DEFENDER
THE NADC NEWSLETTER

Rob Cohen

Sidebar

Contents:

Special Adverse Action Edition

Rob Cohen

For those of you who participate in the NADC List Serve, you have probably seen a flurry of activity regarding adverse action notices. Largely prompted by two recent federal court decisions, the e-mail exchange and banter was concerning for those of us who are uncertain as to how we should advise our clients. Adverse action notice requirements at the dealer level were not clear prior to these two cases; now they are even less so. Providing sound advice to our clients on this topic has never been more important than it is now.

At the suggestion of board member Michael Charapp, I decided to dedicate this entire issue to the topic of adverse action notices under the Equal Credit Opportunity Act and the Fair Credit Reporting Act. Inside this issue of Defender, you will find four articles. The first article is titled Recent Developments in Adverse Action Notice Requirements by Randy Henrick. The remaining three articles, written by Randy Henrick, Michael Charapp, and Larry Byrne, provide differing views of how to best limit liability in this area.

Note: The discussions below assume a basic understanding of adverse action requirements. For an overview of the laws and regulations that create these requirements, please see Randy Henrick's Article, *Adverse Action Notices: An Overview*, available at www.dealercounsel.com/adverseaction.

Rob Cohen is managing partner of Auto Advisory Services, Tustin, CA, First Vice President of the NADC and Editor of Defender, The NADC Newsletter

Recent Developments in Adverse Action Notice Requirements

Randy Henrick

A series of cases prior to 2005 held that when the lenders to which a dealer referred a credit application provided notices of adverse action, the dealer was not obligated to do so as well.[1] These cases generally cited the provision of Regulation B[2] providing that "where a creditor has been requested by a third party to make a specific extension of credit directly or indirectly to an applicant, the notification and statement of reasons . . . may be made directly by such creditor, or indirectly through the third party, provided in either case that the identity of the creditor is disclosed." The courts reasoned that multiple adverse action notices may be confusing to consumers and frustrate the purpose of the Equal Credit Opportunity Act (ECOA)[3] and the Fair Credit Reporting Act (FCRA).[4]

However, two recent federal court

1 *See*, e.g., Thele v. Sunrise Chevrolet, Inc., 2004 U.S. Dist. LEXIS 9670 (N.D. Ill. 2004); Razilov v. Nationwide Mutual Insurance Co., 242 F. Supp. 977, 989-990 (D. Ore. 2003)

2 12 C.F.R. Part 202

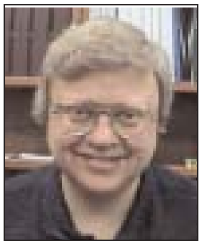
3 15 U.S.C. § 1691 et seq.

4 15 U.S.C. § 1681 et seq.; *See* Thele, *supra2*

continued on page 3

Introducing the contributors to the Adverse Action Feature

Randy Henrick



Randy Henrick is Associate General Counsel for DealerTrack, Inc. in Lake Success, NY. Randy has worked in consumer credit, banking, and finance for 20 years with GE Capital, Citigroup, MasterCard International, and Fleet Bank. The views expressed herein are Randy's and do not necessarily reflect the position of DealerTrack.

Proposed Guidelines for When and If Dealers Should Send Adverse Action Notices

The following represent a series of guidelines that I think reasonably balance the risks of the recent cases to the dealer's ECOA and FCRA compliance requirements.

I would certainly advise a dealer to send an adverse action notice when it declines to send the application to any lender. I think that position is fairly non-controversial. If the dealer takes an application but does not forward it to a lender for decisioning, the dealer will be unable to argue successfully that it is not a creditor that has taken an adverse action under the ECOA or FCRA (the latter assuming it has pulled a credit report on the consumer). The model notice posted as Exhibit "A" at

continued on page 5

Michael Charapp

Michael Charapp is a partner with Charapp & Weiss, LLP in McLean, VA. He is Second Vice President of the NADC and serves as Chairman of the Membership and Advancement Committee.

Adverse Action Notices — Navigating The Confusion

Plaintiff lawyers spend a great deal of time finding problems in car deals that have nothing to do with the customer's complaint since the real complaint often does not provide a cause of action. One of the favorite areas to attack dealers today is the confusion over adverse action notices. And, the results of these cases often add to the confusion.

The statutes, regulations, and commentary concerning adverse action notices are complex and difficult to reconcile. Dealers should follow some common sense approaches in considering whether to send adverse action notices.

Let's assume that a customer comes to a client's dealership wishing to buy a car on credit. He chooses a vehicle and says that he will buy it if the dealership can get him approved for credit. What adverse action notice issues flow from this?

continued on page 8

Larry Byrne

Larry Byrne, is a Partner with the law form of Pedersen & Houpt in Chicago, Illinois. Mr. Byrne represents automobile dealers in the Chicago metropolitan area focusing on litigation related to consumer fraud and related claims as well as implementing compliance procedures to avoid liability. Mr. Byrne may be reached at (312)641-6888.

