Auto Advisory Services

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You "Auto" Know

Inside this issue:

Watch Out for Flood Damaged Trades

Although it seems somewhat trivial in comparison to the tremendous humanitarian tragedy that occurred when hurricane Katrina hit the Gulf Coast Monday, August 29, we feel it is important to pass on a warning to dealers about flood damaged vehicles. Experience suggests that many flood damaged vehicles may end up in auto auctions, such as Texas auctions popular with some California dealers. Flood damaged trades from private parties are also likely.

Earlier this month, NADA issued a press release containing tips on how to spot a flood damaged vehicle. The following is taken verbatim from that press release:

> While there is no sure way to detect vehicle flood damage, NADA offers 10 inspection tips that may be used to detect significant water damage. At a minimum, a prospective buyer should:
>
> 1. Check the vehicle's title his-

(Continued on page 2)

California Supreme Court Rules Lemon Law Doesn't Apply to Vehicles Purchased Out of State

In August, the California Supreme Court issued its decision in *Cummins, Inc. v. Superior Court (Edward Cox)* (36 Cal.4th 478). The court was asked to determine whether a lower court was correct in ruling that the Song-Beverly Consumer Warranty Act (a/k/a "the lemon law") applied to vehicles repaired by manufacturer representatives in this state even if the vehicles were purchased elsewhere.

The case involved a Winnebago motorhome purchased by plaintiffs Edward and Sandi Cox in Idaho. The motorhome had a Cummins engine. Plaintiffs took possession of the motorhome in Idaho and drove it to their home in Riverside, California. Plaintiffs allege they brought the vehicle in for repairs at Cummins Cal Pacific, Inc. (an authorized Winnebago/ Cummins facility) in California "at least eight times." When the problems were not corrected, they sued Winnebago and Cummins for breach of warranty and violations under California and federal warranty laws.

The California Supreme Court overruled the Fourth District Court of

(Continued on page 3)

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Watch Out for Flood Damaged Trades (Cont.)

(Continued from page 1)

tory, it may state whether it has sustained flood damage;

2. Examine the interior and the engine compartment for evidence of water and grit from suspected submersion;

3. Check for recently shampooed carpet;

4. Look under the floorboard carpet for water residue or stain marks from evaporated water not related to air-conditioning pan leaks;

5. Inspect for rusting on the inside of the car and under interior carpeting and visually inspect all interior upholstery and door panels for any evidence of fading;

6. Check under the dashboard for dried mud and residue, and note any evidence of mold or a musty odor in the upholstery, carpet or trunk;

7. Check for rust on screws in the console or other areas where the water would normally not reach unless submerged;

8. Look for mud or grit in alternator crevices, behind wiring harnesses and around the small recesses of starter motors, power steering pumps and relays;

9. Complete a detailed inspection of the electrical wiring system looking for rusted components, water residue or suspicious corrosion; and

10. Inspect the undercarriage of other components for evidence of rust and flaking metal that would not normally be associated with late model vehicles.

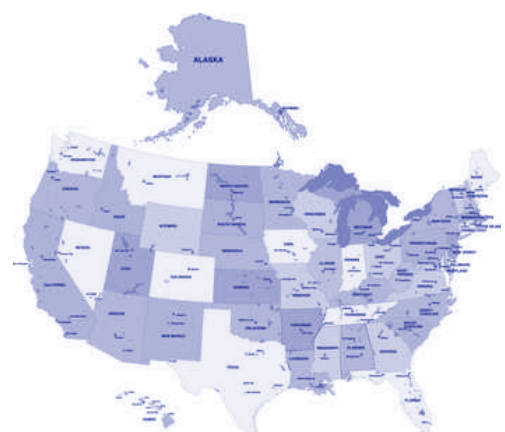
Lemon Law (Cont.)

(Continued from page 1)

Appeals and held that a customer must purchase a vehicle in California in order to take advantage of California's lemon law. The fact that attempts to repair the vehicle were made in California does not create liability for the repair facility under the Song-Beverly Act.

