

5.4.3 “Back End” Sales: Rust-Proofing, Financing, Insurance, Service Contracts, Documentary Charges and Other Add-Ons

5.4.3.1 Back-End Sales Explained

The negotiation of a sales price on a vehicle is often called the front-end of a transaction. As much as ninety percent of dealer profits come from the back-end. The consumer typically is led from the salesman who has negotiated the deal to a finance and insurance (F & I) sales manager, sometimes known as the Business Manager, who is responsible for closing the transaction, arranging financing, and selling after-market items and supplemental products and services. Examples include: the “chemicals,” such as rustproofing, undercoating, paint sealant, fabric protectant, and vinyl protectant; optional items such as floor mats, bras, and spoilers; financing or leasing; service contracts; credit insurance; and, in some states, gap insurance.

The essence of a dealer add-on is that it is usually discussed after a final price for the car is negotiated, and is a charge to the consumer in addition to the negotiated price for the car, increasing both the consumer’s total cost and the dealer’s profit. In practical terms, a dealer add-on is usually listed in the sales agreement on a line below the negotiated price for the car, and may even be pre-printed on the form next to taxes to give the impression that it is standard with every purchase.

5.4.3.2 “Packing” of Back-End Charges

A number of state UDAP regulations find it unfair or deceptive for a dealer to negotiate the terms of the sale of a car and thereafter add the cost of certain items, such as extended warranties, credit life, dealer preparation, or undercoating, to the contract without the consumer’s knowledge and consent.¹¹²²

The dealer can add these costs in one of two principal ways. The more obvious approach is to add these costs onto the negotiated price for the car, and present the consumer with a final contract with these extras included.

One of the more prevalent and surprising techniques dealers use to sell back-end charges does the exact opposite, through the technique of “packing.” Consumer sales resis-

tance to these extra charges is eliminated because the consumer does not even know these charges are being assessed.

Instead of adding these charges onto a negotiated price, the dealer inflates the monthly payment from that which should be derived mathematically from the negotiated interest rate and negotiated sales price, providing “room” for the dealer to add in other charges to make the numbers come out right.

Third-party providers of credit insurance and other back-end products aggressively compete for dealership accounts, and will provide significant financial incentives, training, and marketing assistance to dealers to get business. One of the principle techniques they teach is the “pack,” and, as a result, this practice has become widespread in the automobile dealership industry.

Packing in motor vehicle cases is the intentional misquoting of a monthly payment necessary to retire the debt on a motor vehicle. By adding money to the monthly payment (called “packing” or “loading” the payment) when it is initially quoted to the consumer, the dealer creates “room” into which other products or services can be sold. Because these additional items are “provided” at no increase in monthly payment, consumers are misled into believing there is no charge for the items.

In the normal course of a vehicle purchase, the consumer settles on a particular vehicle and enters into negotiations with a salesperson. The consumer indicates a desired purchase price, cash down amount, trade-in allowance, and occasionally even specifies finance terms. The salesperson takes this information to the sales manager, who inputs the information into the dealership’s computer. The computer then calculates a monthly payment, based on either the customer’s offer or the dealer’s counter offer. This monthly payment is then given to the consumer.

In some cases this payment is a legitimate “stripped” or “bare” payment, in that it will only cover the cost of the car. In many cases, however, the payment will be packed. The desk manager obtains the packed payment by one of three principle methods: (1) adding a flat dollar amount, say \$30, to every payment; (2) setting the defaults on the computer program to include a charge for credit insurance or other back-end items; or (3) setting the defaults on the computer program to calculate the payment with an unreasonably short term and/or an unreasonably high APR.

Assuming the consumer agrees to purchase the motor vehicle at the packed payment amount, the salesperson introduces the consumer to the business manager. The business manager prepares the loan papers, which include the charges for the back-end items. The business manager uses an “assumptive” closing technique, indicating that these services “are provided in the monthly payment as part of our optional payment protection plan.” Only later (or never) does the consumer discover that the transaction included thousands of dollars of back-end charges.

Originally, the packed payment was used to sell credit

¹¹²² Idaho Consumer Protection Regulations, Idaho Admin. Code 04.02.01.234, Other Advertising Practices; Ill. Admin. Code tit. 14, § 475.580, Motor Vehicle Advertising; N.M. Admin. Code tit. 1, § 2.2.24, Advertising and Sale of Motor Vehicles; N.J. Admin. Code § 13:45A-26B.2 (add-ons must be individually itemized, showing price for each); *Delaney v. Garden State Auto Park*, 318 N.J. Super. 15, 722 A.2d 967 (App. Div. 1999) (awarding treble damages for failure to itemize add-ons).

insurance or increase financing costs. It can also be used to sell service contracts, vehicle options, or almost anything the dealer can devise. Often whatever service the dealer can make the largest profit on will be the product being “packed.”

One of the most significant investigations into automotive payment packing has resulted in a consent decree between the State of Washington and Resource Dealer Group, Inc. (RDG). RDG was alleged to be a leader in training car dealerships in how to engage in packing. RDG benefits because the dealers pack RDG’s products into the monthly charges, and the dealers benefit because RDG shares the profits with the dealers.

RDG has now signed a consent agreement with the Washington State Attorney General whereby it agrees in the state of Washington not to teach, train, track, or aid and abet others to misrepresent the amount of a monthly automobile payment, the voluntary and optional nature of RDG’s products, or the price of credit insurance or service contracts. It also agreed not to teach, train, track, or aid and abet others to deceptively adjust higher monthly payment amounts. Restitution for certain customers was also specified, fines and attorney fees are levied, and a *cy pres* award was made to several organizations, including NCLC.

5.4.3.3 Rustproofing and Other Dealer-Installed Add-ons

5.4.3.3.1 General

An important car dealer profit-center (and source of UDAP violations) involves dealer installed add-ons, such as rustproofing, alarms, gas and glaze packages,¹¹²³ and undercoating. While rustproofing was the dealer add-on of choice in the 1980s, it continues to prove profitable under different names, such as an “environmental protection package.” Such a package may include rustproofing, glazing, and undercoating, and may cost over \$1000. The cost to the dealer of this add-on may be in the range of \$100.¹¹²⁴ It is not surprising then that the dealer will aggressively sell the package.

