



CONSUMER PROTECTION IN THE
USED CAR MARKET:
WARRANTIES AND INSPECTIONS

by
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PART ONE -- Theoretical Analysis

I. The Used Car Market

Introduction

Attempts to provide protection for the consumer in the used car market have centered around two ideas: warranties and inspections. Australia and New Zealand both have systems of mandatory warranties for used cars purchased from dealers (but not from private individuals), and Quebec has just released a draft consumer protection law¹ that provides for mandatory used car warranties.

In addition to warranties made mandatory by law, consumers have tried to protect themselves by having cars inspected by

¹ Quebec, Ministre des consommateurs, cooperatives et institutions financieres, "Projet de code de protection du consommateur", deuxieme volet, 14 juillet, 1978

automobile clubs or service stations. Inspections provide independent expert information so the consumer can avoid unexpected problems.

In this paper I will consider two alternative systems to protect used car buyers. One system uses mandatory warranties and optional inspections while the other is based on mandatory inspections and optional warranties. Both systems will be evaluated using the theoretical economic analysis developed elsewhere by the author.² The recent Australian experience in New South Wales with a mandatory warranty law will be looked at closely to provide factual information to supplement the theoretical analysis.

The analysis suggests that a system of mandatory warranties and optional inspections, while providing additional protection for some used car buyers, does so relatively inefficiently and inequitably. The experience in New South Wales lends substantial support to this view. In contrast, a system of mandatory inspections and optional warranties should provide better protection for the consumer and do so at lower cost.

² Spencer Star, An Economic Analysis of Warranties and Product

Liability, forthcoming, Consumer Research and Evaluation Branch, Consumer and Corporate Affairs, Government of Canada. Contact Mr. Jonathan Guss, (819) 997-1018.

Goals of Consumer Protection

The two goals of consumer protection in the used car market can be broadly described as deterrence and compensation. Deterrence is the attempt to prevent certain kinds of losses from occurring. Compensation is used to improve a consumer's welfare after a loss takes place. The need for compensation arises because deterrence is not 100 per cent effective.

In the used car market losses result from defects that are unknown to the buyer at the time of purchase. When a buyer is aware of a defect before the purchase, he takes the defect into account in arriving at his estimate of a fair market price. A loss, in the sense of an unexpected decline in the car's value, occurs because the consumer lacks information about the car's true condition.

II. The Importance of Information

Three Kinds of Information

It should be obvious that we do not have the resources or desire to prevent every possible kind of loss. We must be selective and choose which kinds of losses have a good chance of being deterred at a reasonable cost. Then we must consider compensation for those losses that still occur. The classification of information into three groups provides a guide as to the cause of losses, how they can be deterred, and the problems of compensation.

The first kind of information is knowledge about obviously apparent defects. A typical consumer who makes a brief inspection of a car should be able to spot these. Are the tires bald? Are windows broken? Does the car start easily? Information about these kinds of defects is called simple prepurchase information.

The second type of information is more complex and requires expertise to discover and evaluate. Is the engine running rough because the timing needs a simple adjustment or because the valves need to be reground? Is the car's frame twisted? Is there a serious structural problem due to rust? The former owner of a car acquires a great deal of this kind of information from his own experience and from reports when the car is taken in for repairs. Dealers can be expected to have access to this information through diagnostic testing. All this kind of information is potentially available to the buyer before he made his purchase. I call this expert prepurchase information or, more simply, expert information.

The third type of information cannot be discovered at a reasonable cost before the purchase. Steel belted radial tires can rupture because the steel threads rub against the body creating a dangerous build up of heat. The metal in a gear may have a hairline crack rendering it likely to break under stress. I call information of this sort postpurchase information.

Simple Prepurchase Information

Although a defect may be obvious to a consumer, he often does not know the cost involved in making a repair, thus putting the defect partially in the expert prepurchase information category. Also, if there are many defects, a consumer may find it difficult to keep track of them and to incorporate their total effect in his valuation of the car. But, by and large, the consumer can be expected to cope with obvious defects. Unexpected losses involving simple prepurchase information will, therefore, be relatively unimportant. Since the potential losses are, on the average, going to be small, an expensive effort to deter these kinds of losses or to compensate consumers who sustain them would not be justified on a cost-effectiveness basis.

