CARLAW® IV
THE FEDERAL GOVERNMENT'S WAR ON CAR DEALERS

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THOMAS B. HUDSON

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CONTENTS

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And thanks to my partners Nicole Frush Munro and Michael Benoit for letting me slip in articles that they co-authored with me.

As always, any errors are mine own.

—Tom Hudson

INTRODUCTION

The Federal Government's War on Car Dealers

Since 2010, car dealers have faced crippling assaults from Congress and federal agencies. The kickoff to trouble was the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed by President Obama on July 21, 2012. That legislation created the Consumer Financial Protection Bureau (CFPB) to regulate consumer credit but supposedly exempted all, or nearly all, franchised dealers. The exemption was not entirely effective, though, since the CFPB was left with the ability to wreak havoc with the exempted dealers' operations by regulating the finance companies, banks, and credit unions that buy the dealers' financing contracts. The exemption for car dealers did not extend to dealers who hold their own retail installment contracts or to those without vehicle repair facilities.

The dealerships, and the finance companies they deal with, invited the federal government's tender attentions by misbehaving. Not all of them, by any means, but there were enough bad actors to generate a steady drumbeat of newspaper articles, TV "investigative reporter" pieces, and complaints to officials, and that steady stream, almost all anecdotes, served as the rationale for most of the subsequent legislative and regulatory attacks on dealer practices.

This book recounts the story of the dealer-bashing that has come out of Washington over the last several years, as reflected by articles that I wrote (a few with the help of my partners) as the events occurred. Sprinkled among these real-time observations are descriptions of the burdens that federal laws and regulations impose on dealers, and the new emphasis on enforcement by the federal agencies.

A word of warning—these articles deal with the area of law that I handle on a daily basis. That area encompasses the sales, finance, and leasing activities of dealers, with particular emphasis on what goes on in the so-called finance and insurance, or "F&I" office. Like other businesses, dealers are also subject to laws and regulations dealing with the environment, workplace safety, employment, taxes, and scads of other topics, each of which I suspect is as complicated in its way as those of concern to me. Dealers, as you see, face a very heavy regulatory burden.

As I assembled the articles for this book, I pondered about what the organization should look like. Should I present all the articles on dealer participation in one chapter, all the credit discrimination articles in another chapter, and so on, or should I gather all the Federal Trade Commission enforcement actions, then address enforcement actions by the CFPB, then turn to the Justice Department?

Finally, I decided that simply arranging the material chronologically made sense, since such an arrangement would provide a continuing narrative of the actions by the various agencies and show how the initiatives of one agency played off of the actions of the others.

Having said that, though, and by way of an introduction to this book, I'll start with a 2016 article that describes the federal approach to consumer protection over the years.

As people often say about relationships . . . it's complicated.

The Long Arc of Consumer Protection

One advantage of having practiced law since before the invention of fire is that I have the ability to look back down the mountain I've climbed and perhaps see some things that may not be as visible to those whose time at the bar has been shorter than mine.

That happened to me a few weeks ago when I found myself thinking about an event from the early 1990s. The American Bar Association's Business Law Section does its work through committees, and one of those committees, the Consumer Financial Services Committee, was meeting in Boston. One of the highlights scheduled for the meeting was a debate between my partner Robert Cook and one of the nation's leading consumer advocates (and a good friend of ours), Kathleen Keest.

The question being debated was "Do we need more substantive consumer protection legislation and regulation, or are disclosure and consumer responsibility the answer?" I'm sure the title was catchier, but that was the gist of the debate.

Kathleen, of course, took the "more substantive laws" side, and Robert had the "disclosure is the answer" side. I believe that Robert won the debate handily, which was no mean feat against Kathleen, who, aside from being a good friend, is (1) a true believer in protecting consumers, (2) bright as a new penny, and (3) as acid-tongued as they come. I think my assessment that Robert had carried the day matched that of most of the observers, except for a few academics and die-hard consumer advocate types.

Looking back at it, though, it's pretty clear that Robert had won a battle, and not a war. For the next couple of decades, the consumer advocates kept pushing for more substantive regulation, and every time they did, a few dealers and finance companies cooperated by participating in various abuses, providing the fuel that stoked the legislative fires. I can draw a pretty solid line from that debate to the housing abuses, payday/title lending abuses, the economic collapse, and Lizzy Warren's success in 2011 in launching the Consumer Financial Protection Bureau (CFPB), a federal consumer financial watchdog agency with the mandate to protect consumers from abusive credit practices. The consumer advocates had pretty clearly gained the upper hand.

But then things took an interesting turn. Warren, when setting up the Bureau, decided that while more laws and regulations were nifty and all that, those laws and regulations were just temporary roadblocks that, she claimed, lawyers would just work their way around.

Nope, she had things a great deal more powerful than black and white regulations. She had the power to challenge practices that the Bureau determined were unfair, deceptive, or abusive (UDAP, or UDAAP authority) and discrimination, gray areas where the creditor's obligation varies depending on the whim and agenda of the enforcer. Why have bright lines that creditors can actually see and rules they can actually follow when you can have a "we know bad acts when we see them" standard in the hands of an aggressive federal regulator?

So we've gone from a standard developed through the 1980s and early 1990s—"disclose and let the consumer take care of himself"—to the pre-CFPB consumer advocate position that "more laws will tame the predatory marketplace" to where we are today—"we don't need no stinkin' laws—we've got UDAP, UDAAP, and superior moral judgment."

That's my take on the last 43 years of consumer protection . . . .

Chapter 1

2008: A Shot Across the Bow

Every now and again, I get stuff wrong. That was the case when the consumer advocates started pressing Congress for a number of consumer protection reforms. At first, the proposals were "single-shot" bills that addressed some of the favorite targets of the consumer protection crowd—one bill would ban pre-dispute arbitration in consumer financial contracts, while another proposed a national finance charge rate cap of 36%.