Many dealer-installed add-ons may not be of any real value to the consumer. Rustproofing may even be harmful. Most new cars today come with factory rustproofing and an extensive rustproofing warranty, sometimes even a life-time warranty. Manufacturer warranty books, owner’s manuals and sales brochures may specifically state that after-market

rustproofing is not necessary. Dealer rustproofing may even void the manufacturer’s warranty.

Improperly installed, after-market rustproofing can increase the likelihood of corrosion or rust. The treatment can clog drain holes designed into the automobile, trapping moisture inside. New holes drilled for rustproofing’s installation can be the starting points for early onset of rust. These treatments have also been known to cause damage to electrical and mechanical systems and to interfere with seat belt operation during an accident. Damage caused by after-market rustproofing is not covered by the manufacturer’s new car warranty.

Consequently, dealer representations about rustproofing are often deceptive or fail to disclose important information. For example, it is deceptive to claim that rustproofing is necessary or desirable where the manufacturer has already rustproofed the vehicle. In addition, dealers may not be disclosing before the sale of rustproofing that the owner’s manual and other documents state that after-market rustproofing is not necessary. Automobile buyers generally do not have any opportunity to see a copy of the warranty books and owner’s manuals until after delivery of the vehicle, much less before the purchase order is written up.

Rustproofing is often sold in conjunction with undercoating. Undercoating may also provide little value to the consumer, but may hide any prior damage to the car that would have been revealed by an inspection of the car’s underside. “Glazing” may also provide little real benefit to the consumer.

Glass etching has value in identifying the car and the window, thus preventing thefts and in recovering cars that are stolen. But dealers may aggressively overcharge for this service, for example charging \$595 for something that can be done for one-tenth the charge elsewhere. Other dealers sell a lower priced glass etching in the \$150 range, that includes an insurance policy if the car is stolen, and the paperwork resembles an official state document. Consumers often do not realize they have purchased the item and so do not make claims on the insurance policy if their vehicle is stolen.

5.4.3.3.2 UDAP precedent concerning rustproofing

Most of the case law on dealer installed options relate to rustproofing. Nevertheless, these principles may be applicable to other options as well. A Maine UDAP regulation finds it deceptive for a dealer to fail to apply rustproofing to the whole vehicle.¹¹²⁵ An Ohio UDAP regulation prohibits misrepresentations concerning rust-inhibitors, requires that dealers offer guarantees with rust inhibitor sales, and requires dealers to live up to this guarantee, specifically

¹¹²³ Charges in the \$595 range for about \$30 worth of gasoline and waxing.

¹¹²⁴ *Delaney v. Garden State Auto Park*, 318 N.J. Super. 15, 722 A.2d 967 (App. Div. 1999) (buyer charged \$2200 for rustproofing, undercoating, paint sealer and fabric guard for which dealer paid \$85).

¹¹²⁵ Code of Me. Rules 26-239-105.6, Sale of New Motor Vehicles.

disallowing a number of common dealer excuses for not repairing rust damage.¹¹²⁶

Similarly, the Maine Supreme Judicial Court has found the following rustproofing practices to be UDAP violations: failure to rustproof vehicles adequately, failure to train rustproofing personnel adequately, failure to provide adequate tools and manuals necessary for proper rustproofing, failure to supervise rustproofing operations properly, failure to establish quality-control procedures, and failure to conduct adequate follow-up rustproofing inspections.¹¹²⁷ Illusory rustproofing guarantees are also deceptive.¹¹²⁸

A Florida court awarded an individual consumer \$1250 actual damages and \$5.1 million punitive damages for a Toyota distributor's fraudulent rustproofing practices.¹¹²⁹ According to the consumer, the distributors had never injected rustproofing into the car, and in fact engaged in a pattern of not rustproofing cars as requested.

In another case, consumers alleged that an auto dealer sold them worthless, unnecessary rustproofing that in fact was never applied to the car. The dealer owned the rustproofing company and used its position to sell rustproofing, preprinting this add-on on contract forms. The dealer also sold an extended warranty against paint deterioration that had such vague and broad exclusions as to be worthless. The court held that, on these facts, the buyers had stated a UDAP claim.¹¹³⁰

5.4.3.4 Dealer Kickbacks on Financing

Traditionally, when a merchant assigns a consumer obligation to a financier, the financier pays the merchant less than the face value of the note—it is discounted because the stated interest rate is insufficient to cover the financier's risk. A practice now in widespread use in the automobile industry is the exact opposite—the financier provides the dealer with a kickback for assigning it the note at face value. That is, the financier pays the dealer more than the face value of the note.

The way this works is that the dealer and lender enter into a motor vehicle dealer agreement whereby the lender agrees to purchase car loans from the dealer at specified interest rates (called “buy rates”) depending on the consumer's risk. The dealer, as the credit seller, sets whatever interest rate it wants for the car loan, within a range specified by the lender. The bottom of that range is the “buy rate,” and the lender may also specify a maximum allowable rate. If the loan is made at the buy rate, there is no kickback to the dealer, or only a small fixed payment.

On the other hand, if the dealer convinces the consumer to accept financing at a rate higher than the “buy rate,” this difference between the actual rate and the buy rate is called the “yield-spread premium.” This premium is split between the dealer and lender pursuant to the written agreement. One typical example is where the lender keeps 25% of the difference and kicks back 75% to the dealer. In some cases, 100% of the yield-spread is kicked back to the dealer.

For example, consider a car purchased for \$21,456.17 for a term of 72 months. If the lender is willing to purchase the loan at a 10.5% buy rate, but the dealer convinces the consumer to sign up for 16.5% financing, there is a \$4926.65 yield-spread premium. If the dealer agreement calls for a 75%/25% split, then the dealer would keep \$3694.99 as its kickback and the lender gets an extra \$1231.66 in interest over and above what would occur at a loan written at the buy rate.

