

**House Energy and Commerce Subcommittee on  
Commerce, Trade and Consumer Protection  
"Consumer Protection in the Used and Subprime Car Market"**

**Testimony of Rosemary Shahan  
President, Consumers for Auto Reliability and Safety  
March 5, 2009**

Chairman Rush, Ranking Member Radanovich, and Distinguished Members, thank you for the opportunity to testify today regarding "Consumer Protection in the Used and Subprime Car Market."

This hearing is indeed timely, given the current meltdown in the automotive marketplace, which has created a devastating ripple effect impacting not only individual car buyers and their families, but also auto manufacturers and dealers, suppliers, auto workers, auto lenders, and our economy as a whole, as well as our ability to address climate change by accelerating purchases of newer, safer, more fuel efficient vehicles.

In fact, the stakes for consumers and for our nation and the environment have never been higher.

**Introduction: Consumers for Auto Reliability and Safety**

Consumers for Auto Reliability and Safety (CARS) is a national, non-profit auto safety and consumer advocacy organization dedicated to preventing motor vehicle-related fatalities, injuries and economic losses. Since 1979, I have advocated on behalf of consumers, and am perhaps best known for initiating and working to gain passage of California's landmark auto "lemon law," which became the model for similar laws enacted in all 50 states.

CARS has spearheaded enactment of numerous first-in-the-nation laws to improve protections for new and used car buyers, signed into law by Governors from both major parties. We have also been on the forefront in the promulgation of federal regulations and Federal Motor Vehicle Safety Standards, including rules to require the installation of air bags, modify the design of seat belts to better fit passengers who are small or large in stature, improve the reporting of auto safety defects and safety recall rates, and other major auto safety improvements.

CARS has long supported successful efforts to reduce risky driving behavior, including graduated licensing for teenagers, prohibiting hand-held cell phone use or texting while driving, maintaining reasonable hours of service for truck drivers, and programs to educate caregivers about proper use of child safety seats and booster seats, as well as laws against leaving children unattended in vehicles.

We also work to educate the public about how to avoid common car buying pitfalls and scams, through our website, the public release of reports, a video with tips for car buyers that is posted on YouTube, and via active outreach in the mainstream media, whenever possible, although auto dealers and manufacturers sometimes pull ads and otherwise attempt to censor the news.

In 1996, CARS spearheaded the consumer groups' petition to the Federal Trade Commission

(FTC) seeking action to curb auto "lemon laundering" of seriously defective repurchased lemon vehicles to unsuspecting used car buyers, across state lines.

Last year, CARS and other consumer groups filed comments with FTC regarding the Used Car Rule, seeking reforms including posting information from the National Motor Vehicle Title Information System (NMVTIS) on the Used Car Buyers Guide and providing a special, prominent warning on total loss salvage vehicles.<sup>1</sup>

Last year, CARS joined with Public Citizen and Consumer Action to bring a lawsuit against the United States Department of Justice to compel the DOJ to finally issue long-overdue new rules to require insurers, salvage pools and junkyards to submit vitally important data regarding total loss vehicles to the National Motor Vehicle Title Information System, or NMVTIS. In a huge victory for car buyers last fall, a federal district court ordered the DOJ to make the system available to the public and issue the final rules by January 31 of this year, and the DOJ has complied. The judge's order and the new rules also require insurers and junkyards to provide data on totaled vehicles to NMVTIS by March 31, 2009. *See Public Citizen v. Mukasey*, 2008 WL 4532540 (N.D. Cal. 2008); 74 Fed. Reg. 5740.

## **Problems faced by America's used car buyers**

### **Car buying problems rank #1 among top consumer complaints**

According to the most recent survey of consumer complaints compiled by the Consumer Federation of America, National Association of Consumer Agency Administrators, and North American Consumer Protection Investigators, new and used car sales, repairs, and service problems once again top the chart of consumer complaints filed with consumer protection agencies.<sup>2</sup>

Motor vehicles have a unique place in American life. For most car buyers, in nearly all parts of the country, a safe, reliable motor vehicle is a necessity of life. A motor vehicle is the second-largest purchase most people make, second only to a home. People depend on their vehicles to transport them and their families to work, schools, day care, sports activities, and medical appointments. Many millions of self-employed people, such as landscapers and real estate agents, and small business owners, such as florist shops and carpet cleaners, depend on them to conduct business.

In today's economy, while new car sales have plummeted, car buyers have shifted toward purchasing used autos, which are usually more affordable, but pose greater risks. While there is some overlap between new and used auto sales and lending practices, since the focus in this hearing is on used cars, the bulk of my testimony will also focus on used car problems and solutions.

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<sup>1</sup> See consumer group comments filed with FTC regarding Used Car Rule Regulatory Review, Matter No. P087604, November 18, 2008. Posted at: [http://www.carconsumers.com/FTC\\_USED\\_CAR%20RULE.pdf](http://www.carconsumers.com/FTC_USED_CAR%20RULE.pdf)

<sup>2</sup> Survey conducted by the Consumer Federation of America, National Association of Consumer Agency Administrators, and North American Consumer Protection Investigators. Among the 39 agencies that responded to the annual survey, there was clear consensus on the following: "The biggest challenges to agencies by far is budget cuts and inadequate staffing. Consumer Agencies say that new laws are needed in car sales...Consumer agencies also cited the need for greater enforcement powers at the state and local level and beefed-up consumer agencies at the federal level. Top Consumer Complaints for 2007: 1.Auto: Misrepresentations in advertising or sales of new and used cars, lemons, faulty repairs, leasing and towing disputes." Released July 10, 2008.

Shady auto sales and lending practices are a multi-billion dollar drain on consumers' pocketbooks. They also lead to entirely preventable deaths and injuries, causing incalculable suffering, costing businesses and our economy skilled workers and lost productivity, increasing health care costs and burdening our health care system. When the practices afflict members of our Armed Services and their families, they also pose a threat to our national security and interfere with troops' combat readiness, morale, and ability to accomplish their mission.

Illicit auto sales practices are keeping vast numbers of car buyers from being able to save enough to purchase another vehicle, without falling even deeper into debt. Thus, they are shrinking the car market and harming honest businesses as well as the economy as a whole. In addition, the practices shake consumer confidence and impede sales of newer, safer, more fuel-efficient vehicles. Thus, they are totally at odds with the steps Congress has been taking to shore up the auto industry.

### **Parallels with Home Mortgage Crisis**

Auto sales and financing practices closely parallel the predatory and reckless lending practices that have become all too prevalent in home mortgage lending. The similarities are striking. According to some experts, the shady practices that plague home mortgage lending actually originated with auto lending, including:

- Undisclosed conflicts of interest in arranging financing (yield spread premiums / hidden kickbacks)
- Excessive negative equity / little correlation between collateral for the loan and amount of the loan
- No "skin in the game" for loan brokers / finance managers if borrowers default
- Securitization of loans<sup>3</sup>
- Speculation in securitized loans
- Shift in risk from reckless lenders to borrowers,<sup>4</sup>

### **Burgeoning negative equity: a "house of cards"**

The skyrocketing negative equity in auto loans has been a ticking timebomb that is going off at the worst possible time for our economy. For years, numerous articles in the automotive trade press and in mainstream media warned about the hazards of burdening car buyers with outsized auto loans, often the result of fraudulent activity.

