FUELING FAIR PRACTICES

A road map to improved public policy for used car sales and financing

John W. Van Alst
National Consumer Law Center®

NATIONAL CONSUMER LAW CENTER

The **National Consumer Law Center** is a non-profit organization that seeks marketplace justice on behalf of low-income and vulnerable Americans. NCLC works with, and offers training to, thousands of legal-service, government and private attorneys, as well as community groups and organizations representing low-income families. Our legal manuals and consumer guides are standards of the field.

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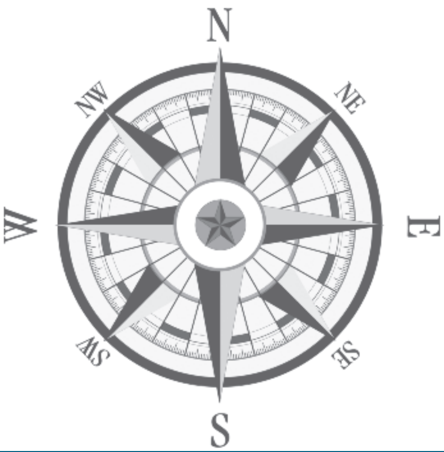
Fueling Fair Practices



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I. Executive Summary

For most working families, owning a car is central to productivity and self-sufficiency. Yet, buying, financing, and keeping a reliable car is fraught with dangers and problems. This is especially true for low-income families. It is not surprising that households with incomes below $25,000 are nine times more likely to be without a car than households with incomes above $25,000.[1] While existing policies offer some protections, consumers still face numerous hurdles and stumbling blocks, such as cars in poor or even dangerous condition, unfair financing arrangements, deceptive sales practices, junk products and fees that add to a car's cost, and outright fraud.

Most Americans understand how difficult it is to obtain a fair deal when buying and financing a car. There is broad public support for policy improvements,[2] and a growing number of policy makers are seeking to address these issues. Reform will be welcomed not only by consumers, but even some car dealers and finance companies that would like to succeed by providing quality cars at fair terms, but cannot when competitors succeed through unfair practices.

This guide examines problems and inequalities in the current used car sales and finance market, and suggests policy reforms that would bring fairness to these transactions. Both state and federal policy improvements are suggested. There are three principles which apply to all the suggested improvements:

- Laws protecting consumers should have a private right of action.
- Dollar amounts should automatically adjust for inflation, and other numbers found in statutes should be periodically reviewed.
- Federal laws should not preempt stronger state consumer protections, nor should state laws preempt stronger local and community protections.

STATE LAW REFORMS

Protecting Used Car Buyers from Sales and Financing Abuses

The sale and financing of used cars is fraught with abuses. One change that would do much to address such abuses is instituting a right of rescission or cooling off period. Other policies states should follow to reduce

[1] U.S. Department of Transportation, Bureau of Transportation Statistics, *NHTS 2001 Highlights Report*, BTS03-05 (Washington, DC: 2003).

[2] In 2004, when an initial, strong, car buyer bill of rights was proposed in California, a statewide poll found that 83% of likely voters supported the measure. See California's Car Buyers Bill of Rights: A Bittersweet Deal for Consumers, Consumers for Auto Reliability and Safety, November 28, 2007, available at http://www.carconsumers.com/CBBR_BittersweetDeal.html.

such abuses include eliminating or limiting dealer finance charge markups to a dollar amount; capping document preparation and fees; and requiring posted pricing and simplified rebate calculation for add-ons.

Even when laws prohibit abuses, often dealers go out of business without the resources to protect consumers. Such closures can leave consumers without good title to a recently purchased car or still owning money on a trade-in that should have been paid off. To address these issues, states should create dealer-funded consumer compensation funds and increase existing dealer bond requirements.

Protecting Used Car Buyers from Dangerous and Unreliable Vehicles

One of the most difficult problems consumers face is trying to obtain a car in good condition. There are several alternatives states can pursue to address this issue by enacting used car lemon laws and required warranties; prohibiting disclaimer of implied warranties and "as is" sales; or requiring inspection of, and minimum condition for, used cars for sale. If such protections are created and a dispute does arise about the condition of the vehicle at the time of sale, the burden of proof should be on the dealer to show that the car was in good condition at the time of sale.

Protecting Car Buyers and the Public from Arbitrary and Dangerous Repossession

Even if families can get a reliable car, they often find it difficult to keep the car. While taking the law into one's own hands is generally disfavored, lenders have extraordinary power to take a car away from a family without protection. This leads in many cases to repossessions when the lender is not entitled to the car, loss of the family's ability to get to work, and all too many instances injuries and fatalities.

States should either ban self-help repossessions or restrict the use of self-help repossession. If self-help repossession is allowed in a restricted form, repossessors should be heavily regulated, including licensing and bonding, and lenders should be liable for all actions of repossessors. To help keep families in their cars and productive, consumers should be afforded a right to cure or reinstate the loan if they do fall behind. Finally, states should adjust anti-deficiency statutes for inflation.

SUGGESTED CHANGES TO FEDERAL LAW

- In order to better understand what happens when cars are sold and financed, and to combat discrimination in such transactions, a federal data collection system for automobile financing should be created similar to existing HMDA mortgage data collection.
- Pre-dispute binding arbitration should be prohibited in auto sales and financing transactions.
- The Federal Trade Commission's "used car rule" should be improved.
- Restrictions on modification of car loans in bankruptcy should be removed.
- Jurisdictional and damage amounts under the Truth in Lending Act should be adjusted for inflation.
- Impediments to proper operation of the Motor Vehicle Information and Cost Savings Act (MVICSA) should be eliminated.

II. The Importance of Cars

For a majority of Americans, a car is a necessity. The design of most cities and suburbs, a lack of public transportation in both rural and urban areas, and numerous other factors make life without a car difficult if not impossible for many. A recent survey by the U.S. Department of Transportation found that 91.2% of adults commute to work using a personal vehicle.[3] While changes such as an ability to telecommute, improved public transportation alternatives, and smart planning may reduce the need for cars, for the foreseeable future many Americans will need a car to be productive, engaged members of society.

This is especially true for working families with low-incomes. Families with higher incomes may have the resources and opportunities to make choices, such as living close to their places of work, obtaining in-home child care or high-cost child care near their homes, working from home, and making other lifestyle changes. These options are typically not available to low-income families.

Households with incomes below $25,000 are nine times more likely to be without a car than households with incomes above $25,000.[4] This indicates that low-income families find it extremely difficult to buy and keep a reliable car. It also demonstrates that a family that does have a reliable car is much better poised to succeed economically than a family without a car.[5]

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[3] U.S. Department of Transportation, Bureau of Transportation Statistics, *NHTS 2001 Highlights Report*, BTS03-05 (Washington, DC: 2003).

[4] U.S. Department of Transportation, Bureau of Transportation Statistics, *NHTS 2001 Highlights Report*, BTS03-05 (Washington, DC: 2003).

[5] A study of one car ownership program, Good News Mountaineer Garage, implied that car ownership has a real impact on families' economic success. The families helped by the program all received Temporary Assistance for Needy Families (TANF) benefits. One year after receiving a vehicle, 70% of the families went off public assistance, 80% were working, and 13% were in job training. In another study of such a program the West Virginia the Department of Health and Human Services found that families receiving cars through a pilot program rather than a statewide leasing program had lower recidivism rates and used their car to become economically independent. For more discussion of the effects of car ownership see http://www.goodnewsmountaineergarage.com/about.html.

III. The Current State of the used Car Sales and Finance Market

A. COMMON ABUSES

Policies currently in place are generally insufficient to protect consumers when buying and financing a used car. Working families, and those that want to be working and self sufficient, understand the role a car can play in their lives and generally purchase a car hoping that it will allow them to improve their situation. All too often, a used car is a liability rather than an asset for a family, draining essential resources instead of providing a route to success and self-sufficiency. Car buyers fall victim to a number of practices that greatly reduce their ability to obtain a useful car that can meet their needs at a fair sales price with fair financing.

The way in which cars are sold and financed is intentionally structured to be needlessly complicated and time consuming in order to confuse buyers and enable dealers to charge excessive prices and fees for the car and financing. Dealers use psychological tactics to influence consumers. Often dealers force the consumer to stay at the dealership for long periods of time by keeping the potential trade-in, keeping the consumer's driver's license, or other ruses. The consumer is worn down and becomes much more susceptible to the dealer's efforts to extract excess profits from the transaction. Dealers mislead and simply lie to consumers.

Dealers also use tactics such as "yo-yo sales" to reduce any chance the consumer has of getting a fair deal. In a yo-yo sale the dealer sends the customer off the lot driving the newly purchased car only to call the customer back several days later to say (sometimes untruthfully) that financing could not be arranged at the original terms and the consumer must sign new documents at a higher interest rate or other worse terms. Of course, if the consumer, rather than the dealer, had reconsidered the transaction and wished to back out, the dealer would be quick to tell the consumer that the deal is binding and the consumer may not cancel the transaction. Sometimes the dealer will have already sold the consumer's trade-in or tell the consumer that the consumer will be responsible for extra charges and costs if the new, less desirable, terms are not accepted. Regardless of whether the dealer is being truthful, often the customer is in no position to refuse the new onerous terms.

Sometimes the dealer is simply bringing the customer back in to get an even higher interest rate or add on more profitable items to the sale. These dealers realize that consumers are more likely to agree to these terms after they already feel so invested in the deal and are reluctant to see it undone. Often the consumer has already paid additional money to third parties for insurance or improvements to the newly purchased car. Indeed sometimes the consumer's trade in has already been sold. In such circumstances the consumer often believes there is no choice but to accept the new terms presented by the dealer. Even if the dealer is truthful and was unable to find a willing lender, the consumer is still in the position of walking away from a deal after investing substantial time and money.

Dealers often structure the negotiation for the sale of a car to obscure the costs and to prevent the consumer from understanding whether he or she is getting the car at a fair price. Excess dealer profits will be hidden in additions such as "window etching," service contracts, rust proofing, and vastly inflated document preparation fees. If a consumer is able to uncover evidence of wrongdoing on the part of the dealer or finance company, often any meaningful compensation for the consumer or any punitive award to stop such behavior in the future will be unavailable because of language inserted in the contract denying consumers the right to go to court and forcing them to resolve any disputes in arbitration.

Financing markups by dealers create another opportunity for abuse. In most car purchase transactions, the dealer arranges the financing in addition to selling the car. Dealers typically contact prospective lenders and present the consumer's financial information. Lenders then inform the dealer of the terms on which they will be willing to lend to that consumer. Often the dealer places the consumer in less favorable financing than the consumer qualifies for, and splits the extra profit with the lender. For example, if the lender was willing to lend to the consumer at an 8% interest rate, the dealer may place the consumer in a loan at 16% interest. The lender and dealer then split the extra money that will be paid by the consumer due to the higher interest charges.

An extremely troubling feature of dealer financing markups is their disparate racial impact. Information obtained through litigation mounted by NCLC and others has demonstrated that minority car buyers pay significantly higher dealer markups than non-minority car buyers *with the same credit scores.*[6]

Yet another problem is the poor mechanical condition of many used cars. Many are unreliable or even unsafe. Many such vehicles are salvage vehicles that have been previously wrecked or flooded. The dealer often knows that the car has defects but misleads the consumer about the condition of the car.

Most used cars purchased by low-income families are sold "As Is." Such cars often require repair soon after purchase. Often the cost of the repairs is more than the consumer can afford or even exceeds the value of the vehicle. As a result, the consumer is often unable to repair the car, so it does not serve the role of helping the family that the consumer envisioned when purchasing it.