The “buy rate” is never disclosed to the consumer, nor the fact that the dealer is making a profit on the financing. Quite the opposite is true—the dealer gives the impression that the interest rate it quotes and that is specified on the retail installment contract is mandated by the lender, that the consumer's full monthly payment will go to the lender. The consumer is unaware that the dealer is quoting an interest rate that will maximize profit for the dealer, and is not the lowest rate that the lender is willing to offer to that consumer.

Truth in Lending is not a productive approach to challenging yield-spread premiums because the interest rate disclosed to the consumer is the rate the consumer pays. Instead, undisclosed kickbacks of a yield-spread premium should be a state UDAP violation.

Any dealer representation that the financier would not accept anything less than 16.5%, for example, is clearly false. If a consumer asks the dealer whether the lender will accept a lower interest rate, the dealer's answer may also be deceptive.¹¹³¹ It may also be deceptive for the dealer to fail to disclose its kickback from the assignee.¹¹³² In other

1126 Ohio Admin. Code § 109:4-3-15, Motor Vehicle Rust Inhibitors (1980).

1127 State v. Bob Chambers Ford, 522 A.2d 362 (Me. 1987).

1128 *Id.*

1129 Drucker v. Oakland Toyota, Inc., Case No. 83-04569 “CR” (Fla. Cir. Ct. Broward Cty. Dec. 1984).

1130 Taylor v. Bob O'Connor Ford, Inc., 2000 U.S. Dist. LEXIS 11486 (N.D. Ill. June 26, 2000).

1131 *But cf.* Bramlett v. Adamson Ford, Inc. (*Ex parte* Ford Motor Credit Co.), 717 So. 2d 781 (Ala. 1997) finds that a common law fraud claim is not available where the consumer merely asked why the interest rate was so high. This same conduct though may state a claim under a state UDAP violation, which is a broader standard than common law fraud.

1132 Sutton v. Viking Oldsmobile Nissan, Inc., 611 N.W.2d 60 (Minn. App. 2000) (reversing dismissal of claim that dealer violated UDAP statute by falsely stating in contract that charge for extended warranty was “paid to others”), *vacated*, 2000 Minn. LEXIS 96 (Feb. 13, 2001) (vacating and remanding for reconsideration in light of Group Health Plan, Inc. v. Philip Morris, Inc., 621 N.W.2d 2 (Minn. 2001)); Smith v. Precision Chevrolet Oldsmobile, Clearinghouse No. 52,495 (N.J. Super Ct. Law Div. July 29, 1999); Harvey v. Ford Motor Credit Co., 8 S.W.3d 273 (Tenn. Ct. App. 1999). Bramlett v. Adamson Ford, Inc., 717 So. 2d 781 (Ala. 1997) finds that a common law fraud claim is not available for the dealer's failure to disclose this kickback. This same conduct though may state a claim under a

words, it is deceptive for the dealer to fail to disclose that the dealer is setting the interest rate, not the lender, and that the dealer receives a kickback.

The dealer has presented an overall impression that the lender is setting the interest rate. The loan papers have the lender's name on it; the dealer indicates it has to obtain approval from the lender; all indicia presented to the consumer are that the car is being financed with the lender. The dealer does not correct the false impression that the lender is setting the interest rate and this failure to disclose is deceptive.

The consumer's case is particularly strong where, in conjunction with a "spot delivery,"¹¹³³ the dealer informs the consumer that it is cancelling the deal because the assignee needs a higher interest rate. In fact, the lender would accept the quoted rate, which is at or higher than the lender's buy rate for such a risk. But the deal is unacceptable to the dealer because there is no room for a kickback of the size it seeks.

While a UDAP approach to yield-spread premiums is a strong one, a potentially even stronger one, particularly on a class-wide basis, involves a claim under the Equal Credit Opportunity Act (ECOA) against the automotive financiers.¹¹³⁴ Investigations have found that providing discretion to dealers to set differing rates among those with the same risk (i.e. the same buy rate) has the effect of charging African-Americans higher interest rates than Whites of the same risk. In cases involving Nissan and GMAC, the plaintiffs have alleged that African-Americans were over 200% more likely to be charged a marked-up interest rate than similarly situated whites, and thus disproportionately impacted by the practice. Furthermore, African-Americans were allegedly charged more per markup—an average of about \$950 per markup, compared with an average markup for whites of, respectively, \$500 (NMAC) and \$650 (GMAC).¹¹³⁵

The allegation is that the credit system created by the financier thus has the effect of discriminating, even if there is no intent by the financier. Credit systems that have such an effect may violate the ECOA. To date, ECOA challenges

have been brought against GMAC, Nissan, Ford, Chrysler and Toyota, with classes being provisionally certified against GMAC¹¹³⁶ and Nissan.¹¹³⁷ Those certifications are now on appeal before the Sixth Circuit.

The federal district courts in both cases denied the lenders' motions for summary judgment and held that NMAC and GMAC could be held liable as direct creditors.¹¹³⁸ The court in *GMAC* went further, holding that the company had a non-delegable duty not to discriminate.

A large amount of paperwork has been filed in these cases, and those interested can find some of the filings at www.consumerlaw.org, under the heading GMAC/NMAC Discrimination Litigation. Reprinted there are two studies detailing the adverse impact of the pricing scheme on African-Americans, the fourth amended complaints in both cases, and other documents. In addition, www.faircreditlaw.com has additional materials about the cases.

5.4.3.5 Service Contracts, Extended Warranties

5.4.3.5.1 Undisclosed dealer profit on sale of contract

There is evidence today that dealers price service contracts, not based on the service contract provider's suggested retail price, but upon the maximum amount that the finance company will allow. In other words, lenders buying dealer paper will set maximum amounts of back-end charges (such as credit insurance and service contracts) that the lender will accept on a deal. For example, a lender may allow \$1300 in back-end fees. The dealer will price the service contract for \$1300, because the dealer will make more that way than selling \$400 of credit insurance and a \$900 service contract.