For example, in 2007 the *Los Angeles Times* cautioned that "Americans haven't just been taking out risky mortgages for homes in the last few years; they've also been signing larger automobile loans for significantly longer terms than they used to. As a result, people are slipping into a perpetual cycle of automobile debt that experts think could lead to a new credit crunch extending from dealerships to

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<sup>3</sup> "New Cars that are fully loaded – with debt," Ken Bensinger, *Los Angeles Times*, December 30, 2007. Posted at: <http://articles.latimes.com/2007/dec/30/business/ft-autoloans30> "About 30% of the loans that are originated by banks, and 100% of those issued by automaker financiers, are, like mortgages, repackaged and sold as securities, according to the Consumer Bankers Assn."

<sup>4</sup> Under the Bankruptcy Act (S. 256) signed by President Bush in 2005, altering the terms of loans so that borrowers forced into bankruptcy are generally liable for the entire amount of the loan, even when the loan is disproportionate to the value of the product / property (eliminating the ability of bankruptcy judges to adjust the amount owed, also known as "cramdown")

driveways and all the way to Wall Street.”<sup>5</sup>

In fact, that credit crunch, which was entirely foreseeable, is exactly what is happening, with disastrous results for consumers, the auto industry, auto workers and suppliers, auto lenders, our economy and the environment.

Approximately 25 -30% of American car buyers owe more than they receive for their vehicles when they trade them in and purchase their next cars. It's called being "upside down," "under water," or "buried" in their car loans. The amount they still owe, in the form of "negative equity," is typically rolled into the loan for their next vehicle purchase. Essentially, they are paying for two or more vehicles with one over- inflated loan.

The amount of negative equity, on average, has risen to over \$4,000 per vehicle. Millions of car buyers are even further upside down, owing \$10,000 or more than their vehicle is worth. The only way to make their monthly payments affordable is to extend the length of the auto loans. The average length of an auto loan has soared “from 57 months in January 2002 to 64 months in March, [2008], according to Edmunds.com data. But some banks, credit unions and captives such as Toyota Motor Credit Corp. and GMAC Financial Services offer loan terms of as long as 84 months or more.”<sup>6</sup>

As a result, the vehicles often die or need an expensive repair the owner cannot afford -- frequently despite paying thousands to purchase a service contract -- long before the loan is paid off. In order to get a functioning vehicle, they trade in the mechanically defective vehicle, and the cycle of debt continues to spiral, sinking them deeper into debt for a product that depreciates from the moment they drive it off the lot.

Despite repeated warnings from bankers, credit rating agencies, and others in a position to assess the increasing risks, auto dealers, manufacturers and lenders ignored the warnings and continued to approve loans, sometimes up to double the price of the vehicle.<sup>7</sup>

Millions of Americans who would otherwise qualify to purchase a home, are unable to qualify due to excessive auto debt which claims a disproportionate share of their monthly income. In other words, auto lending abuses have shrunk the market for buying homes. On the positive side, addressing auto lending abuses will accelerate expansion of the housing market and speed up our recovery from the current recession.

### **Auto sales and financing scams harm used car buyers**

Each year, millions of American used car buyers fall prey to deceptive practices and illicit activity that can be addressed by stepped-up enforcement of existing laws, completion of the National Motor Vehicle Title Information System, prohibiting the imposition of mandatory pre-dispute arbitration in auto sales, and other governmental actions. The most damaging and pervasive practices are described below.

#### **Salvage fraud**

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<sup>5</sup> “New Cars that are fully loaded – with debt,” Ken Bensinger, *Los Angeles Times*, December 30, 2007.

<sup>6</sup> “Dealers hunt upside-down buyers with leases, incentives and long-term loans,” *Automotive News*, May 5, 2008.

<sup>7</sup> “Mark Pregmon, executive vice president for consumer lending at SunTrust Bank, is among the concerned. “Any time you extend the maturity of the loan, you take on more risk. The question is whether there’s enough assessment of that extra risk,” he said. “Obviously, it’s a problem. **It’s a house of cards.**” [emphasis added] -- from “New Cars that are fully loaded – with debt,” Ken Bensinger, *Los Angeles Times*, December 30, 2007.

According to the National Association of Attorneys General (NAAG), "auto salvage fraud [is] the greatest consumer problem facing American used car buyers."<sup>8</sup> NAAG also adopted a resolution calling for improved protections for consumers, noting that "it is estimated that the sale of rebuilt or salvaged motor vehicles costs the motor vehicle industry and consumers up to \$4 billion annually."<sup>9</sup>

In the aftermath of Hurricanes Katrina, Rita and Wilma, when insurers and self-insured entities had dumped the lion's share of an estimated more than 500,000 total loss saltwater flood cars into the American used car market, the United States Senate Commerce Committee held a hearing to hear testimony regarding flood and salvage vehicles. I was invited to testify at that hearing. Rather than repeating my testimony here, please consider it incorporated with this testimony.<sup>10</sup>

As noted in my earlier testimony, auto salvage fraud is a threat to the health and safety of many millions of individuals and families who purchase the vehicles, ride in them as passengers, or share the roads with them. Members of CARS, Robert and Mary Ellsworth, tragically lost their 18-year-old son Bobby, who was killed while riding as a front seat passenger in a salvage pickup truck driven by one of Bobby's friends. The air bags had deployed in a previous crash. State Farm totaled the vehicle and it was subsequently sold at an auction. A rebuilder purchased the salvage vehicle from the auction. But instead of replacing the air bags, the rebuilder stuffed the empty air bag compartments with paper. According to an expert, if the air bags had not been missing, Bobby would have survived.<sup>11</sup>

### **Odometer Fraud**

While auto manufacturers and dealers claimed that digital odometers would make odometer fraud a thing of the past, the exact opposite has happened. Now, instead of "clocking" old-fashioned analog odometers, often leaving telltale traces such as digits that are out of line, unscrupulous dealers simply purchase new odometers online and plunk them into vehicle consoles. "In fact, digital odometers can be easier to manipulate than their analog counterparts and evidence of tampering is harder to detect."<sup>12</sup>

According to a study mandated by Congress and conducted by the National Highway Traffic Safety Administration, "The increased cost consumers pay to purchase passenger vehicles with odometer rollbacks of \$1,056,000,000 per year makes odometer fraud one of the top crimes against property in the United States."<sup>13</sup>

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<sup>8</sup> National Association of Attorneys General Memorandum to United States Senators, March 25, 1998, opposing S. 852, which had been approved by Senate Commerce Committee in 1997.

<sup>9</sup> National Association of Attorneys General Resolution re: Mandatory Disclosure of Salvage History and Major Damage to Motor Vehicles, adopted March 2-22, 1994.

