Consumer Protection in the Used and Subprime Car Market

Written Testimony of
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On behalf of the Low Income Clients of the
National Consumer Law Center[1]
Before the Subcommittee on Commerce Trade
and Consumer Protection of the
Committee on Energy and Commerce
United States House of Representatives

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Chairman Rush, Ranking Member Radanovich, and distinguished Members of the Subcommittee, it is an honor for me to testify before you today on behalf of our low income clients about consumer protection in the used car market. I thank you and your staff for holding a hearing on these very important issues.

In much of the United States, working families can not be self-sufficient and productive without a car. Yet abuses in the market for buying and financing a car often unnecessarily increase the costs of a car, or preclude families from buying and keeping a reliable car. This is especially true for low-income families. Households with incomes below $25,000 are nine times more likely to be without a car than households with incomes above $25,000.[2] Families trying to buy and finance a reliable car face many hurdles and stumbling blocks, such as cars in poor or even dangerous condition that dealers present as safe and sound, kick-backs to dealers from financers for putting consumers in a more expensive loan than they qualify for, deceptive sales practices, junk products and fees that add to a car's cost, and outright fraud.

While many of the changes that are necessary to bring transparency, efficiency, and, fairness to the market will have to occur at the state level, there are a number of very important things that can and should be done by federal regulatory agencies, the administration, and Congress to stop these abuses. The Federal Trade Commission should improve its "used car rule" and increase enforcement of existing rules in the car market. The Department of Justice should ensure that the National Motor Vehicle Title Information System contains complete information and is easily available to car buyers. The National Highway Traffic Safety Administration (NHTSA) should amend its exemptions so that cars over ten years old are subject to the disclosure requirements of the Motor Vehicle Information and Cost Savings Act. Legislative changes should be made such as the creation of a data collection system for car loans, a ban on pre-dispute

[1] The National Consumer Law Center is a non-profit organization that seeks marketplace justice on behalf of low-income and vulnerable Americans. NCLC works with, and offers training to, thousands of legal-service, government and private attorneys, as well as community groups and organizations representing low-income families. Our legal manuals and consumer guides are standards of the field.

[2] U.S. Department of Transportation, Bureau of Transportation Statistics, *NHTS 2001 Highlights Report*, BTS03-05 (Washington, DC: 2003).

binding arbitration clauses in car sales and finance transactions, adjustments of Truth in Lending coverage, and removal of restrictions on modification of car loans in bankruptcy.

Such changes are urgently needed. The current system results in unfair transactions. It hamstrings working families that have to have a car. Ultimately, the fraud and abuse in these individual transactions aggregate into a dysfunctional credit economy.

COMMON ABUSES

Policies currently in place are generally insufficient to protect consumers when buying and financing a used car. Although new and used car dealer complaints are recorded separately by the Better Business Bureau, if the two are combined there are more complaints filed with that organization about car dealers than any other industry.[3] AGs are also inundated with complaints about car dealers.[4] Considering that many car buyers never discover that they have been defrauded, the level of complaints is striking. Abusive practices mean that all too often a used car is a liability rather than an asset for a family, draining essential resources instead of providing a route to success and self-sufficiency. Car buyers fall victim to a number of practices that greatly reduce their ability to obtain a useful car that can meet their needs at a fair sales price with fair financing.

The way in which cars are sold and financed is intentionally structured to be needlessly complicated and time consuming in order to confuse buyers and enable dealers to charge excessive prices and fees for the car and financing. Dealers use psychological tactics to influence consumers. Often dealers force the consumer to stay at the dealership for long periods of time by keeping the potential trade-in, keeping the consumer's driver's license, or other ruses. The consumer is worn down and becomes much more susceptible to the dealer's efforts to extract excess profits from the transaction. Dealers mislead and simply lie to consumers.

Dealers also use tactics such as "yo-yo sales" to reduce any chance the consumer has of getting a fair deal. In a yo-yo sale the dealer sends the customer off the lot driving the newly purchased car only to call the customer back several days later to say (sometimes untruthfully) that financing could not be arranged at the original terms and the consumer must sign new documents at a higher interest rate or other worse terms. Of course, if the consumer, rather than the dealer, had reconsidered the transaction and wished to back out, the dealer would be quick to tell the consumer that the deal is binding and the consumer may not cancel the transaction. Sometimes the dealer will have already sold the consumer's trade-in or tell the consumer that the consumer will be responsible

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[3] It is important to note that BBB does not include numerous related categories such as auto warranty processing, auto leasing, or auto rust proofing in the dealer category. *See* http://us.bbb.org/WWWRoot/storage/16/documents/stats%20pdf/US_by_Complaint_2008_inter.pdf

[4] Top five in Oregon in 2008 *see* http://www.doj.state.or.us/releases/2008/rel030508.shtml; top five in NC 2007 see http://www.ncdoj.gov/DocumentStreamerClient?directory=CPTipAlert/&file=Top%20Ten%20Complaints%202007%20list.pdf

for extra charges and costs if the new, less desirable, terms are not accepted. Regardless of whether the dealer is being truthful, often the customer is in no position to refuse the new onerous terms.