Some deterrence is still necessary, however, because half of the consumers are, by definition, less intelligent buyers than the average consumer. Bald tires may be obvious to the average used car buyer, but there are many buyers who would think a bald tire is good for another 5,000 miles. Adequate deterrence to protect the less-aware consumer might be accomplished if the seller were required to provide a written list of defects with the estimated cost of repair for major items.

Any unexpected losses that would still occur would likely be quite small. Thus compensation would be a very minor issue. Compensation might be required in cases where an unknowledgeable consumer was deliberately misled. But otherwise it appears that a

major compensation plan to protect used car buyers must be based on the unexpected losses associated with the two other types of information.

Expert Information and Two Consumer Protection Plans

This is the area in which consumer protection can be most effective. A consumer has several choices. He can do without expert information, or he can rely on the seller to provide it, or he can obtain it from an independent source. Clearly, if deterrence of unexpected losses is our goal, the choice narrows between relying on the seller or obtaining independent advice. Let's look at warranties and inspections as two different methods of obtaining expert information.

Mandatory Warranties. Typically, a mandatory warranty plan creates an incentive for full and honest disclosure by relying on the combination of a warranty and exclusion clauses. The warranty covers all defects not specifically excluded in writing. Consequently, the seller can limit his warranty liability by revealing problems with the car's current condition.

A dealer must balance two offsetting incentives. If he reveals certain defects and the cost of repairing them, he gains by limiting his liability under warranty. But he also loses because the car cannot be sold for as high a price. The lower selling price is an

immediate and certain effect. The liability for repairs occurs in the future and is subject to the willingness and ability of the consumer to enforce the warranty. The difference between the consumer's theoretical rights and the practical difficulties of enforcing them substantially lessens the dealer's incentive to provide a thorough inspection or to reveal known defects.

Consumers, under this system, have an incentive to maximize the compensation received for defects appearing during the warranty period. We will see from the New South Wales experience that consumers will wait until a few days before the end of the warranty and then order a very detailed auto inspection. After receiving the inspection, which is tailored to the warranty law, the consumer returns to the dealer with a complete list of defects. He then demands that the repairs be made.

It should be emphasized that the inspections which developed in New South Wales are quite thorough. For the average car, they take approximately one and one-half hours and cost C\$39. Prices will be denoted C\$ for Canadian dollars and A\$ for Australian dollars.) Over 94 different questions are answered and a written summary is provided. Keep in mind that the inspections in New South Wales are optional while the warranties are mandatory.

Three major disadvantages can be associated with this type of mandatory warranty system.

First, the cost of the warranty is hidden in with the price of the car. This makes it very difficult to obtain an accurate

estimate of the effect warranties have on the prices of used cars. Uncertainty about future warranty expenses can lead to much larger margins, with dealers paying less for cars they buy and charging more for those they sell. We will see that this is a serious problem in New South Wales. For example, the lowest estimates I received of the average increase in selling price of used cars were from C\$200 to C\$400, while some estimates of the added margin were several times higher. I found no support for the often quoted statement of Mr. Jim Freeman, chairman of the Used Car Committee in South Australia, that the warranty system led to a reduction in advertising costs that more than offset the higher warranty costs.³ Or at least no evidence that these savings were passed on to consumers.

The second disadvantage of the mandatory warranty system is that warranties are only offered on cars bought from dealers. Since as many as half the used cars in Canada are bought and sold privately, mandatory warranties may not even touch the majority of transactions.

Third, the information about defects that dealers present in exclusion clauses is not from an unbiased source. There still remain

³ Jim Freeman, Chairman of the Used Car Committee of the South Australia Automobile Chamber of Commerce, "How South Australian Dealers Have Coped with the Secondhand Motor Vehicles Act", speech printed in the VACC Journal, March 1973, pp. 35-36.

many different methods by which the unscrupulous dealer can take advantage of the customer. The value of a warranty is greatly dependent on the cost and difficulty of enforcing it against a reluctant dealer. For example, one practice noted in Australia is for a dealer to declare a car not yet ready for sale; it therefore does not have the list of excluded defects. The dealer will tell the customer that the car can be bought and will proceed to sell it, preparing the list of excluded defects after the sale. Although the practice is considered illegal, it occurs not infrequently.

Mandatory Inspections. The plan using mandatory warranties takes an indirect approach to provide expert prepurchase information. I would like to propose an alternative more direct approach that involves mandatory inspections while leaving the decision about a warranty as an option in the hands of the consumer.