Some practitioners report that service contract prices range from \$1200 to \$1900, with dealers keeping far more than 50% of that charge. Another reports prices as high as \$3800, where such high premiums are generally assessed against Native Americans. One dealer even charged a consumer \$995 for a contract whose maximum payout was \$1200. *Automobile News* reports that the average gross profit on a used-car service contract is \$455, totalling almost \$2 billion in gross profit for dealers.

state UDAP violation, because failure to disclose is a stronger claim under a state UDAP statute than under a common law fraud theory. See *Taylor v. Bob O'Connor Ford, Inc.*, 1998 U.S. Dist. LEXIS 5095 (N.D. Ill. Apr. 10, 1998) (UDAP violation to fail to disclose kickback where dealer has an agency relationship with the consumer), *later op. at* 2000 U.S. Dist. LEXIS 11486 (N.D. Ill. June 26, 2000) (nondisclosure of yield spread premium could be UDAP violation if buyers allege that dealer acted as their agent).

1133 See § 5.4.5, *infra*.

1134 See National Consumer Law Center, *Credit Discrimination* (2d ed. 1998 and Supp.).

1135 *Cason v. Nissan Motor Acceptance Corp.*, Clearinghouse No. 53,037A, Civ. No. 3-98-0223 (M.D. Tenn. June 9, 2000) (fourth amended complaint); *Coleman v. Gen. Motors Acceptance Corp.*, Clearinghouse No. 53,036B, Civ. No. 3-98-0211 (M.D. Tenn. Aug. 9, 2000) (fourth amended complaint).

1136 *Coleman v. Gen. Motors Acceptance Corp.*, Clearinghouse No. 53,036B, Civ. No. 3-98-0211 (M.D. Tenn. Aug. 9, 2000) (fourth amended complaint). The DOJ filed its amicus brief in July 2000. *Cason v. Nissan Motors Acceptance Corp.*, Clearinghouse No. 53,037B, Civ. No. 3-98-0223, (July 31, 2000) (DOJ brief), available at <http://www.usdoj.gov>; see also *Coleman v. Gen. Motors Acceptance Corp.*, 196 F.R.D. 315 (M.D. Tenn. 2000).

1137 *Cason v. Nissan Motor Acceptance Corp.*, Clearinghouse No. 53,037A, Civ. No. 3-98-0223 (M.D. Tenn. June 9, 2000) (fourth amended complaint), available at www.consumerlaw.org. The fifth amended complaint is reprinted at National Consumer Law Center, *Credit Discrimination Appx. G.6* (Supp.).

1138 *Coleman v. Gen. Motors Acceptance Corp.*, 196 F.R.D. 315, 324–325 (M.D. Tenn. 2000). The court in the NMAC case issued an oral decision on August 24, 2000.

While it may require discovery to determine what portion of the service contract the dealer retains itself, an idea of a fair price can be approximated by finding the price of a service contract offered to the general public and not sold through dealerships.¹¹³⁹ Another tip may be if sales tax is charged on part, but not the full service contract amount. This may indicate that the dealer is paying sales tax on the charge from the provider, but not on the dealer's own mark-up of that service contract price.

There are several ways for a consumer to bring a UDAP challenge against such price gouging. The practice can be found deceptive where the sales agreement describes the service contract price as the "amounts paid to others on your behalf." This is not the amount paid on the consumer's behalf. The actual cost to the dealer is the amount paid on the consumer's behalf, and the dealer keeps the difference.¹¹⁴⁰

The Seventh Circuit, in an important opinion, has described why the undisclosed mark-ups of service contracts is abusive:

The consumer would have a greater incentive to shop around for an extended warranty, rather than take the one offered by the dealer, if he realized that the dealer was charging what the defendants' lawyer described as a "commission," and apparently a very sizeable one, for its efforts in procuring the warranty from a third party. Or the consumer might be more prone to haggle than if he thought that the entire fee had been levied by a third party and so was outside the dealer's direct control. Or he might go to another dealer in search

1139 See, for example, www.warrantydirect.com, which offers extended warranties by Warranty Direct.

1140 See *Cirone-Shadow v. Union Nissan of Waukegan*, 955 F. Supp. 938 (N.D. Ill. 1997) (denying defendant's summary judgment motion relating to UDAP class claim); *Cemail v. Viking Dodge, Inc.*, 982 F. Supp. 1296 (N.D. Ill. 1997) (same); *Lindsey v. Ed Johnson Oldsmobile, Inc.*, 1996 U.S. Dist. LEXIS 10236 (N.D. Ill. July 18, 1996) (same); *Shields v. Lefta, Inc.*, 888 F. Supp. 894 (N.D. Ill. 1995) (same); *Bernhauser v. Glen Ellyn Dodge, Inc.*, 288 Ill. App. 3d 984, 683 N.E.2d 1194 (1997) (it can be deceptive to misrepresent that all the service contract premium would be paid to others; the service contract provider could also be found liable under a civil conspiracy theory); *Grimaldi v. Webb*, 668 N.E.2d 39 (Ill. App. Ct. 1996) (same), *appeal denied*, 169 Ill. 2d 566, 675 N.E.2d 632 (1996); *Cannon v. Cherry Hill Toyota*, 184 F.R.D. 540 (D.N.J. 1999) (certifying class in UDAP challenge to dealer's false statement that price for service contract was "paid to others"). A number of cases have considered this as a Truth in Lending issue, the amount the dealer retains potentially being a finance charge. See, e.g., *Gibson v. Bob Watson Chevrolet-Geo, Inc.*, 112 F.3d 283 (7th Cir. 1997). *But cf. Groth v. Rohr-Ville Motors, Inc.*, 1997 U.S. Dist. LEXIS 15274 (N.D. Ill. Sept. 29, 1997) (disclosing \$1000 as being paid to others was deceptive where only \$468 was paid to others, the balance of \$532 being kept by the dealer; nevertheless, the consumer did not show that this misrepresentation caused any injury; the consumer admitted to not even realizing that the service contract had been purchased).