Even if repairs are not required, the increasing length of used car loans, often five years or more, coupled with excessive interest rates that result from dealer markups, virtually ensure that the consumer will soon owe more than the car is worth. Many times potential car buyers will still owe more than the vehicle is worth when they must purchase a replacement. When such a customer comes in "upside down," dealers will often roll the excess amount still owed on the first vehicle into the deal for the next one and so make it even less likely that the consumer will ever have any equity in the car.

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[6] See, e.g., Ian Ayers, Expert Report, June 2004, available at http://www.consumerlaw.org/issues/cocounseling/content/AHFCIanAyresReportExhibits.pdf; Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." available at http://ssrn.com/abstract=951827.

B. EXISTING PROTECTIONS

There are many federal and state laws that apply to car sales. Yet these laws leave huge gaps. The existing legal framework is inadequate to protect consumers from some of the most abusive practices of dealers and finance companies. An understanding of existing protections is useful to a discussion of what additional protections are needed to create a fair marketplace for used cars and financing.

One of the most useful protections for consumers who finance cars is the Federal Trade Commission (FTC) "Holder" Rule. This Rule allows consumers defrauded by a dealer to raise the dealer's misconduct as a defense to loan repayment whenever the lender is the dealer's assignee or has a business arrangement with the dealer.[7] Before this rule was adopted, the lender could force the consumer to make full payment no matter how fraudulent the transaction with the dealer - even if the car was a rebuilt wreck, the dealer lacked marketable title to the car, or the car was inoperable. The rule not only protects consumers, but also gives lenders an incentive to police dealers' misconduct, since the lender will not be paid if the transaction is fraudulent.

The FTC's "Used Car Rule" is far less effective.[8] The Rule requires dealers to disclose what, if any, warranty comes with the vehicle on a "buyers guide" posted on the vehicle. Language from the guide must be incorporated into the sales contract, and if the sale is conducted in Spanish, the buyers guide and contract must be available in both English and Spanish. The rule does not require any disclosure of the condition or history of the vehicle, even if the dealer knows of specific defects, and even the disclosure it requires about the existence or non-existence of warranty coverage is weak and misleading. The weaknesses of this rule and ways to improve it are discussed in more detail in Section VIII C below.

The Uniform Commercial Code (UCC) has been enacted in every state, and it establishes a uniform framework for commercial transactions, including warranty rights and the rights of auto creditors and other secured lenders.[9] The UCC creates implied warranties applicable to the sale of a used car by a dealer, but allows the dealer to disclaim those warranties. The UCC also allows auto lenders, if they deem the consumer in default, to repossess the car and sell it, all without a court order or government supervision and subject only to minimal standards. Some states have attempted to fill the enormous gaps in the UCC with state laws that give consumers additional rights, but the nature and effectiveness of these state laws varies dramatically from state to state.

The federal Truth in Lending Act does not regulate the substance of credit terms, but only requires the information to be provided to the consumer prior to the making of the loan so that the consumer may compare terms with other lenders and find the best deal. In theory, since the law requires disclosures to be made in a uniform way, consumers can comparison shop for credit, but car dealers commonly frustrate this goal by providing the disclosures too late in the process.[10]

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[7] For a thorough discussion of the rule see National Consumer Law Center, Unfair and Deceptive Acts and Practices § 11.6 (7th ed. 2008.)

[8] FTC Trade Regulation Rule on the Sale of Used Motor Vehicles, 16 C.F.R. pt 455.

[9] Louisiana has adopted only part of the UCC. For more information about the warranty protections under the U.C.C. see National Consumer Law Center, Consumer Warranty Law (3d ed. 2006 and Supp.). For more information about the protections provided by the U.C.C. in the repossession context see National Consumer Law Center, Repossessions (6th ed. 2005 and Supp.)

[10] For more information about TILA. see National Consumer Law Center, Truth in Lending (6th ed. 2007).

Unfair and Deceptive Acts and Practices (UDAP) laws are general statutes that provide consumers protections from abuse and deception in the marketplace.[11] Such laws very from state to state, with some statutes being effective, others having significant limitations, and yet others being essentially worthless.[12] These statutes typically do not focus on car sales or set specific requirements for them, but set general standards applicable to a broad scope of consumer transactions.

The Equal Credit Opportunity Act (ECOA) prohibits discrimination based upon certain protected classes (e.g. race, religion, nationality). It also includes some procedural requirements for credit applications and denials, such as written notice to the consumer that credit has been denied.[13] The Act has proven extremely useful in attacking practices which discriminate against minorities in the areas of auto finance.

The Motor Vehicle Information and Cost Savings Act (MVICSA) prohibits odometer fraud and regulates the nature of title transfers. It has strong remedies, but also has been interpreted to allow several major loopholes. Many states also have odometer laws, usually closely following the federal law.

Finally, states typically have laws requiring vehicle dealers- and sometimes individual salespersons- to be licensed. Dealer licensing laws have a number of weaknesses. First, they often set only very general standards for dealers. Second, they rarely give consumers any means of obtaining redress from a dealer that violates those standards. Third, the main remedy the state licensing agency can invoke is license suspension or revocation, an all-or-nothing remedy that the licensing agency typically seeks only in the most egregious, obdurate cases. And last, state dealer licensing boards are often vulnerable to "regulatory capture," and are dominated by dealers or by individuals whose focus is on fostering car sales more than protecting consumers.

C. MARKET INTERVENTIONS

Market intervention is another approach to increase car ownership for low-income families. For example, non-profit car ownership programs use several different business models, but typically obtain used cars from the community and then either sell or give them to low-income families.[14] In addition, some lenders, notably some credit unions, have made special efforts to provide fair financing to low-income borrowers, especially those whose credit histories would force them to obtain sub-prime financing.[15]

Such programs are very helpful to those able to take advantage of them. Unfortunately, due to the scale of the market, it is unlikely that either approach will result in fair sales and financing for more than a small percentage of low-income families. Public policy should still ensure that families buying and financing a car through the normal system of dealers receive a fair deal.

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[11] For more information about UDAP laws see National Consumer Law Center, Unfair and Deceptive Acts and Practices (7th ed. 2008).

[12] For an analysis of the strengths and weaknesses of individual state UDAP statutes, see National Consumer Law Center, Consumer Protection in the States: A 50-State Report on State Unfair and Deceptive Acts and Practices Statutes (Feb. 2008), available at www.consumerlaw.org.

[13] For more information about the ECOA see National Consumer Law Center, Credit Discrimination (4th ed. 2005 and Supp.).

[14] For information about car ownership programs see http://www.opportunitycars.com/.

[15] For information about the efforts of credit unions in this area see http://www.ncuf.coop/media/REAL%20Solutions/SteerClear-HowCreditUnionsHelpCarBuyersAvoidPredatoryLoans.pdf.

IV. General Policy Recommendations

While specific suggestions for state and federal policy are discussed below, there are some general principles that are applicable to all the suggested changes if they are to be effective.

A. PRIVATE RIGHT OF ACTION

Without enforcement, even the best policy solutions are ineffective. A private right of action allows consumers who are harmed by the bad actions of those selling or financing cars to bring actions on their own, based upon the dealer's misconduct. Otherwise, enforcement rests on regulators and other officials, who may lack the resources to police the many actors in the used car market. Sometimes those charged with regulating dealers are beholden to the dealers and reluctant to enforce consumer protections. While government enforcement can be extremely useful, there should also be a private right of enforcement for all consumer protections.

B. AUTOMATIC ADJUSTMENTS FOR INFLATION

When policies that protect car buyers are limited to certain dollar categories or other quantitative criteria, in time the selected amounts become obsolete. It is far better to adjust dollar amounts automatically for inflation than to engage in contentious legislative or regulatory battles each time an update is sought. Even if dollar amounts are not used, other numbers cease to be relevant, such as the weight and age limits NHTSA has applied to the disclosure requirements under the MVICSA. If these amounts can be automatically adjusted based upon outside criteria, they should be. Otherwise these amounts should periodically be reviewed to ensure the original intention of the consumer protection policy is still being met.

C. PRESERVATION OF STRONGER STATE AND LOCAL CONSUMER PROTECTIONS

As efforts are made to craft policy responses to the existing abuses in the sale and financing of used cars, care should be taken to ensure that stronger state and local protections are not preempted by either federal statutes or state law.

V. State Reforms to Protect Used Car Buyers from Sales and Financing Abuses

A. COOLING OFF PERIOD OR RIGHT OF RESCISSION

Car sales and financing transactions are intentionally structured in a needlessly complex and confusing fashion. Dealers are masters of using psychological techniques to induce consumers to agree to terms to which they would normally never agree. As any car buyer knows, dealing with the dealer can be an incredibly stressful experience and consumers often enter into agreements they very quickly regret.

A cooling off period allows a consumer to review the transaction without the high pressure of the car salesman and make sure the transaction is beneficial. Cooling off periods have been adopted and found beneficial in a number of other contexts that are subject to high-pressure tactics or where significant assets are at stake:

- Door to door sales.[16]
- Non-purchase money home mortgages: "This provision was enacted to give the consumer the opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home."[17]
- Timeshare sales.[18]

Indeed, so many transactions provide such a right that many consumers mistakenly believe that consumers do have such a right in regards to car sales.

Throughout the European Union, consumers have the right to cancel many sales and credit transactions after a suitable time for reflection, including car sales in some countries. For example, France has a seven day right to cancel such credit transactions.[19] During recent efforts to harmonize consumer protections across the E.U.,[20] the European Commission even released a proposed directive in 2002 that would have extended the period the consumer has to withdraw from a credit agreement, including auto finance, to fourteen days after entering the agreement.[21]

16 16 C.F.R. § 429.

17 U.S. Rep. No. 368, 96th Cong., 2d Sess. 28, reprinted in 1980 U.S.C.C.A.N. 264.

18 See, e.g., Part 24 of Title 13 NYCRR.

19 See Article L311-15 C. civ.

20 See Susan Marks, *Can You Cancel It?*, Citizens Advice Bureau, Dec. 2005 (examining European consumer experience with cancellation rights).

21 The proposal was vigorously opposed by the motor trades industry. The industry pointed out that a survey of 42 dealers in France revealed that 1.29% of consumers exercised their right under French law to cancel within seven days, and argued that extending the time period to 14 days could increase that number. (*CERCA's Opinion on The Proposal For a European Directive On Consumer Credit*, European Council For Motor Trades and Repairs.) The fact that a right is being used by consumers is no reason to argue that it is not useful.

In addition to providing the consumer a time for thoughtful reflection about the advisability of the purchase without the pressure of the car salesman, a cooling off period can address another common practice that does tremendous harm to consumers — "yo-yo sales." As described in Section III A, a yo-yo sale occurs when the dealer sends the customer off the lot in the newly purchased car, only to call the customer back several days later to say (sometimes untruthfully) that financing could not be arranged at the original terms and the consumer must sign new documents at a higher interest rate or other worse terms. Typically in such situations the dealer claims that the deal was binding upon the consumer at the time the papers were signed, but the dealer was free to back out of the deal if it could not find a finance company to fund the deal on the terms the dealer wanted.

A cooling off period could level the playing field, allowing both sides some specified time where both the dealer and the consumer would know the transaction is not final. It is important that there is clear disclosure of the consumer's right to rescind and any right the dealer has to back out of the deal. Of course, if an outright ban of yo-yo sales (as recommended in Section V A) is enacted, then disclosure of the dealer's ability to back out will be unnecessary.

An argument often put forward by those opposing a cooling off period in the auto sales and finance area is that consumers will simply take advantage of the opportunity for a free car during the cooling off period and that the cost to dealers will drive them out of business. Anyone who has ever endured the painful process of purchasing a used car from a dealer will realize that the idea that a consumer would summit to such an ordeal merely to have the car for a day or two is ludicrous. Nonetheless, such criticism of a cooling off period can be easily addressed by requiring the consumer to pay a fee approximately that of a car rental, perhaps $30 to $40 per day, after exercising the right to cancel. The fee should not be so high as to discourage the consumer from exercising the right. And payment of the fee should not be a precondition to canceling, but an obligation imposed upon the consumer after the cancellation has been completed. As security, dealers can require a sufficient down-payment, and deduct the daily rental charge from the down payment when it is returned to the consumer.

