was not to require dealers to conduct additional inspections nor to impose constructive knowledge upon dealers.[40] Commissioner Bailey testified that the rule would only require dealers to disclose the general problem without requiring them to discover the specific cause.[41]

Noting this rule would affect only commercial dealers, critics warned that resulting higher prices would cause a market shift from dealers to private sales,[42] causing economic difficulty within the already troubled auto industry.[43] But studies showed dealers were much less likely than private sellers to disclose known defects.[44] Furthermore, there is no evidence dealership prices would increase dramatically.[45] In fact, such disclosure requirements may shift sales to dealers, by assuring purchasers that they are being fully informed.

Critics, who fear further regulation will irreparably harm the troubled auto industry, fail to note used car sales are actually in-

---

(prohibiting a farmer from recruiting, employing, or utilizing "with knowledge, the services of an alien not lawfully admitted for permanent residence").

38. FTC Used Car Rule, 46 Fed. Reg. 41,362 (1981). An appendix to the rule cited several illustrations of situations where the dealer would be charged with knowledge of a defect. *Id.* at 41,368.

39. H.R. REP. NO. 417, *supra* note 4, at 8-11.

40. Even if dealers felt compelled to make thorough inspections, the dealers' $100-250 cost estimates appear excessive. *See infra* note 45.

41. H.R. REP. NO. 417, *supra* note 4, at 11-12. The Commissioner's examples included, "This car leans to the right," and "Oil leaks from the bottom." She stated the specific cause, within the 52 listed defects, need not be discovered. *Id.*

42. Dealers feared the FTC rule would cause a rise in dealer retail prices, as well as a decline in the price that dealers were willing to pay private sellers. These predictions were based upon an assumption that the rule would make dealer inspection necessary. *Hearing on H. Con. Res. 254 & 256, supra* note 26 (statement of Joseph Eikenburg).

43. *Id.* at 9-10.

44. FINAL STAFF REPORT, *supra* note 8, at 116-25.

45. *Interim Hearings on Consumer Protection in the Sale of New and Used Cars Before the California Assembly Comm. on Labor, Employment and Consumer Affairs* (Dec. 14-15, 1979) (testimony of Richard A. Elbrecht, Supervising Attorney, Legal Services Unit, California Division of Consumer Affairs) (on file with author) [hereinafter cited as *Hearings on Consumer Protection*]. It is estimated that even thorough inspections would cost dealers between $25-50 per auto. *Id.* (quoting Robert N. Wiens, Chief of the Bureau of Automotive Repair).

Wisconsin currently requires that dealers inspect used cars for major mechanical defects. WIS. ADMIN. CODE § MVD 24.03(5)a (1974). FTC Commissioner Bailey states surveys indicate most Wisconsin dealers inspect used autos no more thoroughly now than they did before the requirement was established. H.R. REP. NO. 417, *supra* note 4, at 11; *see also* FINAL STAFF REPORT, *supra* note 8, at 213-29.

creasing, despite the decline in new car sales.[46] Many used car dealers cannot even find enough cars to satisfy current market demand.[47] There is no reason to believe defect disclosure requirements would devastate this flourishing industry.[48] Objections to the Used Car Rule, mainly brought by dealer associations, were based upon overly broad interpretations of the rule.[49] These interpretations were expressly negated by the rule's language and reassurances by the FTC Commissioner.[50] Special interest lobbying, rather than the general public's disapproval, caused the veto. The defeat perpetuates current abuses against consumers caused by inadequate consumer information.

A HARSH CONSUMER REALITY WARRANTS IMPOSING A DUTY TO DISCLOSE KNOWN USED CAR DEFECTS

Growing consumer reliance upon the used car market,[51] coupled with the significant increase in used car prices,[52] mandate reevaluation of used auto consumer protection.[53] A complete lack of product uniformity makes used auto purchases highly risky. Furthermore, unequal mechanical sophistication between consumers and dealers leaves the former vulnerable to abuse by the latter.[54]

46. *See generally Lots of Action—A Used Auto Bonanza Helps New-Car Dealers Survive Their Slump*, Wall St. J., Oct. 19, 1981, at 1, col. 1. The article notes the used auto industry was one of the forces escalating the government's consumer price index, although prices are half those of new cars. Hertz Corporation estimates a record 18.7 million used cars were sold in the United States in 1980, compared with 8.9 million new cars sold in the same year. Industry reports estimate used auto prices increased 31 percent between January and September 1981. Some late models actually increased in value during that year, despite being a year older.