Limiting Liability Under Adverse Action Notice Requirements

Federal courts have been issuing rulings expanding on the necessity of car dealers to provide notice of adverse action under the Equal Credit Opportunity Act (ECOA) and the Fair Credit Reporting Act (FCRA). Dealers should take steps to limit their exposure under these acts.

With recent cases in mind, it is important that dealers address issues concerning the adverse action notification at the outset. First, it should be made clear to employees and included in the employee manual that only a finance manager may provide an opinion to a customer regarding financing or credit.

continued on page 10

Recent Developments...
From page 1

decisions take a very different direction and may have implications for auto dealers and their obligations to send adverse action notices to consumers under both the ECOA and FCRA.

The 9th Circuit's View of Adverse Action Notices (The Reynolds Case)

The first case is a decision of the 9th U.S. Circuit Court of Appeals, *Reynolds v. Hartford Financial Services Group, Inc.*[5] The case involved an insurer's obligations to send FCRA adverse action notices to insurance applicants (the FCRA also includes within the definition of "adverse action" the denial, cancellation, or increase in charges for insurance in connection with underwriting of insurance). In *Reynolds*, the 9th Circuit held that if a consumer's "insurance score" (analogous to a FICO score) is used in any way to give the consumer a higher insurance rate than the highest scoring consumers would receive, doing so constitutes an adverse action for which an adverse action notice must be given under the FCRA. (FICO scores are clearly consumer reports under the FCRA; this case ruled that "no-hit" responses from a credit bureau are also consumer reports.) The decision also holds that "the notice requirement applies to any company that makes a decision that a higher rate shall be imposed, issues a policy at a higher rate, or refuses to provide a policy at a lower rate" if the decision was based in any way on the consumer's credit information.

This case involved multiple affiliates and the 9th Circuit held that all of the affiliates were jointly liable and the adverse action notice had to come from all of them, although one omnibus notice would suffice.

Finally, the court held that a company is liable for a willful violation of the FCRA if it fails to give an adverse action notice either knowing its actions violate the FCRA or are "in reckless disregard" of whether its actions violated the law. The court did not allow the willful violation standard to be avoided merely by having an opinion of counsel "with the deliberate purpose of obtaining opinions that provided creative but unlikely answers to 'issues of first impression'" You have to seek "objective answers from counsel as to the true meaning of the statute." (Presumably the insurance company or auto dealer is supposed to know one from the other.) Willful violations justify an award of statutory damages and punitive damages under the FCRA. All violations, willful and negligent, justify an award of actual damages and attorney's fees.

A petition for reargument has been filed with respect to the *Reynolds* decision. However, if the ruling stands, the implications for auto dealers are readily apparent. A dealer who pulls a consumer's credit report and makes an election as to which lenders (e.g., prime or subprime) to send the consumer's application would probably fall within the 9th Circuit's definition of a participating creditor obligated to send an adverse action notice in an auto financing context. In the *Reynolds* case, a subsidiary of GEICO that reviewed the insurance score and decided which GEICO affiliate to send the customer's application to (based on insurance score tier) was found to have an obligation to send an adverse action notice because this determination would establish the insurance rate. The concern is, therefore, that a court in the 9th Circuit following the *Reynolds* ruling could hold that a dealer's decision as to where to send a consumer's credit application could determine the consumer's credit rate.

The 9th Circuit's holding in *Reynolds* that the FCRA requires an adverse action notice "whenever a consumer pays a higher rate because his credit rating is less than the top potential score" is also problematical. The court held that, at a minimum, "such a notice must communicate to the consumer that an adverse action based on a consumer report was taken, describe the action, specify the effect of the action upon the consumer, and identify the party or parties taking the action."

The Padin Case

The second case, *Padin v. Oyster Point Dodge*,[6] is a federal district court decision and involves a consumer's claims that a dealer violated the ECOA

5 2005 U.S. App. LEXIS 16076 (March 8, 2005)

6 2005 U.S. Dist. LEXIS 10292 (E.D. Va. March 3, 2005)

Continued on page 4

New Members...
From page 3

and FCRA by failing to send him an adverse action notice, even though the credit-denying creditor did so.

Mr. Padin came to the dealership to buy a used car and quickly reached an agreement with the dealer. The dealer submitted his credit application to several lenders and received an approval with a "buy rate" of 16.95 percent and permission to mark up the rate to 18.95 percent. The approval contained several customary stips such as employment verification. Mr. Smith signed the contract at the 18.95 percent rate and drove off happy. He even made his first payment on a timely basis to the lender.

About three weeks later, however, the lender rejected Mr. Padin's credit application because it could not verify his job time and income. The lender sent him an adverse action notice informing him of its decline decision and returned his first payment. The dealer, who had sold Mr. Padin's trade-in, called him in and took possession of the car, giving Mr. Padin a check for $1,000 for the value of his trade-in which the dealer in fact sold for only $800.