This recommendation addresses a cooling off period for used cars. A cooling off period for new cars might raise more legitimate concerns about the cost the dealer bears on a return. New cars which have already been sold can no longer be marketed as new and could suffer a substantial diminution in value.

B. LIMITATION ON YO-YO SALES

Yo-yo sales, also called contingent or spot delivery sales are described in section III A. Yo-yo sales cause significant consumer harm, are unnecessary, and should be banned.[22] In almost all car loans, dealers are the original lender to consumers and subsequently sell or "assign" the loan to another lender. Dealers typically can quickly confirm that they will be able to assign the loan they originally extended to the consumer. If dealers

[22] Several states have attempted to limit this practice, without an outright prohibition, through statutory or regulatory measures. Arizona, Colorado, Illinois, Louisiana, Virginia, Utah, and Washington have enacted yo-yo statutes, (Ariz. Rev. Stat. § 44-1371; Colo. Rev. Stat. § 6-1-708; 815 Ill. Comp. Stat. § 505/2C; La. Rev. Stat. § 32:1254(N)(3)(f); Utah Stat. § 41-3-401; Va. Code § 46.2-1530; Wash. Rev. Code § 46.70.180(4))and a North Carolina statute has some relevance to yo-yos. N.C. Gen. Stat. § 20-75.1.Arizona, Maine, Maryland, and Michigan have issued important administrative interpretations to dealers on the subject, The Arizona Attorney General's Automobile Advertising Guidelines (1993); Office of Consumer Credit Regulation, *Maine Creditor Update* p.8 (Issue #38, Oct./Nov. 1999), Clearinghouse No. 52,522; Maine Office of Consumer Credit Regulation, Examination of Cens Auto Group, Inc., Clearinghouse No. 52,521 (Oct. 29, 1999); Maryland Motor Vehicle Administration, *"Spot Delivery" "Fronting"-"MacArthur Statement" etc.*, Bulletin D-11 98-01, Clearinghouse No. 52,142 (Nov. 30, 1998); Letter from Murray Brown, Deputy Commissioner, Michigan Department of Commerce to [the licensee addressed], Clearinghouse No. 52,029 (May 22, 1989); Michigan Automobile Dealers Association, Dealer Advisory, "Spot Deliveries," Clearinghouse No. 52,519 (Oct. 24, 1997).and Idaho and Ohio UDAP regulations provide certain minimal protections. Idaho Admin. Code 04.02.01.237; Ohio Admin. Code 109:4-3-16(A)(30); see Braucher v. Mariemont Auto, 2002 WL 1393570 (Ohio App. June 28, 2002) (yo-yo seller violated regulation by not having written contingency agreement). In addition, many statutes regulate portions of the yo-yo transaction. For example, a number of states limit a dealer's ability to resell the consumer's trade-in before the deal is final.

are unable to do so, they should delay execution of the sales and finance documents until the financing is secured. If they wished to allow consumers to drive the car home overnight while the dealer confirms the financing, they could certainly do so, but sales should not be contingent upon the dealer securing financing. The documents should not be executed until the dealer is comfortable that it will be able to assign the note or is willing to keep the loan that it originates.

Short of an outright prohibition on yo-yo sales, there are other steps states may take to limit the harm to consumers from contingency financing' harm to consumers. If consumers were provided a right of rescission, dealers could also be provided the same time within which to rescind the transaction, subject of course to the same fees or costs that the consumer would pay if the consumer rescinded. Even if consumers are not afforded a right of rescission generally, if a dealer is allowed to make a sale contingent upon the dealer's assignment of financing, the consumer should be permitted to cancel the transaction for the same time period as the dealer.

In any event, dealers should always be prohibited from selling a consumer's trade-in before the transaction is final. The trade-in should be returned in the same condition it was in when it was entrusted to the dealer, along with any down payment. No charges should be permitted against the consumer for the use of the car. Additionally, if dealers are permitted to conduct sales contingent upon assigning the note, the dealer should be required to use the same process for retaking the car as any lender, complying with the laws applicable to repossession. Also the consumer should not face any potential criminal charges for keeping the vehicle while the dealer follows the usual repossession procedure.

C. PROHIBITION OR LIMITS ON DEALER MARKUPS OF FINANCING CHARGES

As discussed previously in section III A, many low-income car buyers end up paying large dealer markups on the cost of financing the transaction. Typically, the consumer qualifies for a lower interest rate based upon the consumer's credit history, but the dealer does not give the consumer this information. Rather, the dealer writes the loan at a higher rate and then receives a kickback from the finance company for much of the increase. This can net the dealer thousands of dollars and cost the consumer even more, because the consumer pays not only for the dealer's kickback, but also for the portion of the increase kept by the finance company.

These markups are hidden from the consumer, and the dealer may even misrepresent that the higher rate is the best it can find for the consumer. Also a number of lawsuits (NCLC was co-counsel in many of these suits) have shown that dealers impose higher markups on minorities than on non-minorities with identical credit scores.[23] Because dealer markups are so unfair, costly to consumers, and often discriminatory, they should be prohibited.

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[23] For more information see http://www.nclc.org/action_agenda/cocounseling/examples_litigation.shtml#auto.

In the alternative, markups should be strictly limited. The California "Car Buyer's Bill of Rights," which passed in 2006, limits markups to 2.5% for loans 60 months or less and 2% for longer loans. (For example, this law allows an 8% loan to be marked up to 10% or 10.5%, but no higher.) While better than no limitation, these limits still allow dealers to overcharge consumers thousands of dollars while the consumer believes the dealer is looking out for the consumer's best interest. Moreover, the California statute does not prevent dealers from charging different consumers different size markups, based on race or any other factor the dealer wishes to use. A far better limit was found in the initial California Car Buyers Bill of Rights initiative, which capped dealer markups at $150.

An even better option would be not only to cap the permissible markup, but also to require the dealer to charge the same markup to every customer. In other words if the dealer arranges financing that provides a $150 markup payment to the dealer, it must do so for all the car purchases for which it arranges financing. This removes the discretion from the dealer and so eliminates the possibility of discrimination.

D. CAP DOCUMENT FEES

Dealers commonly charge the consumer a substantial "document" fee as part of the purchase transaction, allegedly for the preparation of documents. These fees have been increasing in recent years and some dealers now charge over $900. The AAA (formerly known as the American Automobile Association) estimates that the average "doc fee" in states where fees are unregulated is $400 to $700.[24]

Dealers argue that these fees are necessary to comply with federal privacy and security laws. This is not the case. Other businesses do not charge such exorbitant fees and are able to comply with federal law. At least seven states cap document fees at $100 or less,[25] but dealers in these states still operate profitably.

Rather than being necessary in order for the dealer to comply with requirements, high document fees are pure profit for the dealer. As John Nielsen, director of the AAA Auto Repair Network said "This is a way to try to make another $400 or $500 on the sale of a car."[26]

Document preparation fees should be capped at a low dollar amount that simply reflects the cost necessary to process the documents, including notary fees and fees payable to the state associated with placing title in the consumer's name.

E. POSTED PRICING AND OTHER PROTECTIONS RELATED TO ADD-ONS

An area of enormous dealer profit and consumer abuse relates to various add-on charges that are not central to the vehicle purchase, including credit insurance, service contracts, glass etching, and rust-proofing. These items often have no fixed retail price, but are sold for whatever the dealer can get away with, and often without the consumer fully realizing how much the add-on actually costs. Consumers may be charged more than double the actual cost to the dealer for service contracts. Other items such as window etching are almost pure profit. Dealers are always looking for ways to extract additional money from consumers without the con-

[24] Jennifer Saranow, *Paperwork is a rising cost for car buyers*, The Wall Street Journal, Tuesday, October 03, 2006.

[25] California- $55.00- Cal Veh Code § 11713.1; Louisiana- $35.00- La. R.S. 6:969.18; Maryland- $100.00- Md. TRANSPORTATION Code Ann. § 15-311.1; New York- $45.00- N.Y. Comp. Codes R. & Regs. Tit. 15, Section 78.19(d) (2004); Oregon- $50.00- Or. Admin. R. 137-020-0020; Texas- $50.00- Tex. Finance Code § 348.006; Washington- $50.00- Rev. Code Wash. (ARCW) § 46.70.180.

[26] Jennifer Saranow, *Paperwork is a rising cost for car buyers*, The Wall Street Journal, Tuesday, October 03, 2006.

sumer's knowledge. In extreme cases, consumers have paid as much as $2,000 for a pen and key chain costing the dealership $15.[27]

Because the price for these items is not fixed, but is simply decided by the dealer based upon the dealer's judgment as to what it can get away with, this area lends itself to discrimination. The dealership will practice opportunity pricing- changing a price for the add-on based upon what the dealer thinks the customer will pay, or not notice. It is likely that dealers rely upon race or other protected class when guessing which customers will not notice these add-ons or not raise a fuss about their inclusion.

Several policy improvements can reduce or eliminate such practices:

- All add-ons should be negotiated after agreement as to the price to purchase price of the car and the price of any add-ons should be quoted and explained as a cash price, not how much the item adds to each payment.
- All add-ons should be pre-priced and the prices should be posted at the dealership and on file with some administrative body. Any discounts should also be posted and offered to all customers. This would remove dealer discretion in each transaction which would reduce price discrimination.
- Dealers should obtain the consumer's signature on a disclosure of two different total of payments: the total with all add-ons included and a total without those add-ons so that consumers are aware of the price of the add-ons over the life of the loan.
- For add-ons supplied by a third party (such as insurance or a service contract), the posted price and the price quoted to the consumer should include not only the charge to the consumer, but the amount of that price that is being retained by the dealer. This would help the consumer determine if the item was being pushed for the consumer's well being or to line the dealer's pockets.
- Dealers should be prohibited from selling add-ons supposedly supplied by unrelated third parties, when in fact they are supplied by entities related to the dealer. This would prevent dealers from hiding their profit on an item by keeping those profits in the related entity, rather than in the dealership.

A related protection- giving the consumer the right to cancel the obligation to purchase the add-on service or item- is discussed in Section V I below.

F. INCREASE DEALER BOND REQUIREMENTS

Most states require that dealers post a bond as a precondition to doing business.[28] These bonds protect consumers and sometimes others in the event that the dealer is insolvent and unable to pay restitution for bad acts. While useful, existing bond requirements are far too low, typically $50,000 or less for all claims against the dealer. Many bond amounts have not been adjusted for inflation for decades.

This issue has become especially important in recent years. The National Automobile Dealers Association estimates that over 900 *new* car dealerships closed in 2008 and over 1,100 will close in 2009. The number of *used* car dealerships that close will likely be much higher. While the economic impact of these closures has been widely reported, the direct effect on consumers has received little attention.

[27] Gregory Arroyo, Payment Packing in Los Angeles, F&I Management & Technology Magazine, February 2007.
[28] For a state by state listing of bond requirements see National Consumer Law Center, Automobile Fraud Appx. C (3d ed. 2007).

Dealerships seldom shut down in an orderly fashion. Before closing, dealerships often engage in such illegal practices as failing to pay off existing loans on trade-in vehicles or selling cars to consumers without first having obtained good title. By the time the consumer discovers that the trade-in has not been paid off, or that there is a dispute over the title to a newly purchased car, the dealer will often have shut its doors and be insolvent. In such a situation, the claims of lenders and consumers far exceed the limits of the dealer's bond.