of lower mark-ups on third-party charges.¹¹⁴¹

A good argument can be made that the representation of a price for a service contract or extended warranty is deceptive where that is not the price at all, but the total of the contract price and the dealer's markup. Certainly deceptive is any representation that the service contract is a good deal, a good price, or the like. In addition, it is deceptive for a dealer to misrepresent that it had no authority to negotiate the sale price of a service contract, that the price is fixed by the manufacturer.¹¹⁴²

Moreover, it may also be deceptive to fail to disclose the pricing arrangement. It may be that not only the dealer, but also the service contract provider can be found liable for participating in the scheme to deceive the consumer.¹¹⁴³

5.4.3.5.2 Where dealer is actually the service contract provider

Keeping large portions of the service contract price is only one method dealers use to profit from such contracts. Since so little is ever paid out under these contracts in relation to their price, the service contract provider itself will make a large profit even on the portion of the premium that is not kept by the dealer. Dealers thus have an incentive to not only sell the policy, but to become the service contract provider, so that they can keep all the profit derived from the contract's sale. Particularly where the service contract provider is not the car's manufacturer, the contract provider could be owned by the dealer or a close relation of the dealer's, or that an offshore company owned by the dealer owns the service contract provider.

If the dealer owns the service contract company, the dealer may set up a relationship with a fulfillment house, which will actually provide the warranty coverage. The fulfillment house may charge the dealer only \$50 or \$75 dollars a policy; the rest of the profit is split between the dealer personally (the owner of the service contract company) and the dealership. In such a relationship, it is questionable whether the dealer can state that the service contract fee is an amount paid to others, where it is actually being kept by the dealer and dealership. Another consideration where the dealer or a family member owns the service contract company is whether this ownership is allowed under state law—some states prohibit dealers from owning service contract companies.

5.4.3.5.3 Does the contract provide meaningful benefits?

A Maine UDAP regulation deals with the sale of service

1141 *Gibson v. Bob Watson Chevrolet-Geo, Inc.*, 112 F.3d 283 (7th Cir. 1997).

1142 See *Grimaldi v. Webb*, 668 N.E.2d 39 (Ill. App. Ct. 1996).

1143 *Bernhauser v. Glen Ellyn Dodge, Inc.*, 288 Ill. App. 3d 984, 683 N.E.2d 1194 (1997) (civil conspiracy claim against Chrysler can proceed to trial).

contracts or extended warranties. The dealer must disclose if the manufacturer's express warranty that comes with a car offers similar protection to a service contract which must be separately purchased. The dealer must also disclose that under Maine law the consumer has the protection of an implied warranty (that cannot be waived) even if the consumer does not purchase a service contract.¹¹⁴⁴ There also is substantial precedent in the insurance context that sale of illusory coverage is deceptive.¹¹⁴⁵

The FTC has also issued an order against an automobile service contract company, finding that there were hidden limitations on the contract, that it was difficult to obtain the company's authorization for repairs, and that the company unilaterally canceled policies where the consumer filed too many claims.¹¹⁴⁶ The Commission also found no preemption by the McCarran-Ferguson Act, even if the contract was an insurance policy, because state insurance departments were not regulating the company.¹¹⁴⁷ (The McCarran-Ferguson issue is not relevant to an action under a *state* UDAP statute.)

Some companies, such as Wynn, do not offer a traditional service contract. Instead, if a consumer purchases their oil, they warrant a certain performance level for the car in general. The exact nature of this warranty may be misrepresented to the consumer. In addition, some of these warranties do not begin for fifteen days after the contract is signed, and so offer no protection to the consumer during that period—a fact that is rarely disclosed.

5.4.3.5.4 Undisclosed inspection fees

Another service contract scam has been the subject of recent UDAP litigation. A dealer sells a service contract without disclosing any additional fees that will be imposed if the consumer makes a claim under the contract. Then, when the consumer returns to that dealer for repairs under the service contract, the dealer charges an inspection fee to determine if the repairs are covered under the contract. In one case the fees were \$695. A federal court has held that these facts state a UDAP claim.¹¹⁴⁸

5.4.3.5.5 Who must provide benefits on the service contract

A court has found a UDAP violation where a dealer refused to pay benefits under the service contract, even

1144 Maine Unfair Trade Practices Regulations, Sale of New Motor Vehicles.

1145 *Glazewski v. Coronet Ins. Co.*, 108 Ill. 2d 243, 483 N.E.2d 1263 (1985) (sale of illusory insurance coverage is fraud). *See also* *Roche v. Fireside Chrysler-Plymouth Mazda, Inc.*, 600 N.E.2d 1218 (Ill. App. Ct. 1992) (sale of illusory extended warranty coverage held to be UDAP violation by trial court; appellate court holds no UDAP violation because no damages proven).

1146 *Griffin Sys.*, 5 Trade Reg. Rep. (CCH) ¶ 23,603 (FTC Dkt. 9249 1994) (final decision).

1147 *Id.*

1148 *Williams v. Ford Motor Co.*, 990 F. Supp. 551 (N.D. Ill. 1997).

while the dealer attempted to shift blame to the service contract administrator. The court pointed to the language of the service contract whereby the dealer and the administrator both made certain promises.¹¹⁴⁹

Other times the administrator and the insurance company with whom the dealer contracts have no direct contractual relationship with the consumer. In that situation, it is important to always include the dealer in any UDAP claim on the service contract.¹¹⁵⁰

The Texas Attorney General has issued an important advisory concerning service contracts. Where a contract administrator administers a service contract between dealer and consumer, and the administrator becomes insolvent, this does not relieve the duty of the dealer to fulfill its obligations under the contract.¹¹⁵¹ Where the dealer acts as an agent selling the contract for a third party who is responsible for repairs, the dealer is responsible if that third party becomes insolvent. This is because typically the dealer will not be a licensed insurance agent nor the third party a licensed insurer. Where an unauthorized insurer fails to pay a valid claim, any person who assisted in the procurement of such insurance is liable for the full amount of the unpaid claim.¹¹⁵² More on consumer claims under a service contract can be found in NCLC's *Consumer Warranty Law* Ch. 18 (2d ed. 2001).