Then, prodded by Elizabeth Warren and others, the idea surfaced of a federal agency to supervise creditors and enforce federal financial services laws.

The Obama administration had successfully pushed through Congress the health care initiative that has come to be called Obamacare, and the president evidently was feeling his oats. I figured that Obama and the Democrats had spent so much political capital on health care that they would not have anything left for financial reform.

I was wrong about that. Here's an article about the opening salvos that were to lead to an all-out assault.

December 2008

Federal Regulation: The Nanny Commission

A year or so ago, as the mortgage mess began to spin seriously out of control, one of the trade magazines asked me to do an article on the topic of how the mortgage meltdown would affect the auto finance industry. At that time, before $4-plus gasoline and a steep recession, it seemed like the answer was "not much," and that's more or less what I said.

In a later article on the same topic, I got a little closer to the mark, pointing out that because of the emerging credit crisis, it might become a lot tougher for dealers to find banks and sales finance companies willing to buy the retail installment contracts that the dealers were producing.

Still later, I wrote that some of the abuses that were evident in the defaulting consumer mortgages might stir legislators to re-regulate the auto finance industry to ban some of the more egregious practices.

Finally, I predicted that if the Democrats gained control of both the executive and the legislative branches of the federal government, we could expect to see legislation aimed at particularly business-friendly parts of the federal code, such as the Federal Arbitration Act.

But I didn't see this one coming.

Two Democratic congressmen have introduced bills that would create a federal agency to oversee the *safety* of consumer financial products, including mortgages, credit cards, car loans, and other types of credit. Car dealers will be covered by the measure because they enter into credit sales of vehicles with their customers, using retail installment contracts.

Rep. Bill Delahunt (D-Mass.) and Sen. Richard Durbin (D-Ill.) recently introduced bills in the House and Senate that would establish a Consumer Credit Safety Commission. The CCSC, as envisioned by these bills, would oversee any category of lender that extends credit to borrowers.

To this point, federal law has generally been directed at regulating the entities that offer credit, rather than credit products themselves. Content to let the states regulate actual substantive limits on credit products, the feds focused mostly on how creditors disclosed the terms and conditions of those products.

As envisioned by Delahunt and Durbin, the CCSC would focus on whether financial products offered to consumers are "safe."

The Delahunt/Durbin bill provides for a five-member bipartisan agency that would oversee mortgages, credit cards, auto loans, savings accounts, checking accounts, and other consumer credit. The CCSC would "prevent and eliminate unfair practices that lead consumers to incur unreasonable, inappropriate, or excessive debt" and would focus on practices and product features that are abusive, fraudulent, deceptive, or predatory.

In addition, the CCSC would also collect data on the most harmful products, providing consumers with information to help them avoid "dangerous" financial products.

Specifically, the bill provides that the CCSC's objectives are to:

- Minimize unreasonable consumer risk associated with buying and using consumer credit. Who could argue with minimizing unreasonable risk? But do we want government telling us what level of risk is reasonable and what level of risk isn't reasonable? Will the feds prohibit the financing of negative equity?
- Prevent and eliminate unfair practices that lead consumers to incur unreasonable, inappropriate, or excessive debt, or make it difficult for consumers to escape existing debt, including practices or product features that are abusive, fraudulent, unfair, deceptive, predatory, anticompetitive, or otherwise inconsistent with consumer protection. The first part of this mandate sounds like federal underwriting. The second creates a redundant enforcement mechanism since the FTC and most states already prohibit unfair and deceptive acts and practices. And we will have a federal agency that will make it easier for consumers to escape existing debt. Is an obligation that reflects a 120% loan-to-value ratio "excessive" debt?

- Promote practices that assist and encourage consumers to use credit responsibly, avoid excessive debt, and avoid unnecessary or excessive charges derived from or associated with credit products. The bill doesn't say whose practices it intends to promote—those of consumers or those of creditors, but here again, we'll have a federal agency determining what is "excessive" debt and "unnecessary or excessive" charges. More federal underwriting? Is a $495 document fee to cover the preparation of paperwork an "excessive" charge?
- Ensure that credit history is maintained, reported, and used fairly and accurately. I thought that's what the Fair Credit Reporting Act did. Will pre-screening and "firm offer" mail campaigns constitute "fair" use?
- Maintain strong privacy protections for consumer credit transactions, credit history, and other personal information associated with the use of consumer credit. Don't the Gramm-Leach-Bliley Act and the FTC's privacy regulations address these concerns?
- Collect, investigate, resolve, and inform the public about consumer complaints regarding consumer credit. This would replicate duties of the FTC and state consumer protection agencies.
- Ensure a fair system of consumer dispute resolution in consumer credit. This is poorly disguised consumer advocate code for eliminating the ability of creditors to use binding arbitration agreements to reduce the risks and costs of class action lawsuits.
- Take such other steps as are reasonable to protect consumers of credit products. This catch-all provides the Commission members with plenty of discretionary room to make mischief.

Just how the consuming public would be protected by the CCSC isn't spelled out at this early date. Would we have an FDA-type approach, where companies that want to offer financial products have to have them approved by the CCSC? Or would it be a "crash-test" rating system, with the CCSC awarding five stars to the financial products deemed safest and no stars to the ones that would eat a hole in your wallet? The intrusiveness of the CCSC could depend a great deal on the implementation details.

The bills have been referred to committees in the House and Senate and won't be going anywhere in this session. But you can look for them to be revived next year.

Just what we need. A nanny in Washington to keep all those mean old creditors in line. Time to give a call to your trade associations and crank up those lobbying machines.