<sup>10</sup> U.S. Senate Commerce Subcommittee on Consumer Affairs, Product Safety and Insurance, Nov. 16, 2005 Hearing "Protecting the Consumer from Flooded and Salvage Vehicle Fraud," Testimony of Rosemary Shahan, President, Consumers for Auto Reliability and Safety. Posted at: <http://commerce.senate.gov/pdf/shahan111605.pdf>.

<sup>11</sup> See also "Air bag scams, dashboard danger," Reader's Digest, February, 2008. Posted at: <http://www.rd.com/advice-and-know-how/airbag-scams-dashboard-danger/article51930.html> The Ellsworths have also filed a declaration in the case brought by Public Citizen, CARS and Consumer Action versus the U.S. Department of Justice, posted at: <http://www.citizen.org/documents/EllsworthDeclaration.pdf>.

<sup>12</sup> AutoMedia.com. Published November 30, 2008.

<sup>13</sup> National Highway Traffic Safety Administration, Preliminary Report: The Incidence Rate of Odometer Fraud, NHTSA Report Number DOT HS 809 441, April, 2002. Note that NHTSA found that "An odometer may be rolled back and not identified as such in Carfax as long as the subsequent mileage is not lower than the previous mileage." Since the report relied heavily upon Carfax, it is very likely an overly optimistic assessment of incidence of odometer fraud. The report also did not take into account costs to consumers such as increased repair costs, loss of value upon trading in the vehicle, loss of warranty or service contract coverage due to odometer rollback, towing, loss of use due to breakdowns, loss of

A more recent report declares that "Digital odometer fraud is growing at an alarming rate, according to Carfax. The research data reveals the number of vehicles with rolled-back odometers has increased 57 percent nationwide over the past four years." According to Jack Gillis, author of The Car Book, "We estimate one in 10 cars have their odometers rolled back."<sup>14</sup>

Not only does odometer fraud mean car buyers are paying more than vehicles are worth, but they also face a double whammy because the warranty on a vehicle with a rolled-back odometer is generally void. Warrantors, unable to determine the number of miles on a vehicle, refuse to honor the warranty. So even if a consumer purchases a late model used vehicle believing they are protected by the remaining years of a factory warranty, they get a rude awakening when they attempt to get the vehicle repaired under the warranty. Manufacturers have access to prior service records and deny warranty claims based on falsified mileage. Corporations that sell extended service contracts typically have the same policies and deny claims on vehicles with altered odometers.

### **Lemon laundering**

All 50 states have enacted state lemon laws that require manufacturers to repurchase lemon vehicles that fail to comply with their warranties. Typically, the laws are triggered when a vehicle has a defect ("nonconformity") that "substantially impairs the use, value or safety to the buyer." Each year, auto manufacturers repurchase tens of thousands of "lemon" vehicles that had serious defects they failed to cure under the original factory warranty, in compliance with those laws and the federal Magnuson Moss Act.

When auto manufacturers repurchase lemons, they seldom destroy them, regardless how defective they are. Instead, they have been repeatedly caught by states and individual car buyers dumping them back into the automotive marketplace, defects and all -- a practice known as "lemon laundering." Often the vehicles have a history of serious life-threatening safety defects, such as brake failures, steering that locks up during operation of the vehicle, transmissions that suddenly fail to shift out of first or second gear, or electronic/ computer malfunctions that make the vehicle stall in traffic.

States have attempted to curb lemon laundering. About a dozen states require manufacturers to submit the titles to be "branded" as a "manufacturer repurchase" or -- in California -- "lemon law buyback." Most notably, California sought to revoke the licenses of General Motors and Chrysler after the state obtained internal documents and discovered massive fraud in the resales of lemon vehicles. The manufacturers claimed the vehicles in question were not lemons, but instead were "goodwill" repurchases. However, they obtained tax refunds that are allowable only when vehicles are repurchased under the lemon law.

General Motors' own internal documents reflected the fact that the vehicles were lemons. For example, GM officials had noted on the "wash out" reports that vehicles had been subjected to repeated repair attempts for substantial problems under warranty, noting that the cars "qualify as a lemon."

More than 80% of the Chrysler vehicles were repurchased after consumers won decisions in arbitration sponsored by Chrysler itself or after consumers had initiated lawsuits. They had undergone up to \$14,000 worth of warranty repairs prior to repurchase.

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jobs, ruined credit, or other related costs.

<sup>14</sup> "Odometer rollbacks increase 57% from 2004 - 2008. Business Fleet Magazine online. January 26, 2009.

In 1996, CARS spearheaded a petition to the Federal Trade Commission seeking effective action by the agency to curb auto lemon laundering across state lines. CARS provided voluminous documentation showing that lemons repurchased under state arbitration programs were shipped across state lines and resold with clean titles, making their "lemon" histories more difficult to trace. Other consumer groups and auto fraud experts also submitted detailed comments confirming the existence of the problem.

In response, the FTC sought public comments and held a Public Forum where auto manufacturers, auto dealers, consumer groups, representatives of state Attorneys General, and others met to discuss lemon laundering on the record. Consumer groups recommended that the FTC take steps to enforce laws prohibiting unfair and deceptive trade practices in the resales of lemon vehicles. However, to date the FTC has failed to act.

Meanwhile, lemon laundering continues to occur. Private litigation has unearthed numerous cases of lemon laundering. Class actions brought in West Virginia, and North Carolina against Chrysler found repeated fraudulent acts. Internal documents obtained from Chrysler, revealing how much the company recoups by reselling lemons, were posted on the Internet.

A case brought in California against Ford Motor Company, *Johnson v. Ford*, found that Ford was attempting to circumvent California's statute against lemon laundering by offering lemon owners "owner appreciation certificates" toward the purchase of a newer vehicle, and assisting the owners in trading in their lemons at Ford dealerships, instead of repurchasing the vehicles outright.

Ohio has taken the commendable step of prohibiting the resales of lemons repurchased due to safety defects such as brake or steering failures within the state. However, even that has not been sufficient to adequately protect Ohio's used car buyers from being victimized by lemon laundering.

For example, a single mother in Akron, Ohio, purchased a used Chrysler vehicle from a car dealership that concealed the fact it had been repurchased by Chrysler in Michigan due to repeated brake failures. The brakes continued to fail. She became afraid to drive the car. The dealer refused to give her a refund. Finally, she sued, and won a unanimous jury verdict. Among the findings: the vehicle was unsafe to drive. Then Chrysler and the dealership appealed the verdict. Eventually, years after she bought the vehicle, she won again against Chrysler and the dealership, on appeal. Meanwhile, she was unable to drive the car.

### **Vehicle theft and VIN-switching**

Auto theft is one of the most costly, pervasive property crimes in the country. In 2006, the value of stolen motor vehicles was \$7.9 billion.<sup>15</sup> When vehicles are stolen before the loans are paid off, insurers typically pay the owners only the fair market value of the vehicle (or less), leaving them stuck with the unpaid remaining debt. Someone who has a loan that lasts for 6 years, and whose vehicle is stolen after two years, is still stuck having to make four years of car payments. This, combined with GAP insurance scams (see below), sinks car buyers deeply into debt.