To protect consumers, dealer bonds should be increased dramatically. The bond should assure the availability of $500,000 for consumer claims.

G. CONSUMER COMPENSATION FUNDS

A dealer compensation fund offers many advantages when adopted along with a dealer bond requirement. A compensation fund requires annual contributions from all dealers, sufficient to provide coverage for consumer claims against insolvent dealers.

Dealer compensation funds provide a higher dollar amount of compensation for each aggrieved consumer than current bond requirements, especially when used as a supplement to existing bond requirements rather than an alternative. Since the amount each dealer contributes depends upon the number of bad actors within the pool of dealers, a fund also encourages self-regulation and self-policing by dealers. For a dealer compensation fund to be effective, decisions on consumer claims must be made by a body that is not beholden to, or influenced by, the dealers who would ultimately bear the burden of the compensation cost.

A few states, such as California, West Virginia, and Virginia, have already supplemented the protection of their dealer bonds with dealer compensation funds.[29] While these existing funds could be improved- some have issues such as maintaining sufficient funding to pay claims or a difficult claims process which may discourage consumers- they are the vanguard of a more effective way to protect consumers in such situations. Canada also has a similar fund for consumers victimized by auto dealers.[30] Such funds are even more common for certain other businesses, such as attorneys and building contractors.[31]

H. LIMITATION ON PRE-PAYMENT PENALTIES

One solution for consumers victimized by abusive and over-priced financing through a dealer is to obtain refinancing elsewhere. As discussed in Section III C, some lenders, especially credit unions, are able to provide financing for low-income families at fairer terms than dealers typically offer. While the high pressure sales techniques used by dealers often result in consumers financing through the dealership despite the availability of other less costly options, consumers can undo much of the injury later by refinancing. (One disadvantage to refinancing is that the new lender may not be subject to the FTC Holder Rule and so is not liable for the consumer's claims or defenses against the dealer.)

A major impediment to refinancing is that the initial auto loan may include a significant penalty for pre-paying it. (Pre-payment is a necessary part of any refinancing, as the proceeds of the new loan are used to pay off the original loan). Even if a loan does not include an explicit pre-payment penalty, there is still such a penalty

[29] See, e.g., Va. Code Ann. § § 46.2-1527.1 to 46.2-1527.8.

[30] In Canada the Motor Vehicle Dealers Act provides for a Motor Vehicle Dealers Compensation Fund. For more information see http://www.omvic.on.ca/info/compfund/compfund_default.htm.

[31] See e.g. the North Carolina Bar Client Security Fund designed to reimburse clients who have suffered financial loss as the result of dishonest conduct of lawyers.

in effect if the lender uses a formula for calculating the pay-off amount on the original loan that is unfavorable to the consumer. For example, many lenders use a calculation method called the Rule of 78s that always results in a higher pay-off amount than the more accurate actuarial method.

Before computers were widely used, lenders justified their use of the Rule of 78s because it was time consuming to calculate what the consumer owed on the more precise actuarial basis.[32] Of course, the unspoken reason was that the Rule of 78s always favors the lender. With the widespread use of computers, there is no reason to use the Rule of 78s except to extract more money from borrowers than they would pay were the payoff calculated exactly.

Several states have banned the use of the Rule of 78s for all or most consumer credit contracts.[33] The Home Owners and Equity Protection Act recognizes the Rule of 78s as a pre-payment penalty and prohibits its use for high cost mortgages. Federal law also prohibits the use of the Rule of 78s for all consumer credit transactions with terms longer than 61 months, requiring instead that the creditor use "a method at least as favorable to the consumer as the actuarial method."[34] Unfortunately for low-income families, however, most used car loans are less than 61 months, and not within the scope of the federal prohibition.

For these reasons, prepayment penalties, including the use of the Rule of 78s to calculate the payoff amount, should be prohibited for all auto loans, regardless of length. When the payoff amount on the original loan is calculated, the buyer should receive a proportionate rebate, calculated by the actuarial method, of all interest and finance charges (whether termed "origination fees," "prepaid finance charges," or some other term). In addition, a car buyer should receive at the time of sale a useful, understandable disclosure of the right to refinance the loan without any prepayment penalty or similar cost.

I. RIGHT TO CANCEL AND FAIR REBATE CALCULATIONS FOR INSURANCE AND OTHER ADD-ONS

Section VI E lists several ways to limit abuses in the sale of add-on products, such as credit insurance, GAP insurance, and service contracts. In addition to those protections, car buyers should be allowed to cancel the add-on and receive a full rebate for some reasonable time after the sale. This is because consumers are often unaware they purchased such add-ons until the paperwork can be carefully reviewed at home. In addition, a right to cancel add-ons, combined with a prohibition of prepayment penalties, can make refinancing a much more realistic option.

States typically regulate the formula for early cancellation of insurance, and a few states specifically regulate rebates for car service contracts as well. Typically the regulations permit the use of the inaccurate Rule of 78s described above. Rebates for other add-on items are largely unregulated. Refund formulas for these items often heavily disfavor the consumer. The result is that a consumer who is sold add-ons is often locked into the deal because of the high cost of cancelling.

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32 For more information about the history of the rule of 78, calculation of payoffs and the harm the rule does to consumers see National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses 5.6.3.3 (3d ed. 2005 and Supp.).

33 For more information about the history of the rule of 78, calculation of payoffs and the harm the rule does to consumers see National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses 5.6.3.3 (3d ed. 2005 and Supp.).

34 15 U.S.C. § 1615(b).

Consumers attempting to obtain rebates on these items may run into other problems in addition to the rebate calculation. Often the party providing the coverage or service requires the consumer to notify it directly, refusing to allow cancellation if the consumer merely notifies the dealer. The provider may also fail to cancel the add-on automatically if the car is repossessed or if the loan is paid off or refinanced.

The best way to permit consumers to refinance the car purchase at fair loan terms and to cancel unwanted and unnecessary add-ons, is to allow a consumer ten days to simply notify the dealer that the consumer is canceling the add-on. The consumer would receive a full refund of the price paid, inclusive of any amount kept by the dealer. The ten day period would begin to run after the consumer's receipt of a notice of right to cancel and, in the case of insurance, service contracts, or similar products, the policy or similar document. The notice of the right to cancel should be understandable with a clear explanation of a simple method for cancelation.

Allowing consumers to cancel add-ons and receive full rebates would have many benefits. Dealers would be less likely to hard-sell these products, and would be more likely to price them fairly, if they knew that a consumer who was dissatisfied with the purchase could cancel the deal. Allowing cancellation would also encourage competition in the marketplace, as other vendors would be better able to compete for the consumer's business.

VI. State Reforms to Protect Used Car Buyers from Dangerous and Unreliable Vehicles

Used cars marketed to low-income families are often in poor repair and have mechanical defects. Frequently these cars have suffered previous undisclosed damage from traffic collisions or floods. All too often used cars are not only unreliable, but unsafe.

Dealers are very skilled at detecting flood and wreck damage to vehicles they purchase for resale. A person with experience repairing or inspecting cars can identify markers of wreck or flood damage within minutes. There are signs, such as slight paint overspray, that ordinary car buyers would never notice but are obvious to people with experience.[35]

Dealers are able to buy cars with this type of damage cheaply, and then resell them at a substantial profit by failing to disclose the vehicle's adverse history. In fact, the business model of many low-end used car dealers is based on buying vehicles with wreck damage, flood damage, or serious defects, making cosmetic repairs so that lay people are unlikely to detect the problems, and then selling them without disclosure.

Many of these cars are dangerous to drive. Even if the defects are not dangerous, when a car becomes inoperable soon after a family purchases it, the family will find itself at the beginning of a downward spiral. The car is no longer an asset, but a liability. The cost of repairing the car may exceed its value, but, without repair, the car no longer serves its purpose. While the car is no longer helping the family, the car payments are still due. There are a number of policy alternatives that can prevent this turn of events.

A. USED CAR LEMON LAWS AND REQUIRED WARRANTIES

All fifty states and the District of Columbia now have some type of lemon law to protect the purchaser of a *new* car. Only six states, Hawaii, Massachusetts, Minnesota, New Jersey, New York, and Rhode Island, have lemon laws for the protection of *used* car buyers.[36] These laws generally provide a statutory warranty for used cars, often based upon the age or mileage of the vehicle. If the car experiences problems during the statutory warranty period, the dealer has a reasonable opportunity to fix the problem. If the dealer is unable to do so,

[35] For discussion of the ways in which dealers obtain the cars they sell and the ways in which many defects are obvious to dealers, see generally National Consumer Law Center, Automobile Fraud (3d ed. 2007).

[36] Haw. Rev. Stat. §§ 481J-1 to 481J-7; Mass. Gen. Laws ch. 90, § 7N¼; Minn. Stat. § 325F.662; N.J. Stat. Ann. §§ 56:8-67 to 56:8-80 (West); N.Y. Gen. Bus. Law § 198-b (McKinney); R.I. Gen. Laws §§ 31-5.4-1 to 31-5.4-6.

the dealer usually must either replace the car or refund the consumer's money, whichever the consumer prefers.

Several other states, including Arizona, Connecticut, Illinois, Maine, Nevada, New Mexico, and Pennsylvania, do not force a dealer to provide a replacement car or refund after a certain number of unsuccessful repair attempts, but they do establish minimum warranties for used car sales.[37]

Unfortunately, the warranties required both by the used car lemon laws and the other used car warranty laws are very limited in duration. Most used car lemon laws limit the warranty to 60 or 90 days. The minimum warranty laws require warranties as short as 15 days or 500 miles.[38] While a required warranty can be a useful protection for consumers, the warranty must be of sufficient duration that pre-existing problems manifest themselves before the warranty expires.

Some commentators have suggested that a minimum statutory warranty duration ought to be at least as long as the term of the car loan. Given the extraordinarily long terms now common in used car financing this may not be a workable solution, but it does have merit. Certainly, when financing is arranged there is an assumption by the consumer that the car will be usable at least as long as the loan must be paid. Such a warranty is likely to reduce loan defaults. As described previously, when a car stops running, the consumer is much less likely to make payments, often because the consumer is without transportation to work or is forced to use the money for repairs, or buying another car that works. Others have proposed that the length of the warranty depend on the cost of the car.

While extending warranties for the life of the loan may not be a workable solution, if such warranties are to be effective the duration should be at least 6 months or 6,000 miles. In addition an effective used car lemon or warranty law should require a warranty with broad coverage, should prohibit disclaimers, and should preserve the viability of other claims the consumer may have. New York's used car lemon law is a good example of a statute that has an explicit statement that it does not preclude other remedies.[39]

B. PROHIBIT DISCLAIMER OF IMPLIED WARRANTIES AND "AS IS" SALES

Under the Uniform Commercial Code (UCC), a dealer's sale of a used car automatically includes an implied warranty that the car being sold is "merchantable." This warranty guarantees a basic standard of quality and that the car is fit for its ordinary purpose as transportation. However, the UCC allows the dealer to disclaim this implied warranty,[40] and invariably dealers do so, selling the vehicle "as is."

Several states, such as the District of Columbia, Maryland, Massachusetts, and West Virginia, prohibit dealers from disclaiming implied warranties in all or certain categories of used car sales. As dealers continue to operate in all these jurisdictions, clearly such a prohibition will not drive dealers out of business. In addition, since the implied warranty is part of the UCC, which has been adopted in every state except Louisiana, it is a well-accepted concept and its meaning is well-established in the courts. While simply prohibiting disclaimer of these implied warranties does not solve every consumer issue with the condition of the vehicle, it does go a long way to assuring that the car at the time it is sold meets a minimum condition of merchantability.