47. *Id.*; *Cars That Keep Their Value Best*, Money, Aug. 1982, at 54.

48. *See infra* text accompanying notes 85-90.

49. *See supra* text accompanying notes 35-41.

50. *Id.*

51. The used automobile is increasingly becoming the purchaser's main transportation source. H.R. REP. NO. 417, *supra* note 4, at 25. The poor rely heavily upon the used auto market, yet are the most likely to encounter warranty waivers. FINAL STAFF REPORT, *supra* note 8, at 249.

52. *Lots of Action—A Used Auto Bonanza Helps New-Car Dealers Survive Their Slump*, Wall St. J., Oct. 19, 1981, at 1, col. 1.

53. The California Department of Consumer Affairs receives more consumer complaints about used auto sales than any other business activity. *Hearings on Consumer Protection, supra* note 45. The FTC rulemaking committee found that the major abuses suffered by used auto buyers involved dealer misrepresentation and dealer nondisclosure regarding mechanical condition and warranty coverage. FINAL STAFF REPORT, *supra* note 8, at 7, 248.

54. *Hearings on Consumer Protection, supra* note 45. In California implied

"As is" clauses are common in the used auto industry. While implied[55] or express[56] warranties may protect some purchasers of used autos, many consumers are unaware that the "as is" clause often completely waives implied warranties.[57] Over one-half of American used car sales are "as is."[58] Legal aid attorneys report that most, if not all, of their low-income clients who purchase vehicles from dealers do so "as is."[59] Despite the widespread use of "as is" clauses, many buyers of used autos do not realize their serious effect.[60] This misperception is often supplemented by the dealer's oral reassurances that "if anything goes wrong, just bring it in and we'll take care of it."[61] Consumers often do not discover the legal significance of "as is" clauses or reassurances by the dealer until expensive repairs become necessary.[62]

These unforeseen repair costs can financially devastate the unprepared purchaser. The FTC rulemaking report found that many

---

warranties are established when express warranties are provided. Song-Beverly Act, CAL. CIV. CODE § 1793 (West Supp. 1978); *see also* CAL. CIV. CODE §§ 1792.3-.5 (West 1973), 1795.5 (West Supp. 1982). Yet, absent express warranties, used product sales usually do not carry implied warranties in California. *See* Lamb v. Otto, 51 Cal. App. 433, 197 P. 147 (1921); Schratz, *Are There Implied Warranties on Used Cars in California?*, 9 U.S.F.L. REV. 539 (1975); Annot., 22 A.L.R. 3D 1387 (1968). Yet note in Drumar Mining v. Morris Ravine Mining Co., 33 Cal. App. 2d 492, 92 P.2d 424 (1939), the court held an implied warranty of fitness accompanied the sale of used mining machinery when the seller knew the buyer's intended use and the buyer relied on the seller's representations, with no opportunity to adequately inspect the machinery.

55. FINAL STAFF REPORT, *supra* note 8, at 7. Uniform Commercial Code warranty provisions usually apply to used product sales. *See generally* 67 AM. JUR. 2D *Sales* § 478 (1973); Annot., 22 A.L.R. 3D 1387 (Supp. 1982).

56. FINAL STAFF REPORT, *supra* note 8, at 248. *See generally* Annot., 36 A.L.R. 3D 125 (1971).

57. Section 2-316(3) of the Uniform Commercial Code recognizes that the term "as is" can eliminate all implied warranties. Absent express warranties, dealers selling cars "as is" are not legally responsible for post-sale repairs. *See generally* Annot., 24 A.L.R. 3D 465 (1969). Yet, recognizing unequal vendor-vendee bargaining power and the ominous effect of warranty waivers, courts have displayed reluctance in eliminating implied warranties. *See, e.g.*, Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 404, 161 A.2d 69, 95 (1960) (declared new car warranty waiver invalid citing unequal bargaining power and the general public welfare); *see also* Fairchild Ind. v. Maritime Air Serv., Ltd., 274 Md. 181, 186, 333 A.2d 313, 316-18 (1975); Overland Bond Inv. Corp. v. Howard, 9 Ill. App. 3d 348, 350, 292 N.E.2d 168, 174 (1972); Woodruff v. Clark County Farm Bureau Coop. Ass'n, 153 Ind. App. 31, 50-55, 286 N.E.2d 188, 196-99 (1972).