Sometimes the dealer is simply bringing the customer back in to get an even higher interest rate or add on more profitable items to the sale. These dealers realize that consumers are more likely to agree to these terms after they already feel so invested in the deal and are reluctant to see it undone. Often the consumer has already paid additional money to third parties for insurance or improvements to the newly purchased car. The consumer often believes there is no choice but to accept the new terms presented by the dealer. Even if the dealer is truthful and was unable to find a willing lender, the consumer is still in the position of walking away from a deal after investing substantial time and money.

Dealers often structure the negotiation for the sale of a car to obscure the costs and to prevent the consumer from understanding whether he or she is getting the car at a fair price. Excess dealer profits will be hidden in additions such as "window etching," service contracts, rust proofing, and vastly inflated document preparation fees. Consumers may pay thousands of dollars for window etching that costs the dealer fifteen dollars and a guaranty of little or no value. In extreme cases, consumers have paid as much as $2,000 for a pen and key chain costing the dealership $15.[5]

If a consumer is able to uncover evidence of wrongdoing on the part of the dealer or finance company, often any meaningful compensation for the consumer or any punitive award to stop such behavior in the future will be unavailable because of language inserted in the contract denying consumers the right to go to court and forcing them to resolve any disputes in arbitration.

Financing markups by dealers create another opportunity for abuse. In most car purchase transactions, the dealer arranges the financing in addition to selling the car. Dealers typically contact prospective lenders and present the consumer's financial information. Lenders then inform the dealer of the terms on which they will be willing to lend to that consumer. Often the dealer places the consumer in less favorable financing than the consumer qualifies for, and splits the extra profit with the lender. For example, if the lender was willing to lend to the consumer at an 8% interest rate, the dealer may place the consumer in a loan at 16% interest. The lender and dealer then split the extra money that will be paid by the consumer due to the higher interest charges.

An extremely troubling feature of dealer financing markups is their disparate racial impact. Information obtained through litigation mounted by NCLC and others has demonstrated that minority car buyers pay significantly higher dealer markups than non-minority car buyers *with the same credit scores*.[6]

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[5] Gregory Arroyo, *Payment Packing in Los Angeles*, F&I Management & Technology Magazine, February 2007.

[6] See, e.g., Ian Ayers, Expert Report, June 2004, available at

Yet another problem is the poor mechanical condition of many used cars. Many are unreliable or even unsafe. Many such vehicles are salvage vehicles that have been previously wrecked or flooded. The dealer often knows that the car has defects but misleads the consumer about the condition of the car.

Most used cars purchased by low-income families are sold "As Is." Such cars often require repair soon after purchase. Often the cost of the repairs is more than the consumer can afford or even exceeds the value of the vehicle. As a result, the consumer is often unable to repair the car, so it does not serve the role of helping the family that the consumer envisioned when purchasing it.

Even if repairs are not required, the increasing length of used car loans, often five years or more, coupled with excessive interest rates that result from dealer markups, virtually ensure that the consumer will soon owe more than the car is worth. Many times potential car buyers will still owe more than the vehicle is worth when they must purchase a replacement. When such a customer comes in "upside down," dealers will often roll the excess amount still owed on the first vehicle into the deal for the next one and so make it even less likely that the consumer will ever have any equity in the car.

Consumers can also be caught when a dealer goes out of business. The National Automobile Dealers Association estimates that over 900 *new* car dealerships closed in 2008 and over 1,100 will close in 2009. The number of *used* car dealerships that close will likely be much higher. While the economic impact of these closures has been widely reported, the direct effect on consumers has received little attention.

Dealerships seldom shut down in an orderly fashion. Before closing, dealerships often engage in such illegal practices as failing to pay off existing loans on trade-in vehicles or selling cars to consumers without first having obtained good title. By the time the consumer discovers that the trade-in has not been paid off, or that there is a dispute over the title to a newly purchased car, the dealer will often have shut its doors and be insolvent.