Even though Mr. Padin suffered no actual economic damages, he decided to sue the dealer under the ECOA and FCRA because the dealer had not given him an adverse action notice even though he admittedly received one from the lender.

Under the ECOA and Regulation B, dealers who are referral creditors, i.e., creditors who do not participate in credit decisions but who only accept applications and refer applicants to creditors or pass the applications along to creditors, do not have to send adverse action notices to consumer credit applicants. (They do, however, have to comply with the ECOA's prohibitions against credit discrimination or discouraging applications.) Lenders who make the credit decisions send the adverse action notices, not the referring dealer.

In reaching its decision, the *Padin* court relied on the 7th U.S. Circuit Court of Appeals' holding in *Treadway v. Gateway Chevrolet Oldsmobile, Inc*.[7] *Treadway* held that a dealer must send an adverse action notice if the dealer takes the consumer's credit application but never submits it to a lender. In *Treadway*, the 7th Circuit Court rightfully concluded that since no lender ever saw the credit application, the dealer effectively was denying the consumer credit and thus needed to give the adverse action notice explaining its reasons and identifying the credit bureau report it pulled in making its decision. This is an accurate and reasonable interpretation of the FCRA and the ECOA .

In *Padin*, however, the court went a step further. It held that the dealer's marking up the "buy rate" by two percent to 18.95 percent was an "adverse credit decision" to Mr. Padin "by virtue of a higher interest rate being charged than would otherwise have been required by the lender." So, even though the lender had given a proper adverse action notice, the court ruled the dealer had to send one to Mr. Padin as well.

The *Padin* court explained that the dealer's activity in marking up the rate was sufficient to make it a creditor who "regularly participates in a credit decision, including setting the terms of the credit." In the court's eyes, this made the dealer a participating creditor that is required under both the FCRA and ECOA to send an adverse action letter to Mr. Padin, as opposed to being only a referral creditor.

What the court seemed to completely miss was that no credit was extended to Mr. Padin since the lender denied his application and sent an adverse action letter explaining its reasons for doing so. The dealer had nothing to do with that decision. The dealer did nothing in the way of participating in Mr. Padin's credit decision whatsoever since the lender alone declined the credit.

Most attorneys believe the *Padin* case is bad law. But it is out there and, along with *Treadway* and *Reynolds*, the case seems to indicate an activist judicial initiative with respect to adverse action notices. Certainly, these cases will be noticed by the plaintiff's bar and we can anticipate hearing these arguments again.

7 362 F.2d 971 (2004)

Proposed Guidelines...
from page 2

www.dealercounsel.com/adverseaction can be used for this purpose.

I think characterizing the dealer as a "referral creditor" not obligated to send an adverse action notice is a somewhat dubious proposition given what typically goes on in car dealerships. However, even if a dealer is a participating creditor, in the garden variety case when a consumer's credit is rejected by a financial institution, I think it is reasonable for a dealer to rely on the financial institution's adverse action letter under the provision of the ECOA that enables a third party to send an adverse action notice on behalf of another creditor. Even the *Reynolds* case (an FCRA case) indicated that one omnibus adverse action notice could be delivered by the creditors jointly.

If the consumer accepts the credit offered by the dealer, I would rely on the ECOA's language that an accepted counteroffer is not adverse action. As to the FCRA adverse action notice requirement, rate markups can be problematical but a dealer should be able to argue that a rate markup is not an adverse action at all, but rather a business decision it makes to maximize profits on all customers without regard to anything in their credit report. Alternatively, the difference between the buy rate and the sell rate is not adverse action but simply the dealer's compensation for arranging credit on terms acceptable to the customer.

Spot delivery situations present the most risk for dealers. Except for *Padin*, the auto cases I have seen almost invariably involve a situation where the customer winds up getting declined or forced to accept a different credit deal than the one originally proposed. "Yo-yo" financing, as the plaintiff's bar calls spot delivery, will likely produce another bad set of facts causing yet another decision like *Reynolds* or *Padin*.

Dealers should always use spot delivery agreements (conditional sales contracts or bailment agreements) that specifically disclaim any credit arrangement unless and until a lender decides to purchase the contract. If possible, dealers should avoid situations where they have a consumer sign two or more contracts, each containing different rates and terms. If they do so, the dealer should send an adverse action notice if the most favorable of those contracts is not accepted by the financial institution to which the dealer "shops" the deal. I would advise a dealer to use an adverse action notice similar to the form posted as Exhibit "C" at www.dealercounsel.com/adverseaction if the lender accepts one of the shopped contracts containing other than the most favorable terms.

I also would advise a dealer client (especially a dealer client in the 9th Circuit) to send an adverse action notice along the lines of the one posted as Exhibit "C" when it offers credit to a customer but the customer declines the credit offer.