58. *Hearing on H. Con. Res. 254 & 256, supra* note 26.

59. FINAL STAFF REPORT, *supra* note 8, at 249.

60. *Id.* at 262-65. Surveys indicated between 25-59 percent of used auto buyers did not understand the clause's true effect. Buyers often believe the clauses only refer to accessories or that the dealer will not further recondition the car. *Id.*

61. *Id.* at 274-77.

62. *Id.* at 279-80. One survey indicated, "twenty-eight percent of used car buyers who believed at the time of sale that their cars were somehow warranted (or were not sure) reported learning later that the sale was really 'as is.'" *Id.*

used autos develop mechanical problems soon after purchase.[63] This indicates that most defects existed at the time of sale,[64] yet less than one-tenth of buyers surveyed believed their car was in bad or very bad condition when they bought it.[65] These defects are not minor. The FTC Staff Report noted Northern California State Auto Association diagnostic tests revealing that dealer-offered used cars in 1977 contained an *average* of $162.89 per car in defects.[66] The overall price purchasers pay for their cars includes these repair costs.

Buyers usually possess little or no expertise regarding the modern automobile's complex machinery.[67] They usually do not discover hidden defects until post-purchase problems arise.[68] Although buyers will cursorily check under the hood and take short test drives,[69] these "inspections" are almost meaningless considering the purchaser's lack of expertise and the salesman's distractions and reassurances.[70] Used car buyers, as a group, indicate mechanical condition is their main purchasing consideration.[71] Yet most buyers make purchasing decisions without adequate mechanical information.[72] Dealers *universally* invest considerable money in cosmetic work or "detailing"[73] to hide or

63. Surveys indicated between 35-45 percent of all used autos display defects within one month of purchase. The same surveys indicate 56-68 percent develop defects within two months. These unforeseen defects are particularly prevalent in cars purchased by low income buyers. *Id.* at 38-57.

64. *Id.* at 38.

65. *Id.* at 48 (citing NATIONAL ANALYSTS, INC., REPORT ON A SURVEY OF BUYERS OF USED CARS).

66. FINAL STAFF REPORT, *supra* note 8, at 53. Missouri Auto Club records indicated an average $235.64 in defects per car diagnosed. *Id.*

67. *Id.* at 83-87. Unlike most modern consumer items, the used car is a non-standardized product. Information such as make, model and mileage only address generalities regarding the *average* car after *average* use. Yet, *actual* prior use, maintenance and accident record render every used auto unique and specific defects unpredictable. Even buyers' guides merely provide generalities.

68. *Id.* at 86-87.

69. *Id.* at 84-90.

70. *Id.* at 84-87.

71. *Id.* at 102.

72. *Hearings on Consumer Protection, supra* note 45 (testimony of Richard A. Elbrecht); *see also* FINAL STAFF REPORT, *supra* note 8, at 84.

73. FINAL STAFF REPORT, *supra* note 8, at 100-01. Studies show external appearance usually affects buyers more than actual mechanical soundness. The untrained buyer often fallaciously equates the two. *Id.* Not only are buyers misled by the "detailing," but they end up paying the bill for these cosmetic repairs. Professional detailers often charge over $50 per car. *Hearings on Consumer Protection, supra* note 45.

distract the purchaser's attention from the actual mechanical condition. If dealers were required to disclose known defects, more money could be used repairing these defects, rather than drawing buyer attention away from them.

Fewer than half of the purchasers of used automobiles seek an expert's advice when buying a used car.[74] The low income purchaser, typically an "as is" buyer, is the least likely to seek expert advice.[75]

Dealers know the general mechanical condition of the cars they sell. Whether acquiring the car in dealer-to-dealer auctions[76] or from private individuals,[77] a competitive dealer must understand the car's mechanical condition to make his best buy. He knows a car's defects and uses this knowledge later against the retail purchaser. This knowledge serves as the rationale for a dealer's selling a car "as is." Dealers often receive further defect information through independent inspections by "warranty insurers."[78] Should insurance inspectors find too many mechanical defects, they will not warrant the car. These cars are then sold "as is."[79]

Despite their superior ability to detect mechanical defects, used car dealers are understandably reluctant to disclose these defects.[80] Dealers generally represent autos as being in "good" or "very good" condition, but these oral promises are usually unenforceable.[81] When dealers do disclose specific defects, they are usually minor and obvious, implying no major problems exist.[82] Results of one survey determined that purchasers who were warned of specific major defects encountered fewer post-sale re-

74. FINAL STAFF REPORT, *supra* note 8, at 93-95 (citing NATIONAL ANALYSTS, INC., REPORT ON A SURVEY OF BUYERS OF USED CARS). Factors contributing to this low figure include expense, uncertain mechanic reliability, inconvenience and dealer reassurances.