IMPROVEMENTS AT THE REGULATORY LEVEL

Steps the Federal Trade Commission Should Take

The FTC is in a position to address many of the abuses of the used car market. Unfortunately, it has failed to do so. While it has provided some very valuable protections for consumers such as the "Holder" Rule,[7] and some aspects of the Magnuson Moss Warranty Act, in other areas it has failed to adequately protect consumers.

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http://www.consumerlaw.org/issues/cocounseling/content/AHFCIanAyresReportExhibits.pdf; Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." available at http://ssrn.com/abstract=951827.

[7] This Rule allows consumers defrauded by a dealer to raise the dealer's misconduct as a defense to loan repayment whenever the lender is the dealer's assignee or has a business arrangement with the dealer.[7]

The FTC's "Used Car Rule" Rule does not require any disclosure of the condition or history of the vehicle, even if the dealer knows of specific defects. The disclosure it requires about the existence or non-existence of warranty coverage is weak and misleading. The FTC has not sufficiently protected consumer from laundered lemons. The FTC has also not effectively used enforcement actions to address abuses in the sale and financing of used cars.

Improve the FTC's "Used Car Rule"

The FTC "Used Car Rule" requires dealers to disclose what, if any, warranty comes with the vehicle on a "Buyers Guide" posted on the vehicle. The Rule was created in response to an investigation by the FTC's Seattle office in the early 1970's and a subsequent report urging that the FTC require dealer inspections, disclosure of known defects, and mandatory warranties.[8] After years of soliciting public comments and holding public hearings across the country, the FTC staff recommended mandatory inspections and disclosure of defects of certain mechanical and safety components. The FTC's original version of the rule, issued in 1981, would have required disclosure of known defects, but it never went into effect. After a Congressional veto, litigation holding the veto unconstitutional, and a change in leadership at the FTC, the Commission issued a greatly watered-down rule.

In its current form, the rule requires a somewhat misleading disclosure about whether a vehicle comes with a warranty, but it does not require dealers to inspect used cars or even to disclose defects they know about. The rule thus fails to provide any significant protections for buyers of used cars.

Even though the rule in its current form is ineffective, a strengthened Used Car Rule could be a powerful force toward eliminating unfairness and deception in used car sales. The FTC is presently reviewing the rule, so now is an opportune time to examine the possibilities for improving it. The rule should be amended.[9] Among other things the rule should:

- Require dealers to inspect used vehicles prior to offering them for sale.

Before this rule was adopted, the lender could force the consumer to make full payment no matter how fraudulent the transaction with the dealer - even if the car was a rebuilt wreck, the dealer lacked marketable title to the car, or the car was inoperable. The rule not only protects consumers, but also gives lenders an incentive to police dealers' misconduct, since the lender will not be paid if the transaction is fraudulent.

[8] For a discussion of the development of the Rule and the ways in which the original Rule was weakened see Mulock, Bruce K., *The FTC's Used Car Rule*, Published by the Congressional Research Service, Library of Congress, updated Oct. 14, 1983, CRS Report Number : IB81159, available at: http://digital.library.unt.edu/govdocs/crs/permalink/meta.

[9] For a more complete discussion of the needed changes to the Rule see the Comments in response to the FTC's request for comments as part of its review of the rule filed on behalf of Consumer Action, Consumers for Auto Reliability and Safety, Consumer Federation of America, Consumer Federation of California, National Consumer Law Center on behalf of its low income clients, U.S. Public Interest Research Group, and the Watsonville Law Center, available at: http://www.ftc.gov/os/comments/usedcarrule/536945-00015.htm.