Another related problem is VIN-switching or "vehicle identify theft." A Vehicle Identification Number (VIN) is like a vehicle's fingerprint -- a unique identifier that indicates its type and origin. In a common VIN-switching scenario, thieves purchase a salvage or non-repairable vehicle at auction, then steal another vehicle that is the same make and model, and switch the VIN to give the stolen vehicle a

<sup>15</sup> National Insurance Crime Bureau, October, 2008 report, posted at: <http://www.iii.org/media/hottopics/insurance/test4/>

legitimate VIN. Then they sell it to an unsuspecting car buyer, who is unaware it was stolen. In some cases, consumers have made payments for years on a car that was stolen, only to have it towed away by police when they busted a vehicle theft ring, leaving the car buyer without a vehicle and without their payments.<sup>16</sup>

### **Misleading Vehicle History Reports**

Increasingly, car buyers seek information about vehicles on the Internet and from private database services such as Carfax (owned by Polk) and Autocheck (owned by Experian). However, the information offered by those services is far from complete and often unreliable. Often, pertinent information such as prior damage histories, do not appear in a timely fashion, or at all, so the data can be quite misleading. There are also other gaping holes in the data, most glaringly an absence of timely reporting by insurers and self-insured entities.

In addition, access to the data is generally limited to those who have access to computers and to credit, resulting in a serious digital divide that leaves millions of used car buyers vulnerable, without access to vital information. Simply lacking \$29.99 via a credit card for a vehicle history report can have disastrous results, including economic devastation, debilitating injury, or death.

While some auto dealers check Carfax and Autocheck and provide reports, many do not. Some dealers alter the reports to give potential purchasers a false sense of security about the condition of the vehicles. Some seek out damaged autos with clean "Carfax" reports and traffic in them.

It is extremely common for car buyers to be lulled into a false sense of security by a "clean" Carfax report, only to discover after they purchase a vehicle that it was severely damaged in a collision or flood. In one case in Florida, a consumer purchased a used car after being shown a "clean" Carfax report, then the report was updated with information about a collision that had occurred more than a year before the consumer bought the car.

A class action brought on behalf of consumers who obtained Carfax reports against Carfax, alleging that the service was misleading and deceptive, resulted in a settlement agreement that required Carfax to modify disclosures that the information it provides is not complete. We also note for the record that consumers in Canada have access to far more complete data including insurance claims information.

### **Failure of insurers and self-insured entities to properly "brand" titles**

Some insurers fail to comply with state laws that require them to have titles of vehicles they total "branded" with the notation they are "salvage," "junk," or a similar designation. In 2005, the nation's largest auto insurer, State Farm, entered into an "Assurance of Voluntary Compliance" with the Attorneys General of 48 states regarding its failure to brand the titles on between 30,000 to 50,000 salvage vehicles.<sup>17</sup> While State Farm did not admit any wrongdoing, it strains credulity to believe it could have made completely innocent mistakes tens of thousands of times.

In some cases, the vehicles were in fact "chop jobs" -- halves of different vehicles welded

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<sup>16</sup> "Buyers at risk when criminals clone vehicle ID information," by Diane Lade, Associated Press, December 10, 2007.

<sup>17</sup> See Assurance of Voluntary Compliance, posted on website of Iowa Attorney General Tom Miller at: [http://www.state.ia.us/government/ag/latest\\_news/releases/jan\\_2005/State%20Farm%20%20AVC%20-%20Final.pdf](http://www.state.ia.us/government/ag/latest_news/releases/jan_2005/State%20Farm%20%20AVC%20-%20Final.pdf)



together -- and grossly unsafe. Consumers who had purchased the State Farm salvage vehicles generally had paid Blue Book for them, only to receive a letter informing them their vehicle was in fact a junker, and worth far less than they had paid. Thus, overnight, the value of their vehicles plummeted and they were plunged deeply upside down in their car loans.

### **Worthless warranties and extended service contracts**

Car buyers who purchase used vehicles with the remainder of the factory warranty in effect are led to expect that they will be protected against major defects for the life of the warranty. They usually pay thousands extra for the added warranty coverage. However, if the vehicle sustained undisclosed prior damage in a crash or flood, or has an altered odometer, the manufacturer will not honor the warranty for the damaged components, or sometimes for the entire vehicle.

Consequently, a common consumer complaint is that a vehicle is advertised as having the remainder of the factory warranty in effect, but when vehicle owners attempt to have repairs performed under the warranty, their coverage is denied.

Car buyers spend increasing amounts to purchase "extended service contracts," which they are led to believe will provide adequate protection against expensive repairs. Sales of service contracts are a high-profit item for many auto dealers, who sometimes tell car buyers (falsely) that they must obtain the service contract in order to qualify for financing.

However, many extended service contracts are riddled with loopholes and exclusions. For example, they generally will not cover pre-existing, undisclosed conditions. Virtually no service contract company will cover prior damage, a common reason a vehicle needs further repair.

Numerous companies that offer extended service contracts have pocketed the money and moved offshore, or gone belly up, leaving consumers without the protection they paid for, and with expensive repairs they cannot afford. This sometimes also harms well-intentioned dealers, who are left to deal with repair expenses incurred by car buyers who relied on them to choose a solid company for the service contract.

Some dealers pocket the service contract payment and do not activate the policy. The consumer may not discover this until months later, when they attempt to obtain a repair under the policy. Some service contract companies secretly offer dealers incentives to deny claims, in the form of payments based on the amount of the contract that is not used to pay claims.

### **Undisclosed Kickbacks from Lenders /hidden dealer markups**

Last fall, the *Sacramento Bee* published an editorial urging California lawmakers to address the mortgage lending crisis, a major factor in the financial meltdown that has plunged the state's economy into the worst fiscal crisis since the Great Depression. The *Bee* urged the following actions:

- "For all home loans, banning the steering, counseling or directing of consumers to a loan that is more expensive than one for which they would otherwise qualify based on their income and creditworthiness. California already does this for some loans (see AB 489, passed in 2001).
- Banning broker commissions called "yield spread premiums," fees paid by a lender to a broker

for higher-rate loans. As Sheila Bair, chairwoman of the Federal Deposit Insurance Corp., has said, these fees create a financial incentive for brokers to steer borrowers to higher-cost loans.

- A study by the Federal Reserve showed clearly that simple disclosure does not solve the problem. As the Fed said, disclosures end up confusing consumers, who believe, falsely, that mortgage brokers have a duty to find them the lowest interest rate and best terms available."<sup>18</sup>

Virtually the same practices persist in auto lending, only with even less oversight and regulation. Instead of being called "yield spread premiums," the kickbacks dealers receive from lenders in exchange for increasing the interest rate on auto loans are called "dealer markups," "dealer reserve" or "dealer participation." They have become a major profit center for auto dealers at the expense of consumers.

Instead of receiving loans based on their creditworthiness, car buyers receive loans based on how much the dealer and lender think they can get away with. The "buy rate" car buyers qualify for is not disclosed to them. Often, they are told that the increased interest rate, which includes the dealer markup, is "the best we can do for you" or that "we shopped you around and this is the best you can do." Even those with good credit are misled into thinking their credit is blemished.