As a refresher, here are some bullet points on California's lemon law:

- Vehicles are presumed to be a "lemon" if during the first 18,000 miles or 18 months they have undergone four or more repair attempts or the vehicle has been out of service for more than 30 calendar days; and the customer has notified the manufacturer directly of the need for repair.
- If the mechanical problem with the vehicle results in a condition likely to cause death or serious bodily injury, the presumption arises after only two repair attempts to correct the problem, rather than four.
- Manufacturers, distributors, dealers and lien holders are prohibited from requiring any form of "gag order" on a lemon law repurchase. That is, a consumer has the right to disclose problems with the subject vehicle and the terms of the reacquisition. In short, a consumer can get restitution and continue to complain about the manufacturer and dealer.
- Vehicles for personal and/or household use are covered under the lemon law. Vehicles used for business purposes are also covered under the lemon law so long as only five or fewer motor vehicles are registered to the same person or company and each has a gross vehicle weight under 10,000 pounds.



Backdating Purchase Contracts Still Not a Good Idea

In January of 2003, we reported on a federal court ruling out of Virginia that held the backdating of a purchase contract amounted to a Truth in Lending Act violation. (*See Backdating Contracts May be in Violation of Federal Law*, YOU "AUTO" KNOW, January 2003.) We warned California dealers that although the case was not controlling authority in our state, the reasoning was sound and we expected to see similar suits brought in California. Our prediction has come true.

We have received various reports of lawsuits brought against dealers from San Diego to San Jose alleging the backdating of contracts is illegal. The suits follow the same theory used by the plaintiffs in the *Rucker v. Sheehy Alexandria, Inc.* matter decided in 2002. In that case, a customer purchased a vehicle and took immediate delivery. The dealer was unable to obtain financing under the terms of the agreement upon which the customer took delivery, however, a finance company provided the dealer with terms under which they would provide financing. After bringing the customer back, the dealer

(Continued on page 4)

Backdating Purchase Contracts (Cont.)

(Continued from page 3)
rewrote the contract to reflect new (and less favorable) terms and backdated the rewritten contract to the date of the original sale/delivery. The customer then took delivery under the terms of the new contract.

The court explained that under Regulation Z, consummation is defined as "the time that a consumer becomes contractually obligated on a credit transaction." Under that definition, the court reasoned that once the first contract is canceled (i.e., rescinded) for failure to obtain financing, the subsequent contract represents the ultimate obligation between the parties and therefore constitutes the consummation of the transaction. Since a dealer is required to provide an accurate APR disclosure prior to consummation (under Regulation Z), the court held that in backdating the contract, the APR is misrepresented insofar as it is calculated based upon a date that is earlier than the date of actual consummation. The court ultimately held that the APR was understated by 0.4 percent.

If you are still backdating purchase contracts, you are simply playing with fire. Granted, under some backdating circumstances, the APR may still be accurate enough to pass regulatory muster (meaning that the error is within the Regulation Z tolerance threshold of 0.125 percent). However, it is risky to assume this and calculating the actual APR on a backdated contract is not easy. Therefore, it remains our strong opinion that dealers must not backdate purchase contracts. In the event you are working with a finance company that still requires re-written contracts to be backdated, we recommend you demand such a policy in writing (and ideally forward it to us for review). We have yet to see any such written policy issued by either a captive or non-captive auto finance company.

Associations Launch Major Hurricane Relief Efforts to Assist Dealership Employees

The National Automobile Dealers Charitable Foundation (NADCF) has begun a nationwide fundraising effort to assist the thousands of dealership employees that have been affected by hurricane Katrina. The unprecedented damage inflicted on Louisiana, Mississippi, and Alabama by the category four hurricane will undoubtedly impact dealership employees and the dealers themselves. "People may return home with no house to return to, no car left, and they may not have a job to return to," says Bob Israel, executive vice president of the Louisiana Automobile Dealers Association.

