MAKING SURE THE DEAL STICKS

AN ADAMS | NYE | BECHT LLP DEALERSHIP INDUSTRY WHITE PAPER

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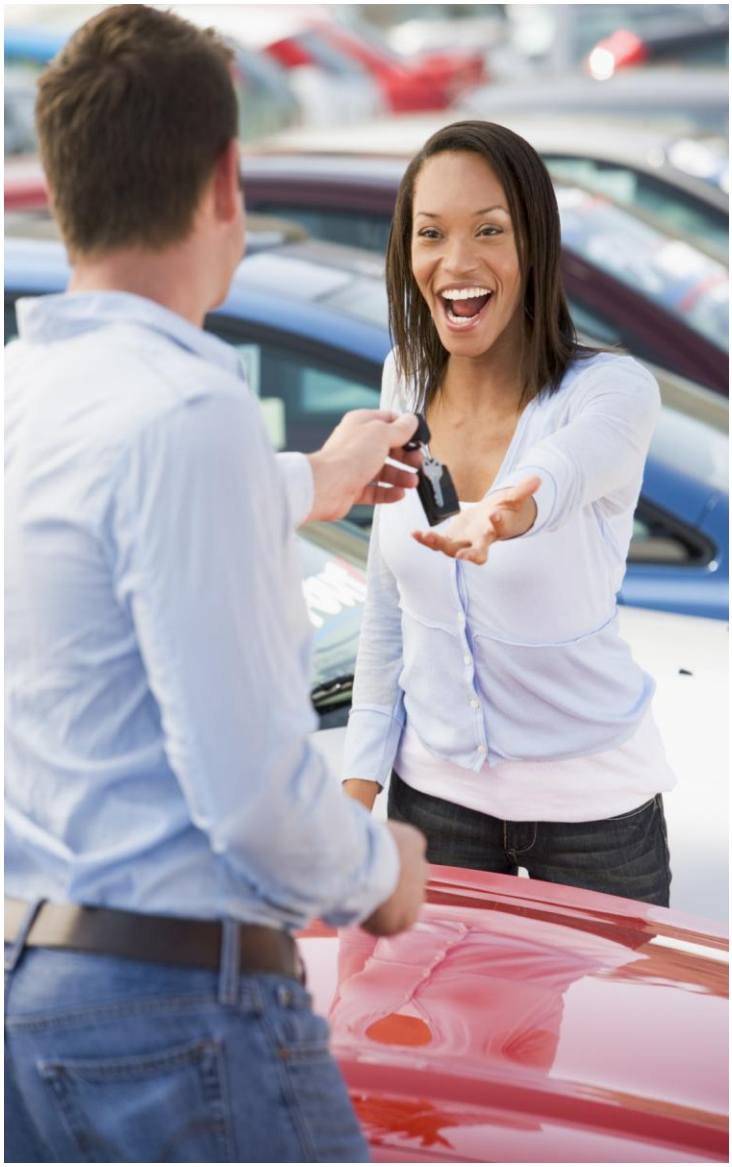


Who Regulates The Dealership Industry? The Lawyers!

Here's a real-life scenario that happens in California all the time: Your sales staff negotiates with a customer and eventually closes on the sale of a certified pre-owned vehicle for $26,000. Your finance manager reviews the customer's credit report, and concludes he can get the customer financing at 8.9% with a 1% buy. It's after hours on a weekend, but the deal looks good, so the finance manager wraps up the deal, finishes the paperwork and sends the customer driving the car home.

On Monday, the finance manager learns the financing didn't work. So he restructures the deal with a different bank, and calls the customer in to sign the new contract. Once again, he wraps the deal, finishes the paperwork and sends the customer on her way.

And that's the last anybody hears of the customer for the next three years. Until the letter comes from a lawyer, certified, return receipt requested, accusing your dealership of violating a whole bunch of consumer laws and demanding that you:

- Take back the car;

- Give the customer all of her money back, including her down payment, her monthly payments and the value of her trade-in;

- Pay her damages and attorneys' fees; and, for good measure

- Identify all the customers you've subjected to similar "mistreatment," take back their cars and give them all their money back too.

