DEFENDER
THE NADC NEWSLETTER

Lease Advertising Under Regulation M

Rob Cohen

The availability of favorable leasing programs has resulted in dealers advertising more leases than in the past. Unfortunately, dealers (and even some manufacturers) often fail to include proper lease disclosures in advertisements. This article will explain the basics of closed-end lease advertising under federal law (Regulation M).

Note: Since dealers generally do not offer open-end leases, I will not discuss the additional disclosure requirements associated with those types of vehicle leases.

Basic Disclosures

Lease advertising, like finance advertising, is all about trigger terms. If you advertise either a monthly payment or anything about the drive-off (e.g., cap. cost reduction, security deposit, "no down payment," etc.) then this triggers the need for the following additional disclosures:

1. Clearly identify the transaction as a lease (e.g., "Lease for"); and

2. State the number, amounts and period of scheduled payments (e.g., "$399 per month for 39 months."); and

3. State the total amount due on or before delivery (e.g., "$999 total amount due at lease signing"); and

4. State whether or *not* a security deposit

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Rob Cohen

Sidebar

Contents:

Andrew J. Weill, Esq.

Part 2: Reinsurance Programs: A Primer for Dealer Counsel

Andrew J. Weill, Esq. and Craig Gordon, Esq.

Note: Part 1 of this article appeared in the October, 2007 issue of Defender.

Problems and Opportunities for Dealer Counsel with Reinsurance Programs and Retros

Counsel should find out if the dealer client is participating in a reinsurance program or a retro. Surprisingly enough, it is often the case that the dealer doesn't really understand what type of program he or she is in. Since the distinction between the two is of considerable significance, it is important to get hold of the program documents and understand the mechanics of your client's program. The typical program will require the dealer's execution of several documents and will see the dealer receive various financial reports. These should be reviewed as well.

If your client is involved with a reinsurance arrangement, there is likely one or more third party providers handling most of the services related to the program. These arrangements can be package deals, with a promoter setting the dealer up with all of the organizational and operational requirements, including managing the program on a day-to-day basis.

You can assist your client by asking several questions intended to bring into relief how well the program is suited to your client's needs. For example: How much is the program costing the dealer? What kind of information is the program giving the dealer? Are there restrictions on a deal-

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President's Message


Michael Charapp

Experience is the Best Teacher

For years I have represented dealers with issues about factory CSI surveys. "They don't really care about satisfying customers," dealers say. "They only use CSI as another tool to hammer us."

I'm paid to take my client's side. And dealer arguments against factory CSI make sense. However, nothing brings home the truth like our own experiences.

From time to time, I've had to personally deal with factory customer relations personnel. Every experience I have had tells me that the factories don't care about true customer satisfaction.

My latest experience was with a noted English car company. I recently leased a British vehicle from one of my clients. (You cynics out there who say that anybody who leases a British vehicle deserves what he gets should keep those thoughts to yourself). When it came time for my first lease payment, I did not have a bill from the manufacturer's apparently-affiliated lease company. I called the lease company. What I learned was that the dealer's salesperson was correct: the dealer does not provide a payment coupon at delivery;the lease company sends it out. Unfortunately, I leased a little too late in the month to make the apparently-affiliated lease company's mailing cycle. With tongue in cheek I suggested that my first payment was excused. I then received the lecture: since I leased at the wrong time of the month, my penance was either to send a check without a coupon with a nearly sure chance that it would not be properly credited or chase down a lease company representative for a bill.

Call me whiny. Call me spoiled. But when I lease a vehicle that costs more than my first house, I think I deserve a little better treatment than having to chase down a bill for my first lease payment. So, after my phone conversation with the lease company, I called the manufacturer.

The first inaptly titled "customer service representative" was totally unsympathetic, "That's not us; that's them." After I insisted it really was the manufacturer's problem since they either let the lease company misleadingly use their product name in the lease company name or the lease company was in fact affiliated, she dismissively told me she would put me in touch with the lease company whom she promptly got on the phone over my objections. Naturally, she was so anxious to get off the phone that once she established the connection with the lease company, she hung up – terminating the call for everyone on the line.

I called the manufacturer back. I got a person who was part of the way to sincere in expressing her sympathy for my mistreatment. She put me on hold to investigate who the previous call handler was. Mysteriously, she just couldn't figure that out. I went on to detail my complaint. In the middle of that, the phone line went dead. Strike two. There won't be a strike three.