NADA is encouraging dealers to support this effort by sending donations to:

NADCF Emergency Relief Fund
8400 Westpark Drive
McLean, VA 22102

The American International Automobile Dealers Association (AIADA) announced the creation of Emergency Relief Auto Jobs, a program to help find temporary jobs for displaced dealership workers. Through this program, AIADA will compile a database of workers and then match their qualifications with jobs submitted by AIADA members. Dealers who would like to participate in this program may contact AIADA by visiting www.aiada.org/aiadajobs, e-mailing autojobs@aiada.org, or calling (800) GO-AIADA.

Adverse Action Notices: Are You Sending Them?

There has been considerable buzz in the auto dealership legal world concerning adverse action notice requirements under the Fair Credit Reporting Act (FCRA) and the Equal Credit Opportunity Act (ECOA). The renewed attention is largely due to a couple of confusing cases recently decided in federal courts. We won't bore you with the details, but we will suggest that you revisit (or establish) your adverse action notice policies.

Whenever this subject is discussed with dealers, there are invariably two questions raised. They are: (1) "How can we avoid having to send out these notices?" and (2) "Why should we be concerned? It is the banks who make credit decisions, not us."

It is true that if you do not make credit decisions, but rather leave it completely in the hands of the financial institutions with which you work, then you are likely to avoid the law's requirements (although at least one court has held to the contrary). However, to truly operate under this umbrella of protection you would have to submit every application for credit – no matter how ridiculous it is – to a financial institution for their consideration. If they deny the application then they are obligated to send the notice of adverse action. Unfortunately, there are a number of factual situations wherein vehicle dealers open themselves to exposure. It is appropriate to take a look at just a few of these examples.

"No Credit" Applicants

Oftentimes unemployed persons are eternal optimists and think perhaps they can purchase a vehicle on credit. They complete a credit application and request that you consider them for an extension of credit. Even the salesperson is able to recognize there is not a chance credit would be extended. The person is politely notified that there is "no way" they will be able to secure credit. In this instance, the dealer would be obligated to provide a written notice of adverse action.

The Credit Challenged

Envision the situation where a customer has completed an application for credit and things look promising. You thereafter run a credit report and discover numerous collection accounts, a very low credit score and a recent bankruptcy filing.

At this point, some dealers will stop the entire application process and simply tell the customer that credit will not be extended. A written notice of adverse action would be required under this scenario.

Phone or Internet Apps

Upon receiving phone or Internet credit applications, a dealer may run a credit report and discover the applicant has very bad credit. If the dealer subsequently decides not to sell a vehicle to the customer on credit without submitting the application to a finance company, then the dealer must provide the written notice of adverse action.

Rollback Sale When Financing Is Unavailable

California dealers using the standard Law® 553 installment sale contract retain the right to rescind the contract if the dealer is unable to assign the contract to a finance company with which it regularly does business.

What dealers may not appreciate, however, is that once a financial institution refuses to accept a contract for assignment, the dealer is arguably now the sole remaining creditor in the transaction. They are faced with the decision whether to carry the contract in-house or elect to rescind. Most dealers elect to rescind.

It is arguable that this subsequent election to rescind is adverse action such that a notice is required. Conversely, it may be argued that, for all intents and purposes, the original contract contemplated the credit decision of a financial institution and therefore, if the financial institution sent the notice, then that was all that was required.

Whether a dealer is required to send a notice when it elects to rescind is not clear. Conservative advice is to recommend the sending of a notice. Procedures could be set up whereby every time a transaction is rolled-back because of failure to obtain financing, a written notice of adverse action is sent to the customer.

Note: This is not intended to be a comprehensive discussion of this topic. For a more thorough discussion, please see YOU "AUTO" KNOW, *Adverse Action Requirements Waking Up*, October, 2002.

A good, compliant adverse action form designed for dealers' use is the LAW® 722. To order this form, please contact Reynolds and Reynolds at 1-800-344-0996.

Legal Article:
Why F&I Shouldn't Be F&I

Rob Cohen, Esq.

Payment packing is illegal. Unless this happens to be the first thing you have ever read about F&I, this should not be new information. For over a decade, attorneys general, plaintiff attorneys and dealer attorneys have been saying—make that screaming—that the practice of payment packing is unfair, deceptive, and downright illegal. Yet, I still hear of repeated instances where dealer personnel are engaging in the practice. What's a dealer compliance attorney to do?