What in the world is going on here? Just this: California, like many states, is a highly regulated environment for automobile dealerships. But California is different in one major way. Most of the regulating is done not by state agencies, but by private lawyers. And a small number of lawyers have become experts at finding what's wrong with your deals and leveraging their expertise into very lucrative practices. In most cases, California law allows them to use flaws in a deal – often trivial ones – to force you to unwind that deal years after it was made. The customer gets free use of the car for months or years. The lawyer gets paid. Everybody comes out fine – except your dealership.

In this white paper, we'll talk about some critical steps an automobile dealership can take if it wants to make its deals bullet-proof, stay out of court and avoid spending money for lawyers on both sides.

Don't Certify Cars With Extensive Service Histories.

CPO programs play an important in the marketing of high-end used cars. Properly managed, a CPO program creates a win-win. The customer gets a rigorously inspected and often upgraded late model used vehicle with an extended warranty. The dealer gets a revenue source that recognizes the value of top level used cars.

Dealers should be aware, however, that many consumer attorneys have CPO programs in their cross-hairs. When a CPO vehicle has mechanical problems, the customers will just about always claim "the salesman told me these cars were the best of the best." And factory CPO criteria are not always as rigorous as they might be. Many manufacturers permit certification of vehicles with extensive adverse service histories.

When a customer makes a claim involving mechanical problems with a CPO vehicle that has a troublesome service history, he will almost always allege fraud. He and his lawyer will claim that given the car's history, the salesman's statements about the value of the CPO certification and the selection of such vehicles for the certification program were either flat-out false, or at least misleading without more disclosures. To make matters worse, manufacturers often refuse to defend dealerships when there are fraud allegations.

Before a Used Car Sales Manager decides to certify, he should review all known information about the vehicle and ask these questions:

- Would I want a used car with this service history?
- If a salesman told a customer this car was from the "cream" of used cars, would that be true?

Unless the answers to both questions are "Yes," you are better off not certifying the car.

One more thing: before you sell a certified car, The Car Buyer's Bill of Rights, Vehicle Code section 11713.18, requires you to give the buyer "a completed inspection report indicating all the components inspected." The best practice is to (a) have someone from sales give the inspection report and known service history to the customer before she goes to finance; and (b) have the customer sign a copy of the inspection report and a document indicating she received the service history.

Neither Sales Nor The Customer Should Sign A Four-Square

For as long as automobile dealerships have negotiated vehicle prices, sales staff have used "four-squares" and other worksheet forms as sales tools to secure customer commitment. Typically, the salesman proposes relevant terms, the customer agrees, the salesman writes them on the worksheet and asks the customer to initial or sign. The dealership, and almost certainly the customer, both know this isn't a binding agreement to buy the car. But it is a powerful sales tool.

Unfortunately, by obtaining a signature on a document that lists the vehicle and some terms, the salesman is arguably creating a purchase order, defined by the Automobile Sales Finance Act (Civil Code section 2981(l)) as "a sales order, car reservation, statement of transaction or any other such instrument used in the conditional sale of a motor vehicle pending execution of a conditional sales contract." If a four-square worksheet is a purchase order, then it must conform to Federal Reserve System Regulation Z and contain almost all of the mandatory disclosures for a conditional sales contract. Since the worksheet never contains this information, a deal involving a signed worksheet is often vulnerable to challenge.

We recommend that if the dealership uses worksheets in the sales process, the forms not contain signature lines, sales personnel be strictly prohibited from obtaining customer signatures, and they have the following footer on each page: "This worksheet is not a contract. Dealership is not bound to sell a vehicle and customer is not bound to buy a vehicle until both have signed a sale contract."

Follow The Single Document Rule

When a dealer sells a car at retail, California law requires that all of the agreements of the buyer and seller with respect to the total cost and terms of payment must appear in a single document. When a dealer leases a car to a consumer, the rule is even stricter: a single document must contain all of the agreements with respect to the obligations of each party. Documents violating the single document rule can include:

1. Payoff adjustment agreements.

2. Hold check agreements (written or oral).

3. Trade-in history disclosure form where the customer agrees to compensate the dealer if the history is inaccurate.

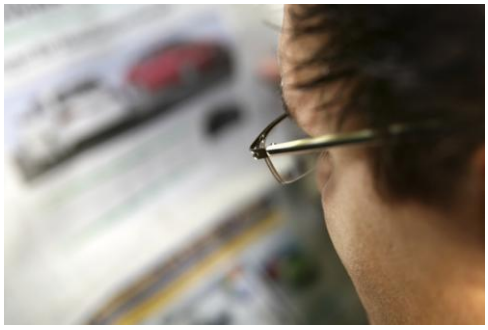
4. Due bills that contain, or modify, obligations.

