The CARLAWYER©

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This feature brings you federal and significant state legislative highlights as well as a recap of some of the litigation that we track every month. Note that what we report here is not every recent development, but just ones that we think are of particular interest, and that this column does not offer legal advice – you need to consult your lawyer with questions.

We are including items from other states for two reasons. First, we want you to be able to see trends, and, second, another state's laws might be a lot like your own state's laws – if laws are being enacted there, or AGs are pursuing particular types of claims, those laws and claims might be coming soon to a theater near you. As always, though, you need to check with your own lawyer before you rely on anything we report or if you have any questions.

General Interest

We've been warning that consumer advocates would be lobbying the federal Congress hard to eliminate mandatory binding arbitration of consumer disputes. That effort has seen its first tangible results. On October 25, 2007, the House Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, held a hearing on H.R. 3010, the Arbitration Fairness Act of 2007. Stay tuned! This could be a biggie!

We've still got Carolina on our minds. Last month, we reported that North Carolina authorities had decided that the vehicle "rent-to-own" business is not permitted by NC law. It turns out that the documents that we reviewed had not been officially released, and we are now told that the matter is still under consideration by the North Carolina folks. We also reported that we had heard rumbles that some other state regulators were scratching their heads over RTO, trying to determine its legality in their states. While RTO seems to work just fine, thank you, in many states, you need to make sure that you've dotted and crossed everything that needs dotting and crossing if you're launching an RTO business. Our recommendation stands - if you're in the RTO business (or, just thinking about it), it's time to sit down and have a long chat with your lawyer so that you know your risks.

Make a note – it's probably a bad idea to ignore legal documents you receive from the Attorney General. Connecticut Attorney General Richard Blumenthal recently instituted an enforcement action against Crabtree Subaru and Crabtree Dodge of Shelton for failure to respond to subpoenas for documents. The subpoenas were issued in connection with a lawsuit brought against the dealer this summer for alleged false and misleading advertising. The enforcement action seeks penalties and a court order compelling the dealer to comply with the state's demand for documents.

Drum Roll, Please! At long last, the Red Flag Rules are here! The Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Federal Reserve Board, Office of Thrift Supervision, National Credit Union Administration, and Federal Trade Commission have issued final rules and guidelines implementing Section 114 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) and final rules implementing Section 315 of the FACT Act. The mandatory compliance date for these rules and guidelines is November 1, 2008. These are the agencies' final "Red Flag" rules and guidelines. They require covered entities to establish an Identity Theft Prevention Program that is designed to detect, prevent, and mitigate identity theft. The final rules clarify that they apply to automobile dealers. Plan to start your "Red Flag" compliance efforts quickly – November 2008 isn't that far away.

Interested in the Hispanic market? A revised Spanish-language version of "Understanding Vehicle Financing," a brochure prepared by the American Financial Services Association Education Foundation and the National Automobile Dealers Association, is available from the web sites of these organizations. In addition, AFSA and NADA are co-leading efforts for Americans Well-informed on Automobile Retailing Economics (AWARE), which has launched a Web site in English and Spanish providing a variety of vehicle financing resources and tools for consumers.

Litigation

Out-of-State Internet Lender Subject to Licensing in Kansas: If your dealership sells cars across state lines on EBay or using other Internet tools, here's something else to worry about. An Internet payday lender located in Utah made payday loans to, among others, residents of Kansas. The Kansas Office of the State Bank Commissioner sanctioned the lender for making loans in Kansas without the license required by the Uniform Consumer Credit Code. The lender sued, claiming that the UCCC's licensing requirement, as applied to it, was unconstitutional under the Commerce Clause and the Due Process Clause. The **U.S. District Court for the District of Kansas** granted the OSBC's motion for summary judgment on both claims, finding that while the lender did not have an office or employees in Kansas, it had contacts with Kansas because it solicited in Kansas and made loans to Kansas residents. The court noted that the UCCC expressly provides that loans are "made" in Kansas if they involve a Kansas resident and are induced by solicitation in Kansas. It may not be much of a leap for state regulators to use cases like this to argue that dealerships are subject to the licensing and other laws of the states where their customers live. *See* ***Quick Payday, Inc. v. Stork***, 2007 WL 2581881 (D. Kan. September 7, 2007).