The general outline of the proposal is this. Require that all cars have a detailed inspection (much more detailed than the simple safety inspections now required in several provinces) within a fixed number of days or miles before the sale takes place. The inspection would be carried out by an independent third party. The kind of inspection would be prescribed by government regulation. Warranties would have to be offered by dealers, but they would be purchased at the buyer's option. The warranty would be sold separately from the automobile. The coverage of the warranties would be regulated by law.

The warranties involved in this plan are specifically related to automobiles and are in addition to any implied warranties that exist. The effect of optional warranties on implied warranties should be considered in more detail by legal scholars.

My proposed mandatory inspection plan is designed to meet and overcome the three weaknesses of the mandatory warranty plan.

First, prices could be easily monitored so that the economic impact of the law could be more simply estimated. I could not help but be struck by the fact that the New South Wales law was currently being revised, but that no one was able to collect hard empirical evidence about its present impact on prices or the industry structure. The data they had were based on interviews and off the cuff opinions. If, however, we compare the low estimates of C\$200 to C\$400 cost per car for warranties (keeping in mind their soft empirical foundation) with the C\$39 cost of an inspection, the proposed inspection system is unequivocally less costly.

Second, the inspections would apply to all private sales as well as to sales by dealers. Thus the deterrence of losses by mandatory inspections is not only more efficient, it provides a wider and more equitable coverage. The inclusion of private sellers in the protection system should help to prevent serious structural changes in the market of the type experienced in New South Wales, where there was a large market shift away from dealers and toward private sellers.

Third, the proposed inspections would be performed by independent third parties. I anticipate that economies of scale exist so that the quality of an average inspection would be higher and its cost lower than the average inspection currently available. It remains an open question in my mind as to whether the government should perform the inspections itself or merely regulate their content.

Both systems would achieve the goal of deterring losses by making expert information available, but the proposed mandatory inspection plan with optional warranties would provide deterrence more efficiently and more equitably. However, before one system can be chosen as preferable over another, a third category of losses must be considered.

Postpurchase Information

Regardless of how thoroughly someone, even an expert, inspects a car, some problems will only become apparent after the car has been driven further. Since these kinds of defects cannot be discovered prepurchase, there is no way to deter the related loss from occurring.

However, the market price does take into account the general reputation a car has for reliability and the likelihood of further unknown problems occurring. Thus, some brands and even certain models or years of the same brand depreciate more rapidly. Depreciation is

also based on a combination of mileage and age of a vehicle, which reflect the increased risk of certain parts ceasing to function.

To the extent that the selling price of used cars are lower to reflect the probability of latent defects, buyers on the average do not sustain losses when the defects actually occur. They receive compensation in advance through a relatively lower purchase price.

But not every consumer has the same luck as the average person. It is the unlucky buyer that we are interested in, the buyer who despite all the available prepurchase information finds he has bought a lemon.

We know there is no way of deterring this from happening. Unlike the other types of defects, better information does not help. This is true of either a mandatory warranty or of a mandatory inspection scheme.

The central question is what kind of insurance should be available to compensate for these kinds of losses. A mandatory warranty plan insures only those people who purchase cars from dealers. Consumers can exercise their choice over warranty coverage only by choosing between buying privately or from a dealer. The dealer loses all consumers who do not want to pay the extra price for warranties.

Under the proposed optional warranty plan dealers would be required to offer warranties, but they would leave the final choice to the consumer. The price of the warranty would be separate from the

price of the automobile. The advantages of this plan are that it enables the government to track the economic effect of the law on prices and that it makes use of the competitive market system to develop a market in warranties.

One possible weakness is that dealers who do not want to bother with warranties may charge very high warranty prices to discourage their purchase. But the forces of competition will come to the aid of the consumer.

Since every dealer must offer the warranties, there will certainly be a number of dealers offering them at reasonable prices. If the warranties were standardized, following, for example, the warranty system proposed by Quebec, a consumer could compare warranties and their prices relatively easily.