My dealer clients are right. Manufacturers have no real concern whether buyers of their vehicles are truly happy. They want to move the metal. If there is some fallout along the way because the factory mistreats some pain-in-the-derriere customers, so be it.

But heaven forbid a customer should claim that a dealer mistreated the customer. Then the factory pays attention like Michael Vick at the Westminster Kennel Club.

Factories seek out customer complaints about dealers because it gives them leverage over their dealers. I also know this from personal experience because I once broke down in another city in my Japanese brand car that was fifteen days old. There were apparently so many other alternator problems for my model that the part for my car wouldn't be available for two to four weeks. When I called the manufacturer to complain that I was stuck without a car in another city for two to four weeks, the representatives only wanted to grill me on what the dealer did to upset me. When it finally sunk in that I was happy with the dealer but unhappy with the manufacturer, the manufacturer representatives simply wanted to argue with me about whether I was eligible for a rental car since I was only 250 miles from home.

All of us zealously represent our clients. We work with them to develop logical and compelling theories to support their positions. But the next time I get a CSI case, I will have added incentive. Not only are my clients' arguments about the fallacies and improper purposes of factory CSI measures logical, I know they are correct from personal experience.

Michael Charapp, President of the NADC, is a partner with Charapp & Weiss, LLP in McLean, VA.

NADC
National Association of Dealer Counsel
California Chapter

Dissecting the LAW® 553-CA Retail Installment Sale Contract

December 7, 2007

Hilton Irvine/Orange County Airport

NADC members are invited to attend the California Chapter workshop Application has been made for California CLE. Registration is $375; $325 for chapter members. Contact the hotel at 949-833-9999 for room rate of $119, plus tax. Join some of the top California dealer attorneys as they painstakingly analyze the industry standard California retail installment sale contract (the LAW(R) 553-CA). Find out from the experts the proper way to complete and defend the 553 and participate in a "roundtable" discussion regarding future versions. Look for updates at: **www.dealercounsel.com**

Workshop Sponsor Reynolds & Reynolds

9:00 am **Introduction — Andrew Weill, Benjamin, Weill & Mazer and Chapter Chairman**

9:05 am **History of the California 553 — Steve Tjaden, Auto Advisory Services, Inc.**

9:15 am - 10:30 am **Part 1 Front Side Section Analysis — Moderator: Rob Cohen, Auto Advisory Services, Inc; Panelists: Alicia Tortarolo, Hudson Cook, LLP; and Bert Rasmussen, Manning, Leaver, Bruder & Berberich**

- Fed Box
- Itemization of Amount Financed
  - Total Cash Price
    - Accessories
    - Doc Fee
    - Smog Fee
    - Sales Tax
    - Theft Deterrent Devices
    - Surface Protection Products
    - Electronic Filing Fee
    - Service Contracts
    - Prior Credit or Lease Balance
    - Gap Contract
    - Contract Cancellation Option Agreement
    - Other
  - Amounts Paid to Public Officials
    - License Fees
    - Registration Fees
    - California Tire Fees
    - Other
  - Amounts Paid to Insurance Companies
    - Statement of Insurance Section
  - Smog Certification or Exemption Fee

10:30 - 10:45 am **Break**

10:45 am - 12:15 pm **Part 2 Front Side Section Analysis**

- Total Downpayment
  - Trade in description
  - Prior Credit or Lease Balance
  - Net Trade In
  - Deferred Downpayment
  - Other
  - Cash
- Seller Assisted Loan
- Auto Broker Fee Disclosure
- Seller's Right to Cancel
- Application of Optional Credit Insurance
- Option Box
- Representations of Buyer
- Notice to Buyer
- Signatures
- Annual Percentage Rate disclosure
- Guaranty Box

12:15 - 1:15 pm **Lunch - *Sponsored by Auto Advisory Services, Inc.***

1:15 - 2:15 pm **Back Side Language Analysis — Robert Daniels, Manning, Leaver, Bruder & Berberich; and Aaron Jacoby, Venable**

- Use of vehicle
- Insurance requirements
- Default provisions
- Warranties of Buyer
- Arbitration clause

2:15 - 3:15 pm **Problems Encountered/Wish List (Desired Changes) Group Discussion Rob Cohen, Alicia Tortarolo and Terry O'Loughlin, Reynolds & Reynolds**

3:15 pm **Concluding Remarks — Andrew Weill**

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is required (e.g., "(no security deposit required)").