As class action litigation brought by the National Consumer Law Center and others on behalf of African American and Latino car buyers under the Equal Credit Opportunity Act showed, auto dealer markups tend to be higher for minority borrowers, even when they have the same credit as their Caucasian counterparts.<sup>19</sup> However, no car buyers who depend on auto dealers to find them a loan are immune from falling prey to excessive interest charges.

While the settlement agreements in the discriminatory lending class action cases reduced the allowable markups among many major lenders, the caps on the markups still allow dealers to receive thousands of dollars for arranging a bad loan, when the consumer could get a better loan on their own for free. This turns the profit incentive on its head and means the worse a job the dealer does in arranging financing, from the consumer's perspective, the more money the dealer makes.

In an attempt to rein in the worst dealer markup abuses, California passed two landmark laws. The first (spearheaded by CARS) requires dealers to maintain relevant records for up to 7 years, or the length of the loan, whichever is longer. This provides a tool for law enforcement agencies to monitor markups, but it appears that so far no agency has even requested the data. The second law, California's Car Buyers Bill of Rights (based on an initiative drafted by CARS) caps dealer markups at 2.5% for loans up to 60 months and at 2% for longer loans. However, that still allows thousands of dollars in undisclosed markups.

Only one other state -- Louisiana -- caps dealer markups, at 3%. Other states have loosened protections, with predictable results. For example, when Ohio repealed its law that had effectively reined in dealer markups for decades, the costs to Ohio car buyers soared.

In 1999, Texas enacted legislation, signed by then-Governor Bush, that was amended in the waning minutes of the legislative session, with no discussion or debate, to retroactively legalize non-disclosure of dealer markups. The new Texas law passed as an emergency measure that took effect

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<sup>18</sup> "State Can't Delay Mortgage action," Sacramento Bee Editorial, August 18, 2008. Posted at: <http://www.sacbee.com/110/story/1164578.html>

<sup>19</sup> See, for example, *Borlay v. Primus Automotive Financial Services, Inc. and Ford Motor Credit Company*, United States District Court for the Middle District of Tennessee, at Nashville (Civil Action No. CV-3-02-0382). This was widely regarded as the test case regarding discriminatory auto lending, and the judge ruled that the plaintiffs had proven their case.

immediately upon signing and applied retroactively to then-pending litigation brought on behalf of thousands Texas car buyers.<sup>20</sup> Subsequent class action litigation against General Motors' "captive" finance arm, GMAC, found that Texas car buyers were being charged up to approximately \$15,000 in undisclosed dealer markups.

Often, consumers are subjected to "bait and switch" financing, enticed into going to a dealership that advertises in huge lettering "0% financing." Then, under an asterisk, in tiny print, is written: "Upon credit approval, for qualified buyers." Some ads state the FICO or other credit score needed to qualify for the special rate in the ad, but when car buyers who have scores at least as good as those attempt to get a loan at the advertised rate, they are told (falsely) that their credit does not qualify them for the loan at that rate. Since most consumers do not have ready access to their credit scores, they are prone to being deceived. Auto industry analysts have noted for years that most consumers do not obtain the "0% financing" that is so prominently advertised.

### **Dealer falsification of credit applications**

Another common practice that plagues used car buyers: auto dealer finance managers who falsify credit applications. This happens several different ways. Often, consumers fill out a credit application truthfully, only to have it altered without their knowledge after they have signed it.

For example, the consumer fills out a credit application, stating that their income is \$1100 per month. They sign the application. Then the finance manager alters it to indicate that their income is \$4100 per month, and submits the false information to prospective lenders. Typically, consumers are not given a copy of the credit application that has been submitted to the lenders, so they may never realize it was altered after they signed it.

While lenders are required by federal law to report such acts to authorities, when they become aware the applications were false, they may be reluctant to comply. Lenders who blow the whistle risk losing business directed to them by auto dealers.

However, recently, federal authorities have received reports from lenders alleging that loan applications were falsified, and have brought actions to curb such activity. For example,

"A combined force of nearly a dozen FBI and Immigration and Custom Enforcement agents raided [a dealership in Madera, California.] According to the indictment, the suspects operated a scheme to enable customers to obtain financing, even if they didn't qualify, by preparing false financial documents and forwarding them to Valley First Credit Union.

Federal investigators believe the suspects entered fictitious information on loan applications, including the names of employers for whom the customers didn't work. The men also inflated the earning amounts of customers, in addition to creating fictitious earnings statements to reflect payments of wages by businesses that never employed the customers, according to the federal indictment....Investigators believe VFCU sustained a loss of about \$540,000, because many

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<sup>20</sup> H.B. 2180, enacted in 1999. See also "Suits are threatened by new law," by Mary Flood, *Wall Street Journal*, June 30, 1999. "Thanks to some little-noticed legislative tweaking, a banker-backed measure approved by the Texas legislature last month could lead to the dismissal of a pair of East Texas consumer lawsuits...the suits... accuse area auto dealerships and some large national banks of defrauding consumers who financed their car purchases through the dealerships at higher rates than the dealers were getting from the banks....attorneys for defendants in the earlier case -- Peltier Enterprises Inc...and Bank of America Corp. ...filed a motion to dismiss the case the Monday after Gov. George W. Bush signed the measure into law [on a Saturday]."

customers didn't have the ability to meet the terms of the loans."<sup>21</sup>

In North Carolina, the owner of six auto dealerships plead guilty to aiding in the filing of falsified loan applications. Law enforcement officials told reporters that some loan applications included household appliances listed as traded-in vehicles. Employment records were also faked<sup>22</sup>

### **Yo-yo financing**

Even sophisticated car buyers who succeed in negotiating good terms on an auto loan are often no match for a prevalent high-pressure auto sales tactic known as "yo-yo" financing. Auto dealers usually call it "spot delivery." It is basically a form of financial "bait and switch."<sup>23</sup>

In a typical yo-yo transaction, a car buyer and dealer agree on the terms of a loan, at a reasonable interest rate. The car buyer signs a retail installment contract spelling out the terms, and the dealer congratulates them on their purchase. The car buyer then drives off in their newly purchased vehicle, and shows it to their family, friends, and co-workers. Then a week or two later, he or she receives a call from the dealership telling them that the financing was not approved and they need to return to the dealership with the car. When they do, they are pressured into signing a different agreement with worse terms -- a larger downpayment and / or a higher interest rate.

The reality is that with rare exceptions any finance manager with basic knowledge of his business knows almost immediately whether a car buyer will qualify for a purchase. Virtually all major auto lenders either approve or reject loans within a matter of seconds, electronically, 24/7. Some dealers do not even attempt to find financing for the car buyer at the lower rate, so the claim that they were rejected is false. Other dealers shop the loans around in an attempt to find a higher kickback from another lender, then engage in yo-yo tactics to increase their own profit on the sale.

If the car buyer has traded in another vehicle, they are told that they cannot have it back -- even if the traded-in vehicle is still sitting on a back lot. This is known as "de-horsing" the buyer -- getting them out of the vehicle they own, so they need another vehicle in order to have transportation.