5.4.3.6 Credit Insurance and Other Insurance Products

Very profitable back-end charges for auto dealers are credit insurance, gap insurance, and other insurance products. Insurers compete with each other to provide insurance products that offer the dealer the highest commission, and dealers work for a high "penetration rate" (percentage of customers who purchase this voluntary insurance). UDAP precedent concerning credit and other insurance products is found at § 5.3, *supra*. See also NCLC's National Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* Ch. 8 (2d ed. 2000 and Supp.).

5.4.3.7 Documentary Fees and Other "Paper" Charges

5.4.3.7.1 Introduction

Most car sales today include extra essentially illusory fees added to the final purchase price: documentary (doc) fees,

1149 *Ron Craft Chevrolet, Inc. v. Davis*, 836 S.W.2d 672 (Tex. App. 1992).

1150 *See Harman v. MIA Service Contracts*, 858 P.2d 19 (Mont. 1993).

1151 Texas Attorney General's Business Advisory Regulating Extended Service Warranties, Clearinghouse No. 47,929 (Oct. 14, 1991).

1152 *Id.*

conveyance or transfer fees,¹¹⁵³ NADW, or other coupon books,¹¹⁵⁴ inventory tax,¹¹⁵⁵ advertising fees,¹¹⁵⁶ dealer services, emergency road-side assistance, consumer packages, consumer services, and the like.¹¹⁵⁷ Often preprinted on the final sales agreement near government fees and taxes, they are intended to appear as if they are required by a government agency, where they are really simply extra profit to the dealer and provide little or no benefit to the consumer. A good example is a \$295 charge for “advertising” that is preprinted next to the taxes line. In fact, all that has happened is that the sales price has been increased after a negotiated price had been reached.

5.4.3.7.2 UDAP challenges

UDAP claims can successfully challenge many fees. If a fee is optional, not disclosing this option is deceptive, especially while making it appear that the fee is required, such as by pre-printing the charge on the sales agreement.¹¹⁵⁸ A state court has ruled deceptive the practice of using preprinted sales forms already having printed on them a \$97.50 charge for the “NADW coupon packet” without explaining the charge or informing the consumer it is optional.¹¹⁵⁹ Similarly, it is a UDAP violation to preprint a “delivery and handling” fee on the order form, implying that the fee is non-negotiable, and to print a list of services

the fee covers that includes many that the dealer does not actually provide.¹¹⁶⁰

It can also be deceptive to label a charge as being official fees, where only a portion of that charge actually goes to government fees.¹¹⁶¹ In addition, the dealer’s oral explanation of the fee often will be deceptive. Note how the charge is described in the Truth in Lending and other documentation. Similar to the parallel issue with service contracts,¹¹⁶² if the charge is described as an amount paid to others, this may be deceptive where the dealer keeps most of the charge as profit.

It is also a UDAP violation to add a fee after the final price has been negotiated. This is a unilateral repudiation of an agreement, and done without the consumer’s knowledge or knowing authorization.¹¹⁶³ In addition, if the doc fee is just to provide the consumer with good title to the car purchased, isn’t good title implicit in a purchase of a car? Charging extra for arranging the title is akin to charging separately for the steering wheel after a final price has been arrived at.

Where a charge is not optional, but required, it is a UDAP violation not to disclose that charge as part of any disclosure of the vehicle’s price: in advertising, in a window sticker, as part of the negotiated price, as indicated on the deal sheet, and on subsequent documents. Where the dealer defends that the charge was really optional, discover if anyone actually purchased a car without the charge. In the case of window etching (a \$199 charge for a minimal job of etching a number into glass), one dealer has stated in deposition that 100% of its new cars are etched at the time they are brought into inventory, meaning that this is not an option at all.

Make sure the service or product related to the charge was also delivered; the dealer’s failure to perform is a UDAP violation.¹¹⁶⁴ Did the consumer receive the \$300 worth of

1153 A documentary or conveyance fee, ranging from \$50 to even \$400, is usually explained as the cost of the service that the dealer’s runner, not the consumer, stands in line at the department of motor vehicles. But in some states the consumer still has to wait in line even after paying the doc fee. In others, the consumer’s insurance agent will arrange the transfer or the dealer can register on line in a matter of seconds.

1154 For example, dealers are charging around \$275 for a book that contains coupons for free oil changes and discounts on car rentals and hotel stays. The value of the book to the consumer is far less than \$275. Some coupon books may even appear to have a value close to their cost, but in many cases the consumer will not own the car for enough years for the book to really be worth it.

1155 Inventory tax or ad valorem charges are for taxes the dealer must pay, not the consumer.

1156 Advertising fees are also dealer expenses, not services provided to the consumer.

1157 One dealer has a CRA fee which is for “customer retention appreciation.”

1158 *Motzer Dodge Jeep Eagle, Inc. v. Ohio Attorney General*, 642 N.E.2d 20 (Ohio Ct. App. 1994); *Charlie’s Dodge, Inc. v. Celebrezze*, 596 N.E.2d 486 (Ohio Ct. App. 1991); *Jones v. Swad Chevrolet, Inc.*, Clearinghouse No. 41,256A (Ohio C.P. 1985), *aff’d on other grounds*, 1986 Ohio App. LEXIS 6904 (May 22, 1986). *But cf. Nigh v. Koons Buick Pontiac GMC, Inc.* 2001 U.S. Dist. LEXIS 5374 (E.D. Va. 2001) (no UDAP violation where fee mandatory for all customers and no representation that it was a government fee).

1159 *Jones v. Swad Chevrolet, Clearinghouse No. 41,256* (Ohio C.P. Franklin Cty. 1985), *aff’d on other grounds*, 1986 Ohio App. LEXIS 6904 (May 22, 1986).

