DEFENDER
THE NADC NEWSLETTER

Lenders Using "Trigger Leads" Present New Risks to Dealer Financing

Randy Henrick

Randy Henrick, Esq.

Imagine this scenario: You are about to close the sale and financing of a new vehicle with a happy customer when the customer's cell phone rings in your F&I office. On the phone is a lender with whom you have no relationship. The lender tells the customer not to finance at the dealership, that they will give the customer a lower APR and a better price on GAP and service contracts if the customer finances with them directly. Just say no to dealer financing and aftermarket sales they say. The customer puts down his or her pen and leaves to contact the lender. You lose the financing and may lose the vehicle sale as well.

Can't happen, you say? Well it is happening in a major midwestern state. The concept is called "trigger leads," something lenders started doing about two years ago in the mortgage industry (we know how well that turned out) and are now bringing to auto finance at the behest of credit bureaus who actively sell the product. It is a takeoff on the practice of prescreening, in which a lender gives the credit bureau a list of credit and other criteria for

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Sidebar

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State AGs Deputized to Help Enforce TILA

L. Jean Noonan

L. Jean Noonan, Esq.

President Obama has signed a new law that, for the first time, will allow state Attorneys General to enforce the Truth in Lending Act. (Omnibus Appropriations Act of 2009, H.R 1105, Sec. 626(b))

In most states, auto dealers and finance companies only worry about TILA lawsuits from consumers and the Federal Trade Commission. A small number of states (Connecticut, Maine, Massachusetts, Oklahoma, and Wyoming) are exempt from the federal TILA, and in those states the state AG can enforce the state equivalent of the federal TILA. The enforcement environment is about to get a lot hotter. Under the new law, auto dealers and finance companies will need to start worrying about TILA enforcement by state AGs in every state.

Enforcement is likely to become particularly hot in the area of credit advertising. Under TILA, consumers cannot bring lawsuits for violations of the credit advertising rules (although dealers have been subjected to many "backdoor" TILA suits under states' UDAP statutes). Until now, only the FTC and the federal bank regulators could directly enforce TILA's credit advertising rules. It has been more

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President's Message

Michael Charapp

Michael Charapp

As I write this, I have just completed helping a state dealer association that worked tirelessly to convince the state legislature to revamp its motor vehicle franchise statute. One of the key elements of the revision was manufacturer assistance for dealers in the event of a line-make termination.

The manufacturers pulled out all stops to try to kill the bill. Dealers didn't lose a single legislator's vote during the whole process. Faced with this unanimous legislative rejection of their position, the manufacturers took to the media.

With typical manufacturer subtlety, franchisors charged that the bill would end the car business as we know it. Nevermind that their vast posse of hangers-on helped the Detroit 3 CEOs from their private jets at Reagan National Airport to beg for billions to save their companies from their own management follies. The real problem, according to the manufacturer flacks, is that dealers have the nerve to expect some compensation from manufacturers who make the voluntary decision to breach their sales and service agreements by ceasing production of the vehicles they are obligated to continue supplying to dealers. "Save us from those dealers who were foolish enough to believe us when we told them we were committed to our products" is an accurate translation of their rallying cry.

Dealers who sat through the legislative hearings and otherwise followed the process were shocked by the behavior of the manufacturers. Dealers, who just 45 days before were cajoling their Congressional representatives to help the manufacturers out of the holes they dug for themselves, saw those same manufacturers disrespect them by claiming that dealers wanted to avoid the risks inherent in business and were looking for a bailout. It was a disgusting performance, and dealers learned a lot of lessons. They are lessons that we, their lawyers, must keep in mind as we represent dealers.

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selection. The credit bureau then produces a list of consumers who meet the criteria and to each of whom the lender must then make a "firm offer of credit." The new wrinkle of "trigger leads" is that the lender gets the names one by one (called a "prescreen of one") and the credit bureau communicates the consumer's information when an auto dealer makes a credit inquiry to the consumer's credit file at the credit bureau. So when you get the customer's credit score, the lender is getting the customer's information to call them and try to undo your deal.

Is this legal? No court or regulator has ever approved it, at least as far as I can tell. Arguably it is not legal under the Fair Credit Reporting Act ("FCRA") (15 U.S.C. § 1681b(c)), and the FTC's rules on prescreening (16 C.F.R. Part 642).