Therefore, if a particular dealer discourages the purchase of a warranty with a high price, this should be his right. The main concern is that enough dealers offer warranties at competitive prices so as to provide the consumer a reasonable set of choices. I believe it very likely that warranties offered in the mandatory inspection and optional warranty framework will sell at prices substantially below what would occur in the other system. Competition and easily compared prices almost invariably serve to help hold prices down. One should also keep in mind that the warranties will only cover those defects not discovered in the very detailed automotive examination and which show up within the warranty period. I would expect that the

warranties would be structured also to cover the repairs of defects that were originally in the excluded category.

III. Evaluation of the Two Plans

The two warranty plans can now be compared.

Both plans offer deterrence, but the mandatory inspection plan deters losses for all consumers while the other plan does so only for those who buy from dealers. For the mandatory warranty plan we can expect higher prices and a loss of volume through dealers' showrooms and car lots as more buyers switch to private sellers. And there is no simple way to measure the impact of the legislation on car prices because the warranty price is included with the car price.

In comparison, the mandatory inspection plan provides unbiased expert information to people who buy from private sellers as well as those who use dealers. The price of an inspection is out in the open. The Australian experience indicates it is about 1/10 the cost of a warranty.

Both plans offer compensation through warranty insurance, but the mandatory warranty plan gives consumers a choice only by choosing the kind of seller they use. The optional warranty plan allows consumers to stay with dealers and to still have free choice.

On the basis of the economic analysis both plans move toward the goals of deterrence and compensation. But the plan with mandatory

inspections and optional warranties does it more efficiently and more equitably.

PART TWO -- The Experience in New South Wales

IV. Used Car Warranties in NSW

Introduction

The first legislation providing a system of express warranties specifically for used cars was passed in South Australia as the Second Hand Motor Vehicle Act, 1971. After South Australia broke ground, New Zealand and most of the other states in Australia followed suit with similar acts of their own. The act considered to be the strongest is the New South Wales Motor Dealer Act, 1974. New South Wales (NSW) was thus chosen to be the target of further research about the impact of warranty legislation.

In June, 1978, I spent 10 days in Sydney, Australia, interviewing officials and collecting information about used car warranties in NSW. In this part of the paper I will report the major finding and integrate them with the analysis already presented.

Some Background

New South Wales is one of 6 states (plus 1 territory and the federal capital) in Australia. Its population is about 4.8 million

people of which 2.8 million or 60 percent live in or around Sydney. In Sydney the winters are mild and short, without snowfall, while the summers are hot and dry. Although I was there during the winter season, I might note that some of the summers I spent in Vancouver were colder and wetter.

There are about 3 million registered private cars in NSW. The Australian automobile market is quite protected, there being five domestic manufacturers for the total Australia population of 15 million. This results in car prices being perhaps 30 to 40 percent higher than in Canada. The foreign exchange rate is roughly \$1.30 Canadian to buy \$1 Australian.

The Consumer Affairs Bureau of NSW is responsible for administering the Motor Dealer Act 1974 (hereafter called the Act). The Commissioner of Consumer Affairs is assigned responsibility for keeping a register of Motor Vehicle Dealers and for the direct administration of the Act.

The Act was passed in 1974, but was not proclaimed in all its parts until July, 1976. Thus, there have been about 2 full years of experience. At the time of my visit, the Consumer Affairs Bureau was preparing to propose several revisions to the Act.

Essentials of the Act

The Act provides that used car dealers must offer a warranty on all cars for which the original offer price is between A\$500 and

A\$20,000. For cars selling from A\$500 to A\$999 the warranty is 2 months or 3000 kilometers (1,800 miles); for cars from A\$1,000 to A\$20,000 the warranty is 3 months or 5,000 kilometers (3,000 miles). Cars selling for less than A\$500 need only have a safety inspection certificate. The current plan is to raise the limit at which warranties start from A\$500 to A\$1,500.

Every car being offered for sale must have a dealer's notice on it, which consists either of a form 4 or 6. Form 4 provides a warranty without exclusions while form 6 provides a warranty subject to exclusions noted in writing. An estimate of repair costs for excluded defects must be included in form 6; the dealer is liable for repair costs above the estimate and for defects not specifically excluded. Copies of forms 4 and 6 are reproduced on the following 2 pages.

V. Dispute Resolution to NSW

In the event of a dispute over a warranty claim the consumer has a choice among three alternatives: the disputes committee, the consumer claims tribunal, and the court system.

Disputes Committee

This committee was set up specifically to deal with automobile warranty complaints. It is financed out of the revenues

DO NOT WRITE ON THIS SECTION

Part below second perforation is for use on the vehicle for sale.