75. FINAL STAFF REPORT, *supra* note 8, at 93-97, 103-13.

76. Most dealer auctions require sellers to fully disclose any known defects. All sales are revocable upon subsequent inspection by purchaser-dealers. *Id.* at 71.

77. Dealers employ professional appraisers to test-drive and inspect autos before they purchase these cars. The appraisers are widely recognized as experts at identifying defects upon brief inspection. *Id.* at 72-75.

78. *Id.* at 81.

79. Sellers are often aware of defects in cars which they resell after repossessing them. Buyer defaults are often caused by overburdensome repair bills. Many dealers, such as car rental and leasing agencies, are intimately familiar with the car's repair history. *Id.* at 81-83.

80. *Id.* at 112-30. One survey found 58 percent of dealers told purchasers the auto had been inspected, yet only 15 percent acknowledged *any* defects existed. *Id.* at 114.

81. *Id.* at 113 (survey found that dealers represented 94 percent of the cars they offered as being in "good" or "very good" condition).

82. *Id.* at 108.

pair problems than those who were not.[83]

The current market does not encourage disclosure. Honest dealers lose sales to dishonest dealers who do not rely upon return sales. These dishonest dealers will not disclose an automobile's true condition; in fact, these dealers will use general statements to reassure buyers of mechanical soundness.[84] Because buyers lack the knowledge necessary to distinguish honest from dishonest claims, these dealers are rewarded.

Although used autos are not uniform products, prices are currently based upon averages, because buyers cannot evaluate them individually.[85] Automobiles in the same categories of model, year and mileage are priced similarly. These prices are based upon consumer expectations regarding *average* previous wear.[86] The averages, reflected in wholesale prices, discourage owners of well-kept autos from selling to dealers.[87] Dealer disclosure of defects would create prices that more accurately reflect an auto's value.[88] More disparate and accurate pricing would encourage sale of well-kept autos by private owners to dealers and improve the quality of dealer-marketed cars.

Dealers should disclose major mechanical defects they know exist in the used cars they offer. Current knowledge disparity between buyer and dealer creates unequal bargaining power and prices that do not accurately reflect an auto's value. If buyers were more familiar with the used auto's condition and "actual cost," they could make more informed decisions. They could also negotiate prices that more accurately reflect true value[89] and purchase cars they could realistically afford after repair costs. Furthermore, increased consumer knowledge would also en-

83. *Id.* at 115 (survey found that 30 percent of the purchasers informed of defects experienced post-sale problems, whereas 40 percent of unwarned purchasers experienced mechanical trouble).

84. *Id.* at 132.

85. *See supra* note 26.

86. FINAL STAFF REPORT, *supra* note 8, at 133-36.

87. *Id.*

88. *Id.* at 67-70.

89. *Id.* Surveys showed that when purchasers are informed of major mechanical defects, approximately 70 percent asked dealers to repair the defect before purchase, often accepting a price increase in return. Yet, some buyers may prefer a defective car at a reduced price, as a "fixer-upper." *Id.* at 65-69; *see also* AUTOMOBILE CLUB OF MISSOURI, STUDY REGARDING THE CONDITION OF VEHICLES PURCHASED AS USED CARS (1977); CALIFORNIA STATE AUTOMOBILE ASS'N, STUDY REGARDING THE CONDITION OF VEHICLES PURCHASED AS USED CARS (1977).

courage dealers to focus pre-sale expenditures on repairing defects rather than hiding them.

Dealers argue that "as is" auto purchasers are receiving discounts because they are willing to "take a gamble." But they fail to note that used auto prices are increasing as more consumers look to the industry for their primary transportation source.[90] Despite dealers' concerns, there is no reason to believe that requiring known-defect disclosure would raise used auto prices significantly. To the contrary, dealer disclosure would attract higher quality cars into the dealer market.