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[37] Ariz. Rev. Stat. Ann. § 44-1267; Conn. Gen. Stat. § § 42-220 to 42-226a; 815 Ill. Comp. Stat. § 505/2L; Me. Rev. Stat. Ann. Tit. 10, § 1474; Nev. Rev. Stat. § § 482.36661, 482.36662, 482.36663; 37 Pa. Code § 301.2(5) (Pennsylvania's UDAP regulation, while not strictly a warranty statute, provides that there is an implied representation in every car sale that he car is roadworthy, which serves much the same function as a required warranty).

[38] For summaries of the warranty statutes see National Consumer Law Center, Consumer Warranty Law 15.4.6 (3d ed. 2006 and Supp.).

[39] N.Y. Gen. Bus. Law § 198-b(d)(2).

[40] Although Louisiana has not adopted Article 2 of the Uniform Commercial Code, which provides these warranties, it does have a similar doctrine. While vast majority of states have adopted this interpretation of the applicability of the U.C.C. to used car sales, in two states, Alabama and Texas, there exist some questionable cases that have held these implied warranties do not arise in the sale of used cars.

C. REQUIRED INSPECTION AND MINIMUM CONDITIONS OR DISCLOSURE

Some states require dealers to inspect used cars before selling them, but typically these inspections are limited to safety issues, such as lights, brakes, and turn signals, or only emission levels. A few states do go beyond safety or emission inspections, and require dealers to inspect the vehicle to determine whether it can serve as reliable transportation. Nevada dealers must inspect cars with over 75,000 miles for both safety and soundness of the engine and drive train and disclose in writing any defects that are found or reasonably should have been found.[41] In New York dealers must inspect the vehicle and give the consumer a certification that the car is in satisfactory and adequate condition for highway travel.[42]

Widespread adoption of laws such as Nevada's and New York's with some improvements would accomplish several important goals. There would be some assurance that vehicles were not only safe, but also were reasonably reliable as transportation. All used cars would have to meet a general standard which buyers could rely. Dealers would no longer be able to claim ignorance of defects that should have been apparent from an inspection. An effective law would prohibit the sale of vehicles that are not roadworthy. Such vehicles would have to be repaired before sale, or if they cannot be repaired then recycled. Mere disclosure of defects is not enough. The disclosure may not be provided before the sale finalized and written disclosures are often "explained away" by the salesman.

D. BURDEN OF PROOF ON DEALER TO SHOW CAR'S CONDITION AT TIME OF SALE

A consumer who is saddled with a lemon vehicle usually wants to return the vehicle and receive a full refund. Dealers, however, typically resist this remedy. If a dealer is forced to provide some redress for the sale of a defective used car, the dealer usually resists anything other than promising repair attempts, or replacing the car with another off the lot (often overpriced and with its own defects).

The UCC remedy of "revocation of acceptance" allows a buyer to return a product such as a motor vehicle and receive a refund when the product does not conform to warranties or other promises and the defects substantially impair its value. A number of factors make it difficult for consumers to obtain this (or any) remedy, however. Roadblocks include difficulty in finding an attorney to take the case at an affordable fee, the dealer's sale of the car "as is," and arbitration clauses that prevent the consumer from taking the case to court.

Another hurdle for revocation of acceptance is that the consumer has the burden of showing that the defects existed at the time of sale (and not just during the consumer's use).[43] Proving that the defect existed at the time of sale can be very difficult.

A recent European Union directive addresses this issue. It allows the consumer to seek redress for any problem which makes a vehicle unfit for the purposes for which cars are normally used,[44] if the defect becomes apparent within two years from the purchase.[45] Importantly, for defects the consumer discovers within the first six months after purchase, the defect is presumed to have existed at the time of sale.[46] If the dealer believes that the defect arose after the sale, the dealer has the burden of rebutting this presumption by showing the defects were not present at the time of sale. Adopting such a rule for used car sales in the United States would go a long way toward leveling the playing field.

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41 Nev. Rev. Stat. § 482.36661.
42 N.Y. Veh. & Traf. Law § 301 (McKinney).
43 U.C.C. § 2-607(4).
44 1999 O.J. (L 171) 7.7, DIRECTIVE 1999/44/EC, Art. 2.
45 1999 O.J. (L 171) 7.7, DIRECTIVE 1999/44/EC, Art. 5.
46 1999 O.J. (L 171) 7.7, DIRECTIVE 1999/44/EC, Art. 5.

VII. State Reforms to Protect Car Buyers and the Public from Arbitrary and Dangerous Repossession

A. CONSUMER ABUSES RELATED TO VEHICLE REPOSSESSION

Obtaining a reliable car at fair terms is only half the battle for low-income families. Keeping the car can prove just as difficult. Considering that a car is for most families a basic necessity, there are surprisingly few protections for a car owner when a lender decides to take a family's car. Every state now permits a lender, when it believes the car owner to be in default, to take a car away from the owner without any formal judicial process or the use of law enforcement, through a procedure known as "self-help" repossession. The creditor then sells the vehicle, again without court supervision.

This ability of the lender to take away the consumer's car and sell it at an unsupervised sale leaves the consumer in a very vulnerable situation. If the lender is in error and the consumer is not really in default, the consumer is still without a car and without transportation to work while the dispute plays out. Because the lender need not file a court action, if the consumer disputes the lender's repossession, this will be after the car is gone, and conceivably after it is sold.

In addition, the consumer bears the burden of trying to take the matter to court. This is highly impractical and almost never happens. Even if the family is able to file a case in court and prove that the car should not have been repossessed, it is often too late to save a job lost for lack of transportation.

Lenders, knowing they have this cudgel to wield against the consumer, often threaten repossession without process as a way of forcing the consumer to comply with their demands, whether justified or not. This tactic is especially common among buy here, pay here dealerships that act as both the lender and dealer.

In most contexts, the law does not permit private actors to take justice into their own hands; it discourages vigilantism. The story of how policy makers permitted auto lenders to take these extraordinary measures is long and interesting. Historically lenders, landlords, and others were permitted take action without judicial process because of the weakness of the legal system.

> *The origins of the self-help remedy for creditors as embodied in today's law go back to the Dark Ages. Self-help was tolerated because legal institutions were too weak to prevent it. ...The remedy had been totally abolished by*

the time of the Norman Conquest, but the practical considerations involved in creditors' needs to protect their property caused its revival…[47]

Secured creditors were permitted to take these extraordinary measures because the legal systems at the time were weak and ineffective. Today our judicial system is well equipped to protect both consumers and creditors. In other areas, there has been progress toward prohibiting unsupervised retaking of property by private parties. Historically landlords were permitted to use self help to evict holdover tenants:

It would seem that at common law the landlord had the right, after the expiration of the tenant's term, to immediately re-enter and take possession of the rented premises, and that in so doing a resort to force was legal, provided no more force was used than was actually necessary to eject the tenant. It is manifest, however, that proceedings of this kind would have a tendency to cause breaches of the peace; and, in this country especially, it is more than probable that they would frequently result from attempts by landlords to forcibly evict tenants who were unwilling to peaceably and quietly surrender possession of premises.[48]

In the nineteenth and twentieth centuries there was growing concern that tenants might be unfairly dispossessed of their homes or, even if the landlord was entitled to possession, that the use of self-help to retake the property would lead to violence. A discussion from a decision at the turn of the century by the Washington State Supreme Court illustrates these concerns and is useful in analyzing auto repossessions as well.

But this rule, which makes the landlord a law unto himself, is not conducive to good business principles or to good order, and for that reason is not looked upon with favor. The statutes of this state (§ 5527, Bal. Code), provide a speedy, adequate, and orderly method for a landlord to obtain possession of his property upon failure of the tenant to pay rent, or upon failure to perform any other condition or covenant contained in a lease. These statutes we think should be held to provide an exclusive remedy, notwithstanding an agreement permitting possession to be taken by force.[49]

These obvious problems with the use of self-help led to widespread statutory reform in the area of landlord tenant law. Judicial procedures were created that allowed an expedited judicial process to remove a tenant in possession. Today the vast majority of states prohibit landlords from using self-help to evict residential tenants.[50]

Unfortunately, the law concerning the repossession of automobiles has not developed to the same degree. In today's society, a car can be just as important to a family's survival as an apartment, and repossession without the benefit of judicial process and law enforcement officials is just as likely to lead to violence as self-help eviction. Every year, many car owners and those hired by secured creditors to repossess cars are injured or killed during attempted self-help repossessions.[51]

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[47] Wallace v. Chrysler Credit Corporation, 743 F.Supp. 1228 (W.D.Va. 1990).

[48] Entelman v. Hagood, 95 Ga. 390, 22 S.E. 545 (Ga. 1895).

[49] Spencer v. Commercial Co., 30 Wash. 520, 71 P. 53 (1902).

[50] For more discussion see Randy G. Gerchick, Comment, *No Easy Way Out: Making the Summary Eviction Process a Fairer and More Efficient Alternative to Landlord Self-Help*, 41 U.C.L.A. L.Rev. 759 (1994).

[51] See, e.g., Dave Fehling, KHOU-TV News, *Think Twice before using Deadly Force* (broadcast Friday Nov. 30, 2007) (transcript available at FOX11AZ.com) (describing a car owner who shot and killed a repo man mistaking him for a car thief and subsequently committed suicide, citing the tragedy in a suicide note); Fox News: *Tot Tumbles From Repossessed Car* (Sept. 8, 2007, available at foxnews.com) (a four-year-old boy jumped out of a vehicle that was being repossessed); Cathy Spaulding, *Arrest made following repo injury*, Muskogee Phoenix (Okla.) (2008 WLNR 6057037), March 31, 2008 (car owner was run over by repossession team); Steve Gonzalez, *Jury awards man who drove golf cart into his cavalier while it was being repossessed*, The Madison St. Clair Record, June 28, 2007 (man awarded compensation after suffering disabling injuries in his attempt to stop a repossession); Brian Nearing, *Tow Truck Death Probe Continues*, Times Union Albany, NY, Aug. 4, 2007 (tow truck driver struck and killed man who was trying to stop his car from being repossessed); Eric Rich and Hamil Harris, *Hip-Hop Figure Killed After He Chased Tow Truck*, Washington Post, Oct. 14, 2006; B01 (a man was shot and killed trying to stop his car from being towed); Rebecca Catalanello, *Crist's Towing Bill Gets New Name*, St. Petersburg Time, March 29, 2007 (describing the naming of a bill to regulate towing after a car owner who was fatally shot by a tow company owner); Jason Whitely, *Wrecker passenger recounts deadly repo*, KHOU-TV Local News (broadcast Friday July 6, 2007) (repo man ran over and killed a woman while trying to repossess her car); Jennifer Hall, *Local repo man takes friendly approach*, Kansas City Star, B2, Sep. 15, 2007 ("friendly" repo man describes being hit by a car he was attempting to repossess suffering a broken pelvis, torn muscles, and internal bleeding); News 10 Now of Syracuse, *Repo Worker Shot At* (July 3, 2007, available at news10now.com); The Indy Channel, *Officers: Man Ejected, Died at Scene* (July 6, 2007, available at the indychannel.com) (man dies in accident after trying to evade repo man attempting to take his car).

B. A BAN ON SELF-HELP REPOSSESSION

A secured lender should be required to obtain a court order to seize a vehicle, and the seizure should be accomplished by law enforcement officials. This process would be similar to the existing system most jurisdictions already have for obtaining and enforcing eviction orders and seizing personal property pursuant to a court order. Such a system would both preserve the right of the consumer to raise defenses which might preclude repossession, and also minimize the likelihood of injury and death for car owners and repossession employees compared to the use of self-help.