Affix part below perforation to vehicle:—

1. To the inside surface of the near side of the windscreen of the vehicle.
2. To the near side internal sun visor of the vehicle.
3. To the top of the dashboard of the vehicle on the near side or in such a position that it is clearly visible from immediately in front of the vehicle.

CONSUMER
AFFAIRS
BUREAU

FORM 4
MOTOR DEALERS ACT, 1974
Section 24 (1)

REGISTER SERIAL

MTA No 99983

DEALER'S NOTICE—Part 1

DEALER			
BUSINESS ADDRESS			
Make of Vehicle		Engine No.	
Model Series		Chassis No.	
Model Designation OR Year of Manufacture		Odometer Reading	km miles
Body Type		Date Notice affixed to vehicle	/ /19
Cash Price \$		Registration No.	

Signature of Dealer,
Agent or Employee.....

Print Full Name

**THE ODOMETER READING IS THE READING AT THE TIME THE VEHICLE WAS BOUGHT,
EXCHANGED OR TAKEN IN POSSESSION FOR SALE BY THE DEALER.**

WARRANTY

\$1,000 (cash price) and over—3 months or 5 000 kilometres (whichever first occurs).

\$500 (cash price) and over—2 months or 3 000 kilometres (whichever first occurs).

Less than \$500 (cash price) no warranty, but purchaser must receive a Certificate of Inspection for roadworthiness for the vehicle, issued not earlier than one month prior to sale date.

NOTE: "A person shall not, without the prior consent in writing of the Commissioner, be competent to waive any rights conferred on him by this Act and the purported waiver of any such rights without that consent is of no effect." (S. 44).

This Vehicle is being sold on behalf of another Dealer namely:—

DEALER

ADDRESS

FORM 6
MOTOR DEALERS' ACT, 1974
Section 29 (1)

CONSUMER
AFFAIRS
BUREAU

DEALER'S REGISTER
SERIAL No.

DEALER'S NOTICE

DEALER			
BUSINESS ADDRESS			
Make of Vehicle		Engine No.	
Model Series		Chassis No.	
Model Designation OR Year of Manufacture		Odometer Reading	km miles
Body Type		Date Notice affixed to vehicle	/ /19
Cash Price \$		Registration No.	

Signature of Dealer,
Agent or Employee

Print Full Name

ODOMETER READING is the reading at the time the vehicle was bought, exchanged or taken in possession for sale by the dealer.

This vehicle contains the following defects:

PARTICULARS	Estimated Fair Cost of Repair or making good that Defect

The cost of repairs up to the estimate shown for each item is the responsibility of the Purchaser. Under the Act the dealer is only obliged to (1) repair or make good unlisted defects, or (2) pay the difference where the fair cost of repairing or making good a listed defect estimated by the dealer is less than the fair cost of then repairing or making good that defect.

from automobile dealers' license fees. Consumers pay no fee to use it.

For warranty cases involving used cars there are three members. The Chairman is the Assistant Commissioner of the Department of Consumer Affairs. The Executive Director of the MTA (Motor Traders Association) represents the dealers. The Chief Engineer of the NRMA (National Roads and Motorists Association) represents consumers. For a warranty involving a new car a fourth member representing new car dealers is added. Under contemplated revisions a member of the automobile unions will be added to the committee.

The Disputes Committee works in the following way. A buyer with a complaint must return the car to the dealer and give him the first chance to make the repair. The warranty period is extended by the time the car is with the dealer.

If the dealer will not make the repairs, makes them unsatisfactorily, or delays making them, the buyer calls the Committee. A staff member will try to reach the agreement with the dealer by phone. If that is impossible the buyer will be sent a form, called a Notice of Dispute, to be returned to the Commissioner. The Notice provides for a brief description of the dispute.

The Committee then sends an inspector and another officer to meet with the dealer and customer at the dealer's office. The inspector is an expert mechanic; another officer goes along to act as

a witness. The customer signs an agreement to pay for the cost of necessary dismantling if it turns out the defect is due to owner abuse. Then the car is inspected.

The inspector makes a decision on the spot. He can decide to split the costs for repairs in any proportion. The meetings usually take between one and two hours and resolve 95 per cent of the disputes. At the end of the meeting the inspector makes a written report of his recommendations.