My thinking for this advice in the current environment is as follows:

1. The lender will not be sending an adverse action notice in this scenario in all likelihood;

2. Since the customer has not accepted the credit (a counteroffer), you can't argue it's not "adverse action" under the ECOA using the provision in the ECOA that acceptance of a counteroffer negates a finding of adverse action. The customer declining the credit also negates any ability to rely on the provision of the ECOA that if one creditor provides credit to a customer, the other creditors are relieved of their obligation to send an ECOA adverse action notice;

3. Under the 9th Circuit's reasoning in *Reynolds*, the dealer has selected the lenders to which it submitted the credit application and presumably that will result in the consumer getting something less than the best rate the highest scoring consumer would have gotten, either with those lenders or other lenders who cater to higher quality credit individuals and to which the lender did not send the credit application. (Curiously, perhaps the best defense to the 9th Circuit's *Reynolds* ruling is to "shotgun" all applications to every lender with which the dealer does business but I wouldn't recommend doing that for business reasons.);

4. If the dealer has marked up the rate, that could buttress the argument that the dealer has participated in the credit decision (the dealer in such a case being a participating creditor and not just a referral creditor). If so, and this is the *Padin* case, the dealer could thereby fall within the category of creditors obligated to give adverse action notices in any event. (This argument has been rejected on a stand-alone basis in other decisions, but in this context with the other arguments, it could carry some weight.);

5. The "catch-all" provision of the FCRA provides that an "adverse action" for FCRA purposes is: "an action taken or determination that is (I) made in connection with an application that was made by, or a transaction that was initiated by, any consumer...; and [is] (II) adverse to the interests of the consumer." This is a pretty broad standard if the dealer pulled a credit bureau on the customer.

This "catch-all" section of the FCRA could arguably be read to mean that almost any action by a dealer after reviewing a customer's credit report (including deciding where it sends the application) could necessitate an

continued on page 6

President's Letter

Jonathan P. Harvey

After a summer full of work, and very little play, I resume my monthly letter to the membership, and focus on personal, corporate and governmental responsibility.

The August 29 issue of *Automotive News* contains an article about Ford's loss of an appeal of a $47.7 million verdict in a Lincoln LS backseat latch lawsuit. The article states that the Georgia Court of Appeals pointed out that "Ford was aware of the possibility of a tragic accident . . . occurring but decided not to alert the public to this danger. A jury was authorized to find such conduct callous and wanton." On its face, the story is about a large punitive damage award, but the jury's reaction to what it perceived as a lack of corporate responsibility is the troubling, underlying theme. This notion led me to think about responsibility at a lot of different levels.

We are all aware of the terrible tragedy in New Orleans, and I wonder if we must take some responsibility for the conditions that gave rise to the failure of a timely response, and for the job that must be done to rebuild and prevent recurrence of the mistakes that have been made. I am concerned that we have become complacent in our daily routines and simply assume that life will go on as usual. For most of the victims of Katrina, life will not go on as they knew it, and they will spend a lifetime looking over their shoulder. This natural tragedy, compounded by inadequate response is, in my view, a wake-up call to take stock and see whether we can do better. And that means improvement in our profession, doing better in our personal relationships, and encouraging our elected officials to raise the bar. I don't suggest we get into the blame business, but rather, the improvement business. You may think this has little to do with the NADC, and perhaps you are right. But at the end of the day, we are in this together, and we have influence. Use it when you can, think about what can be done to improve your preparation and performance, and figure out how to create the incentive for people to follow your lead. Incentive is the most significant motivating factor in the retail automobile business, and if our clients can motivate people, so can we. If we all spend a little time thinking about how to make our society a better place, only good can come of it. If we go on with business as usual, it's just a matter of time.

Jonathan P. Harvey of Harvey and Mumford LLP is President of the NADC and can be reached by e-mail at jpharvey@harveyandmumford.com

Proposed Guidelines...
from page 5

adverse action notice. But that would be an unreasonable interpretation and negate a principal purpose of the statute which is that only some, but not all, credit decisions require adverse action notices; and

6. FTC commentary to the FCRA provides that a creditor must provide an FCRA adverse action notice when it "raises the charge for credit...based on a scoring system, where a credit report received less than the maximum number of points possible and caused the application to receive an insufficient score."[8]

Again, if the customer accepts the credit offer (the counteroffer for ECOA purposes and FCRA purposes except for the "catch all" section cited above), it would be reasonable not to send the adverse action notice. The ECOA provides the basis for this position in its provisions that if a consumer accepts the credit offer, adverse action notices from other creditors need not be sent.

But if the customer declines the credit, especially in the 9th Circuit, I might think otherwise. Dealers have been sued for not sending adverse action notices when financing is declined or provided at higher rates than originally agreed or intended. I think the risk of a consumer getting too many adverse action notices from different creditors is less problematic than the cases holding that the consumer did not get ones it needed. Put it this way: when was the last time you saw a case where a dealer got sued for sending an adverse action notice?