Currently the Blackfeet Tribe and the Navaho Nation prohibit self-help repossession on the reservation,[52] and the District of Columbia allows repossession only with the permission of the consumer immediately prior to the repossession.[53] In addition, until recently, Louisiana and Wisconsin also prohibited self-help repossessions. Until 2006, the Wisconsin Consumer Act prohibited self-help repossession by auto lenders, and was lifted only after intense lobbying by auto lenders.[54] The industry made two major arguments for lifting the ban: that self-help repossession would only be permitted for automobiles, but not other personal property, and that consumers often failed to appear at the court proceedings the lenders were required to bring before repossession. As consumer advocates pointed out, this showed that the system was working: consumers who did not have defenses or objections did not contest the lender's case, while those who did object had a forum for resolving their objections.[55] By analogy, advocates pointed out that no one would seek to eliminate the right to vote simply because voter turnout is often low.

Protecting consumers and the general public from the dangers of self-help repossession may add some cost to lenders, but clearly would not cause a market failure depriving people of the ability to obtain cars and financing. During the almost 35 years that the prohibition on self-help repossession was in place in Wisconsin, families were still able to buy and finance cars.

One argument that is sometimes advanced by those opposing requiring landlords and secured lenders to use court action before depriving people of home and possessions is that a court action will reflect negatively against the consumer. While there may have been some limited merit to this argument when public court records were one of the few records available to potential lenders and landlords, it is much less applicable today. The overwhelming majority of auto lenders will report a consumer default on the loan and a subsequent repossession to credit reporting agencies. The repossession reflected on the consumer's credit report will likely have as much negative impact with potential creditors as a court action to take back the car.

C. ALTERNATIVE AND ADDITIONAL POLICY REFORMS FOR REPOSSESSION

While abolishing self-help repossession should be the primary policy means of protecting car owners and public safety, alternative measures would bring at least some increase in fairness and safety. These alternatives include requiring additional steps and warnings before repossession, regulating repossession agents more strictly, and clarifying the lender's liability for the acts of the repossessor. In addition, even if self-help repossession is banned, consumers should be allowed to reinstate their loans after repossession and deficiency judgment abuses should be reformed.

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[52] Ordinance # 81. Blackfeet Commercial Code; Chp 4; Navajo Nation Code tit. 7, § 621.

[53] D.C. Mun. Regs. Tit. 16, § 118.

[54] For a discussion of the changes to the repossession law see Kelly Anderson and Steve Meili, *Wisconsin's New Automobile Repossession Law, Wisconsin Lawyer*, Vol. 80, No. 2, Feb. 2007.

[55] Letter from Stephen E. Meili, Clinic director of Wisconsin Law School's Consumer Law Litigation Clinic, to Wisconsin Governor James Doyle (March 27, 2006).

D. ADDITIONAL PROCESS BEFORE REPOSSESSION

Short of banning self-help repossession, requiring some process before repossession would provide consumers some protection. Many states require some notice to the consumer before repossession, and Illinois and Wisconsin require that the creditor send not only a notice to the consumer of the default and pending repossession, but also provide the consumer a way to dispute the repossession. If the consumer asserts defenses, the creditor must go to court before repossessing the car. While this creates a process for the consumer to dispute a seizure, it is difficult to expect the consumer to ask to be sued, which is essentially what the consumer must do to dispute the matter.

E. RIGHT TO CURE

Repossession is generally available to creditors as soon as the consumer is in default. If a consumer is a day late on the car payment, the secured lender may take the car. Some states provide a "grace period" before the secured creditor may accelerate the debt and commence repossession. This can be helpful, but often the consumer is unaware of his or her exact rights in such a situation.

More helpful is the law in many states that, before a lender may repossess the vehicle, it must first provide the consumer with a notice of the default and the right to pay the missed payment and late fees within some prescribed time, such as 10-20 days.[56] This is also known as "curing" the default. The lender may not proceed with repossession until after the time to cure has passed.

The right to cure can help low-income families keep their cars and avoid costly repossessions. It also benefits lenders: if the lender's goal is to receive payments on car loans, rather than to repossess and resell cars, the right to cure restores a car loan to performing status. It also means that the lender or repossession agent does not have to undertake a costly and often dangerous repossession.

F. PROHIBITION AGAINST PROCEEDING WITH REPOSSESSION IF CONSUMER OBJECTS

Many, although not all, of the deaths and injuries that have arisen during vehicle repossessions have occurred when the repossession agent was trying to repossess the vehicle over the consumer's objection. This scenario is certainly the most dangerous, with two private parties, each of whom may be armed, trying to wrest control of a 2,000 lb. vehicle that may be moving at a high speed.

In a number of states the courts have held that a repossession agent who proceeds with a repossession over the consumer's objection can be liable to the consumer for breach of the peace. This rule only creates potential civil liability, however, plus a rule is stronger if it is stated explicitly in a state statute. While prohibiting self-help repossession altogether is preferable, it would probably save a number of lives if state law made it clear that a repossession agent must discontinue the repossession if the consumer objects in any way.

[56] Jurisdictions providing a right to cure include Colorado, Connecticut, District of Columbia, Iowa, Kansas, Maine, Massachusetts, Missouri, Nebraska, New Hampshire, Puerto Rico, South Carolina, South Dakota, Virginia (although very weak- no notice required) and Wisconsin.

G. RIGHT TO REINSTATE

After a secured lender has repossessed a family's car, the car is typically sold. The consumer has a right to redeem the vehicle by paying the total loan amount, including fees and costs associated with the repossession. Such a right is seldom of much use to low-income families as the money to pay off the full balance owed on the car is rarely available.

A more useful policy is the right to reinstate the loan. This allows the consumer to pay only the missed payments along with late fees and costs of repossession, and then get back the car and reinstate the loan.[57] An important part of the right to reinstate is that the lender must promptly notify the consumer of the right within a few days of the repossession. After receiving the notice, the consumer typically has fifteen to twenty days to reinstate the loan.

H. REGULATION OF REPOSSESSORS: LICENSING AND BONDING

Repossession by private entities is a dangerous and all too often deadly activity. While banning self-help repossession is the ideal way to address these issues, at a minimum, repossessors should be required to be licensed and bonded in every state where they operate. Several states already require licensure.[58] While no panacea, strict licensing would allow continuing education of those engaged in repossession work as to the duties and dangers. Those who violate state regulations or have a history of criminal activity could be denied the right to repossess.

In addition to licensing, those engaged in repossession should be required to post sizable bonds, allowing for compensation to victims of illegal repossessions, even if the repossessor lacks sufficient assets to compensate those harmed. Bonds also provide another set of eyes to monitor the activities and compliance of the repossessor, as the bonding company has a very real interest in seeing that the repossessor behaves properly.

I. CREDITOR LIABILITY FOR ACTIONS OF REPOSSESSORS

Creditors typically claim that they are not liable for the bad acts of the repossessors they hire. They claim that the repossessor is an independent contractor, not under the creditor's direct control. Because self-help is such an extreme remedy, the creditor ought to remain liable for the actions of those hired to carry out its repossessions. Many court decisions[59] and the UCC's Official Comments support the view that the lender is responsible for the repossessor's actions.[60] However, it would be helpful to make this explicit by statute, as already the case in the District of Columbia.[61]

J. ANTI-DEFICIENCY STATUTES

A lender, after repossessing a car, typically sells it, applying the sale proceeds to the debt, which now includes not only the amount still owed under the loan, but also the costs of the repossession, storage, and other costs. The consumer remains responsible for this amount, known as the deficiency. The deficiency is often astronomically high, reflecting the inflated price of the car when it was sold to the consumer, the extremely low price produced by the lender's unsupervised sale, and the costs of the other added charges.

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[57] Jurisdictions with a right to reinstate include: California, Connecticut, District of Columbia, Illinois, Maryland, Mississippi, New York, Ohio, and Wisconsin.

[58] Jurisdictions that require repossessors to be licensed include Hawaii, Maine, Michigan, Nevada, New Mexico, Oregon, and Pennsylvania.

[59] See National Consumer Law Center, Repossessions § 13.10.4 (6th ed. 2005 and Supp.).

[60] Official Comment 3 to U.C.C. § 9-609.

[61] D.C. Code § 28-3812(d)

A number of states have anti-deficiency statutes that prohibit the creditor from both retaking the car and then seeking a deficiency. Such statutes protect consumers from the low prices resulting from repossession sales and from excessive attorneys' fees, storage, and repossessor fees. They also discourage dealers and lenders from structuring transactions with excessive car prices, as the lender may have to rely upon the sale of the collateral to cover the amount owed.

Unfortunately, existing statutes typically only apply to deficiencies or sales of $1000-2000,[62] making them largely irrelevant to today's used car market. Most of these statutes were enacted over 30 years ago, and have never been adjusted for inflation. A statute protecting transactions under $2,000 in 1970 when adjusted for inflation, would apply to transactions under $11,098.09 in 2008.[63] Existing or any new anti-deficiency statute should reflect modern prices and should then be indexed for future inflation.

Currently, the $1,000 to $2,000 cap in most anti-deficiency statutes refers to the original cash price of the vehicle. This is somewhat arbitrary and could even lead dealers to price cars over any limit. Even if the statutory amount is increased to $10,000, a car that sold for $9,000 would not be subject to any deficiency, while a car sold for $11,000 would be subject to a full deficiency. This would be true even if more money is still owed on the less expensive car. One potential improvement is to make anti-deficiency statutes applicable to all potential deficiencies, up to the statutory amount. The amount would apply to the potential deficiency owed, rather than the sales price. The lender would only be entitled to the portion of any deficiency that is above the statutory amount.

Anti-deficiency statutes which require the lender to elect between seeking repayment of the entire debt and retaking the vehicle discourage the lender from using the possibility of repossession as a threat to intimidate consumers. The statutes also provide incentives for the lender to take good care of the vehicle if it is repossessed and attempt to get the best price possible when it is sold. If the lender instead elects to seek repayment of the debt rather than repossession, the consumer still has transportation to keep a job in order to repay the lender.

Some anti-deficiency statutes that attempt to force the creditor to elect between repossession and pursuing the debt leave an enormous loophole: They allow the creditor to accomplish exactly the same result by obtaining a money judgment on the debt and then forcing a judicial sale of the car.[64] Statutes that intend to force the lender to elect between these two options should specify that if the lender brings an action on the debt rather than repossessing the car, then the car is not subject to seizure.[65]

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62 Ala. Code § 5-19-13 ($1000); Ariz. Rev. Stat. Ann. § 44-5501(B) ($1000); Colo. Rev. Stat. § 5-5-103(2) ($3000); Conn. Gen. Stat. § 36a-785(g) (motor vehicles and boats with aggregate cash prices of more than $2000); D.C. Code § 28-3812 (consumer protection) ($2000); Fla. Stat. § 516.31 ($2000); Idaho Code Ann. § 28-45-103 ($1000); Ind. Code § 24-4.5-5-103 ($1000, but adjusted periodically); Kan. Stat. Ann. § 16a-5-103(2) ($1000); Me. Rev. Stat. Ann. tit. 9-A, § 5.103(2) ($2800); Md. Code Ann., Com. Law § 12-626 (West) (retail installment sales) (Op. Md. Att'y Gen., Consumer Cred. Guide ¶ 97,933, 1978 Md. AG LEXIS 46 (Md. Att'y Gen. June 6, 1978) interprets this statute to prohibit deficiency judgments, unless the agreement permitted them and either the price of the goods exceeded $2000 or the consumer exercised the statutory right to request a public auction; Md. Code Ann., Com. Law § 12-921 (revolving credit) and § 12-115 (West) (loans secured by goods) contain similar language); Mass. Gen. Laws ch. 255, § 13J (conditional sales, loans) ($2000); Mass. Gen. Laws ch. 255B, § 20B (motor vehicle retail installment sales) ($2000); Mass. Gen. Laws ch. 255D, § 22 (retail installment sales and services) ($1000) (all three Massachusetts statutes provide that if collateral is destroyed or damaged prior to repossession, then the dollar limitations do not apply with regard to insurance proceeds); Minn. Stat. § 325G.22 ($5700 as of May 1, 2004, and subject to periodic adjustment); Mo. Rev. Stat. § 408.556 (no deficiency if the original amount financed was less than $500); Neb. Rev. Stat. § 45-1054(2) ($3000); Okla. Stat. tit. 14A, § 5-103(2) ($1000; subject to adjustment under Okla. Stat. tit. 14A, § 1-106); S.C. Code Ann. § 37-5-103 ($1500; subject to adjustment under S.C. Code Ann. § 37-1-109(6)); Utah Code Ann. § 70C-7-101 ($3000); W. Va. Code § 46A-2-119(2) ($1000); Wis. Stat. § 425.209 (Consumer Act) ($1000); Wyo. Stat. Ann. § 40-14-503 ($1000).