Car buyers who balk at being yo-yo'ed are sometimes threatened with destruction of their credit and / or arrest for auto theft. The pretext is that the contract is void since the financing was not approved. Some have actually had their vehicles towed by tow truck drivers who told their employers and co-workers they stole the vehicle. If they abandon the vehicle at the dealership, they risk having it treated as a voluntary repossession, ruining their credit.

Members of the Armed Forces are particularly vulnerable to yo-yo financing. Dealers threaten to report troops to their command, and / or to police, telling them they will lose their security clearances unless they sign the new contract. According to testimony by military personnel in

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<sup>21</sup> "Feds raid Merced auto dealership, arrest four men in bank fraud investigation," *Madera Sun-Star / Modesto Bee*, December 4, 2008. Posted at: <http://www.modbee.com/1623/story/521620.html>

<sup>22</sup> "Charlotte car dealer to plead guilty to false loan papers," the Associated Press. *Winston-Salem Journal*, January 6, 2009. The indictment said some Harrelson employees lied about the ability of customers to pay for vehicles by falsifying incomes, down payments and employment history on loan applications...Prosecutors said the loans cost financial institutions more than \$1.2 million and that the conduct was "open and notorious." Posted at: <http://www2.journalnow.com/content/2009/jan/06/charlotte-car-dealer-plead-guilty-false-loan-paper/>

<sup>23</sup> "Yo-yo deals: Stringing car buyers along," by Don Oldenburg, *Washington Post*, October 19, 2004. Posted at: <http://www.washingtonpost.com/wp-dyn/articles/A43629-2004Oct18.html>

California, based on an informal survey of military Judge Advocates General, "yo-yo" financing was a major factor in making auto purchasing the single worst financial readiness problem facing troops stationed in the state.<sup>24</sup> In Arizona, a military base resorted to declaring some dealerships off-limits due to practices including yo-yo financing.<sup>25</sup>

### **Loan packing**

“Loan packing” is a very common, highly sophisticated scam that has become a major source of profits for many unscrupulous auto dealers. Loan packing involves deceiving car buyers about the amount they are being charged for add-on items. If the buyers resist, finance managers may pressure them by telling them (falsely) the items must be part of the deal in order to get a lower interest rate or to be approved for financing.

Items commonly "packed" into loans are usually high-profit items that are added on and have little or no inherent value. Common examples: theft etching, paint sealant, rust proofing, GAP insurance, extended service contracts, and special sound systems. In some cases, car buyers have been misled into paying thousands, over the life of their loan, for items that cost the dealer less than \$40.

Not only is loan packing a waste of consumers' hard-earned cash, it also keeps them from being able to afford other items they could have purchased for less, such as electronic stability control systems, which are proven to greatly reduce the risk of rollover deaths and injuries.

### **GAP insurance scams**

In an attempt to ensure protection from being saddled with negative equity, more consumers are purchasing “Guaranteed Asset Protection” policies to cover the full amount of the loan, in the event their vehicle is damaged or stolen. However, the policies are riddled with loopholes and exclusions, and companies that offer "GAP" policies often shortchange consumers and delay making payments for many months. Meanwhile, consumers are left to fend for themselves to obtain transportation.

Some dealers pocket the GAP payment, then fail to activate the policies. Particularly if the dealership goes out of business without activating the GAP policy, car buyers have little or no recourse.

### **Car Title Loans**

In some states, it is still legal for consumers to surrender the title to their vehicle as collateral for a loan, a practice sometimes also known as "car title pawning." Many experts consider this to be tantamount to legalized car theft. Typically, the loans are far less than the value of the vehicle and the terms are nearly impossible for the car owner to meet. For example, the loan must be repaid in person at an exorbitant interest rate on a weekday at a time when the shop is closed. The end result: desperate consumers who need a short-term loan for a medical procedure or other emergency too often end up losing their only means of transportation. Enactment of interest rate caps at 36% have proven effective in curbing car title loans.

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<sup>24</sup> Testimony presented before California Assembly Banking and Finance Committee, Pico Rivera, CA, March 11, 2005.

<sup>25</sup> "Military base declares dealerships off-limits," Arizona Daily Star, July 13, 2008.

## **Failure to Report Good Credit Activity to Credit Bureaus**

Many "Buy Here / Pay Here" used car lots lure car buyers to shop there by advertising that they will help them build up their credit. They target car buyers who either lack a credit history because they have not used credit in the past, or who have subprime credit. However, the dealerships generally fail to report credit activity to any of the major credit reporting agencies.

Consequently, even when the car buyers make every payment in full and on time, they generally fail to benefit in terms of achieving a good credit rating. In addition, the practices at "Buy Here / Pay Here" lots often involve various frauds that end up hampering the car buyers' ability to get better terms at other dealerships in the future.

## **Dealers going out of business and leaving customers in the lurch**

When car dealers go out of business, they sometimes leave their customers holding the bag for unpaid liens. Subsequent purchasers also suffer, through no fault of their own. This is a serious and growing problem nationwide.

Car buyers who had credit good enough to qualify for loans even in the current climate, where credit is very tight, are having their good credit trashed by dealers who promise to pay off the negative equity on their auto loans. The negative equity is rolled into the next transaction. Then the dealer fails to pay, leaving the hapless car buyer saddled with two car payments but only one car.

Usually the car buyer is unaware the loan has not been paid until months after their new purchase, when their lender contacts them to demand payment and informs them they are behind on their payments. Although the car was traded in, the car buyer is still on the hook to pay the loan. Unable to pay for the loan on the car they traded in, in addition to their new purchase, they fall behind on their payments. Sometimes one or both vehicles are repossessed, a very negative report which may remain on their credit history for the next 7 years. A bad credit report can keep the consumer from getting employment, or housing.

Car buyers who purchase used vehicles with unpaid liens are also being victimized by dealers who sold them vehicles without disclosing that the loans had not been paid. They may make every payment in full and on time, only to have their vehicle repossessed by the former owner's lienholder. Suddenly, without any warning, they are without their down payment and /or traded-in vehicle, any repairs they have made, and their car. In some cases, the sudden lack of transportation has cost them their good credit and / or their job.<sup>26</sup>

As the auto market shrinks, dealers are closing their doors in record numbers. Nearly every manufacturer is consolidating its dealership network. General Motors alone has announced plans to eliminate several hundred dealerships this year. However, they have not made public which dealers are going to be bought out.

California has been harder hit than any other state, with 137 new car dealers closing in 2008 and another 131 stating in a survey that they will be forced to close within the next 6 months unless they get assistance from the federal government.<sup>27</sup> In addition, at least 416 used car dealerships closed in 2008.

<sup>26</sup> For news reports by the Associated Press, New York Times, San Francisco Chronicle, and other news organizations about this growing problem, see links posted at CARS' website, at: [http://www.carconsumers.com/Bailout\\_news.html](http://www.carconsumers.com/Bailout_news.html).

<sup>27</sup> "Sacramento car dealers seek federal loan help," *Sacramento Bee*, February 26, 2009.