The notice posted to www.dealercounsel.com/adverseaction as Exhibit "C" requires the customer to write for specific reasons. I would instruct the dealer's sales and F&I employees not to tell the customer anything as to why or how their credit offer was determined. If the customer wrote and asked for the reasons (this rarely happens in the real world), I would state that the customer's credit score did not qualify him or her for lending programs on better terms and the dealer selected the lenders that had the program requirements best suited to customers in that credit score band.

I think these guidelines are workable and will mitigate, but not eliminate, dealer adverse action risk. Hopefully, the FTC will clear up some of these issues when it issues its risk-based pricing regulations under the FACT Act, due later this year.

8 Comment 615-9 to FCRA § 615, 15 U.S.C. § 1681

Fall Workshop:

Buy-Sell Transactions

November 4, 2005

Hilton San Diego
Gaslamp Quarter

One-day workshop will offer in-depth coverage of the topic.

CLE credit available.

Details by e-mail and updates at:

www.dealercounsel.com

Associate Member Spotlight: CounselorLibrary.com Spot Delivery is Only the Tip of the Iceberg

CounselorLibrary.com, LLC is the publisher of *Spot Delivery*, a monthly legal newsletter for dealers that NADC members get as a perk of membership. But CL's offerings don't stop at Spot Delivery

As a matter of fact, CL's flagship publication is *CARLAW*. *CARLAW*, introduced in 1993, is a comprehensive monthly recap of federal and state legal developments. *CARLAW* reports legislation, regulations, AG opinions and litigation for every 30-day period. *CARLAW* is a serious compliance service.

As an example of the material offered by *CARLAW*, each month we feature 50-75 reported court opinions. The cases are arranged by topics, which include arbitration, fraud, Truth in Lending, Equal Credit Opportunity Act, privacy, advertising, electronic commerce, titling, state consumer protection laws, dealer-manufacturer relations, warranty law and many others. We provide a summary of each court decision and the court's opinion in full text as well.

CARLAW is searchable as well, so if you are looking for every arbitration case we have reported on, you can pull up the summaries of those cases, and the court opinions, in a matter of seconds.

Originally offered in print, *CARLAW* is now offered as an Internet service. Subscribers can access *CARLAW* from any place they can get an Internet connection. When a company subscribes to *CARLAW*, anyone from the company can access the service. There are no "per user" or "per use" fees.

CARLAW is available on a subscription basis. A national subscription is $6,500 per year. Companies who operate in from one to three states can subscribe for $995 per year.

For more information, NADC members can call Tom Hudson at 410-865-5400, or can arrange for a guided tour of the service by calling Mike Willer at 614-855-0505, or emailing him at mjwiller@counselorlibrary.com.

Associate Member Spotlight Dixon Hughes PLLC: Committed to Dealerships

With over 50 years of dealership industry experience and a team of more than 100 professionals dedicated solely to dealerships and clients of all sizes from around the country, Dixon Hughes' Dealer Services Group (DSG) has earned its reputation for client service.

According to DSG Member Wayne Fortier, "Our passion for serving dealerships shows, and our clients have rewarded us with their trust. We're committed to helping them achieve their performance goals and objectives."

DSG consultants maintain industry credentials and remain current on industry trends and regulations; many have served as in-house dealership professionals. The Group maintains a strong presence through leadership in industry organizations such as NADC.

In addition to traditional audit, tax and accounting services, Dixon Hughes' DSG offers clients assistance with a variety of services, including FTC safeguards, F&I compliance, assurance, due diligence and business valuations. For more information on Dixon Hughes' services, call 888-683-4825 or visit the Dixon Hughes website at www.dixon-hughes.com/dcg.

Associate Member Spotlight Litigation Defense Strategy Services

gvo3 Consulting, LLC specializes in assisting auto dealers with the development and implementation of a litigation defense strategy to assist in the defense of litigation and governmental inquiries using a structured, comprehensive risk management approach to forms, processes, documentation, auditing and training. This strategy becomes part of a dealer's overall risk management plan, and in some cases may lead to a reduction in the dealer's garage keeper's premium.

The gvo3 Consulting, LLC Litigation Defense Strategy includes:

- An exhaustive risk assessment, including:
  - Analysis of the dealership's sales and F&I forms, operating processes and procedures
  - Initial deal jacket review
  - In-depth review of compliance with dealer-lender agreements, dealer's safeguard program Truth in Lending and Consumer Leasing Deceptive Trade Practices Acts
- Development of the F&I policy and procedure and compliance training program
- Facilitation of the compilation of a corporate diary and ongoing maintenance
- Quarterly audits of deal files for compliance with F&I policy and procedure, present state laws, federal regulations, recurring litigation theories
- Expert witness services

gvo3 is an associate member of the NADC. Contact Gil Van Over, president, gil@gvo3consulting.com or 312-961-9065.