63 CPI inflation calculator available at http://data.bls.gov/cgi-bin/cpicalc.pl.

64 For further discussion of this issue see National Consumer Law Center, Repossessions § 12.4.7 (6th ed. 2005 and Supp.)

65 See, e.g., Ariz. Rev. Stat. Ann. § 44-5501(C); Colo. Rev. Stat. § 5-5-103; Conn. Gen. Stat. § 36a-785(h); D.C. Code § 28-3812(e)(7) (consumer protections); Idaho Code Ann. § 28-45-103; Minn. Stat. § 325G.22; S.C. Code Ann. § 37-5-103; W. Va. Code § 46A-2-119; Wis. Stat. § 425.209; see also U.C.C.C. § 5.103(6) (1968); U.C.C.C. § 5.103(7) (1974); Official Comment 6 to U.C.C.C. § 5.103 (1968); Official Comment 7 to U.C.C.C. § 5.103 (1974).

VIII. Recommended Federal Policy Improvements

A. ENACT A FEDERAL AUTOMOTIVE INFORMATION REPORTING ACT (FAIR)

One difficulty faced by policy makers, researchers, and others interested in the issue of auto finance is a lack of useful data about current and past auto sales and finance. Such information could play an invaluable role in determining the existence of discrimination in auto lending and sales, the availability of credit at fair rates, and other matters of importance to consumers and policy makers.

Auto sales and finance transactions are often structured in an intentionally complex and confusing way. Typically the dealer focuses the consumer's attention on monthly payments, giving the dealer great discretion in other terms such as the interest rate, sales price, and add-ons. If a consumer seems particularly concerned about one of these other areas of the transaction, the dealer will adjust the terms the consumer is not focused upon. Accordingly, it is important that any proposed data reporting system capture all this information to permit true understanding of the transaction.

A Federal Automotive Information Reporting Act (FAIR Act) could address this gap by creating a data collection system for automobile financing similar to the existing federal data collection for mortgage transactions under the Home Mortgage Disclosure Act (HMDA). Data collection should include race, gender, income, lender information, location, disposition of application, credit score, loan to value ratio, make/model of car, and terms of loan including- price of the car, amount financed, interest rate, down payment, dealer markup, add-ons, and length of the loan.

This data collection would greatly increase our understanding of the auto finance market. Currently, some information is available from proprietary sources, but the FRB is the main source of information now available publicly. Its monthly statistical releases on Finance Companies (G.20) and Consumer Credit (G.19) provide only limited information about auto finance. These releases are created from a voluntary report collected from a sample of finance companies. The raw data itself is not released; rather the information collected is used to create estimates which are then released. The FRB's Survey of Consumer Finances (SCF), issued every three years, includes financial information about U.S. families and looks at the terms of debt as well as how the lender was chosen and other relevant information. It is also based upon voluntarily supplied information, so it fails to capture negative information which lenders or dealers may be reluctant to share. Neither the monthly releases nor the SCF links information to particular lenders, so they do not allow analysis of individual lenders' practices.

Publicly and privately available data lack information about a borrower's race or other characteristics that may be used by lenders to discriminate against particular consumers. Ending discrimination against consumers on the basis of such personal characteristics was the reason for the creation of the Equal Credit Opportunity Act (ECOA).[66] As discussed in section III A, several class actions and academic studies have identified the auto finance's disparate impact on minorities in vehicle financing.

One hurdle to obtaining race-based data is the FRB's Regulation B, implementing the ECOA. Regulation B prohibits non-mortgage lenders from asking about or documenting a consumer's race, in order to stop racial discrimination. As several commentators including the Government Accountability Office have noted, requiring lenders to collect and report such data could actually assist in stopping discrimination.[67]

An exception to Regulation B's prohibition on asking for or documenting of racial information has been established for mortgage lending. The Home Mortgage Disclosure Act (HMDA) and the FRB's Regulation C mandate that lenders collect certain information about their mortgage lending.[68] This data provides information about individual lenders, and is also used to create reports for different geographical areas related to census tracks. In addition to acting as an aid to document and end discrimination, the data is also intended to aid the U.S housing market in general by showing if lenders are meeting the housing needs of the communities they serve and ways in which public and private funds may be used to better the market.

While very useful, the HMDA data collection also suffers from limitations. The data collected includes the type and purpose of the loan, the amount of the loan, the applicant's race, ethnicity and sex, and, for higher interest rate loans, the difference between the loan interest rate and the rate for comparable treasury securities. The data collected does not include other very important information about the transaction, such as loan to value ratios and credit score. A primary reason for omitting this information appears to be a concern for consumer's privacy. The issue was addressed in a Federal Reserve Bulletin:

> *The potential for compromising consumer privacy is also a consideration. More than 90 percent of the loan records in a given year's HMDA data are unique – that is, an individual lender reported only one loan in a given census tract for a specific loan amount. These unique loan records can be matched with other publicly available information, such as property deed records, to determine the identities of individual borrowers. With such a match, any data item in the HMDA data, such as loan pricing, becomes publicly known… Expanding HMDA to include data items such as credit scores that may be considered highly personal would likely also raise privacy concerns.*[69]

The issue of privacy would not present the same obstacles in the area of auto finance. There are over 250 million cars registered in the United States.[70] About 44 million used cars and almost 17 million new vehicles are sold each year.[71] The majority of these transactions are financed, with many more applications than completed transactions. By contract, in 2004, HMDA disclosures revealed only about 28.1 million applications for home mortgages.[72] In addition, much less information about auto sales and financing is typically available

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[66] "It is the purpose of this Act to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to [sex, marital status, race, religion, national origin and age]." Equal Credit Opportunity Act, Pub. L. No. 93-495, S 502, 88 Stat. 1521, 1521 (1974).

[67] U.S. Government Accountability Office, Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending, GAO-08-698(June 2008).

[68] For a discussion of HMDA and its usefulness in proving credit discrimination see National Consumer Law Center, Credit Discrimination §4.4.5 (4th ed. 2005 and Supp.).

[69] "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin,* Summer 2005, p. 367.

[70] U.S. Department of Transportation, Research and Innovative Technology Administration, Bureau of Transportation Statistics, National Transportation Statistics, available at http://www.bts.gov/publications/national_transportation_statistics.

[71] Automotive News Data Center, CNW Marketing/Research, and ADESA Analytical Services.

[72] "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," Federal Reserve Bulletin, Summer 2005.

publicly when compared to real estate transactions. The higher number of auto loans made each year and the fact that less information about most auto finance transactions is publicly available would make it less likely that particular data could be tied to an individual transaction.

B. BAN ARBITRATION CLAUSES IN AUTO SALES AND FINANCE TRANSACTIONS

Arbitration clauses, inserted in the fine print in many consumer contracts, require that any dispute the consumer may have with the business must be submitted to arbitration rather than court. Car dealers use arbitration clauses not to settle disputes efficiently, but to rob consumers of any effective means to challenge dealer fraud.[73]

Car dealers draft arbitration clauses for the purpose of weakening consumers' ability to bring legal claims. The clause often bans consumers from seeking class-wide relief, prevents them from utilizing remedies granted by state law, and forces them to pay the *dealer's* attorney fees if the arbitrator does not rule for the consumer. Decisions made by arbitrators are typically not public, and are not subject to appeal even if the arbitrator fails to follow the law.

Unlike the nation's court system, which serves the public function of dispensing justice and is supported by public funds, arbitration is a pay-as-you-go system. Arbitration can cost the consumer thousands of dollars a day, as the arbitrator charges the parties hundreds of dollars an hour. It is typically difficult to engage in legal discovery of the dealer's files and practices in arbitration. The dealer also picks the arbitration service provider that picks the arbitrator. Because of the limitations of arbitration, and the costs involved, many consumer attorneys are unwilling to represent consumers if they are bound by an arbitration agreement.

Arbitration clauses also injure the public at large. Unlike court proceedings, arbitration decisions are not matters of public record, and the arbitration hearings are conducted in private. As a result, the public is unable to avail itself of the knowledge of bad actions by dealers and financers. While dealers and finance companies may develop an understanding of the results arbitrations produce because of their repeated involvement in arbitrations, the public and consumers are unable to see if justice is served.

Arbitration clauses are so widespread that it is often impossible to buy a car without signing an agreement giving up one's right to go to court if problems develop.[74] The dealer's arbitration clause also typically applies to the auto lender, eliminating the consumer's ability to sue it as well.

Ironically, car dealers themselves admitted the unfairness of arbitration clauses when they successfully lobbied Congress to prevent auto manufacturers from imposing arbitration clauses on dealers.[75] The dealers argued that the arbitration clauses deprived them of important rights and that they suffered from unequal bargaining power when negotiating with the manufacturers.

Clearly the transaction between the low-income consumer and a car dealer or finance company is even more unequal. The use of arbitration agreements in auto sales and finance agreements should be banned. There is currently pending federal legislation to ban arbitration clauses in auto sales.[76]

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[73] For more detailed information about the abusive use of arbitration in consumer contracts, see National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007).

[74] Stephanie Mencimer, *The Quest for a Car, Sans Arbitration Clause*, Mother Jones, December 14, 2007 (describing the author's unsuccessful attempt to buy or finance a car without an arbitration clause).

[75] See the testimony of Gene Fondren, President of the Texas Automobile Dealers Association, before a U.S. Senate Subcommittee on March 1, 2000.

[76] See H.R. 5312, the Automobile Arbitration Fairness Act of 2008, introduced February 7, 2008.

For more information about ongoing efforts to ban arbitration clauses in auto transactions see the website of Consumers for Auto Reliability and Safety: http://www.carconsumers.com.

C. IMPROVE THE FTC'S "USED CAR RULE"

The FTC "Used Car Rule" requires dealers to disclose what, if any, warranty comes with the vehicle on a "buyers guide" posted on the vehicle. The Rule was created in response to an investigation by the FTC's Seattle office in the early 1970's and a subsequent report urging that the FTC require dealer inspections, disclosure of known defects, and mandatory warranties.[77] After years of soliciting public comments and holding public hearings across the country, the FTC staff recommended mandatory inspections and disclosure of defects of certain mechanical and safety components. The FTC's original version of the rule, issued in 1981, would have required disclosure of known defects, but it never went into effect. After a Congressional veto, litigation holding the veto unconstitutional, and a change in leadership at the FTC, the Commission issued a greatly watered-down rule.

In its current form, the rule requires a somewhat misleading disclosure about whether a vehicle comes with a warranty, but it does not require dealers to inspect used cars or even to disclose defects they know about. The rule thus fails to provide any significant protections for buyers of used cars.