1160 *Motzer Jeep Eagle, Inc. v. Ohio Attorney General*, 95 Ohio App. 3d 183, 642 N.E.2d 20 (1994).

1161 *See Fielder v. Credit Acceptance Corp.*, 19 F. Supp. 2d 966 (W.D. Mo. 1998), *vacated and remanded on other grounds*, 188 F.3d 1031 (8th Cir. 1999).

1162 *See* § 5.4.3.5.1, *supra*.

1163 *People v. Conway*, 42 Cal. App. 3d 875, 117 Cal. Rptr. 251 (1974); Massachusetts Consumer Protection Regulations, Mass. Regs. Code tit. 940, § 5, Motor Vehicle Regulations; *Jones v. Swad Chevrolet, Inc.*, Clearinghouse No. 41,256A (Ohio C.P. 1985), *aff’d on other grounds*, 1986 Ohio App. LEXIS 6904 (May 22, 1986); *Richardson v. Car Lot Co.*, 10 Ohio Misc. 2d 32 (Akron Mun. Ct. 1983) (raising price \$325 for “delivery, get ready, and handling”); Ohio Admin. Code § 109:4-3-16, Advertisement and Sale of Motor Vehicles; *Sanders v. Francis*, 277 Or. 593, 561 P.2d 1003 (1977); Pennsylvania Regulations of the Bureau of Consumer Protection, 37 Pa. Code ch. 301, Automobile Industry Trade Practices; *Northview Motors, Inc. v. Commonwealth*, 562 A.2d 977 (Pa. Commw. Ct. 1989); *Crawford Chevrolet Inc. v. McLarty*, 519 S.W.2d 656 (Tex. Civ. App. 1975).

1164 *Motzer Dodge Jeep Eagle, Inc. v. Ohio Attorney General*, 642 N.E.2d 20 (Ohio Ct. App. 1994); *Jones v. Swad Chevrolet, Inc.*, Clearinghouse No. 41,256A (Ohio C.P. 1985), *aff’d on other grounds*, 1986 Ohio App. LEXIS 6904 (May 22, 1986).

NADW coupons? Did the dealer actually perform handling and prep services, has the manufacturer already reimbursed the dealer for these services, and do these services even apply to a used vehicle?¹¹⁶⁵

If the consumer pays a sales tax on the dealer fee, discover what that implies under state law concerning the fee. If sales tax is only assessed on goods, not services, sales tax on a “doc fee” shows that no service is offered, it is just a disguised add-on to the car’s price.

In addition, a number of states have UDAP car sales regulations that specify in detail permissible dealer charges.¹¹⁶⁶ A court may also find the mark-up implicit in the fee to be so excessive as to be unfair or unconscionable, particularly where a UDAP statute specifies excess price as one type of unfair or unconscionable practice. That is charging two hundred dollars for a two dollar service may be viewed as a UDAP violation.

5.4.3.7.3 Truth in Lending challenges

If the fee is considered optional, determine if it is required of all credit customers. If a fee is optional for cash customers, but required of credit customers, then the fee is a finance charge and should be disclosed as such. Dealers violate the federal Truth in Lending law (TIL) if they disclose such fees in the amount financed, instead of in the finance charge.¹¹⁶⁷ An example is doc fees required for credit purchasers (the dealer will want to make sure its lien is properly recorded on the title), but in theory are optional for cash customers, who can do this service themselves.

A way to show that a fee is not required of cash customers is to demonstrate that the fee is not included in the buyer’s order or other document reflecting the final cash price. The fee instead only shows up later on the credit agreement, and is thus linked to credit and should be treated as a finance charge.

5.4.3.7.4 Anti-Trust claims

Consumers have anti-trust claims (for treble damages and attorney fees) if car dealers, through their association or otherwise, get together to establish standard types of extra fees. For example, an action has successfully alleged that the Louisiana dealership association colluded with the state’s dealers, in violation of the Federal Clayton Act, to create a separate charge to reimburse dealers for the inventory tax dealers must pay the state. The allegation was not that the dealers had fixed prices, but that they had engaged in concerted action that had an impact on prices.

1165 See *Motzer Dodge Jeep Eagle, Inc. v. Ohio Attorney General*, 642 N.E.2d 20 (Ohio Ct. App. 1994).

1166 See § 5.4.3.7.5, *infra*.

1167 See National Consumer Law Center, *Truth in Lending* §§ 3.6, 3.10 (4th ed. 1999 and Supp.).

The federal court certified a plaintiff class of all Louisiana car purchasers over a ten-year period and a defendant class of all Louisiana car dealers, and rejected the defendants’ summary judgment motions. A settlement has been reached valued at several hundred million dollars. Key documents in the case are available as Clearinghouse No. 52,030.¹¹⁶⁸

5.4.3.7.5 State statutory restrictions

States also have explicit restrictions on certain dealer charges. Virginia requires all charges to be disclosed on the buyer’s order. Connecticut requires doc fee charges to be included in advertised prices. New York and Rhode Island regulate the amount of documentary fees. Indiana’s documentary fee statute requires that the fees reflect expenses actually incurred to prepare documents that are not incidental to the extension of credit, that the fee be both disclosed and negotiated, and that it not be preprinted on the sales documents.¹¹⁶⁹ Louisiana’s statute allows a \$35 documentary fee.¹¹⁷⁰ Illinois’s statute provides for a \$40 fee, adjusted annually for inflation that need not be included in the advertised price, but whose nature must be disclosed to the consumer.¹¹⁷¹ Texas allows a voluntary fee up to \$50.¹¹⁷² California provides for a \$45 limit on document fees.¹¹⁷³ Ohio law limits documentary fees to \$30.¹¹⁷⁴

5.4.4 Unfair Dealer Negotiation Practices

5.4.4.1 The Turnover System

One of the most oppressive typical sales techniques that car dealerships employ is the “TO” or turnover system, where a series of sales personnel are used to wear down a consumer. The first salesperson the consumer meets is a “liner” or “greeter” who qualifies the consumer—that is sizes up how vulnerable the consumer is and how much the dealer can take advantage of the consumer. When the consumer settles upon a car, the parties go inside, where the salesperson obtains a driver’s license, keys to the trade-in, or deposit, which is given to the “desk.” This prevents the consumer from leaving prematurely.