- Require dealers to provide written disclosure of known defects and prior use. Even those who might oppose required inspection agree that such disclosure would be best. As the National Independent Automobile Dealers Association has previously commented "NIADA believes that a beneficial balance in consumer and dealer knowledge can be achieved by means of a rule requiring a window sticker which would disclose both significant known defects and defects discovered during any state-required safety inspection.[10]
- Require dealers to check with warrantors to ascertain whether any warranty on the vehicle, including the manufacturer's warranty, is still in effect and not void due to prior damage or other condition, and accurately report that information on the Buyer's Guide.
- Require auto dealers to check the Vehicle Identification Numbers (VINs) of used vehicles they offer for sale, in the National Motor Vehicle Title Information System (NMVTIS) database, and disclose essential information from NMVTIS on the Buyer's Guide. This would effectively put the very important information from NMVTIS where it would do the most good- in front of consumer when a car buying decision is being made.
- Require dealers to provide more detailed, complete disclosures.
- Require auto dealers to provide a separate Buyers Guide, placed on the driver's side of the windshield, warning prospective buyers when either 1) a vehicle is designated in NMVTIS as "salvage," "flood," "junk" "rebuilt" or otherwise totaled, or 2) the dealer knew or should have known a vehicle was totaled by the insurer or self-insured entity.
- Remove language from the existing Buyers Guide, regarding "AS IS- NO DEALER WARRANTY" sales, which presently states that "THE DEALER WILL NOT PAY ANY COSTS FOR ANY REPAIRS. The dealer assumes no responsibility for any repairs regardless of any oral statements about the vehicle." This language is inherently misleading because it lends credence to the false notion that the dealer may misrepresent the condition of the vehicle with impunity. It goes beyond allowing dealers to disclaim implied warranties and creates the false impression they can lie to consumers about the condition of the vehicle or the dealer's intent to repair the vehicle and that, if they check that box on the Guide, they avoid any liability for their statements.
- Preclude 50/50 Warranties or other dealer warranties where dealers represent they will split the cost of repairs with the customer, as qualifying as a warranty under the Buyer's Guide. Such warranties are inherently deceptive. What appears to be warranty coverage is in fact illusory, as the warrantor can recoup all of its costs for a given "warranty" repair simply by inflating its total charge for the repair so that the consumer's portion covers the warrantor's entire cost.
- Require auto dealers to provide a completed translation of the Buyer's Guide in the language used to negotiate the contract.
- Prohibit the sale of rebuilt wrecks and other problem vehicles as "certified" used cars.

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10 Bruce K. Mulock, *The FTC's Used Car Rule*, Congressional Research Service, Library of Congress, issue Brief #IB81159, update Oct. 14, 1984.

Improve the regulations under the Magnuson Moss Act

The Magnuson Moss Warranty Act regulates and standardizes written warranties. While the FTC has provided some protections for consumers through its regulations under the Act, there is room for improvement. The Act prohibits the disclaimer of implied warranties when a dealer gives a written warranty or service contract. Prior to this useful rule, many dealers would provide written warranties that actually reduced the warranties a consumer would have had with no written warranty at all. As a House report stated: "…the paper operated to take away from the consumer the implied warranties of merchantability and fitness arising by operation of law leaving little in its stead."[11]

Dealers have tried to avoid the application of this rule by selling a service contract provided by a third party, while retaining a large portion of the sale price of the service contract, often up to 50%. Some courts have held that when a dealer sells a service contract in which a third party is ostensibly contracting with the consumer, implied warranties may still be disclaimed. Such a narrow view does not recognize the way in which the service contract is being sold by the dealer as part of the car sale. It also disregards the fact that any ambiguities in the Act should be construed in favor of the consumers, who are the intended beneficiaries of the Act.

The FTC should adopt a regulation or official interpretation stating that these courts that have protected consumers by understanding there is no difference from the consumers prospective between a dealer warranty and a third-party service contract have "got it right." The FTC should clarify that implied warranties cannot be waived when a consumer "enters into" a service contract as part of the car buying transaction. This should explicitly include selling a service contract from which the dealer or an affiliate of the dealer acquires any revenue or consideration.

As part of the Magnuson-Moss regulations, the FTC should preclude "50-50" warranties, *i.e.* warranties that are conditioned upon the consumer's payment of a percentage of the cost of the warranty work. Such warranties are inherently deceptive. What appears to be warranty coverage is in fact illusory, as the warrantor can recoup all of its costs for a given "warranty" repair simply by inflating its total charge for the repair so that the consumer's portion covers the warrantor's entire cost.

The FTC should define "50-50" warranties as deceptive. The Magnuson-Moss Act, 15 U.S.C. § 2310(c)(2), defines a deceptive warranty as one 1) that contains an affirmation, promise, description, or representation which would mislead a reasonable individual exercising due care, or 2) that uses a terms such as "guaranty" or "warranty," if the terms and conditions so limit its scope and application as to deceive a reasonable individual.

[11] H.R. Rep. No.93-1107 (1974), reprinted in 1974 U.S.C.C.A.N. 7702, 7703-7706.

50-50 warranties are deceptive under either of these tests. The promise of repair would deceive a reasonable person exercising due care, because the illusory nature of the warranty is hidden in its formula. Likewise, the terms and conditions of the warranty limit scope and application: it allows the warrantor to raise the overall price of repairs so that the warranty provides no protection at all. This deception is likely to deceive a reasonable individual.