Adverse Action Notices... from page 2

1. Even if the customer's credit is so bad that no potential assignee will approve it, a dealership should submit a credit application to a potential assignee that the dealership is confident has an adverse action notice procedure. In an often cited recent decision, the 7th Circuit Court of Appeals ruled that a decision by a dealer to refuse to submit a customer's application for credit to a proposed assignee was an adverse action by the dealer requiring an adverse action notice.[9] There is some logic to this position. If, based upon the dealership's evaluation of the credit, the customer's chances of obtaining credit are so bad that the dealership won't even submit the application, then the dealership has taken a position arguably adverse to the customer's interest, without the customer having the opportunity to know why because no adverse action notice is issued.[10]

Frankly, a dealer should not get itself into this position. Few dealers have adverse action notice processes that are sufficiently sophisticated to regularly provide accurate notices. If a customer is prepared to buy, provided credit can be obtained, then the dealer should submit the application to a creditor that does have an adverse action procedure regardless of the dealer's opinion of the customer's ability to be approved for credit.

2. Should a dealer be concerned about the type of creditor to which it sends the application? Some commentators have expressed the view that because of court decisions that a failure to submit a credit application to a potential assignee is an adverse action, by logical extension submitting an application to a secondary credit source with an interest rate higher than would be charged with primary credit approval is also an adverse action.[11] This stretches the laws too far, however, for at least two reasons.

First, a complaint that a credit application was not submitted to a primary lender would generally be made by a customer who has accepted credit at a higher rate, since a customer who received no credit would complain of credit denial. Under both the ECOA[12] and the FCRA,[13] a counteroffer of credit at a higher rate accepted by the customer is not an adverse action. Thus, where a dealer offers to seek approval for the customer at a secondary credit lender, this is in essence a counteroffer that, when approved by the proposed assignee and accepted by the consumer, does not require an adverse action notice.

Second, if Congress believed that it had previously obligated creditors to provide adverse action notices when they offer certain customers solely higher rate loans, why did it recently require creditors to provide risk based pricing notices when credit at higher rates is offered? When the Fair Credit Reporting Act was reauthorized at the end of 2003 with the passage of the Fair and Accurate Credit Transactions Act (FACT Act), Congress included a provision requiring a creditor to provide a notice when it extends credit on terms "materially less favorable than the most favorable terms available to a substantial proportion of consumers."[14] This process would be unnecessary if existing statutes required adverse action notices to customers obtaining higher rate loans.

3. Once the application is sent and rejected, must the dealer provide an adverse action notice in addition to that of the proposed assignee? There is ample authority that neither the ECOA[15] nor the FCRA[16] requires that a dealer provide an adverse action notice in addition to that of the proposed assignee. Despite a recent decision by a magistrate-judge in the Richmond Division of the Eastern District of Virginia,[17] a requirement that only one notice be given makes good sense. Most dealers, where allowed by law, will provide for rescission of the credit agreement if an assignee cannot be found. Thus, final credit decisions depend totally on the decisions of the proposed assignees. Of what benefit is another adverse action notice (especially, as discussed below, one that may be inconsistent) from the dealer when the final decision maker issues its adverse action notice?[18]

9 Treadway v. Gateway Chevrolet Oldsmobile, 362 F.3d 971 (7th Cir. 2004); *see also* Lacey v. Witham Chrysler Plymouth, 2004 WL 415972 (N.D. Ill. Feb. 23, 2004)(failure to submit credit application to allow purchase of vehicle customer really wanted instead of vehicle sold); Payne v. Ken Diepholz Ford Lincoln Mercury, 2004 WL 40631 (N.D. Ill. Jan. 5, 2004)(failure to submit wife's application without husband's).

10 *See* Treadway, 362 F.3d at 978.

11 A court that found the failure to submit a credit application was an adverse action seemed to disagree with this position. In Payne v. Ken Diepholz Ford Lincoln Mercury, *supra* note 4, at 5-6, the court noted that it did not consider the submission of a credit application to a secondary finance source to be an adverse action.

12 12 C.F.R. § 202.2(c)(1)(i).

13 According to the FTC, "No adverse action occurs in a credit transaction where the creditor makes a counteroffer that is accepted by the consumer." Notice to Users of Consumer Reports: Obligations of Users Under the FCRA, 16 C.F.R. § 698 App. H, 69 Fed. Reg. 69796.

14 15 U.S.C. § 1681m(h)(6). Dealers have not had to implement risk based pricing procedures because the FTC and the FRB have yet to propose and promulgate a rule.

15 "Where a creditor has been requested by a third party to make a specific extension of credit directly or indirectly to an applicant, the notification and statement of reasons required by this subsection may be made directly by such creditor, or indirectly through the third party, provided in either case that the identity of the creditor is disclosed." 15 U.S.C. § 1691(d)(4). *See, e.g.*, Thele v. Sunrise Chevrolet, 2004 WL 1194751 (N.D. Ill. May 28, 2004); Brand v. Rohr-Ville Motors, 2004 WL 21078022 (N.D. Ill. May 9, 2003); Leguillou v. Lynch Ford, 2000 WL 198796 (N.D. Ill. Feb 14, 2000).