The FCRA's statutory purpose is "to require that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner which is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy and proper utilization of such information in accordance with the requirements of this title." (15 U.S.C. § 1681(b)) "There is a need to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy." (15 U.S.C. § 1681(a)(4))

Under the FCRA, prescreening is an exception to requiring a consumer's consent or a permissible purpose for a creditor to access a consumer report. The lender gives its selection criteria to the credit bureau and all the credit bureau can return to the lender are the customers' names and addresses and an identifier not unique to the consumer to verify their identity. (15 U.S.C. § 1681b(c)(2)) It is certainly questionable whether a customer's cell phone number is part of their address. (*See*, e.g., *U.S. v. Wndehake*, 2006 U.S. Dist. LEXIS 87649 (S. D. Fla. 2006) (cell phone and address delineated as different information fields by court in its decision)) But the FCRA specifically prohibits the credit bureau from giving the lender "a record of inquiries" on the consumer's credit file and informing of the credit inquiry made by the auto dealer would appear to violate the prohibition. (*See*, 15 U.S.C. § 1681b(c)(3)) The credit bureau also cannot identify the relationship or experience of the consumer "with respect to a particular creditor or other entity." (15 U.S.C. § 1681b(c)(2)(C))

The lender also has to give the customer a "firm offer of credit," a standard that has ebbed and flowed in case law decisions since a federal appeals court in Chicago ruled in 2004 that the firm offer of credit had to include all of the material terms for the credit offer. (*Cole v. U.S. Capital, Inc.*, 389 F.3d 719 (7th Cir. 2004)) That standard has been loosened in subsequent cases and the bright line for how much specificity a "firm offer of credit" must contain is hard to define. But prescreening can't be used for an advertisement or solicitation.

The FCRA seems to contemplate, but nowhere requires, that the firm offer of credit be made in writing and not over the phone. Traditionally, you would get prescreen offers in the mail such as those credit card offers saying you have been pre-approved for a Platinum Visa card. The FTC's prescreening rules require a written prescreen offer to contain a clear and conspicuous, simple and easy to understand set of disclosures to the consumer containing information about their ability to opt out of prescreening (which any consumer can do by simply calling 1-888-5-OPT-OUT). (16 C.F.R. § 642.3) It is hard for me to imagine that the FTC would require such clear and conspicuous notices in writing but omit any need for them altogether in a phone solicitation. Additionally, whether just throwing out an APR number to the customer and then offering to undercut the dealer on aftermarket sales pricing is a legitimate firm offer of credit is also subject to debate.

Under the FCRA, any consumer whose credit report was pulled illegally, which would be the case if a "firm offer of credit" was not made or if the credit bureau communicated prohibited information like a cell phone number or the auto dealer's credit inquiry, can bring an action against the lender and the credit bureau for actual and punitive damages, plus attorney's fees. (15 U.S.C. § 1681n, 1681o) The FTC and state Attorneys General can bring enforcement proceedings or lawsuits against both the lender and credit bureau as well. (15 U.S.C. § 1681p(a), (c)) Penalties for knowing violations of the FCRA were recently increased to $3,500 per violation. (*See*, 74 Fed. Reg. 857 (Jan. 9, 2009)) Penalties for violating Section 5 of the FTC Act were also increased from $11,000 per violation to $16,000 per violation. (*Id.*)

Dealers may have legal claims under state Unfair and Deceptive Trade

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State AGs ... from page 1

than 20 years since the FTC has actively focused on suing dealers or finance companies for violations of the credit advertising rules. State AGs may decide to fill this vacuum.

There are many reasons to think the AGs will use their new authority aggressively:

- Advertising is often focused locally. That makes it a higher priority for local state officials than for federal lawyers in Washington, DC. State AGs may want to show local voters that they can protect consumers by enforcing consumer protection laws.
- Violations are easy to identify and easy to prove. For example, if a dealership places an ad promising that a customer can drive away for only $300 down or can have payments of only $300 a month (with no disclosures), you have handed the AG an easy-to-prove TILA case.
- In order to bring a private action under many states' UDAP statutes, consumers must prove actual damages (which is difficult in credit advertising cases). Therefore, AGs may feel more responsibility for bringing these actions.