Instead of continuing to warn dealers about the possible ramifications of payment packing, I have decided to concentrate on the prevention and detection of it. Along those lines, what I am about to propose may shock some and vindicate those that are already doing it. I propose dealers eliminate the selling of financing in F&I. Let me explain.

Evolution of "The Leg"

Under traditional payment packing, the sales manager (a/k/a "the desk") would merely add about $25 of "air" to the payment during negotiations. Upon closing the deal (and assuming the customer failed to negotiate away the pack), there was a "leg" left in the deal for F&I. I know this, not because I have read about it in consumer rights publications or heard stories from salesman. Rather, I experienced this practice firsthand in the first dealership I ever worked. As a young and inexperienced car salesman, I was told not to worry about things such as interest rates and contract length. "Just work the payment," my sales manager told me. I was taught to answer questions about how the payment was calculated with, "Oh, the finance department will explain that to you."

Honestly, I didn't even know the payments I was quoting to customers were packed until I had already sold about 20 cars. Call me naïve, but in my defense, I was only 19 at the time.

For reasons unrelated to payment packing, that dealership is now closed, but the practice lives on. Granted, the nature of the packing has evolved somewhat. Perhaps in response to widespread litigation, or all that screaming I mentioned, dealership personnel have moved away from traditional payment packing and moved toward the more subtle rate and term packing techniques. Although these practices may be more subtle, they are just as problematic for dealers as the traditional payment packing methods.

Rate packing works like this. The desk will run the credit of a prospective buyer and, knowing full well the buyer has A+ credit, calculates the monthly payment using an interest rate that is well beyond what an A+ credit customer would normally receive and even higher than the rate on which the finance company would be willing to pay reserve. Once the deal is closed, the desk has effectively left a leg in the deal for finance. Finance personnel will drop the rate down to the maximum rate on which they can receive reserve and put some products in the deal. After all, there is no economic reason to submit a contract to a finance company with an interest rate above the maximum rate on which they will pay reserve. The customer is then presented with expensive options or service contracts "for only a few extra dollars per month" or "for no extra charge." To accomplish this, the finance writer merely writes down the APR and adds the options accordingly.

Term packing works the same way except that instead of using an inflated APR to close the customer, the desk or closer uses a shorter term (i.e., 36 or 48 months) to calculate the quoted payment. Then, once in F&I, the contract is written at 60 months and options are included (again for little or no extra charge).

These modifications of the old shell game are just as improper, unethical, and illegal as traditional payment packing.

The real challenge for dealer principals and upper management is in the detection of these types of practices. Oftentimes it is difficult to know whether some of your employees are engaging in this type of bad behavior. Clearly, if you discover your employees are engaging in packing of any kind, you must take immediate disciplinary and corrective steps. However, what if you don't find out?

A Solution

In light of the fact that packing (in any form) is difficult to audit for and/or uncover, I propose taking the finance out of F&I. Put simply, payment, rate, downpayment and term should all be set by the desk/sales manager and locked into place upon closing the customer. As a matter of policy, finance personnel should not be allowed to change the rate, term, or downpayment. If individual circumstances require a change in any of these, then the sales manager must be called back in and the customer "re-closed." However, with

(Continued on page 7)

Legal Article:
Why F&I Shouldn't be F&I (Cont.)

(Continued from page 6)

proper disclosure early on in the negotiations and proper sales manager training, customers will generally not try to re-negotiate the terms once in F&I.

For this approach to work properly, the worksheet (or foursquare) must include full finance disclosures. Specifically, when presented to the customer, the worksheet should include the monthly payment, APR, downpayment, and length of contract. Penciling deals back with just monthly payments is "old school" and a practice that needs to stop.

The main objection I often hear to this approach is that sales managers aren't as knowledgeable about the finance programs offered and the credit requirements of individual lenders. My response to this is, "They should be." If sales managers are quoting payments, then they are running credit bureaus. And if they are running credit bureaus, then they are likely making financing decisions. I have found that when sales managers are not knowledgeable about finance program requirements, they tend to over-quote the rate to be safe. This sets the stage, perhaps unwittingly, for rate packing to occur.

