

AUTO TRANSACTIONS: UNDERSTANDING THE TRANSACTION

I. INTRODUCTION

Given the almost universal need for transportation, all people end up purchasing cars at several times in their lives. Most people's lack of knowledge about cars coupled with this absolute need to purchase a car makes them prime targets for several types of predatory practices, especially when the sale is financed by the dealer or a related finance company. For most people, their relative lack of knowledge about cars combines with the level of their financial sophistication to create poor financial decisions about car buying.

For car cases, a knowledge of what to look for in the transaction is important because in many cases the real problems may not what the consumer thinks, nor will they always be shown on the face of the documents in the consumer's possession.

To fully advise clients about their financial decisions about car buying requires understanding the whole process by which car dealers sell and finance cars. Understanding that process first requires a basic knowledge of motor vehicle titling procedures and statutes, several federal consumer protection statutes, and the relationships between car dealers and the finance companies that back them.

In addition to the basic aspects of any car sale for cash, when a car dealer decides to finance a car sale, the transaction is then subject to even more regulation as a credit transaction. Consequently in the credit sale of a car, the federal laws that are usually involved include the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the federal Odometer Act, the Magnuson-Moss Warranty Act, the Buyer's Guide Regulation, and FTC Holder Rule. Most states also specifically regulate the sale of cars, the sale of insurance, the way in which interest rates can be charged, and consumer sales. Finally, the general requirements of the Uniform Commercial Code on sale of goods, remedies, and enforcing security interests need to be followed and can provide very clear remedies.

Consumers do need to protect themselves and can do so in a few easy ways in any car sale.

1. All consumers should leave themselves time to shop for a car.
2. If the car is not a new car, then an independent mechanic should be paid to do an inspection and identify any problems.

3. All credit consumers should leave with a copy of the Truth in Lending Act disclosures prior to signing any agreement or any kind and comparison shop the credit terms with at least one other lender before agreeing to any purchase.

4. Fourth, consumers should demand to observe the dealer signing title to the car over to the consumer and ensure that the signed title is delivered immediately to their state's Department of Motor Vehicles or title agency.

An indispensable tool about this area is the National Consumer Law Center's Automobile Fraud book. This manual is updated annually with supplements and available from the Center's website at www.consumerlaw.org.

II. SOME SPECIFIC FRAUDULENT PRACTICES

The yo-yo: In the classic yo-yo sale, the consumer signs a credit contract, is given a temporary registration, temporary license plates, and properly thinks the transaction is complete. The consumer is only waiting for the permanent DMV documents and anticipates making the payments pursuant to the schedule on the credit contract. The dealer does not notify the DMV about the sale. Instead, days or weeks later, the dealer informs the consumer that a new credit contract on different terms must be signed. Sometimes the consumer ends up with a different car, the same car on different terms, or no car at all. Some important questions are what are the terms of the credit contract, do other documents contradict the credit contract, how did the dealer process the title to each car involved, and what was the consumer told about the sale.

For the yo-yo sale, you will want to know exactly how the dealer handled the title to the car. Like most states, Virginia's titling laws are strict and specific. For instance, under 46.2-628, 629, and 631, the dealer is required to sign and deliver the old title to the consumer at the time of delivering the car. The only way to sell a car is for the owner to sign the old title over to the buyer. Allstate Insurance Co. v. Atlanta Casualty Co., 260 Va. 148 (2000). These title statutes are strictly construed and dealers must comply with them. Thomas v. Mullins, 153 Va. 383 (1927); Rawls Auto Auction v. Dick Herriman Ford, 690 F.2d 422, 427 (4th Cir. 1982). These statutes are enacted for the protection of the public and their provisions are mandatory. Thomas v. Mullins, 153 Va. 383, 391 (Va. 1929). Virginia also provides dealers with a Dealer Manual that instructs them on how to process titles, and if the dealer has signed a contract to process title information electronically, then a very particular contract specifies the dealer's duties. The individual state practices and policies need to be known so that you can identify when the dealer is not following them. A violation of the title statutes also makes

the contract unenforceable against the buyer. See *Eure v. Jefferson National Bank*, 248 Va. 245 (1994)(applying the common-law doctrine of unenforceability when a seller violates a statute designed to protect the public).

The basic fraud in a yo-yo sale is making the consumer think the sale was a done deal, when in fact the dealer set it up so that the dealer could call it off, seize the car, and sell it to another purchaser. See *Pescia v. Auburn Ford Lincoln*, 68 F. Supp.2d 1269 (M.D. Ala. 1999)(upholding fraud claim for failure to inform consumer that dealer was treating the sale as contingent). To make the consumer misunderstand the transaction, the dealer will tell the consumer the deal is final and deceive the consumer into thinking the dealer signed title over at the time of sale. Many claims will flow from the dealer trying to claim that the credit contract prepared by it was cancelled when the dealer could not sell it to a third party. Unless the dealer used a properly conditional credit contract, and treats the title, insurance, and date of interest accrual according to that condition, then dealer is stuck accepting the stream of payments agreed to in the first credit contract. See *Walker v. Walker Mobile Homes*, 965 S.W.2d 271 (Mo. App. 1998). In addition to the NCLC Autofraud Manual, discussion of this practice can also be found in section 5.4.5 of its NCLC's Unfair, Deceptive Acts and Practices Manual, Sixth Edition, and is discussed in its Truth in Lending Act Manual, Sixth Edition, section 4.4.5