16 *See* 15 U.S.C. §1681(d)(2)(c); Sapia v. Regency Motors of Metairie, 276 F.3d 747, 753 (5th Cir. 2002).

17 Padin v. Oyster Point Dodge, (E.D. Va. March 3, 2005) (Pacer, Va. Case Law) *available at This Week's Opinions*, VIRGINIA LAWYERS WEEKLY, March 21, 2005, at 23. The court's ruling that a dealer is a participating creditor and not a third party because it has discretion to set the rate of the credit disregards not only the substantial authority to the contrary, but the express language of the ECOA that only one party is obligated to provide an AA notice whether the proposed credit may be offered "directly or indirectly." If the credit requested by the customer is indirect, the dealer by definition must be a creditor since an indirect relationship arises when the dealer, the original creditor, assigns the finance contract. Therefore, the statute itself assumes that the "third party" that may rely upon the proposed assignee's AA notice may also be a "creditor."

18 *See*, e.g., Brand v. Rohr-Ville Motors, 2003 WL 21078022 (N.D. Ill May 9, 2003).

continued on page 9

Adverse Action Notices... from page 8

4. To respond to the confusion over the need to send adverse action notices, one suggestion is that a dealer should simply send an adverse action notice whenever the proposed assignee takes an adverse action. However, a dealer sending its own adverse action notice in addition to that of a potential assignee faces certain risks. Under the ECOA, one must provide a notice to state the action taken and the precise reason for the action or notice of the right to request the reason.[19] The FCRA requires that an adverse action notice identify that the adverse action was taken and must also provide sufficient information to allow the consumer to understand clearly the nature of the adverse action.[20]

The dealer frequently does not learn the specific reason for adverse action from a potential assignee. Consequently, a dealer sending its own notice in addition to that sent by the proposed assignee runs the risk of having differing information in its notice. What problem does this cause?

It is not hard to conceive of a lawsuit over the denial of credit where the defendant dealer's F&I manager is deposed and testifies that, from a practical standpoint, the dealer never actually provides credit unless it can assign the contract. The reason that the plaintiff's credit was declined, the deponent would testify, was because no assignee could be found.[21]

Armed with that, the plaintiff then identifies differences in the adverse action notices of the dealer and the proposed assignee. Since the dealership's decision was totally dependent on its potential assignee's decision, there should be no differences in the two adverse action notices. Where there are differences, the dealer's misstatements are potentially actionable. Consequently, a decision to issue dealer adverse action notices in addition to those issued by the proposed assignee will require a very high level of diligence on the part of the dealer if it is to avoid this problem

Given the significant amount of litigation focusing on adverse action notices recently, practitioners representing car dealers must pay careful attention to the trends evident in the decisions issued and to be issued under the ECOA and the FCRA. And those practitioners trying the cases will have to take the time to adequately and carefully provide for the court not only the statutory and case precedents, but also the reasons and logic supporting the positions of dealers.

19 12 C.F.R. § 202.9.

20 15 U.S.C. § 1681m(a); Razilov v. Nationwide Mut. Ins. Co., 2004 WL 3090083 (D. Or. March 3, 2004).

21 One court has ruled that where a finance contract is subject to the condition subsequent of assignee approval, and the reason the dealer seeks to rescind is the failure to find an assignee, this is not an FCRA adverse action since the dealer's decision is not based on the credit report. Brand v. Rohr-ville Motors, 2003 WL 21078022 (N.D. Ill. May 9, 2003.

CLE Credit Update

We applied to all states requested for credit for the Member Conference in April and show below the responses to those applications. All attendees receive certificates of attendance.

State	CLE Credit Status
Alabama	10 hours CLE credit
Arizona	Accepts certificate of attendance
California	Accepts credit of jurisdictions with which it has reciprocal agreements*
Colorado	12 hours CLE credit
District of Columbia	Has no mandatory CLE requirements
Florida	12 hours CLE credit
Georgia	10 hours CLE credit
Indiana	10 hours CLE credit
Kentucky	10 hours CLE credit
Maryland	Has no mandatory CLE requirements
Massachusetts	Has no mandatory CLE requirements
Minnesota	10 hours CLE credit
Missouri	12 hours CLE credit
New Jersey	Has no mandatory CLE requirements
New York	Accepts credit of jurisdictions with which it has reciprocal agreements**
North Carolina	10 hours CLE credit
Ohio	10 hours CLE credit
Oklahoma	12 hours CLE credit
Pennsylvania	10 hours CLE credit
Tennessee	10 hours CLE credit
Texas	10 hours CLE credit
Virginia	9 hours CLE credit
Washington	10 hours CLE credit
Wisconsin	12 hours CLE credit

* including all accrediting states above

** including CO, GA, IN, NC, OH, OK, PA, TN, VA, WI

Limited Liability...
From page 2

As the *Treadway*[22] decision outlined, even very casual communication with a consumer about credit could create exposure for a dealer.