These bargaining inequities between purchasers of used cars and dealers now make legal reform imperative. Legislative or administrative enactments similar to the FTC rule would appear to be the optimal solution because of their definitive and documentary character. Yet, such action appears politically infeasible despite its popular appeal. In view of this legislative standstill, it is now incumbent on the judiciary to protect the consumer through the expansion of common law theories. In particular, courts could extend liability for nondisclosure based on a fraud cause of action.

Expansion of Liability Through a Fraud Cause of Action

Courts traditionally adhere to the general rule that mere nondisclosure is not fraud.[91] Vendors are required to disclose a product's material hidden defects only when (1) the vendor/purchaser relationship is fiduciary, or (2) the vendor's *affirmative* statements would be misleading absent such disclosure.[92] These limited rules, unfortunately, have not cured used auto dealer/purchaser inequities[93] because courts have failed to find that vendor/purchaser transactions involving used cars fit within either of these two exceptions to the general rule. Despite buyer reliance upon dealer knowledge,[94] the normal used auto dealer/buyer rela-

90. *See supra* notes 46-47 and accompanying text.

91. Stone v. Lawyer's Title Ins. Corp., 537 S.W.2d 55, 67 (Tex. Civ. App. 1976); Wiechman Eng'rs v. California, 31 Cal. App. 3d 741, 751-52, 107 Cal. Rptr. 529, 535 (1973); Zanbetiz v. Trans World Airlines, Inc., 72 Ill. App. 2d 192, 201, 219 N.E.2d 98, 103 (1966). Fraud traditionally includes the following elements:

> A representation was made as a statement of fact, which was untrue and known to be untrue by the party making it, or else recklessly made; that it was made with intent to deceive and for the purpose of inducing the other party to act upon it; and that he did in fact rely upon it and was thereby to act to his injury or damage.

Am. Jur. 2d *Fraud and Deceit* § 12 (1968).

92. *See generally* W. Prosser, Law of Torts § 106, at 696 (4th ed. 1971).

93. *See supra* text accompanying notes 51-90.

94. *See supra* text accompanying notes 67-84.

tionship has not been characterized as fiduciary.[95] Further, a dealer's general representations regarding overall quality may not always establish a duty to disclose specific defects;[96] this is generally a question of fact. This "half truth" distinction creates a dealer manipulation scenario: a dealer will say enough to reassure buyers, yet avoid making statements which would create a full disclosure duty. That is, many dealers completely avoid addressing a car's trouble areas.[97] Thus, under current law, a half-truth imposes fraud liability, while complete nondisclosure does not.

Absent special relationships or affirmative representations, courts are recognizing that a vendor may be required to disclose a product's material defects which the purchaser is not competent to detect.[98] California courts, among others,[99] have carved out a

95. One party's dependence upon the other's superior knowledge may establish a fiduciary relationship. *See generally* 37 AM. JUR. 2D *Fraud and Deceit* § 16 (1968). Yet a thorough search disclosed no case holding that a used auto dealer owes such a duty to a used auto purchaser.

96. *See, e.g.*, Barni v. Kutner, 45 Del. 550, 76 A.2d 801 (1950) (dealer not liable in fraud for representing that used auto was in good condition but not disclosing the car's defective brakes); Roby Motors Co. v. Cade, 158 So. 850 (La. Ct. App. 1935) (used truck sold "as is" placed purchaser on notice of all defects, despite seller's alleged assurances that the truck was in generally good mechanical condition); Randall v. Smith, 136 Ga. App. 823, 222 S.E.2d 664 (1975) (dealer's representations that a used car was in "good condition" were merely the salesman's "puffing" and statements of opinion). *But see* Edwards v. Port AMC/JEEP Inc., 337 So. 2d 276 (La. Ct. App. 1976) (even though sale was "as is," representation that the used car had been checked and was in sound condition was fraudulent when a serious transmission defect was later discovered); Neil Huffman Volkswagen Corp. v. Ridolphi, 378 So. 2d 700 (Ala. 1979) (dealer liable in fraud for failing to disclose $2,000 in major defects after representing car was in good condition with only minor damage). *See also* Ford Dealer's Ass'n v. Dept. of Motor Vehicles, 32 Cal. 3d 347, 650 P.2d 328, 185 Cal. Rptr. 453 (1982). The California Supreme Court overturned an injunction against enforcement of administrative regulations holding dealers liable for "misleading" statements made by salespersons to prospective purchasers. The court also held that the Department of Motor Vehicles may define certain types of statements as inherently misleading. The regulation required dealers to disclose a used car's prior use as a rental vehicle or taxi cab. The court held that a failure to so disclose would be misleading.