5. Lease turn-in agreements if the dealer agrees to make final lease payments.

6. Any oral agreements.

Ideally, every obligation of dealer and customer should be in the Retail Installment Sales Contract form or lease form. If this is not feasible, there is an alternative. The California Attorney General has recently expressed the opinion (available at http://tiny.cc/ANTBAGDealerOp) that the requirement is met if all pages containing obligations are attached and consecutively numbered (e.g., 1 of 6, 2 of 6, etc.). Of course, dealers will have to make sure that this is acceptable to the financial institutions.

Prove The Customer Received A Translated Contract



An automobile dealership has two different obligations to provide translated documents. First, for used car sales transactions conducted in Spanish, the Federal Used Car Rule requires you to post a Buyer's Guide translated into Spanish.

In addition, California has its own rule, requiring translation of "each and every term" of any retail installment contract or vehicle lease if it was negotiated primarily in Spanish, Chinese, Tagalog, Vietnamese, or Korean. Remember: (a) the customer must be given the translation before signing; (b) any document that amends or is incorporated into the RISC or lease requires translation (for example, a GAP contract); (c) while the English language document is the actual contract, is signed by the customer and sent to the bank, you and the customer should each keep a copy of the translation document; and (d) we recommend placing a diagonal line across the translation, having the customer sign the diagonal line, and keeping a copy of the signed translation as evidence that the dealership complied with the law. Finally, when in doubt – offer a translation.

Be Prepared To Prove You Didn't Pack Payments.

"Payment packing" – quoting a base payment to the customer while leaving room, or "leg" for adding F & I products – has long been illegal under generally applicable consumer protection statutes. More recently, California has implemented three measures aimed directly at this practice:

- It is unlawful to negotiate the terms of a vehicle contract and then add charges without first disclosing the goods and services to be added and obtaining the consumer's consent.

- It is unlawful to inflate the amount of an installment payment or down payment or extend the maturity of a contract in order to disguise the actual charges for added goods or services.

- Before a customer signs a conditional sales contract, he or she must be presented with and must sign a written disclosure showing the installment payment without additional product and the installment payment including each of the following products, if the customer is purchasing them: service contract; insurance product; debt cancellation agreement (i.e., "GAP"); theft deterrent device (e.g., "Lo-Jack" or window-etch product); and a vehicle contract cancellation option agreement.

Be Meticulously Accurate In Filling Out The Contract

Reading and understanding the statutes that regulate automobile sales and leases is much like reading and understanding the Internal Revenue Code: complicated, ponderous, and a headache. But what dealerships and F & I personnel need to know, above all else, is this: every Automobile Lease, and every Retail Installment Sales Contract, must be filled out completely, precisely, and accurately. Failure to do any of these things is, in many cases, grounds for unwinding the deal – sometimes years after the customer took delivery of the car. An experienced consumer lawyer knows how to find the problems in a contract, and can make even the most trivial mistakes very expensive. While every line in the contract form presents the potential for error, the most common problems are these:

- *Back-dating re-written contracts*: On March 1, your F & I desk writes up the deal, sends the customer on her way with the car, and submits the paper to the lender. On March 2, the lender rejects the deal. F & I finds another lender who accepts the deal, but on slightly different terms. The dealership calls the customer back to the store to sign the revised deal on March 3. But the computer shows the deal as a "March 1" deal, and prints that date on all the papers. The result: the interest calculations are incorrect by two days, and while the law is not clear-cut, you run the risk that a judge will order the deal unwound.

