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LITIGATION TRENDS IN THE AUTOMOTIVE INDUSTRY

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CONSUMERS ATTACK DEALER RESERVES

Recently, consumer groups have tried to challenge the historical "markup" dealers have imposed on retail installment contracts for the services they provide in coordinating financing with lenders. Nationally, there is also an effort by consumer groups to codify a cap on the commission that dealers can earn for their services as well as a disclosure of the "spread." The momentum of these efforts finally impacted Massachusetts with the filing of the Car Buyer's Bill of Rights that seeks both disclosure and a cap (the greater of .5% of the loan or $150) as described above. The reason for the legislative efforts throughout the country is that courts have almost universally endorsed the practice of dealer reserves. For example, most recently, a Tennessee Court of Appeals (Beaudreau v. Larry Hill Pontiac/ Oldsmobile/GMC, Inc.) ruled that dealer reserves was not an unfair and deceptive practice when it determined that consumers should anticipate a "for profit retailer" would expect to be paid for arranging financing.

Despite consistent endorsement by the courts, consumers have attacked dealer reserves on numerous theories, including, truth-in-lending act violations, and unfair and deceptive practices under state consumer protection laws similar to Massachusetts' General Laws chapter 93A. However, state and federal courts have consistently approved of dealer reserves as a lawful practice so long as the claims have not included other allegations of wrongdoing. Specifically, some federal courts have recognized that absent some sort of misrepresentation, the dealer is not acting as the consumer's agent when it arranges financing through a lender.

Accordingly, it should be a customer's expectation that the dealer seeks a profit on the services it provides. (Balderos v. City Chevrolet).

Consumers in California recently challenged the practice of dealer reserves under the extensive regulation of retail installment contracts and consumer protection afforded to California residents. However, based in part on interpretations of Regulation Z by the Federal Reserve Board, the California courts determined that disclosure of dealer reserves is not required by law given that it is entirely unclear whether disclosure would be useful to consumers. (Kunert v. Mission Financial Services Corporation). Perhaps the California Court of Appeals put it best when it stated, "Unfair competition law was not intended to eliminate retailer's profits by requiring them to sell at their cost, whether the product is automobiles or automobile financing."

CONSUMERS CHALLENGE THE USE OF ARBITRATION CLAUSES

Throughout the country, dealers have begun inserting arbitration provisions within their consumer contracts to protect against the high cost of litigation and the liability threat of large class action claims. While this practice is new to the automotive industry, it is a practice that has been historically used in other consumer-related industries by such entities as credit card companies and wireless phone providers.

Consequently, the ability to include such provisions in consumer contracts has, to a large extent, already been litigated. In fact, this past summer, a federal court (Iberia Credit Bureau, Inc. v. Cingular Wireless LLC) endorsed a binding arbitration provision in a consumer contract similar to those widely used by auto dealers. The "endorsed" provision specifically (and unequivocally) banned potential "class claims" while also providing confidentiality that would prevent any consumer from publicizing any adverse decisions against the retailer.

More recently, courts have enforced the use of arbitration provisions and bans on class action claims (often referred to as "class action waivers") over the objections of consumers and the arbitrator handling their dispute. (Gipson v. Cross Country Bank). This decision came about when one of the country's largest alternative dispute resolution providers (JAMS) refused to enforce an arbitration provision that prevented individual consumers from

combining their claims against a single dealer to form a "class" group. The Federal Court in Alabama overturned this attempt through an injunction preventing the arbitrator from allowing the combination of claims where such a right had been specifically waived when the consumers signed the arbitration clause at issue.

Further support for class action waivers is evidenced by the Class Action Fairness Act of 2005, passed by Congress and President Bush earlier this year. While the Act is a good beginning for reform, it still does not prevent consumers from bringing the type of class action suits that have threatened dealers.

When incorporating arbitration provisions and "class action waivers" into consumer contracts, dealers should insure that any such provisions that appear in separate documents (such as a retail order agreement and a retail installment contract) be consistent in terms and scope, otherwise, a court may very well find the disparate provisions ambiguous to the consumer and consequently unenforceable. For example, a court in New Jersey recently found that the presence of two unrelated arbitration provisions with conflicting terms was grounds to reject a dealer's attempt to compel arbitration. (Rockel, et al. v. Cherry Hill Dodge).