97. *See supra* note 83 and accompanying text.

98. W. PROSSER, LAW OF TORTS § 106, at 697-98 (4th ed. 1971).

99. *See, e.g.*, Obde v. Schlemeyer, 56 Wash. 2d 449, 353 P.2d 672 (1960) (realty seller must warn purchaser that house suffers termite infestation); Crum v. McCoy, 41 Ohio Misc. 34, 322 N.E.2d 161 (1974) (vendor had duty to warn buyer that property lacked adequate water supply, despite "as is" sales clause and buyer's inspection of premises); Hauben v. Harmon, 605 F.2d 920 (5th Cir. 1979) (held that Florida state law required vendors to disclose material facts not readily discoverable by the buyer). *See generally* Annot., 8 A.L.R. 3D 550, 559 (1966).

specific exception to the general rule in the context of realty sales. A realty vendor has an affirmative duty to disclose material facts to his vendee;[100] any breach of that duty constitutes fraud.[101] When a realty seller knows facts materially affecting a property's value or desirability and also knows that "such facts are not known to, or within the reach of the diligent . . . observation of the buyer, the seller is under a duty to disclose [these facts] to the buyer."[102] When a seller's failure to disclose induces buyer action, the vendor is liable in fraud.[103] Neither an "as is" clause[104] nor a buyer's actual inspection[105] will discharge this duty. This disclosure duty should be extended to used auto sales where buyers lack the knowledge or skill necessary to make intelligent purchasing decisions. Used auto purchasers require and deserve no less protection than do realty purchasers.[106]

---

100. Lingsch v. Savage, 213 Cal. App. 2d 729, 29 Cal. Rptr. 201 (1963) (seller's agent must disclose building is in a "state of disrepair" despite contract clause stating buyer took property "in its present state and condition"); Clauser v. Taylor, 44 Cal. App. 2d 453, 112 P.2d 661 (1941) (realty sale rescinded where vendor did not disclose that house rested on filled land); Orlando v. Berkeley, 220 Cal. App. 2d 224, 33 Cal. Rptr. 860 (1963) (realty vendor required to disclose termite infestation, although no affirmative statements were made regarding termites).

101. Lingsch v. Savage, 213 Cal. App. 2d at 736, 29 Cal. Rptr. at 205.

102. *Id.* at 735, 29 Cal. Rptr. at 207.

103. *Id.* at 737-38, 29 Cal. Rptr. at 205-06.

104. In *Lingsch*, the sales contract, signed by all parties, stated the buyer took the property "in its present state and condition" and "no representations, guarantees or warranties of any kind or character have been made . . . which are not herein expressed." *Id.* at 733, 29 Cal. Rptr. at 203. The court held such clauses generally mean "the buyer takes the property in the condition visible to or observable by him." The clause did not excuse the vendor's disclosure duty. The court stated that their interpretation "not only makes good sense but equates sound law with good morals." *Id.* at 740-43, 29 Cal. Rptr. at 208-09; *see also* Crawford v. Nastos, 182 Cal. App. 2d 659, 6 Cal. Rptr. 425 (1960) ("as is" clause only meant the purchaser accepted the land "as seen by her"); Orlando v. Berkeley, 220 Cal. App. 2d 224, 33 Cal. Rptr. 860 (1963) (neither "as is" clause nor specific waiver of termite clearance excused vendor's duty to disclose termite infestation or damp rot); CAL. CIV. CODE § 1663 (West 1973) (stating liability for fraud may not be contractually excused). *Contra* Driver v. Molene, 11 Cal. App. 3d 746, 90 Cal. Rptr. 98 (1970) ("as is" sales clause, coupled with purchaser's exceptional skill and experience, relieved seller's duty to disclose concurrent condemnation proceedings regarding property sold).

105. *See, e.g.*, Oakes v. McCarthy Co., 267 Cal. App. 2d 231, 73 Cal. Rptr. 127 (1968) (buyer's inspection did not excuse vendor's duty to disclose that house rested upon filled land, despite no purchaser inquiries).