With rate, term, and downpayment locked prior to the customer going into F&I, the finance representative will focus on two things: selling products and explaining all the documents to the customer (including those that contain the finance terms previously agreed upon).

With full disclosure made to the customer on the worksheet, auditing for payment packing or other aggressive sales techniques becomes much easier. An auditor can easily see how the exact terms of finance were arrived at by looking at the worksheet. The auditor can then follow those numbers directly to the installment contract. Any deviation should be properly explained through documentation in the deal.

I know this strays from customary practice and creates commission issues (based on finance reserve) that must be addressed. But, look what this accomplishes:

1. It dramatically reduces employees' ability to engage in payment packing.
2. The customer is aware of the exact terms of financing very early on in the sales process. This transparency creates more trust and eliminates "APR shock" in F&I (which often requires finance personnel to "re-close" the deal).
3. Finance personnel can spend more time on selling products and explaining documents.
4. Avoids Truth in Lending Act violations by preventing finance personnel from telling customers their interest rate will be lowered if they purchase a service contract (or other options).
5. It leaves a clear audit trail for self-regulation.

So, if we eliminate financing from F&I and take into consideration the fact that in some jurisdictions (such as California) dealerships no longer sell insurance, we reach the inescapable conclusion that F&I shouldn't really be called "F&I." Given this, I think I would like to start a one-man campaign to promote a name change of F&I to something like "contracting." It just makes more sense to me.

Identity Theft

Is your dealership prepared?

Workshop Schedule

Please Check

☐ October 11, 2005 – Radisson Hotel Los Angeles Westside

☐ October 12, 2005 – Ayres Suites Ontario Airport

Cant attend? Ask about our in-house program!

Who Should Attend?

• Dealer Principals • General Managers
• Controllers • Finance Personnel
• Business Managers • Sales Managers
• Compliance Directors.

Registration Fees

Identity Theft Guide and one attendee, $155. Each additional attendee from same dealership, $60. Guide only, $95 plus tax and shipping & handling.

Identity theft is the number one reported privacy concern and the fastest growing crime in the country. Is your dealership prepared to comply with all the new identity theft laws? More importantly, is your dealership vulnerable to an identity theft scam? Don't know? Then, Auto Advisory Services has a program you will not want to miss.

The Guide

Auto Advisory Services is proud to announce the release of *Automotive Dealership Identity Theft, a Guide to Compliance and Prevention.* Believed to be the first of its kind, this guide is designed to assist dealers in complying with the ever-increasing number of laws and regulations related to identity theft. The publication will also help dealers develop policies and procedures aimed at keeping identity thieves away from your dealership.

The Workshop

Auto Advisory Services is holding informative workshops that will explain all the new identity theft rules and walk you through proper usage of the new Identity Theft Guide. Example discussion topics include: Compliance with New Identity Theft Laws, Credit Bureau Alerts, Freezes and Discrepancies, Dealers as Victims, Detecting the Perpetrator, Disposing of Records, Customer Information and Identification Procedures, Insurance Coverage, Social Security Number Restrictions, and more.

Dealership/Company: ______________________________

Address: ______________ City: ______________ State: ______ Zip: ______

Phone: ______________ Fax: ______________

Attendees (1): ______________ (2): ______________

(3): ______________ (4): ______________

*Please fax this form to **(714) 838-2205**. Mail check to AAS, 14771 Plaza Drive, Suite A, Tustin, CA 92780. Questions? Contact us at (800) 785-2880 or questions@autoadvisory.com.*

______ @ $155 (Includes one attendee and one Identity Theft Guide*) .... $______
Quantity

______ @ $60 (Additional attendees from same dealership, no Guide) .... $______

______ @ $95 (Identity Theft Guide only)* .... $______

Subtotal: .... $______

*7.75% Sales Tax (on Guides only) .... $______

Shipping and Handling ($5 per Guide if not attending seminar):... $______

Total: .... $______

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