Hundreds more are expected to close this year. In response, California State Senator Ellen Corbett has introduced the Car Buyers Consumer Protection Act, SB 95, to help improve protections for car buyers. (SB 95 is "sponsored" by CARS.)

While several states have established restitution funds to help compensate victims, the amounts in the funds are not always sufficient to cover all the claimants. California's restitution fund is capped at a maximum of \$5 million per year. According to DMV officials, that will not be sufficient to cover all the losses California car buyers are suffering. Some large dealerships have left hundreds of car buyers holding the bag, costing them a total of \$500,000 or \$1 million in losses, per dealership.

Also, the restitution funds do nothing to restore consumers' good credit or get them back jobs they have lost. For many car buyers, the harm to their good credit, and the negative ramifications for them, are far worse than the monetary loss.

Most states require only a minimal surety bond of \$5,000 or \$10,000 for dealers to obtain a license. When they go out of business, there is usually little recourse for car buyers who are harmed. The bond is not enough to cover a single average-priced used car.

### **National Motor Vehicle Title Information System (NMVTIS) not yet complete**

NMVTIS is a national vehicle database system mandated by the Anti-Car Theft Act of 1992,<sup>28</sup> which required the U.S. Department of Transportation to create NMVTIS, and the Anti-Car Theft Improvements Act of 1996,<sup>29</sup> which shifted authority over NMVTIS to the U.S. Department of Justice after DOT failed to act.

According to a cost-benefit analysis commissioned by the U.S. Department of Justice, completion of NMVTIS will save the American public between \$4 billion and \$11.3 billion annually, by curbing auto theft, salvage fraud, odometer fraud, VIN-switching, and related crimes. It will also enhance homeland security.<sup>30</sup>

On January 30, 2009, the U.S. DOJ implemented consumer access to the system and issued long-overdue new rules to require insurers and junkyards to provide data on totaled vehicles to NMVTIS, where the data must be updated every 30 days and made available to the public at cost. The U.S. DOJ took this important step in compliance with a court-ordered deadline issued pursuant to litigation filed by Public Citizen, CARS, and Consumer Action.<sup>31</sup>

However, while significant progress is being made toward completing NMVTIS, and it currently includes 73% of the vehicle population, 14 states fail to participate in the system. Others are providing data to the system but not fully participating.<sup>32</sup> For details about state compliance,

While California now provides data to NVMTIS, the state has entered into an illegal agreement with the the system operator, the American Association of Motor Vehicle Administrators, that bars consumers from accessing California's data directly through NMVTIS. Instead, California car buyers will be more restricted in being able to access the information, under a contract California's DMV has

<sup>28</sup> P.L. 102-519 Sections 202-04, 106 Stat. 3390-93.

<sup>29</sup> P.L. 104-152 Sections 2-3, 110 Stat. 1384.

<sup>30</sup> Logistics Management Institute Report, Cost-Benefit Analysis, submitted to U.S. Department of Justice, 2001. Posted at: [http://www.ojp.gov/BJA/pdf/LMI\\_NMVTIS.pdf](http://www.ojp.gov/BJA/pdf/LMI_NMVTIS.pdf)

<sup>31</sup> *Public Citizen et.al. v. Michael Mukasey*, filed in the U.S. District Court, Northern District of California. This action has since been amended to *Public Citizen v. Eric Holder*.

<sup>32</sup> For details about states' compliance, see: <http://nmvtis.gov/>

with Polk (Carfax). Currently, CARFAX charges \$29.99 for the history for a single VIN. Consumers in other states will have access to other vendors. One such vendor is offering vehicle histories for \$2.50 for a single VIN. Thus, used car buyers in other states will benefit from a competitive environment, while California's used car buyers will not enjoy the same benefits.

Ironically, California, with the nation's largest auto market, and where auto salvage fraud is rampant, has the most to gain by participating in NMVTIS. According to California's Department of Motor Vehicles, more than \$1,692,000 vehicles registered for used on California roads have titles indicating they were once totaled by an insurer and are considered "salvage."<sup>33</sup> California also has 4 out of the top 5 auto theft "hot spots" in the United States -- Modesto, San Diego/Carlsbad/San Marcos, Stockton, and San Francisco/Oakland/Fremont.<sup>34</sup>

In order for NMVTIS to fulfill its Congressional mandate, additional funding in the amount of approximately \$40 million is needed so that the DOJ can update NMVTIS and provide necessary assistance to states.

We are pleased to note that the DOJ has proposed working with the FTC regarding posting information about NMVTIS on the Used Car Buyers Guide, a step long recommended by CARS and included in the consumer group comments to the FTC.

### **Mandatory pre-dispute arbitration leaves car buyers at the mercy of unscrupulous dealers and lenders**

One of the leading reasons auto sales and lending practices have sunk so low is that consumers have lost the ability to defend themselves against even the most blatant violations of existing federal and state laws and regulations due to the widespread imposition of binding mandatory pre-dispute arbitration.

Given the sheer volume of auto sales each year, with tens of millions of transactions, state agencies and local consumer protection agencies cannot possibly police all the transactions, or even enough of them to deter illicit behavior. During this era of strapped state and local budgets, when consumer protection agencies have had to lay off staff, enforcement is becoming even weaker.

While auto sales and service complaints perennially top the list of consumer complaints, car buyers who have been subjected to illegal practices are almost always told that it is a civil matter and they are on their own.

In the past, they would have had the ability to invoke longstanding consumer protection laws and regulations in their own defense by bringing civil litigation. However, due to dealers and lenders inserting arbitration clauses in auto contracts -- often on the back, in fine print, in confusing and legalistic terminology -- they have lost the ability to defend themselves.

As Members of Congress argued in favor of granting auto dealers access to courts for resolving disputes with auto manufacturers:

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<sup>33</sup> Message from Dennis Clear, Legislative Director, California Department of Motor Vehicles, July 18, 2007: "As of 7/1/07, we have 1,692,535 salvage vehicles on file." This number does not include those vehicles with "washed," altered or counterfeited titles, where the "salvage" brands have been removed. The number is also far lower than before the ruling in *Martinez v. Enterprise*, interpreting California's definition of "salvage" to allow a vehicle to be destroyed up to 100% of its pre-crash value before it must be branded as "salvage."

<sup>34</sup> America's car theft hot spots, Forbes.com, quoting data from the National Insurance Crime Bureau, July 11, 2008.



- The contracts are take-it-or-leave-it, boiler-plate contracts of adhesion. There is no real opportunity to negotiate.
- The parties to the contracts are on an unequal footing.
- Arbitrators are inherently biased in favor of repeat customers, who can track their decisions and have the advantage of knowing which arbitrators have ruled in their favor in the past.
- Arbitrators are not required to apply the law or adhere to judicial precedents.
- Even if the arbitrators totally disregard the law, there is little or no review, and rarely any check on their power. There is seldom even any record that would be subject to review.
- Discovery is either non-existent or very limited. Without discovery, consumers are severely disadvantaged. This enables crooked dealers to conceal material facts from their victims and from the arbitrators.
- Arbitrations occur in a vacuum. They almost always operate in secret. If a dealer has engaged in widespread violations of the law, it may never come to the attention of law enforcement agencies or policymakers, who might otherwise act to protect the public.