106. California courts have recognized this need for protection in the case of odometer misreadings. An action for fraud may lie where a dealer knew, or should have known, that his representations as to the mileage of the car were false, and that the representations were made to induce the purchase of the car. Munchow v. Kraszewski, 56 Cal. App. 3d 831, 835, 128 Cal. Rptr. 762, 765 (1976) (finding made even though dealer expressly disclaimed any warranty or representation as to the accuracy of the mileage on the odometer).

One court has extended protection in another area. *See* Liebergesell v. Evans, 93 Wash. 2d 881, 887-88, 613 P.2d 1170, 1176-77 (1980) (held that a borrower had a duty to inform the lender that a proposed interest rate was illegal and that, absent

A used car dealer's liability under a fraud theory should be expanded to include nondisclosure of major defects for the same reason that tort liability presently exists for dealers who fail to disclose *dangerous defects*—the purchaser's inability to detect such defects. The *Restatement of Torts* requires that a vendor who knows his product contains dangerous defects must so inform buyers.[107] This warning need only be given if the seller has reason to believe the buyer will not discover the defects. Vendors failing to disclose defects are liable in tort for resultant injuries.[108] In recognizing that used car purchasers normally lack adequate mechanical skill, courts consistently apply this duty to used car vendors.[109] The vendor's disclosure duty is based upon the foreseeability that purchasers will not discover mechanical defects which the dealer can detect.[110] Still, this duty is limited to defects which cause accidents and liability is limited to resultant injuries. This reasoning should be extended to all major mechanical defects. Although no threat to physical safety may be involved, the economic loss for uninformed buyers may be great. As in other areas of tort law, an actionable harm should not be limited to physical injury.[111]

---

a fiduciary relationship, a duty to disclose relevant information could be implied by a contractual duty to deal in good faith); *see also* U.C.C. § 1-203 (1977).

107. RESTATEMENT (SECOND) OF TORTS § 388 (1965).

108. *Id.*

109. Johnson v. Ernest G. Beaudry Motor Co., 170 F. Supp. 164 (D.C. Ga. 1958); Hembree v. Southard, 339 P.2d 771 (Okla. 1959); Thrash v. U-Drive-It Co., 158 Ohio St. 465, 110 N.E.2d 419 (1953).

110. Gaidry Motors, Inc. v. Brannon, 268 S.W.2d 627, 629 (Ky. Ct. App. 1954). Most states also require that dealers reasonably *inspect* used cars for safety defects. *See, e.g., id.*; Thrash v. U-Drive-It Co., 158 Ohio St. 465, 49 Ohio Op. 402, 110 N.E.2d 419 (1953); Benton v. Sloss, 38 Cal. 2d 399, 240 P.2d 575 (1952); *see also* WIS. ADMIN. CODE § MVD 24.03(5)(6)(a)2 (1974); N.Y. VEH. & TRAF. LAW § 301 (McKinney 1970).

111. Pure economic loss is becoming more widely recognized as an actionable harm under a negligence cause of action. *See, e.g.*, Fentress v. Van Etta Motors, 157 Cal. App. 2d Supp. 863, 323 P.2d 227 (1958) (awarded recovery against an auto manufacturer based on a negligence claim resulting from safety defects which caused damage to the automobile itself only); Sabella v. Wisler, 59 Cal. 2d 21, 377 P.2d 884, 27 Cal. Rptr. 689 (1963) (awarded negligence recovery based on a finding of negligence against the contractor for not properly testing soil which caused damage to the house, depreciating its value; award was for depreciation only); J'Aire Corp. v. Gregory, 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979) (restaurant operator recovered damages in negligence due to a contractor's unnecessary delay in finishing the construction work ordered even though restauranteer was not a party to a construction contract); *see also* Rabin & Grossman, *Defective Products or Realty Causing Economic Loss: Toward a Unified Theory of Recovery*, 12 SW. U.L. REV. 4, 31-35 (1981) (suggests recovery under a theory of negligence for

Even the use of an "as is" clause often will not discharge a dealer's duty to disclose latent, dangerous defects.[112] In *Kopischke v. First Continental Corp.*,[113] the Montana Supreme Court held an "as is" clause did not relieve a used car dealer's duty to detect and disclose steering defects. The court found that the dealer would have discovered the defect if he had conducted a reasonable safety inspection, and held that although the "as is" clause effectively waived implied warranties, it did not make the buyer's ignorance regarding the defect and the resulting injury any less foreseeable.[114]