Either party can object to the inspector's decision and ask for a referral to the Disputes Committee. The Committee receives the inspector's report and a written brief from each party. Neither the buyer nor seller appears before the Committee at this point. The Committee then makes its decisions in the form of a recommendation to the Commissioner. No recommendation has yet been overruled by the Commissioner.

One final step remains. If either party is dissatisfied with the Committee's decision, he may request a hearing in person before the Commission. This is very rarely needed.

A summary of some statistics will put the Committee's work in perspective. They receive 100 to 150 phone calls per week. About 50 of these require meetings with inspectors. All but 2 or 3 cases are resolved at this stage. The 2 or 3 cases get referred to the Committee, which calls a meeting every two weeks or so. About half a dozen cases are handled at a meeting. Only a couple times a year is there a request for a rehearing.

I was fortunate to be able to attend a meeting of the Disputes Committee. Six cases were discussed that day and one of them involved a personal appearance for a hearing.

The Committee impressed me as being efficient and fair. For example, in the first case the problem was with a faulty transmission. The inspector brought in the gear cog and explained that since all the teeth were severely bent it was not a defect in the metal but rather very hard driving that caused the problem. Since the fault appeared after the sale, it was judged a case of owner abuse. The dealer did not have to pay for the repairs.

The next case involved a personal appearance. Only the buyer was able to attend, the dealer having a conflicting appointment. The Committee had previously decided the dealer did not have an obligation. The problem was noise in the transmission. The inspector said his written report was not clear on the point, but he believed the noise was a defect. The dealer in a letter also referred to the noise as a defect, but said it was due to towing a trailer. The inspector brought in evidence on factory recommended load limits which indicated the consumer was not at fault. After hearing the consumer present his case the Committee reversed its prior decision and made the dealer liable.

The biggest problem the Committee faces is obtaining evidence that clearly indicates where the responsibility lies. When the facts

of who said what are in dispute there is often no simple way to determine who is at fault; and mechanical problems do not always indicate clearly whether the customer was contributorily negligent.

In the light of the difficulty of obtaining a preponderance of evidence, the committee uses a rule of strict liability with a partial defence of contributory negligence. If a part does not function, the dealer is liable unless it can be shown the consumer's behaviour caused the problem. Where it appears that both parties are at fault the costs are apportioned.

Direct consequential damages to other parts of the car that result from a warrantied defect are also included under the warranty. But consumers are not allowed to recover for consequential damages other than those affecting the car.

The committee receives enough complaints to have developed a record of certain problem dealers. But there is no mechanism, other than refusing a licence, for the committee to penalize these dealers.

I was able to develop some interesting figures on the cost of operating the Disputes Committee and its team of inspectors.

The Committee is almost complete self-financing. It collects a A\$100 annual license fee from each of the 3,400 dealers. Twenty-five per cent goes into a fund to compensate consumers who face firms that are out of business or insolvent. The other 75 per cent, or A\$250,000, pays the Committee's expenses and salaries.

The Committee deals with 5,000 to 7,000 telephoned complaints per year for an average cost of A\$35 to A\$50 per phone call. If we consider only the cases for which inspectors are needed, there are 2,500 cases per year for an average cost of about A\$100 (C\$130) per case.

Consumer Claims Tribunal

These tribunals are roughly equivalent to Canadian small claims courts. They were established under the Consumer Claims Tribunals Act 1974. For a fee of A\$2.00 the consumer will have his case heard by a referee who takes evidence under oath, but in a very informal manner. The referee must have regard to what is "fair and equitable", but does not have to pay attention to legal principles.

There are only two grounds for appealing a decision: denial of natural justice and lack of jurisdiction. Jurisdiction is limited to transactions under A\$1,500, that are less than 2 years old, and that have been entered into by a consumer, not a business. Natural justice essentially requires that both parties have had a fair opportunity to present their case.

Hearings at smaller regional offices are held within 6 weeks of the initial filing. At the Sydney office the wait is 3 or 4 months. But as the number of claims is growing rapidly, the waiting time will likely increase.

Automobile cases go to the Claims Tribunal sometimes because the Disputes Committee can only consider statutory warranty disputes. Thus, a complaint about a repair not made under a warranty or a complaint about misleading advertising would go to the Claims Tribunal.