Mortgage Broker that Rejected Application Subject to FCRA and ECOA: Although this case involves a mortgage broker, it could apply equally to dealers. The broker took an application for a mortgage loan and obtained the applicant's credit report to evaluate the application. The broker rejected the application, but did not give the applicant notice that it had taken **adverse action** on her loan application or give the reasons for the adverse action. The applicant sued the broker for violating the Equal Credit Opportunity Act and the Fair Credit Reporting Act. The **U.S. District Court for the District of Connecticut** concluded that the broker was subject to both the ECOA and the FCRA. Because the broker decided not to submit the loan application to any lenders (sound familiar?), the court found that the broker participated "in a credit decision" and, therefore, was a creditor subject to the ECOA. The court also found that the broker took adverse action based in whole or in part on a credit report and was, therefore, required to give notice of its adverse action under the FCRA. *See* ***Cochran v. Northeast Mortgage, LLC***, 2007 WL 2412299 (D. Conn. August 21, 2007).

Financing of Negative Equity Results in Bifurcation of Vehicle-Secured Creditor's Claim: If banks and finance sources tighten up on dealers who finance negative equity, it may be because of cases like these bankruptcy cases. When Chapter 13 debtors proposed to cram down the claims of holders of liens on their vehicle, the creditors objected, arguing that their claims were protected from bifurcation because they held purchase-money security interests in the vehicles that the debtors bought for their personal use within 910 days before the debtors filed their bankruptcy petitions. The debtors argued that because the creditors financed negative equity on the debtors' trade-in vehicles, they were not holders of purchase-money security interests. In an earlier opinion, the **U.S. Bankruptcy Court for the Northern District of Ohio** found that the transactions contained both purchase-money and non-purchase-money components because the negative equity was not an expense incurred in order to obtain rights to the collateral. The court found that the non-purchase-money component took the creditors' claims outside of the anti-bifurcation protection provided for purchase-money liens. After requesting additional briefing, the court concluded that although negative equity is not part of a purchase-money security interest, it was "more equitable" to apply the dual status rule rather than the transformation rule. The court noted that in order to determine the non-purchase-money component of the transaction, a court should apply to the claim the same percentage that the negative equity comprised of the total amount financed. *See* ***In re Westfall***, 2007 WL 2777709 (Bankr. N.D. Ohio September 24, 2007). Now, don't let all this bankruptcy mess scare you into bad habits. It's important that you disclose negative equity properly. If you need a reason why, read the next case.

Class Action Certified in Case Alleging Dealer Violated California Law by Concealing Negative Equity: Just what you needed – more bad news on negative equity. A car buyer filed a class action suit against the dealership where he bought his car, claiming the dealership violated California's Automobile Sales Finance Act and other California laws by rolling some or all of the negative equity on a trade-in into the cash price of the vehicle being purchased. The trial court denied the motion for class certification.

Because various customers had engaged in individual negotiations regarding the purchase price and trade-in value, the trial court concluded that individual fraud issues and punitive damages questions predominated. The **California Court of Appeal** reversed the trial court's decision regarding class certification. The appellate court found that the core issues of whether the cash price of the vehicle being purchased included negative equity from a trade-in without adequate written disclosures and whether the failure to disclose negative equity violated the ASFA predominated. *See* ***Cornell v. Robinson Ford Sales, Inc.***, 2007 WL 2812991 (Cal. App. September 28, 2007). Interestingly, this case started out as a case about a disgruntled customer whose car had mechanical problems, and turned into a class action brawl over disclosure errors. As if you needed another reason to keep the customer happy!

Stay legal, and we'll see you next issue.

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