Some courts base negligence liability in an "as is" clause context on its finding of what the buyer intended to accept "as is." In *Turner v. International Harvester Co.*,[115] a used truck's weak frame collapsed and crushed the purchaser two years after purchase. In an action for negligence and strict liability, the court held that a jury could determine which defects the parties intended to be excused by the "as is" clause.[116] This emphasis upon purchaser intent demonstrates the courts' reluctance to allow "as is" clauses to impose constructive knowledge of defects upon used auto buyers.[117]

In some instances, the use of an "as is" clause may waive negligence liability regarding certain defects if vendor/buyer mechanical skill and knowledge is substantially equal. In *Stapinski v. Walsh Const. Co., Inc.*,[118] a construction company sold a used truck "as is" to a private security company. The company's

---

economic damage to personal property should not be limited to damage caused by violent occurrence). *See generally* Annot., 16 A.L.R. 3D 683, 690-94 (1967) (citing cases affording buyers a negligence claim against manufacturers resulting from defects caused by product deficiency alone).

112. *See* Mulder v. Casho, 61 Cal. 2d 633, 394 P.2d 545, 39 Cal. Rptr. 705 (1964) (presence of an "as is" clause did not relieve the dealer's statutory duty to sell an automobile with safe brakes).

113. 610 P.2d 668 (1980).

114. *Id.* at 675, 679; *see also* Flemming v. Stoddard Wendle Motor Co., 70 Wash. 2d 465, 423 P.2d 926 (1967), in which the Washington Supreme Court stated that an "as is" clause seems to prima facie disclaim warranties but does not excuse a dealer's duty to disclose latent, dangerous defects. The defendant seller did not warn the buyer, a used car dealer, that the car would start in any gear. When the buyer's employee accidentally started the car in "drive," the car lurched forward and crushed the plaintiff. The court held that, despite the purchaser's extensive mechanical knowledge, the seller had reason to believe he would not have the opportunity to detect this type of defect before it created a danger.

115. 133 N.J. Super. 277, 336 A.2d 62 (N.J. Super. Ct. Law Div. 1975).

116. *Id.* at 281, 336 A.2d at 66. The court stated that the parties could have intended the clause to cover all defects, only safety defects, or only those not discoverable upon the buyer's inspection and test drive. *Id.* at 287, 336 A.2d at 73.

117. FINAL STAFF REPORT, *supra* note 8, at 262-65 (surveys indicate used auto buyers are often unaware of even the warranty-waiver effect of an "as is" clause).

118. 395 N.E.2d 1251 (Ind. 1979).

agents inspected the truck before the purchase and performed monthly maintenance work on the trucks, including grease work. The truck had a loose grease fitting at the time of purchase which caused an accident fifteen months later. The court held that the "as is" clause excused the seller's duty to discover and disclose the defect because the seller was not a used car dealer and the purchaser had ample, perhaps superior, opportunity to discover the defect.[119]

Negligence law recognizes the unequal mechanical skill between the used auto dealer and purchaser. This recognition creates a dealer's duty to inspect cars for safety defects and disclose those he finds to purchasers. Absent exceptional purchaser knowledge, an "as is" clause will not put the purchaser on notice of these defects. Yet, the dealer's liability is currently limited to defects which actually cause physical injury and property damage.

The foregoing demonstrates that consumers commonly suffer considerable injury because they cannot determine a used car's overall mechanical condition before purchase. Recognizing the seriousness and scale of the used auto problem, courts should extend the dealer's *disclosure* duty to all known major defects, not just dangerous defects. This requirement would place no additional burden upon used auto dealers and would benefit both the market and individual consumers.

CONCLUSION

The FTC Used Car Rule was proposed to remedy serious market problems caused by unequal understanding between used auto purchasers and dealers. The rule was defeated because the used auto industry misinterpreted its requirements and exaggerated its potential effect. Used auto purchasers remain seriously underinformed and unprotected, particularly those who purchase "as is." The "as is" purchaser should better understand the condition of a car when he buys it so he may bargain a reflective price and more realistically understand the total cost. The courts should recognize the used auto purchaser's exceptional vulnerability, as they have with realty purchasers. Considering the used auto dealer's current disclosure duty under negligence due to

119. *Id.* at 1252-54.

their familiarity with the condition of the cars they offer, requiring that he disclose all known major defects would not be an unreasonable extension. Failure to disclose should now constitute actionable fraud.

DOUGLAS DEXTER