1168 *Cook v. Powell Buick, Inc.* (W.D. La. complaint filed 1994). Documents available through the Clearinghouse number include the First Amended Complaint, Findings and Recommendation (concerning class certification and defendants’ motion for partial summary judgment), The Proposed Settlement Agreement, and The Notice of Settlement.

1169 Ind. Code § 9-23-3-6.5.

1170 La. Rev. Stat. 6:960.

1171 See 815 Ill. Comp. Stat. 375/11.1; 14 Ill. Admin. Code 475.

1172 Tex. Fin. Code § 348.006.

1173 Cal. Veh. Code § 11713.1(b) (sales); Cal. Civ. Code § 1985.8 (c)(5) (leases).

1174 Ohio Admin. Code 109:4-3-16(21).

At some point early in the negotiation, the consumer may be passed on to another salesperson, often called the “closer” who is specially trained to negotiate. But even the closer does not have authority to make a deal. Instead, offers are shuttled between the consumer and the “desk” for approval. The closer may not even take an offer to the desk, but just pretend to do so as part of the technique.

When a price is negotiated, then the consumer is moved to the highest paid salesman—the finance and insurance manager. It is this person who will sell many of the extras—service contracts, credit insurance, and other options, switch the consumer to a lease or finalize the financing.

5.4.4.2 Dealer’s Illegal Use of Consumer Credit Reports

In an apparently standard automobile sales technique, many car dealers pull a consumer’s credit report almost as soon as the consumer walks into the showroom. The dealer requires the consumer’s driver license to test drive a car, to enter a contest, or just as a precondition for meeting with a salesperson. With the license or similar information, the dealer pulls the consumer’s credit report without the consumer’s knowledge. This provides key information to the salesperson in sizing up the consumer, information that will be used to the dealer’s best advantage in any negotiations.

The FTC has found this practice to be illegal,¹¹⁷⁵ because the Fair Credit Reporting Act (FCRA) only allows release of a consumer’s credit report for specified permissible purposes.¹¹⁷⁶ To size up a potential customer before the consumer has even applied for credit is not such a permissible purpose. While the dealer can seek a credit report if the consumer applies for credit or pays by personal check, the dealer has no permissible purpose when the consumer is only comparison shopping, test driving the vehicle, or negotiating the purchase price.

Pulling a consumer’s credit report illegally causes the consumer two types of harm. One is to put the consumer at a disadvantage to the dealer in the sales negotiation. The other is that user requests for a consumer’s credit report are themselves recorded in the consumer’s credit reporting file. Many creditors view adversely consumer credit reports that contain too many creditor requests for the consumer’s report. In other words, the dealer practice of immediately pulling a consumer’s credit report can seriously injure a consumer’s credit rating when the consumer does nothing other than visit five or so dealers over a weekend.

Proving this illegal use of a credit report may not be too difficult, even if the consumer later applies for credit from

1175 See Letter from David Medine to Karen Coffey, Texas Automobile Dealers Association (Feb. 11, 1998), found on the companion CD-Rom.

1176 See National Consumer Law Center, Fair Credit Reporting Act Ch. 4 (4th ed. 1998 and Supp.).

the dealer or gives the dealer a personal check. Credit reporting agencies should have the time the dealer ordered the report, and most dealerships “clock in” a customer when they arrive at the dealership.¹¹⁷⁷ Look for cases where the report was pulled within minutes of the consumer walking in the door.

When a consumer wants to bring a UDAP challenge to a car dealer’s sales practices, there are certain advantages to adding a claim based on the illegal use of the consumer’s credit report. If the consumer wants to be in federal court, this FCRA violation will provide a basis for such jurisdiction. (If the consumer wishes to stay in state court, the same claim can be made under the UDAP statute or a state credit reporting statute.¹¹⁷⁸) A FCRA violation also leads to consumer attorney fees, if there is any doubt about such fees under a particular state’s UDAP statute, or if there is any doubt about the consumer prevailing on other claims. The FCRA violation can also lead to punitive damages if the violation is wilful and knowing.

5.4.4.3 “Unhorsing” and Selling the Consumer’s Trade-In Prematurely

The car industry uses the term “unhorsing” for its established practice of stripping consumers of their existing vehicles so that the consumer has no choice but to purchase another vehicle. Dealers may do whatever it takes to unhorse the consumer, even to the point of simply refusing to return a consumer’s car keys when requested or laughing at the consumer and throwing the keys on the roof. If the consumer takes a new vehicle home for a test drive, and returns to get his old vehicle the next day, the dealer may claim that the trade-in has already been sold.

The failure to return a trade-in can take place at a number of different times. It is a UDAP violation for a dealer to refuse to return a car it is appraising for its trade-in value.¹¹⁷⁹ Selling a trade-in immediately so that the consumer cannot back out of the sale has also been found to be a UDAP violation.¹¹⁸⁰

The most common situation is where the dealer cancels a sale because the financing falls through, and then refuses to return the consumer’s trade-in, thus putting pressure on the consumer to renegotiate the original deal at a higher financ-

1177 Records indicating this clock time will often be found in documents held at the sales desk tower or in the manager’s deal log. Larger dealerships will have the time entered into their computer system.

1178 See National Consumer Law Center, Fair Credit Reporting Act § 12.4 (4th ed. 1998 and Supp.).

1179 State v. Ralph Williams N.W. Chrysler Plymouth, Inc., 87 Wash. 2d 298, 553 P.2d 423 (1976). See also Apple Imports, Inc. v. Koole, 945 S.W.2d 895 (Tex. App. 1997).

1180 Mapp v. Toyota World, Inc., 344 S.E.2d 297 (N.C. Ct. App. 1986); Apple Imports, Inc. v. Koole, 945 S.W.2d 895 (Tex. App. 1997).