[Reference: 12 CFR § 213.7(d)]

Put them all together and you get a good closed-end lease disclosure:

> Lease for $399 per month for 39 months. $999 total amount due at lease signing (no security deposit required).

All of the above disclosures must be clear and conspicuous. Also, be aware of the "equal prominence rule." This aspect of federal law says if you state anything at all about any component of the drive off, such as "no down payment," then the total amount that is due at the time of delivery must be disclosed no less prominently than any such component. (12 CFR § 213.7(b)(1))

Leasing & Rebates

Recall that the law requires dealers to disclose the total amount of the drive-off required to initiate the lease. Problems can occur when a dealer attempts to automatically include a manufacturer's rebate into the drive-offs without making an appropriate disclosure.

Let's say we have a lease for which the total drive-off is $3,500. A $2,000 factory rebate is also available. In my opinion, it is misleading to advertise "Total to start $1,500" when in fact the dealer requires the $2,000 rebate be applied to the amount due at lease signing.

A recommended way to disclose the drive-off would be:

> $1,500 cash or trade equity from customer, plus $2,000 factory rebate equals $3,500 total due at lease signing.

"Sale Prices Exclude Leases"

I often see this disclaimer in ads but recommend against it. In the past, law enforcement in California has indicated that they consider leases to be nothing more than continuing purchases and, therefore, (depending on the law in your state) the duty to sell at an advertised price may apply to leasing as well. Also, I have heard the argument that switching people from an advertised purchase deal to a more lucrative lease could be a form of bait-and-switch.

Ultimately, I just recommend dealers use the advertised selling price as the "agreed upon value" of the vehicle on a lease contract in order to avoid problems in this area.

Note: There is one possible exception in cases where the manufacturer is offering dealer cash on a purchase but not on a lease. In these limited circumstances it may be permissible to use this disclaimer. However, the dealer should be prepared to justify a higher price by showing proof of a factory-to-dealer incentive program for purchases that does not exist on leases. Be sure to check the laws in your state on this one.

Quoting Lease Payments

I know of a problematic practice whereby a customer is closed on a lease payment and a "downpayment" only to discover in finance that the downpayment was just a portion of the total amount due at lease signing (i.e., the cap. cost reduction). Due to potential unfair business practices claims, I discourage the use of the term "downpayment" with respect to leases. I believe a best practice is to always quote the total amount due at lease signing.

State Law

It is important to note that state law may impose additional obligations. For exam-

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er's ability to obtain information about the program's performance, including all of the key service and profitability indicators? Under what terms can the dealer take money out of the arrangement? Is the dealer getting meaningful help to ensure all of the players maintain an effective program? The purpose of the review will be to see if the program is in fact operating as your dealer client intended. All too often, you will learn about supposed "modifications" to the program that are supported by ambiguous or non-existent documentation.

Legal issues can arise between your dealer client and the third-party program provider. Often this happens when your client decides to switch programs. This should be a relatively smooth transition, but I have encountered several situations where the former program has attempted to impose unreasonable restrictions on the ability to move the business. I have even encountered situations where the program has taken positions flatly contrary to the written agreements of the parties.

In Typical Lawyer Fashion – Anticipate the Unexpected

Product-choice pressure on your client

I have also heard rumblings of situations where the dealer has been pressured to sell only the factory's financial products. Usually such anti-competitive practices can be resolved with a single letter citing your state's unfair trade practices law.

Reinsurance reserve accounts become tempting

It is all too frequent that the reinsurance company is viewed as essentially a "private" asset of the dealer. This can lead to all sorts of problems. I have encountered dealers who have never disclosed the reinsurance to any accountant, or to the spouse, or to business partners or investors. I have even encountered a situation where the dealer established a company, placed the ownership in the name of his relatives, and proceeded to handle the reinsurance company without any notification (or distributions) to the putative owners. These issues need to be candidly assessed, and usually creative and satisfactory solutions can be found.

Tax Considerations

There are potential issues, as noted above, deriving from federal tax consequences of these structures. The most important service you can give your client in that regard is to be sure that these issues are evaluated by a qualified professional familiar with this body of law. The best programs have top-flight legal and accounting support and will be able to give you assurance. If you aren't comfortable with what the program's advisor tells you, get a second opinion. Some of the ways to run afoul of IRS rules and regulations include: improper access to the reserves held by the reinsurance company; improper pricing of financial products; questionable loans, investments, or withdrawals involving the reinsurance company's assets; and a variety of other issues.