Another safe practice is to have the consumer sign a disclosure advising the customer that if he wishes to be advised of the reasons of any adverse action, he should notify the dealer in writing. The disclosure should also note that the consumer was advised of the reason for the adverse action. Section 202.9 of the ECOA provides that an adverse action notice is required when adverse action is taken, and that the notice must contain certain information, such as the name and address of the creditor and statement of action taken. In addition, the notification must contain either a statement of specific reasons for the action taken, or a "disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification." Disclosing the applicant's rights at the outset will shift the burden on the consumer to ask in writing for a statement of reasons. This disclosure form should comply with the requirements of both the ECOA and FCRA.

The ECOA portion of the notice should include the following language:

> The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is The Federal Trade Commission, Equal Credit Opportunity, Washington, DC 20580.

The ECOA portion should also include:

- A statement that the consumer has the right to a written list of reasons for the denial of the credit application if requested in writing within 60 days; and
- The name, address and contact number for the person at the dealership who is to handle the request

The FCRA portion of the disclosure form should include the following:

- The name, address and toll free number of the consumer reporting agency
- A statement that the credit reporting agency did not participate in the decision
- A statement regarding the consumer's right to a free report; and
- A statement that the consumer has the right to dispute inaccurate information

Finally, it is recommended that an arbitration provision state that the parties agree to arbitrate any claims for failure to comply with the FCRA or the ECOA. Although arbitration provisions are not a compliance panacea, plaintiff attorneys generally disfavor arbitration as it limits their fees in fee shifting litigation.

If the customer does request reasons for an adverse action, the dealer should use the model notification form provided by the Federal Reserve Board (FRB) (available at www.dealercounsel.com/adverseaction). This form is straightforward, and allows the finance manager to check boxes that most resemble the reasons the creditor provided in its fax declination letter. Use of the notification form provided by the government is a simple way to avoid litigation concerning the form's sufficiency. It is unlikely that a court will find the FRB format unacceptable.

Dealers should also take measures to avoid pointing out that they are involved in the credit decision in any way. There are additional liabilities under the FCRA for denying a consumer financing based upon a credit report, and a dealer may often be able to obtain summary judgment in this situation as the plaintiff does not have any evidence on whether the adverse action was based in whole or in part upon the credit report.

Many dealers are unaware of their legal exposure regarding the ECOA and the FCRA. Taking the steps outlined above is a relatively simple way to minimize liability.

22 Treadway v. Gateway Chevrolet Oldsmobile, 362 F.3d 971 (7th Cir. 2004)

Associate Member Spotlight: MD Johnson, Inc.

MD Johnson, Inc. is a highly specialized mergers and acquisitions firm that solely concentrates on the acquisition and divestiture of automobile dealerships and dealership platforms. The company maintains offices in Seattle, Washington and West Palm Beach, Florida.

The company receives success fees only upon successfully executing transactions and is compensated by either the company's buyer or seller client, never both. The company does not act in capacity as a dual consultant.

The company authors a detailed memorandum of sale and executes a list of approximately 45 tasks, which includes the management of the entire transaction from the exit planning stage through 24 months past closing.

The company has a 100% closing ratio on its engagements.

The company has represented Asbury Auto Group and sold numerous dealerships to AutoNation, including Lexus of Palm Beach, Schooley Cadillac and Borton Volvo Volkswagen.

Save the Date!

Fall Workshop: Buy-Sell Transactions

November 4, 2005

Hilton San Diego Gaslamp Quarter

One-day workshop will offer in-depth coverage of the topic.

CLE credit available.

Look for details by e-mail and updates at:

www.dealercounsel.com

New Members

Each month we will list members who joined the previous month.

Full Members

Lawrence Byrne
Pedersen & Houpt
Chicago,IL

Lane Webb
Wilson, Elser, Moskowitz,
Edelman & Dicker
San Diego, CA

Executive Members

Gerard Murphy
Washington Area New Automobile
Dealers Association
Washington, DC

Stuart Rosenthal
Greater New York Automobile
Dealers Association
Whitestone, NY

Fellow

Cheryl Brown
Hughes Watters Askanase
Houston, TX

Nick Pace
CarMax Auto Superstores
Glen Allen, VA

Murray Thayer
Jason Kent
Albuquerque, NM

John Valdivielso
CarMax Auto Superstores
Glen Allen, VA

Assoiate Member

Jay Ferrriero
Capital Automotive REIT
McLean VA

NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL
Volume I, Number 10
September, 2005
Rob Cohen, Editor
rob.cohen@autoadvisory.com
Defender, The NADC Newsletter is published by the National Association of Dealer Counsel
P.O. Box 383
Linthicum, MD 21090
410-684-6165
Fax 410-684-3036
www.dealercounsel.com