In some cases, car buyers who were defrauded have been compelled to submit their disputes to arbitration, only to have the dealer delay responding to communications for years, trapping them in "arbitration hell," where years go by without a hearing. One consumer in the San Diego area who was sold a rebuilt wreck has had to continue making payments for more than two years on a vehicle that he cannot drive because it is unsafe, while he has waited simply to get a hearing before an arbitrator in a forum chosen by the dealership that sold him the clunker. If he had been able to litigate, he very likely would have recovered his losses in an out-of-court settlement, within a matter of months.

In some cases, consumers have won cases in arbitration, only to have the dealership refuse to abide by the decision, forcing the consumer to litigate in order to enforce the decision. The absurdity of this situation puts the lie to any claim by auto dealers that arbitration is somehow a better alternative to litigation, since it is only the prelude.

The same arguments that were made by auto dealers and Congress in favor of preserving the rights of auto dealers apply equally to consumers, if not more.

As Senator Hatch stated when he introduced S. 1140, "The Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001," the new law was needed to protect auto dealers from having mandatory arbitration clauses imposed upon them by auto manufacturers, due to their "unequal bargaining power."<sup>35</sup> As Senator Grassley, speaking in support of S. 1140, stated:

"While arbitration serves an important function as an efficient alternative to court, some trade-offs must be considered by both parties, such as limited judicial review and less formal procedures regarding discovery and rules of evidence. When mandatory binding arbitration is forced upon a party, for example when it is placed in a boiler-plate agreement, it deprives the

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<sup>35</sup> Statements on Introduced Bills and Joint Resolutions, United States Senate, June 29, 2001. Statement by Senator Hatch of Utah.

weaker party the opportunity to elect another forum. As a proponent of arbitration I believe it is critical to ensure that the selection of arbitration is voluntary and fair...Unequal bargaining power exists in contracts between automobile and truck dealers and their manufacturers. The manufacturer drafts the contract and presents it to dealers with no opportunity to negotiate... The purpose of arbitration is to reduce costly, time-consuming litigation, not to force a party to an adhesion contract to waive access to judicial or administrative forums for the pursuit of rights under State law.”<sup>36</sup>

Senator Grassley also stated that:

“This legislation will go a long way toward ensuring that parties will not be forced into binding arbitration and thereby lose important statutory rights. I am confident that given its many advantages arbitration will often be elected. But it is essential for public policy reasons and basic fairness that both parties to this type of contract have the freedom to make their own decisions based on the circumstances of the case.”<sup>37</sup>

While S. 1140 did not pass, auto dealers were given an exemption from the Federal Arbitration Act by passage of H.R. 2215 in 2002. That act, now codified at 15 U.S.C. section 1226, prohibits auto manufacturers from including any type of pre-dispute arbitration clause in franchise contracts with auto dealers. Specifically, it provides that arbitration may be used to settle a controversy arising out of a motor vehicle franchise contract only if both parties consent, in writing, and only after the dispute arises. The same rights should be restored to car buyers.

A year ago, I testified in support of passage of legislation sponsored by Representative Linda Sanchez, H.R. 5312, the Automobile Arbitration Fairness Act. That legislation passed in the House Judiciary Subcommittee on Commerce and Administrative Law. It should pass in Congress and be signed by the President. The sooner it passes, the sooner car buyers can begin to feel more confident if they are cheated over their car purchase, they can right the wrong and obtain justice.

It is important to note for the record that the National Automobile Dealers Association wrote to Congress when car dealers sought their exemption from the Federal Arbitration Act and promised not to oppose similar legislation to protect consumers. However, auto dealers have violated the spirit, if not the letter, of that promise, since auto dealers' state trade associations and individual auto dealers have been actively opposing passage of H.R. 5312.

### **Solutions**

In order to restore consumer confidence in the automotive marketplace, save the American public many billions of dollars, save lives, prevent injuries, and accelerate the replacement of the U.S. vehicle fleet with newer, safer, more fuel efficient vehicles, CARS strongly urges that Congress, the Federal Trade Commission, and the U.S. Department of Justice take the following actions:

#### **Congress should:**

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<sup>36</sup> Statements on Introduced Bills and Joint Resolutions, United States Senate, June 29, 2001. Statement by Senator Grassley of Iowa.

<sup>37</sup> Statements on Introduced Bills and Joint Resolutions, United States Senate, June 29, 2001. Statement by Senator Grassley of Iowa.

- Act immediately to provide relief and restitution for car buyers victimized by dealers that go out of business
- Act immediately to establish a federal task force to assist car buyers victimized by dealers that go out of business in restoring their good credit. The task force should be empowered to provide pro-active outreach to victims, identifying them and working with lenders and credit reporting agencies to put victims on a fast track to have their credit restored.
- Provide approximately \$40 million in funding to the US Department of Justice for completion of the National Motor Vehicle Title Information System, or NMVTIS. This includes funds to assist states in fully complying with the law.
- Enact legislation to amend the Anti-Car Theft Improvement Act of 1996 to:
  - Tighten the time period allowed auto insurers and junkyards to submit data to NMVTIS from the existing 30 days to the same day as the vehicle is totaled
  - Require full disclosure regarding vehicles with serious damage below the threshold for being "totaled," so vehicle buyers can weigh whether to purchase those vehicles or not, and are made aware the prior damage will likely reduce their value and /or safety
- Grant the Federal Trade Commission authority to issue new regulations through a more efficient, less burdensome process
- Continue to exercise oversight over the Federal Trade Commission's rulemaking and other activities to curb predatory, unfair, and deceptive practices in the automotive marketplace
- Enact H.R. 5312, The Automotive Arbitration Fairness Act, sponsored by Representative Linda Sanchez
- Enact the "Protecting Consumers from Unreasonable Credit Rates Act of 2009" (S. 500), sponsored by Senator Richard Durbin, to amend the Truth in Lending Act to impose a national cap on consumer credit interest rates

**The FTC should:**

- Step up enforcement against unfair and deceptive practices in the automotive market
- Modify the Used Car Rule, as described in comments CARS and other consumer groups filed with the FTC, including requiring specific written warnings on total loss vehicles that appear in the NMVTIS database.
- Update the Used Car Rule in order to comply with new legislation enacted by Congress to amend the Anti-Car Theft Improvement Act of 1996 to include full disclosure regarding vehicles with serious damage below the threshold for being "totaled"

**The US DOJ should:**

- Continue to move forward in completing NMVTIS
- Step up enforcement of existing laws against falsifying credit applications and other forms of

fraud

- Participate on behalf of consumers in legal actions to enforce the Equal Credit Opportunity Act and Truth in Lending Act.

CARS also strongly urges the White House and other Executive Branch agencies to work closely with Congress, the DOJ and the FTC to ensure the actions outlined above are taken and car buyers are protected.

Thank you again, Chairman Rush, Ranking Member Radanovich, and Distinguished Members, for the opportunity to testify. I greatly appreciate your work and that of the Committee and Subcommittee staff, and look forward to working with you to improve protections for America's car buyers and their families.