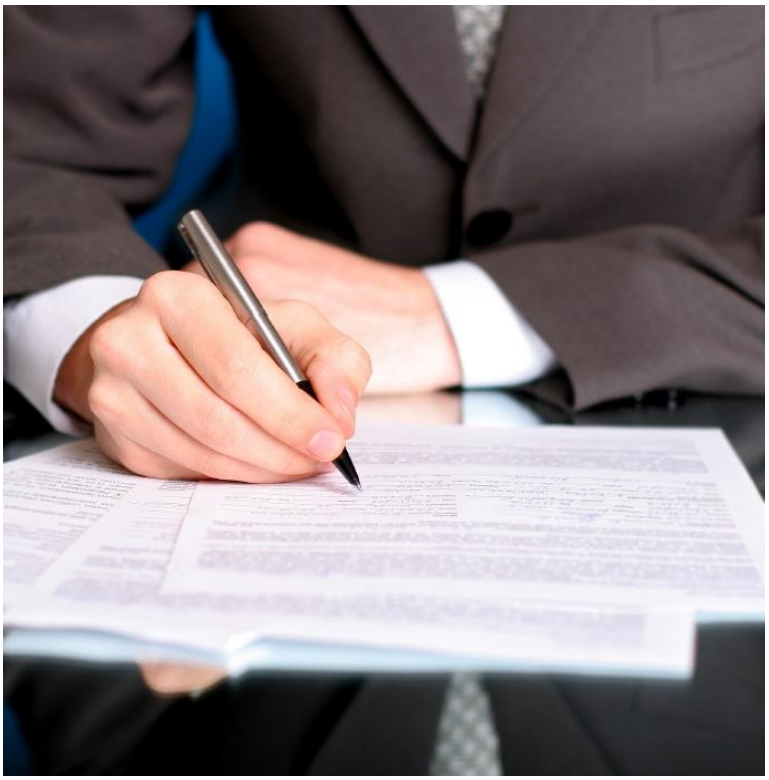
- *Burying prior balances*: The customer is upside down in his trade-in car (e.g., has "negative equity.") You show the trade-in as a net zero on the contract, rolling the

excess into the price of the new car. This practice has been heavily litigated in California, and is clearly illegal in both sales and leases.

• *Combining the amounts paid to public officials*: The standard California Retail Installment Sale Contract has four lines for "Amounts Paid to Public Officials": A. License Fees, B. Registration/Transfer/Titling Fees, C. California Tire Fees, and D. Other. It has become common to combine the "A" and "B" amounts. Trivial though it may seem, several trial courts have held that this violation alone is sufficient to require the deal to be unwound. These lines should be separately and accurately stated.

• *New/Used errors*: In the vehicle description section of the contract, the vehicle must be described as "New" or "Used." There are no other options. A vehicle that has never been registered by any jurisdiction and never sold or used for any purpose other than test drives for prospective buyers is a "New" vehicle. Every other vehicle is a "Used" Vehicle. Note that some vehicles that are reported on the State's "Report of Sale" as "New" (e.g., Demos) must nevertheless be described in the contracts as "Used."

• *Blanks in the Contract*: Before the customer signs a sales contract or lease, every blank must be filled in with either the relevant information or "N/A." One of the two "Primary Use For Which Purchased" boxes must be checked. The contract stack must be physically handed over to the customer, with the customer given full opportunity to review before signing. And the customer must be given his or her copies of all documents, with both the dealer's and the customer's signatures, immediately after signing.



Above All Else: When The Customer Complains, Listen And Act

As we stated at the beginning, a small, expert, and highly tenacious group of California lawyers has made a very lucrative business out of suing automobile dealerships over just the kind of seemingly trivial issues described in this White Paper. California law provides that the successful side in most customer vs. dealership disputes is entitled to all attorneys' fees; such fee awards can rapidly dwarf the dollars involved in a particular deal, usually running in the tens of thousands, and occasionally the hundreds of thousands of dollars. Accordingly, when a customer first contacts you with a complaint, there is almost never a solution that isn't cheaper than going to litigation.

When you have an unhappy customer, you should always, at a minimum ask these questions: "What does this customer really want? What can I do to make this customer happy? Am I better off unwinding this deal than running the risk of litigation?" And then, you should make every effort to resolve the problem now. While you may feel you did nothing wrong (and quite possibly you didn't do anything wrong), heading off small problems before they become big ones just makes good business sense.

Finally, if you receive a written complaint about a deal, or about service, from either a customer or a customer's lawyer, you should immediately have the letter and the relevant documents (deal jacket, service records, or both) reviewed by counsel. In some circumstances, the law imposes a thirty day deadline for responding to complaint letters, and you want to make sure your response is timely and right.

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Adams | Nye | Becht is a firm of trial lawyers. We represent automobile dealerships and other business throughout California in consumer, product liability, toxic tort and business litigation matters. For more information, contact Bruce Nye at

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