All yo-yo sales are based on some sort of claimed ability for the dealer to cancel the sale. The contractual basis for that claim must be analyzed to determine if it is merely giving the dealer the ability to pick and choose whether to enforce the contract. "To be lawful consideration supporting such a contract, the promises must be valid — that is, they must promise something detrimental to the promisor or beneficial to the promisee. *See* 3 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts* § 7:14 (4th ed. 1993 & Supp.2005). If one of the parties is free to choose whether or not to perform its promise, there is no binding contract. *See *Busman v. Beeren & Barry Invs., LLC**, No.2005-002650, 2005 WL 3476681, at *2-3 (Va. Cir. Ct. Dec.12, 2005) (finding similar real estate contract unenforceable)." *BCBE Properties, LLC v. Land-O-Sun Dairies, LLC*, 433 F.Supp.2d 723, 726, fn 3 (W.D. Va. 2006). The truth is that a dealer can always sell a credit contract to a buyer if the dealer is willing to sell for the price the finance markets will pay. Thus, a contract can always be sold.

Odometer Act violations: Odometer Act violations are not limited just to misstatements about the car's odometer. Unknown to most people the Odometer Act does not merely require an accurate disclosure. It requires the disclosure to be in a particular place after a car has been titled: on the title document being used to assign ownership of the car. Thus, all used car sales should use the title document for the odometer disclosure. The reason for this is so that the consumer can see the prior information from prior owners that appears on any title document.

Prior-wreck: Selling prior wrecks without proper disclosure is a huge problem in

the industry. Insurance companies like State Farm have admitted to having established practices of putting prior wrecks back out in the stream of commerce without proper disclosure. Some dealers seem to be intentionally selling distressed cars because they can be expected to break down. By selling a car that the dealer knows will quickly develop problems, or be brought back by the consumer, the dealer can obtain down payments from consumers and threaten the consumers with deficiency judgments on unpaid loans. Although a title history will not always disclose that a car was salvage (because of insurance companies repeated violations of law, many title histories are not accurate) it will tell you if one car has been repeatedly sold by one dealer, and that is an indication of this practice.

Used as new: Like the prior wreck, selling a used car as new is both a normal fraud and one that is sometimes related to financing. Jordan v. Suave, 219 Va. 448 (1978) is a good common law fraud case example almost thirty years old. More recently, look at Tuckish v. Pompano Motor Co., 337 F. Supp.2d 1313 (S.D. Fla. 2004) to see that this practice is still around. But remember, the dealer needs to sell the credit contract to a finance company, and the funding criteria of that institution will determine the allowable loan balance. Thus, a dealer may misrepresent the status of the car because more money can be loaned on a new car rather than a used car. For Virginia, the definition of a new car is found in Va. Code 42.6-1500, and each state will usually have its own definition. Pursuant to regulations adopted by the Fair Trade Commission, a used car that must display the FTC Used Motor Vehicle Buyer's Guide, is any car driven more than the limited use necessary for moving or road testing prior to delivery to a consumer. 16 C.F.R. 455.1 This scheme has become more sophisticated because manufacturers are willing to provide substitute Certificates of Origin to some dealers. In these cases, a car that has once been sold and had that sale recorded on the Certificate of Origin will get a new clean Certificate of Origin. It thus will appear to be a new car because the old Certificate of Origin will not have been processed into a title yet. Any car with more miles on it than necessary to moving or road testing is not a new car.

Bait and Switch: Bait and Switch takes many forms, and the yo-yo sale mentioned above is actually one type of bait and switch financing. Many consumers will have responded to a specific advertisement but will not then get the car on the credit terms that were advertised. Locating the ad is the quickest way to develop the case and show the bait and switch. Be sure to check to see whether your state has a False Advertising statute. This will supplement other claims and usually allows for statutory damages.

Other times the bait and switch may be on the price of the trade-in, a practice called lowballing. After the deal is struck, the dealer suddenly realizes the trade-in was

overvalued and needs more money to close the deal. See Peacock Buick v. Durkin, 221 Va. 1133 (1981); for an extensive list of other deceptive practices, see In re Peacock, 86 FTC 1532 (1975).

Another type of bait and switch occurs when the consumer thinks a deal has been negotiated and then is turned over to the finance manager. The finance managers are trained salespeople whose job is to sell additional products in addition to the car. These sales techniques are designed to sell finance-related products whether the consumer wants them or not. If the consumer is not offered a contract on the terms agreed to with the salesman than a bait and switch occurred.