Even though the rule in its current form is ineffective, a strengthened Used Car Rule could be a powerful force toward eliminating unfairness and deception in used car sales. The FTC is presently reviewing the rule, so now is an opportune time to examine the possibilities for improving it. The rule should be amended[78] so as to:

- Require dealers to inspect used vehicles prior to offering them for sale.
- Require dealers to provide written disclosure of known defects and prior use.
- Require dealers to check with warrantors to ascertain whether any warranty on the vehicle, including the manufacturer's warranty, is still in effect and not void due to prior damage or other condition, and accurately report that information on the Buyer's Guide.
- Require auto dealers to check the Vehicle Identification Numbers (VINs) of used vehicles they offer for sale, in the National Motor Vehicle Title Information System (NMVTIS) database, and disclose essential information from NMVTIS on the Buyer's Guide.
- Require dealers to provide more detailed, complete disclosures.
- Require auto dealers to provide a separate Buyers Guide, placed on the driver's side of the windshield, warning prospective buyers when either 1) a vehicle is designated in NMVTIS as "salvage," "flood," "junk" "rebuilt" or otherwise totaled, or 2) the dealer knew or should have known a vehicle was totaled by the insurer or self-insured entity.
- Remove language from the existing Buyers Guide, regarding "AS IS- NO DEALER WARRANTY" sales, which presently states that "THE DEALER WILL NOT PAY ANY COSTS FOR ANY REPAIRS. The dealer assumes no responsibility for any repairs regardless of any oral statements about the vehicle." This language is inherently misleading because it lends credence to the false notion that the dealer may misrepresent the condition of the vehicle with impunity. It goes beyond allowing dealers to disclaim implied warranties and creates the false impression they can lie to consumers about the condition of the vehicle or the dealer's intent to repair the vehicle and that, if they check that box on the Guide, they avoid any liability for their statements.

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[77] For a discussion of the development of the Rule and the ways in which the original Rule was weakened see Mulock, Bruce K., *The FTC's Used Car Rule*, Published by the Congressional Research Service, Library of Congress, updated Oct. 14, 1983, CRS Report Number : IB81159, available at: http://digital.library.unt.edu/govdocs/crs/permalink/meta. he rule filed on behalf of Consumer Action, Consumers for Auto Reliability and Safety, Consumer Federation of America, Consumer Federation of California, National Consumer Law Center on behalf of its low income clients, U.S. Public Interest Research Group, and the Watsonville Law Center, available at: http://www.ftc.gov/os/comments/usedcarrule/536945-00015.htm.

[78] For a more complete discussion of the needed changes to the Rule see the Comments in response to the FTC's request for comments as part of its review of the rule filed on behalf of Consumer Action, Consumers for Auto Reliability and Safety, Consumer Federation of America, Consumer Federation of California, National Consumer Law Center on behalf of its low income clients, U.S. Public Interest Research Group, and the Watsonville Law Center, available at: http://www.ftc.gov/os/comments/usedcarrule/536945-00015.htm.

- Preclude 50/50 Warranties or other dealer warranties where dealers represent they will split the cost of repairs with the customer, as qualifying as a warranty under the Buyer's Guide. Such warranties are inherently deceptive. What appears to be warranty coverage is in fact illusory, as the warrantor can recoup all of its costs for a given “warranty” repair simply by inflating its total charge for the repair so that the consumer’s portion covers the warrantor’s entire cost.
- Require auto dealers to provide a completed translation of the Buyer’s Guide in the language used to negotiate the contract.
- Prohibit the sale of rebuilt wrecks and other problem vehicles as “certified” used cars.
- Strengthen enforcement of the Rule, and make enforcement of the Rule a top priority for the agency.

D. PERMIT MODIFICATION OF CAR LOANS IN BANKRUPTCY

The United States Bankruptcy Code allows bankruptcy judges to modify both unsecured and secured loans. The modification may change the payment amount, defer payments, or even eliminate the creditor’s lien. Modification may allow the consumer to keep an item that is acting as security on a loan and yet reduce the monthly payment. This in turn may make monthly payments affordable, allowing the consumer to keep property that other would have been taken by the lender.

In 2005, significant changes were made to the Bankruptcy Code, including restrictions on bankruptcy courts’ ability to modify auto loans. Before the law changed, if a consumer owed $12,000 on a car loan and the car was only worth $5,000, the creditor’s secured claim was reduced to $5,000. This was the amount of the debt that was backed by the collateral that the creditor could take if the debt was not paid. The remaining $7,000 was an unsecured claim, and only a portion of that might be paid through the bankruptcy case. Importantly, the consumer in bankruptcy could retain the car by paying off only the $5,000 secured claim. In a chapter 13, that could be paid out over a period of years.

Through the efforts of the auto finance industry, the law was changed so that auto loans made within 910 days of the bankruptcy can no longer be modified in this way. Some courts have even held that negative equity from a prior trade-in also may not be modified.[79]

This 2005 change has encouraged reckless lending. Creditors know that a borrower wishing to keep the family car in bankruptcy will have to pay the full $12,000 debt, even though the creditor’s collateral is only worth $5000. As a result, creditors are more willing to finance cars at inflated prices--the same practices that contributed to the home mortgage crisis.

Bringing the bankruptcy law back to its pre-2005 language would eliminate the incentive for lenders to overlook consumer overcharges and roll-overs of negative equity. Instead, lenders would be likely to police dealers’ unnecessary add-ons and roll-overs of negative equity. Such a change would also keep many consumers in their cars, while still repaying to lenders the actual value of the car. Allowing families to keep their cars would help keep those families self-supporting.

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[79] For more information regarding this issue see: National Consumer Law Center, Consumer Bankruptcy Law and Practice 11.6.1.4 (8th ed. 2006 and Supp.)

E. THE NATIONAL MOTOR VEHICLE TITLE INFORMATION SYSTEM

In 1992, Congress passed a bill mandating the creation of the National Motor Vehicle Title Information System to consist of a database designed to aid in the tracking and analyzing of vehicle title histories. States, junk yards, and insurance companies would be required to report on totaled vehicles. Car buyers would be able to access the database to determine if a car they are thinking of purchasing is a salvage vehicle or a stolen vehicle. Originally, the Department of Transportation was charged with developing and implementing the system. In 1996 that responsibility was moved to the Department of Justice.

Despite the many years since the legislation was passed, little progress had been made in creating this useful system. In 2008, a number of groups including Consumers for Auto Reliability and Safety (CARS) and Public Citizen brought a court action seeking to force the Justice Department to create the database. These groups obtained a court order requiring the Department of Justice to proceed with the database.[80] As the system becomes operational, new issues have arisen.

Some states, particularly California and New York, are reluctant to provide information to the database as they currently sell the same information to private reporting services for a profit.[81] Reports can be difficult for consumers to understand because of the myriad of "brands" that states use to designate cars that have been salvaged, totaled, rebuilt, flooded, or otherwise damaged or changed. Consumers must access the database through private vendors. There is a fee for consumers to access the information and, at least for one vendor, that fee is payable only by credit card.

For the system to be effective all states and other required entities must contribute information. The information should be available to consumers at a reasonable fee with a variety of payment methods for those without a credit card. Consumers should not have to pay higher prices than dealers or other volume purchasers of the information. Most importantly, as described in section VIII C, a NMVTIS report should be posted on every car for sale by a dealer. This would eliminate the need for the consumer to purchase the information and have the information available at the time and place it would do the most good.

F. ADJUST TILA'S JURISDICTIONAL AND STATUTORY DAMAGE AMOUNTS FOR INFLATION

As described in section III B, the Truth In Lending Act (TILA) requires creditors to disclose credit terms of auto finance and other credit transactions. While TILA's promise of enabling consumers to shop for credit has not been as successful as it could have been, it does give consumers essential information about a transaction's credit terms of a transaction before they bind themselves to those terms.

But today TILA contains an enormous loophole. It applies to car transactions only if the amount financed is $25,000 or less. Dealers need not provide TILA disclosures if the amount financed exceeds $25,000. The $25,000 cap was part of the 1968 bill that became TILA, and has not been updated in the 41 years since then.

While $25,000.00 was a large amount in 1968 and would have covered almost any conceivable car purchase, today TILA does not apply to many transactions involving rather modest cars. Moreover, because the limit applies to the amount financed and not the car's sale price, negative equity from a trade-in, expensive service contracts, and other add-ons can bring the amount financed above $25,000 even if the car's sale price is well under that amount. For a large and growing percentage of car sales, federal law no longer requires that even the most basic disclosures about the credit terms be given to the buyer.

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[80] For more information see: http://www.citizen.org/litigation/forms/cases/CaseDetails.cfm?cID=457.

[81] Christopher Jensen, A Used-Car Promise Finally Delivered, New York Times Blog, January 29, 2009, available at http://wheels.blogs.nytimes.com/2009/01/29/a-used-car-promise-finally-delivered/.

TILA also provides for statutory damages when key disclosure requirements are violated. These minimum damages encourage the buying public to help enforce the Act's important protections. This is critical, since a disclosure violation is likely to be repeated in thousands of other transactions. In order for the statutory damages to provide an incentive for consumers to help police the marketplace and discourage dealers and lenders from violating the Act, the damages must be sufficiently high. Unfortunately, the $1000 statutory damages amount for car loans has also remained unchanged since 1968 (although the amount has increased for mortgage loans).

If TILA's $25,000 coverage limit were adjusted for inflation since 1968, it today would be over $132,000.[82] The $1,000 statutory damages amount would be over $5,000. Not only should these amounts be increased today to reflect this inflationary change, but this increased amount should also be indexed for future inflation.

G. STRENGTHEN THE MOTOR VEHICLE INFORMATION AND COST SAVINGS ACT

The Motor Vehicle Information and Cost Savings Act (MVICSA) outlaws odometer fraud, requires important disclosures, and regulates the method of transferring a vehicle's title.[83] Over 20 years ago, the National Highway Traffic Safety Administration (NHTSA) exempted from many of these requirements for vehicles over 10 years old and also vehicles with gross vehicle weight ratings over 16,000 pounds from many of these requirements.[84]

At the time, cars over 10 years old were thought to have such little value that odometer tampering would have little impact on the vehicle's price. But today 10 year old cars are better built and have significantly longer useful lives. Many still have significant market value after ten years if they are low-mileage, so fraudulent dealers and wholesalers have an economic incentive to roll back the odometer. Thus these older cars today are targets of odometer fraud which can cause considerable consumer injury. Buyers of these cars need the same protection under MVICSA as buyers of newer used cars.

The 16,000 pound exclusion was drafted to exempt commercial buses and trucks, which are often sold with much more extensive maintenance records than private vehicles, providing a check against odometer tampering. But today this exemption also applies to larger recreational vehicles (RVs). The higher market value of these RVs makes them even more tempting targets for odometer fraud than passenger cars, and there is no reason to exempt RVs purchased for consumer use from MVICSA's protections. All motor vehicles for consumer use should be covered by MVICSA.

The NHTSA exemptions should be amended to provide coverage under MVICSA for vehicles less than twenty years old and all vehicles for consumer use, regardless of weight.

In addition, a number of courts, taking a strained view of MVICSA's legislative language, have found that consumers can sue dealers who intentionally violate the Act only if the dealers' fraudulent intent was to sell cars with spun odometers, not a fraudulent intent to sell cars with undisclosed salvage, daily rental, or other serious titling defects. This makes no policy sense, and should be changed by a statutory amendment to clarify language that other courts have correctly read—that parties are liable under MVICSA if they violate the Act with intent to defraud, even if the fraud takes a form other than odometer tampering.

[82] See Comments of the National Consumer Law Center to the Board of Governors of the Federal Reserve System, 12 CFR Chap.II [Docket No. R-1180] regarding the Economic Growth and Paperwork Reduction Act "EGRPRA" available at: http://www.consumerlaw.org/initiatives/test_and_comm/content/egrpra-final.pdf.

[83] For more information about the MVICSA see National Consumer Law Center, Automobile Fraud § 4 (3d ed. 2007).

[84] 49 C.F.R. § 580.17.

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