A brief list of some of the tax-related issues to consider would be: (1) is the reinsurance company filing US tax returns; (2) has the company made a proper election under IRC § 953(d), and if so, does it have a copy of the approved election; and (3) does the company qualify for favorable tax treatment under IRC §§ 501(c)(15) or 831(b), and if so, have appropriate steps been taken. It is quite likely that this information is not really known to your client. Be sure to establish contact with the persons (frequently representatives of the program your client participates in) who have the necessary information.

Preparing for the Worst – Insurer Bankruptcy

As noted above, there have been several bankruptcies of insurers of these programs

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ple, California imposes the following additional disclosures for all lease ads:

1. The mileage limit after which excess mileage charges will accrue and the charge per mile (e.g., "39,000 total miles for lease term, 15 cents per excess mile."; and

2. The statement: "Plus tax and license" or a substantially similar statement, if amounts due for use tax, license fees, and registration fees are not included in the payments.

[Reference: California Civil Code § 2985.71]

Credit Qualifier

This is not required under Regulation M but very important nonetheless. As with all finance offers, be sure to include a prominent credit qualifier in any lease ad. For example, the simple statement "on approved credit" will properly qualify most lease offers.

Toll-free Number Misconception

Dealers and attorneys alike often have the misconception that a toll-free number can be used in radio and television ads in lieu of all the disclosures. This is simply not true. What is true is that a toll-free number where customers can get the required disclosures can be used to avoid only two disclosures, one of which is for open-end leases and the other is the amount or non-existence of a security deposit.(12 CFR § 213.7(f)(1)) Again, since dealers do not generally advertise open-end leases, a toll-free number really would only save a dealer from having to mention a security deposit (hardly worth the trouble).

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

New Members

NADC welcomes the following new members:

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Associate

Connie Fish, Wolters Kluwer Financial Services
Minneapolis MN

Plan to attend — 4th Annual NADC Member Conference

April 6 to 8, 2008, Ritz Carlton, St. Louis

Information will be posted at www.dealercounsel.com as it develops.

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in recent years. You will be doing your dealer client a great service by reviewing the program and satisfying yourself that your client has protection in the event of insurer liquidation. As a general rule, reinsurance programs tend to provide a degree of safety not enjoyed by retro programs. However, only by a careful review of the contractual arrangements and the documentation regarding control of the reserve account can you assess the safety of these assets.

Ensuring a Loan Between the Parties is Legally a Loan

A particular area where counsel attention is required is loans from the reinsurance company to the dealership. The making of such loans is common; the proper documentation of such loans is not. There are several undesirable consequences of improperly documented loans, particularly if the IRS determines that the "loan" is in fact a deemed dividend. You should try to impress on your client that there is no reason not to have the loan transaction properly documented. Waiting until the IRS has started an audit is not going to be an effective strategy.

Guiding Your Client to Keep an Eye on the Bigger Picture

Although clients may understand the importance of structure and ownership issues for their dealership corporations, they tend to forget all these lessons when setting up reinsurance companies. Corporate formalities need to be observed. There are significant estate planning opportunities available with these companies. Buy-sell arrangements should be considered. Spousal ownership rights should be assessed. Again, all of these are opportunities for dealer counsel to provide significant value to the client.

For those of you whose dealer clients do not have these programs, you will be providing your client with a service by recommending their consideration of these programs. At this point, reinsurance programs have been examined under the microscope by the IRS and state authorities. The major players in the industry are healthily competitive and are sensitive to keeping dealers in compliance.

These programs can offer significant opportunities to increase return to car dealers. And the more we enhance our clients' wealth opportunities, the more we will build their trust and reliance on us for their wider-ranging legal needs.

Andrew J. Weill is a principal of Benjamin, Weill & Mazer, a leading complex litigation firm in San Francisco. His practice includes complex business, tax and estate disputes across the nation. Mr. Weill graduated from Yale University in 1973 and obtained his J.D. from University of California, Berkeley (Boalt Hall) in 1976. He is a Certified Specialist in Taxation Law. He is a frequent speaker and writer on tax and litigation issues. Mr. Weill represented the taxpayers in obtaining the favorable rulings discussed in his article.

Craig Gordon assisted in that representation and related matters, and in the preparation of this article.

Save the date!

4th Annual

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