There is one other reason for going to the Tribunal that the Disputes Committee does not care to advertise. The consumer must make a choice as to which group will hear his case, and he cannot appeal to the other group after a verdict has been rendered. But he can switch groups anytime before the final verdict is entered. If, for example, on the basis of the mechanic's recommendation to the Disputes Committee the consumer believes the decision will go against him, he can switch to the Claims Tribunal.

I estimate the total cost of hearing and making a decision to average about A\$75 (C\$90) per case. This is about 25 per cent less than the cost of hearings for the Disputes Committee; the difference probably being due to the on site visits of the mechanics in the warranty cases. About 4,000 cases will be heard before the Tribunal in 1978, split among the four regional offices. There were 3,200 cases heard in 1977, indicating a 25 per cent one-year increase. Figures are not available on the proportion of automobile cases. It does not appear that the Disputes Committee has siphoned off many cases from the Tribunals; instead it seems as if new fields of consumer dissatisfaction have been tapped.

The Court System

Any consumer has the right to use the ordinary court system to resolve a dispute, but he foregoes this right if he makes use

of either the Disputes Committee or the Claims Tribunals. The court system, as in Canada, is used primarily for major disputes and is quite costly.

VI. Inspection in NSW

Three Types of Inspections

The NRMA (National Roads and Motorists' Association) provides three types of general auto inspections for its members: Newspec, Warspec, and Autospec. There are also a number of specialized inspections available such as gearbox, transmission, or body work inspections.

Newspec is an inspection of a new car before the buyer takes delivery from the dealer. The car is usually driven to one of the metropolitan inspection centres where over 170 items are checked. The average new car has from 15 to 30 defects that are discovered with this type of inspection. In a few cases dealers themselves will ask for a Newspec in order to be sure a car is properly prepared for a special customer. About 4,000 Newspecs are done per year.

Warspec is a thorough inspection for new cars just before the end of their warranty period. Defects found which are considered to be warrantable are recorded and an annual report is sent to the manufacturer. All the Australian Auto Associations cooperate with this system. The inspection is recorded on computer readable sheets and is designed for computer analysis. About 12,000 Warspecs are done per year.

Autospec is designed specifically for used cars near the end of the warranty period. The inspection usually takes about 1½ hours to perform and includes a roadtest. Inspections for more complex cars can take as much as 3 hours to do. Most of these inspections are performed when the car is brought into the branch garage, but the inspection can be done on site, although it is somewhat less thorough. A list of essential and optional repairs is presented with their estimated labour cost. About 54,000 Autospec examinations are done each year.

Inspection Costs

The cost for each inspection is A\$30 (C\$39) for the typical car and \$46A (\$60C) for specially complex cars such as a Mercedes or Jaguar. The NRMA has about 60 mechanics who do inspections with a goal of 20 inspections per mechanic per week. Thus, about 1,200 inspections are performed per week.

An NRMA official noted that mechanics in large dealerships are becoming very specialized and often know only one brand of car very well. The NRMA demands mechanics familiar with the whole range of brands and, therefore, must undertake some in-house training.

An interesting point was made with respect to the estimation of labour time for repairs. Apparently, manufacturers have two sets of standard rates: one when the public pays and one when the manufacturer pays. The warranty repair times are presented in pamphlets distributed by the manufacturers while the standard times

are in a large book. The warranty times are considerably shorter. Dealers complain that times allowed for warranty work are too short since they are based on times for well-trained factory mechanics.

The heavy demand for the NRMA's inspection services indicates a strong consumer desire for useful information. Since the inspections are available only to NRMA members, there is probably an additional large but untapped demand.

VII. Some Problems with the Warranty Law

Cost of Warranties

A government official estimated that warranties added A\$150 to A\$200 to the selling price per car, while an industry representative mentioned a A\$200A cost to recondition a car; the sum needed after reconditioning to cover warranty claims, would be rather small, perhaps A\$50 per car. A consumer spokesman estimated the total margin had gone up substantially more than these estimates (he estimates by about A\$500) because in addition to the higher selling price, the purchase price dealers are paying has dropped.

In some visits I made to used car dealers I noted that there was almost no cars for sale in the A\$500 to A\$800 range. Since an increase in price from A\$499 to A\$500 moves the car into the mandatory warranty group, it appears that many dealers do add on roughly A\$300 per car.