It is not clear what penalties an AG will be able to inflict. Under the new law, states can bring suits in either state or federal court. The law says that a state can "obtain penalties and relief provided under" TILA. That probably means that an AG can obtain a court order prohibiting a dealer or finance company from violating the law in the future. But what about civil fines or damages? Because TILA does not provide for "penalties," using that term, it is not clear that a civil fine or similar "penalty" could be awarded by a court. The state can probably recover damages for some TILA violations, but it is not clear that damages are available for a credit advertising violation. Consumers cannot obtain damages for credit advertising claims, and the FTC is generally limited to obtaining a cease-and-desist order.

Courts will have to work out the remedies available to AGs who bring credit advertising cases under TILA. Although rulings that dealers and finance companies are not subject to money damages and penalties would be welcome, they are not reasons to be complacent. In any case like this, the damage to a company's reputation is always the biggest risk. And, in many states, the AG may be able to fall back on state law remedies for unfair or deceptive business practices.

Now would be an excellent time to be sure your client's ads are in full compliance with TILA.

L. Jean Noonan is a Partner, Hudson Cook, LLP, Washington, DC.

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Practices laws and possibly common law tort claims for unfair competition, interference with business relationships, and perhaps even defamation depending on what the lender says in that cell phone call or afterwards. Attorneys General in a number of states are looking negatively at trigger leads and evaluating their options. This is very different from a situation where a consumer is just shopping for mortgage rates.

If you experience this type of situation, it would be a good idea to involve your state dealer association as there is strength in numbers. Trigger leads represent a profit center for credit bureaus so I don't think they are going away unless a court or a regulator steps in. But there may be ways for dealer associations to pressure credit bureaus to prohibit this kind of behavior by lenders if the trend continues. I would not want to have to defend this practice in court or before the FTC.

Hopefully, reasonable heads will prevail and credit bureaus may take a closer look at what lenders are doing with trigger leads in the auto finance context and limit this behavior. Auto dealers are major credit bureau clients and indirect auto financing is another major revenue source for credit bureaus. One can only hope that an industry initiative may be successful in getting the credit bureaus to see the light of day. If not, a lawsuit or regulatory enforcement action may be brought to do so.

Randy Henrick is Associate General Counsel and lead Compliance Counsel for DealerTrack, Inc. This article is intended for information purposes only and does not constitute the giving of legal or compliance advice to any person or entity. Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations from a knowledgeable attorney or compliance professional licensed to practice in your state.

President's Message ... from page 2

The battles between manufacturers and dealers must be fought in several arenas, not the least important of which is the public relations arena. Whether it is the mainstream media, trade publications, or just blogs, dealers must be prepared to counter manufacturer spin.

• The manufacturer is not the dealer's partner. During my career, I have heard many manufacturers claim that dealers are their partners. I have even had dealers, who should know better, tell me the same thing. I always caution dealers to think about that carefully. A manufacturer is, at best, the fair weather partner of a dealer. When it suits the manufacturers, "God bless our partnership!" When the going gets tough for manufacturers, it's "every man, woman, former industrial giant, and dealership for itself!" Nothing showed this more clearly that the recent events where dealers came to the aid of manufacturers on Washington's Capitol Hill, but then had to listen to the endless tirade about how manufacturers should be allowed to protect themselves by crushing dealers with total immunity.

• Dealers represent cost savings, not a cost center, for manufacturers. Over the years, dealers have saved manufacturers tens or even hundreds of billions of dollars the manufacturers would otherwise have to put into distribution and warranty repair capabilities. It's the dealers who build multi-million dollar facilities, equip them, hire the personnel, stock hundreds of vehicles, and pay the monthly bills to sell cars to customers one by one and to fix cars under warranty.

• There are no real savings to a manufacturer when a dealer is terminated. One of the great myths perpetuated by the manufacturers and their media fellow travelers is that there are too many dealers and this problem is crushing the manufacturers. What nonsense! This absurd argument may serve the purposes of manufacturers who wish to deflect responsibility for their own management failures. However, exactly what manufacturer investment is poured into dealers that would generate billions of dollars in savings when the dealer herd is thinned? In fact, there are no savings from terminating dealers. The fact that there are too many dealers is a dealer problem, not a manufacturer problem.

