

CAR DEALER INSIDER

Profit Making Secrets for the Competitive Dealer

Home

Search Articles

Topical Index

Past Issues

Print Current Issue

PDF Issue Archive

Conferences

Activate E-access

Subscribe Now

Privacy Policy

About Us

Contact Us

Issue Date: May 02, 2005

Warning: negative equity deals may pose legal risks

Lawsuits arise as customers seek relief from dealers for loan defaults

Dealers report they're seeing as many as seven out of 10 of their new vehicle customers showing up with negative equity in their current vehicles - a figure that sometimes runs \$10,000 or more.

But here's the rub: Despite all the work you're doing to help these customers finance a new vehicle and deal with the balance on their trade-ins, there's a risk that customers may not understand the deal dynamics and sue you for the lack of clarity. In some cases, they may even claim that you inflated income levels as a way to work negative equity into a new deal and obtain lender approvals.

That's at least part of the story behind a handful of lawsuits filed by a single plaintiff's attorney firm against Northgate Ford, Binghamton, N.Y. In March, a state appellate court ruled in favor of the store on two cases, arguing that there wasn't enough evidence to support the plaintiff's claim of deception and fraud, thereby dismissing the cases.

Attorney Matthew Butler, who represented Northgate, says that while he believes the cases had little merit, they represent a new breed of cases that dealers will have to confront. He adds that he's seen about 10 cases with the same fundamental complaint.

Meanwhile, plaintiff's attorney Thomas Vitanza believes the court's ruling overlooked what he believes is an abusive practice by dealers. "They think they're doing a favor to customers by helping them get financing," he says.

The cases made two basic claims:

1. The dealers misrepresented the customers' income on deal documents to get lender approval. Both sides claim the other is wrong on this point. Butler says the store relied on what customers told dealer sales and F&I staff. Vitanza contends there's evidence that the stores tweaked the income. The appellate judges ruled there wasn't enough proof to support the fraud claim. (Other dealers have faced similar allegations of "power-booking," which industry experts say is rare but does happen (CDI, 8/9/04).
2. The dealers didn't properly explain how a new finance deal would account for the balance owed on a trade-in vehicle. Vitanza contends the dealer glossed this by saying "we'll take care of it," leaving the customer with the impression the balance would be forgiven. The courts ruled that customers signed the deal documents, which contained the proper disclosures and showed how the negative equity would be rolled into the deal, and were responsible for understanding the deal terms. At least one plaintiff admitted she hadn't read the loan documents prior to signing them.



Experts agree: Address negative equity early in the deal to avoid problems

Dealer litigation defense consultant **Gil Van Over** of gvo3 Associates says legal cases that stem from negative equity deals are "creeping up more and more." He sees two potential problem areas:

Problem #1: Proper disclosure of negative equity balances on retail contracts. In some cases, lenders haven't helped. Some lender contracts do not contain distinct line items to account for negative equity, which can result in dealers incorrectly wrapping the balance into the purchase price of a vehicle.

The FTC's Regulation Z stipulates how to use a "netting" or "non-netting" approach for disclosing this part of a transaction and how it relates to a customer's down payment. However, deal documents do not always echo the regulation, which has some dealers crafting their own approaches to ensuring customers and lenders are aware of how they're accounting for negative equity.

"It's our policy that the customer, the dealer and the lender are all aware," says an executive for a Southeast dealer group. They're working with a DMS vendor to develop separate line items to account more clearly for negative equity. The concern: A lack of consistency could lead to deceptive practice claims.

Van Over sees another potential risk: As negative equity becomes a component of the purchase price on contracts, plaintiffs' lawyers may make a claim that a dealer has advertised a given price for a vehicle that doesn't square with the purchase price listed on contracts.

Problem #2: Audit credit applications and retail contracts. You should check to make sure the information is consistent between the two documents to ensure your F&I managers aren't tweaking customer income to make a deal look more favorable to lenders.

Sales consultant Mark Tewart of Tewart Enterprises advises that you also account for negative equity during your sales process with customers in an open-book fashion. As you craft your first proposal, he recommends asking this question: "How would you like us to handle your current balance?" The query immediately opens dialogue about the amount the customer owns on an existing vehicle. From there, Tewart says it's best to offer all options - having the customer pay more to eliminate the balance, paying off part of the balance and rolling the remainder into the new deal or rolling the entire amount into the new deal. The approach "really puts the issue into the hands of the customer," Tewart says.

Categories: [F & I](#)

© 2005 [UCG](#). All rights reserved.

Do not duplicate or redistribute in any form.

Car Dealer Insider is available for internal use only by authorized users.

Car Dealer Insider

11300 Rockville Pike, Suite 1100, Rockville, MD 20852.

Phone: 888/287/2223 Fax: 301/816-8945 Email: cdicustomer@ucg.com