Changes in Market Structure

One reaction of consumers has been to move away from dealers toward private sellers. Entrepreneurs have taken advantage of this to open large flea markets for cars. A shopping center parking lot may be rented for a Sunday and sellers are charged \$15A per car for a display space. NSW has a warm climate and a strong tradition of large weekend outdoor markets, so these Sunday car markets attract hundreds of cars and many buyers. They also attract quasi-professional dealers, called backyard dealers, who buy and sell for a living, but on a small enough scale so they escape regulation.

Another type who has profited from the law is the car broker. For \$50A he will buy or sell a car for you, but the purchase is made between private parties. The broker does not take title. It is possible to have a lot with a number of cars on it but to act only as a broker rather than as a dealer.

Perhaps the biggest thorn in the dealers' side has been the expansion of auctions. Auctioned cars are not covered by warranties. Previously, auctions were used to wholesale cars from one dealer to another. Now, a large proportion of the cars are auctioned to private buyers. On the one hand this has raised the price that dealers have to pay to stock a lot, but on the other hand it allows them to get better wholesale prices. Also, some dealers run auctions, thus providing a conflict of interest and a great deal of debate among the dealers.

The dealers have been lobbying to require warranties to be mandatory on auctioned cars sold to individuals. They also want operators of Sunday markets to post a bond to guarantee the clear title to all cars sold on their lots. Apparently, NSW has a problem with titles because there is no registration of an encumbrance on a vehicle. If a bank makes an automobile loan, the car is registered in the individual buyer's name with no mention of the bank's claim.

If the dealers would be successful, the auctions and Sunday markets would probably no longer be open to private buyers. This would close off an important avenue of consumer choice. The need for these private markets arose, of course, because of the mandatory nature of the warranty law.

An alternative proposal by the dealers is to raise the minimum price that must be reached before a car must be warranted. Apparently the dealers have gained this point because plans are to raise the minimum price to A\$1,500 (C\$1,950). This will allow dealers to compete with private sellers, auctions, and Sunday markets on a greater range of cars.

Deceptive Practices

The warranty law has not forced dishonest dealers out of business, although it has given consumers a better chance against them. The Disputes Committee noted that some dealers show up frequently while others almost never have a dispute.

One of the shady practices used by some dealers is to list excluded defects in very general terms. For example, "the engine runs rough and smoke comes from the exhaust." The law states that the defects must be described with "reasonable particularity" (Sect. 29(1)). Undoubtedly, a dealer can still write the terms so as to gain an advantage in a dispute with a consumer who does not thoroughly know the applicable law.

Some dealers have found another way to mislead consumers. The law provides that cars not affixed with a dealer's notice, that is, a warranty, must have the following notice posted: "Notice. This vehicle is not for sale until a dealer's notice is attached." Some dealers will have entire rows of cars posted with a price and the "Not for Sale" form. Dealers sell the car first, then describe the defects. Although this is technically illegal, it still occurs often enough to be an important problem.

VIII. Conclusion

We have seen that the consumer's problem in the used car market is that he lacks enough good, unbiased information to know in advance what a car is really worth. He buys a car and then finds out it has a number of defects, which create unexpected losses.

A system of mandatory warranties with exclusion clauses, such as the NSW system, is designed to deter these losses by creating an incentive for the dealer to reveal defects, thereby limiting his warranty liability.

The problems with mandatory warranties are that they are expensive, they change the structure of the industry and hurt dealers, they restrict consumers' range of choices, they leave the consumers who purchase cars privately completely unprotected, and they do not curb deceptive practices.

In contrast, the proposed plan for mandatory inspections with optional warranties is much cheaper (perhaps 1/10 the cost) and it should not cause a change in the industry structure. It will enable price effects of the law to be tracked easily, and it leaves consumers with a free choice about whether to buy a warranty from a dealer. Because the information about the automobile's current condition is provided by third party experts, it should make it much more difficult for dealers to continue deceptive practices. Inspections are applicable to private sellers as well as dealers, thus protecting all buyers.

The NSW Disputes Committee appears to be quite relevant for Canada. It has been working for two years and seems to be doing an excellent job. Moreover, it is completely self-financing from dealers' fees.

A system that contains mandatory inspections, optional warranties, and a disputes committee would appear to provide a realistic, efficient, and equitable method to protect the consumer in the used car market. It is, therefore, the system I recommend.