Another type of bait and switch is where the consumer thinks they are entering into a legitimate transaction, but the dealer is instead falsifying information about the credit side of the transaction. The dealer does this so that the dealer can sell the credit contract for more money to an assignee. Sometimes, the assignee will be involved in the falsifications. An enlightening discussion case on this issue is Knapp v. Americredit Fin. Servs., 245 F. Supp.2d 841(S.D. W.Va. 2003). This summary judgment opinion details how the finance company was helping the dealer to falsify documents to make the consumer appear more credit worthy.

Disclosure of credit terms: The Truth in Lending Act, 15 U.S.C. 1601 et seq., requires that the consumer receive these in a form that can be kept prior to the consumer signing them. Polk v. Crown Auto, 221 F.3d 691 (4th Cir. 2000); Lozada v. Dale Baker Olds, 91 F. Supp.2d 1087 (W.D. Mich 2000); Terry v. Whitlock, 102 F. Supp.2d 661 (W.D. Va. 2000). Ask the clients if they received a copy to keep, to put in their pocket, to walk out with, prior to signing. Consumers need to know they are entitled to leave with this document before agreeing to any credit terms, but whether they try to or not the dealer still has to give them physical possession of the disclosures prior to the signing of a credit contract.

If items are included and labeled as options, ask the consumer why they purchased that item. Although checking the basic validity of the APR should be a standard practice, most dealers have programs so that their disclosures initially look accurate. The numbers should not just be internally consistent; they should properly reflect reality.

Many dealers still do not understand that they are the creditor when they write a Retail Installment Sale Contract. They are required to give the TILA disclosures because they have entered into a credit contract with the consumer. Dealers who write such credit contracts need to understand and follow their duties as creditors.

Notices about credit decisions: When dealers do not understand their role as creditors, they end up violating more than just the TILA. The Equal Credit Opportunity Act and

the Fair Credit Reporting Act require notices to consumers when adverse action is taken on a credit application. New regulations are also being developed for the FCRA notice that is required when a consumer report is used to increase the cost of credit made available to a consumer.

The main issue under these cases will be whether notices were required and whether they were sent. A notice is required if the dealer, as the creditor who prepares a RISC, takes an adverse action as long as the consumer does not accept a counter-offer of credit from that creditor.

The NADA has issued guidelines to car dealers regarding ECOA adverse action notices. "Here's what the guidelines say about when a dealer is required to send an adverse action notice:

- When a customer's credit is so bad that you don't send the deal to any finance company
- When you send a deal out to one or more finance companies and no one extends credit to the customer
- When you send a deal out, the finance company wants to extend credit with different terms and the customer refuses the new terms"

See http://www.fi-magazine.com/t_inside.cfm?action=article_pick&storyID=1522.

Insurance issues: When a car dealer also decides to start selling insurance, many other issues arise. States have different disclosures that are required for insurance products, and sometimes it is difficult to determine what disclosures were made to the consumer. For example, in Virginia, for credit insurance to be excluded from the finance charge, the dealer or creditor must disclose the monthly payment and amount financed if no credit insurance is purchased, Va. Code 38.2-3735, but the consumer may no longer have that separate document.

The price of the car: The dealer may inflate the price of the car to a credit customer for many different reasons, but all boil down to the dealer wanting more profit. If you can, determine what the price would have been if the credit customer had paid cash and had no trade-in. A dealer may not charge a credit customer a higher price for the car than would charge a cash purchaser. See Walker v. Wallace Auto Sales, 155 F.3d 927 (7th Cir. 1998). It also may not inflate the cash price to cover any alleged negative equity in a trade-in. Negative equity transactions are common in the industry, and hiding the negative equity is equally common. The consumer will be harmed by this if the consumer paid taxes on that inflated sales price; no consumer should have to pay sales tax on a direct loan from the dealer. Hiding the negative equity is also a fraud on the parties downstream of the transaction who will purchase or invest in the credit contract (usually by way of pools of securitized contracts).

Arbitration clauses: The most dangerous new area for car cases is the exponential growth of arbitration clauses. Bad actors in the economy are using binding mandatory arbitration clauses to perpetuate illegal business practices. Two good websites on this are www.callbeforeyoubuy.com and www.givemebackmyrights.com. The first is specific to car buying and includes helpful hints on car buying and a quick tips sheet. The second is general to the whole range of consumer and employment areas where binding mandatory arbitration clauses are being used to bar Americans from accessing the American justice system. In court, defeating this attack on the American justice system usually ends up being state specific under contract law principles. The NCLC has an excellent manual “Consumer Arbitration Agreements” that should be consulted. More importantly, certain military lawyers can bypass the civil justice system entirely and instead bring criminal actions in federal court based on the same type of claims normally brought in the statutory based civil claims.

On this issue, legislation is currently pending in Congress that would seek to ban binding mandatory arbitration agreements in car contracts. HR 5312, the "Automobile Arbitration Fairness Act of 2008." This proposed legislation builds upon the fact that car dealers have already persuaded Congress that mandatory binding arbitration clauses are unfair when forced upon the dealers by manufacturers.