• Line-make termination legislation creates no new rights for dealers. According to the manufacturers, line-make termination legislation creates new rights that are unfair to manufacturers. If you believe that, ask yourself a simple question. If a dealer needs line-make termination legislation to recover damages, exactly why did GM spend more than a reported one billion dollars getting rid of Oldsmobile dealers when almost no states had such legislation at the time? The manufacturers know that they cannot breach their dealer sales and service agreements without consequences. A manufacturer that makes the voluntary decision to terminate a line-make breaches its franchise agreements with its dealers. Dealers make certain commitments to manufacturers when they sign a franchise agreement. But manufacturers make certain agreements to the dealers, one of which is that they will continue to supply products. When a manufacturer decides to stop doing that voluntarily, it breaches the contract. Dealers are entitled to damages. The only thing that specific statutes provide is a definition of or a process to determine those damages. It does not create the dealer's right to those damages. That's created by the manufacturer's breach of contract.

• The car business is plenty risky for dealers. According to the manufacturers, line-make termination legislation takes the risk out of business for dealers. Oh, really? Dealers invest millions to build and equip facilities and millions more to stock vehicles. They hire people, and they commit to monthly expenditures. They pour their lives' work into their businesses. Their families depend on the businesses. The families of their employees depend on them. When a manufacturer decides to stop manufacturing vehicles, dealer dreams are shattered and dealer investments are lost. The termination assistance requirements of line-make termination statutes pale in comparison to the true losses suffered by dealers, their families, and their employees and employees' families when a line-make is euthanized.

• Manufacturers' endless demands exacerbate the risks of dealers. Manufacturers' publicity flacks act as though dealers are in full control of their own destinies. Any business dependent on a manufacturer to keep producing and supporting products is never in control of its own destiny. And the manufacturers' demands for more and more expensive single-use facilities, more and more fancy furnishings and expensive equipment, and more

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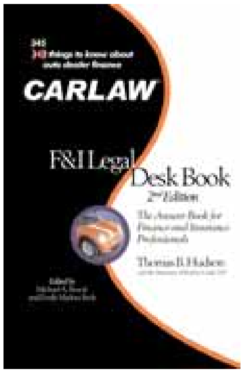
Member News



Hudson Cook LLP, a nationwide provider of legal compliance services for the financial services industry, announced that it was the recipient of a silver medal awarded in the 2009 annual Axiom Business Books Awards competition for its book, CARLAW F&I Legal Desk Book.

The Jenkins Group Inc, which sponsors the annual awards, stated "The Axiom Business Book Awards are intended to bring increased recognition to exemplary business books and their creators."

Tom Hudson, the book's author, along with the lawyers of Hudson Cook, LLP, wrote the book on legal issues dealing with automobile sales financing and leasing. Tom said, "The award recognizes the breadth of auto financing experience that Hudson Cook, LLP lawyers have accumulated. The book would not have been recognized without the contributions of many of the Firm's lawyers."

Among his other achievements, Tom Hudson has created the popular monthly legal reporting services CARLAW and HouseLaw, and Spot Delivery, a monthly newsletter for auto dealers. Tom has authored and edited two other books on the topic of auto sales, finance and leasing. He is a frequent speaker at industry gatherings, and his articles appear in many industry publications.

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and more days supply inventory magnify the risks that dealers take on.

• Manufacturers need dealers. The biggest myth that manufacturers try to sell is that dealers are somehow a burden on manufacturers, and that dealers exist because of the largess of manufacturers. But without dealers, manufacturers would have to create their own distribution systems and warranty repair centers. Their investments would be in the tens or hundreds of billions of dollars. Even if a manufacturer had the expertise to run dealerships (which it doesn't as shown in numerous experiments), it doesn't have the billions lying around necessary to create a distribution and warranty service network.

Dealers invest their fortunes and their lives depending on the promises of manufacturers. Dealers have a compelling story to tell about the arrogance of manufacturers who argue that they should just be able to simply crush dealers without any compensation. As their lawyers, we should help spread the story.

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

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Rob Cohen, Editor
rob.cohen@autoadvisory.com
Trudy Boulia, Assistant Editor
tboulia@harveyandmumford.com
Defender, The NADC Newsletter is published by the National Association of Dealer Counsel
7250 Parkway Drive, Suite 510
Hanover, MD 21076
410-712-4037
Fax 410-712-4038
www.dealercounsel.com