Despite rulings like these in New Jersey, it is important to note that under the current state of the law (both state and federal), the use of arbitration is specifically promoted. Most courts find that the policy in favor of the arbitration of disputes sufficiently outweighs consumers' statutory right to present their claims in a court of law. However, dealers should be aware that, while the use of binding arbitration provisions and "class action waivers" is currently legal, other “consumer-friendly” states have taken steps to thwart the practice. For example, in March of this year, the State of Arkansas passed a law that banned the inclusion of binding arbitration clauses other than through the use of a state crafted document entitled "waiver of purchaser’s right to sue."

In the end, dealers should be cognizant of the requirements that make arbitration provisions more likely to pass muster. Not only is it imperative that consumers be given reasonable notice, but the terms of the provision must be clear and unequivocal, prominently placed in the agreement, so as to make it distinguishable (including print size and font), and accurately describe the manner and procedure which would govern the arbitration

proceeding. Dealers must also avoid using boiler-plate arbitration language that may conflict with state laws and regulations (such as the Massachusetts Lemon Law).

Above all, arbitration provisions need to be specific enough to inform consumers that they are waiving their statutory rights to litigation in court.

RENTAL COMPANIES HAVE LIMITED DUTY TO CHECK DRIVER'S LICENSES

A Massachusetts court recently held that car rental agencies do not have a legal duty to inquire whether a driver's license has been suspended once a renter produces a facially valid license. Earlier this year, a Massachusetts court sided with a rental car company and ruled that requiring rental companies to be responsible for monitoring the renter and confirming that such renter is properly licensed, without further regulation, would be "sufficiently onerous" as to result in limited service. (Nunez, et al. v. A&M Rentals, Inc.). This particular case involved a wrongful death action brought against a rental company for claims that it negligently rented a car to a driver who caused another driver's death. The renter presented the rental company with a facially valid license, but, unbeknownst to the rental company, it had been suspended a year earlier for a failure to pay a speeding violation. Although the family of the victim argued that the rental company has commercially available systems and procedures to verify the status of the renter's license, the Court found that a rental company's duty is fulfilled when a renter shows a "duly issued license."

The relevant law upon which the Court relied is Massachusetts General Laws, Chapter 90, Section 32C which provides, in part, that "No lessor shall lease any motor vehicle or trailer until the lessee shows that he or his authorized operator is the holder of a duly issued license to operate the type of motor vehicle or trailer which is being leased." In this case, as in most rental or loaner car situations, the company did not have any independent knowledge of any incompetence or unfitness on the part of the renter and relied solely on the license that the lessee presented at the time of rental. At least for the moment, and until the Legislature decides otherwise, the obligations of dealers that rent and/or loan vehicles has been reasonably limited since Massachusetts does not require license verification beyond that

expressed in Section 32C (a duly issued license).

ENVIRONMENTAL AND DOCUMENT PREPARATION FEES CAN LEAD TO SUPERSIZED SETTLEMENTS

Earlier this winter, an Oklahoma judge approved a settlement between Jiffy Lube and several consumer groups (Bayhylee v. Jiffy Lube International) for $2.75 million based on allegations that the customers paid a misleading "environmental surcharge." The surcharge was presented to the consumers as a regulatory/required "tax" when in fact, there was no applicable legal requirement to charge any environmental fee.

Currently, in Massachusetts, there is also no rule or regulation that requires or prohibits a dealer from charging consumers for the environmental costs associated with their transaction. However, what is highly regulated is a dealer's attempt to hide profits. As we have expressed in previous bulletins, dealers should be very careful to avoid hiding profits through any types of "fees." "Fees" should also not be presented in any way that would lead a consumer to think it is a regulatory tax or surcharge. Rather, the charge should be an attempt by a dealer to allocate amongst his customers a cost incurred for an associated service.

Similarly, charging documentary preparation fees ("doc fees") is not necessarily prohibited under Massachusetts law. However, it has also been questioned by consumers and challenged in other states as a means to hide a "profit center." Some states have chosen to regulate their doc fees through various types of means. For example, some states require that dealers disclose that documentary preparation fees represent additional profit to the dealer (Florida), while others have simply capped the fee (Ohio, California and Washington). Some states require that documentary preparation fees be disclosed, not preprinted on the form, and negotiated as part of the transaction. In some states, consumers have alleged that doc fees exceeding certain amounts are "unconscionable" whether or not the disclosure of the fee satisfied applicable regulations.

Dealers can still use both environmental fees and doc fees as legitimate cost recovery tools if the charges are presented properly. However, dealers should be aware of consumers' successful efforts to challenge fees that do

not directly correlate to a dealer's cost recovery.