In the alternative, the FTC should adopt an interpretation that a 50-50 warranty is a violation of the Magnuson-Moss Act's anti-tying provision where the consumer is required to pay a portion of the dealer's charge for parts or service as a condition of the warranty. 15 U.S.C. § 2302(c) provides:

> No warrantor of any consumer product may condition his written or implied warranty of such product on the consumer's using, in connection with such product, any article or service (other than article or service provided without charge under the terms of the warranty) which is identified by brand, trade, or corporate name… .

The reason for this prohibition is clear. If a warrantor can condition a warranty on the consumer's purchase of other products or services, the warrantor has the ability to make the warranty illusory. The warrantor can simply cover the costs of warranty service by charging artificially high prices for the tied product or service. Thus, allowing tying would enable warrantors to offer a warranty that in actuality provided no benefit to the consumer.

The application of this prohibition to used car 50-50 warranties is illustrated by one of the interpretations of the Magnuson-Moss Act adopted by the FTC: "Under a limited warranty that provides only for replacement of defective parts and no portion of labor charges, [the anti-tying provision] prohibits a condition that the consumer use only service (labor) identified by the warrantor to install the replacement parts."[12]

A 50-50 warranty differs from this example in that it typically provides that the consumer is to pay half of the charge for labor and half of the charge for parts, instead of all of the charge for labor and none of the charge for parts. But the principle is identical. If the warrantor can charge whatever it wants for the parts and labor, and the consumer is required to pay half of that amount, then nothing prevents the warrantor from setting the consumer's share at the full cost of the "warranty" repairs.

In 1999, the FTC, in its review of its Magnuson-Moss rules, stated that 50-50 warranties "likely violate" the Magnuson-Moss anti-tying provision.[13] The FTC went on to state: "Since the consumer must pay a significant charge for parts and labor under these warranties, the warranties may violate section 102(c) by restricting the consumer's choices for obtaining warranty service."[14]

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12 15 C.F.R. § 700.10(b).

13 64 Fed. Red. Reg. 19,700, 19703 (Apr. 22, 1999).

14 *Id*.

However, after consumers in Ohio sued low-end used car dealers for conditioning warranty service on the consumer's payment of half the cost of parts and labor, the FTC was approached by dealers seeking a retraction of this statement. In 2002, the FTC issued a letter disavowing its previous statement.15

FTC should return to the position suggested by its 1999 comments. The 2002 letter does not set forth a convincing rationale for holding that 50-50 warranties do not violate the anti-tying provision. Indeed, the 2002 letter recognizes that, unlike warranties that provide parts without charge but require the consumer to pay for labor, "in a 50-50 warranty the warranted repair work is not, as a practical matter, severable into two parts, one that the warrantor can perform and another part that another auto repair shop can perform." In other words, a consumer who wishes to take advantage of a 50-50 warranty is bound--tied--to use of the warrantor's services, and payment of the warrantor's charges, whatever they may be.

Department of Justice

The National Motor Vehicle Title Information System

The Department of Justice (DOJ) has been charged with the creation of the National Motor Vehicle Title Information System. This system is a database to aid in the tracking and analyzing of vehicle title histories. It has enormous potential to protect car buyers from unwittingly buying total cars.

However, problems exist in the implementation of this system. Some states are reluctant to provide information to the database as they currently sell the same information to private reporting services for a profit.[16] Reports can be difficult for consumers to understand because of the myriad of "brands" that states use to designate cars that have been salvaged, totaled, rebuilt, flooded, or otherwise damaged or changed. Consumers must access the database through private vendors. There is a fee for consumers to access the information and, at least for one vendor, that fee is payable only by credit card.

For the system to be effective, all states and other required entities must contribute information. The information should be available to consumers at a reasonable fee with a variety of payment methods for those without a credit card. Consumers should not have to pay higher prices than dealers or other volume purchasers of the information. Most importantly, as described in the recommended changes to the FTC's Used Car Rule, a NMVTIS report should be posted on every car for sale by a dealer. This would eliminate the need for the consumer to purchase the information and have the information available at the time and place it would do the most good.

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15 Letter from the FTC to Keith E. Whann (Dec. 2, 2002), available at www.ftc.gov/os/2003/01/niadaresponseletter.htm.

[16] Christopher Jensen, *A Used-Car Promise Finally Delivered*, New York Times Blog, January 29, 2009, available at http://wheels.blogs.nytimes.com/2009/01/29/a-used-car-promise-finally-delivered/.

Discrimination in Car Credit Transactions

As I explained in my description of common abuses, dealers commonly charge a "mark up" when financing a consumer's purchase and subsequently selling the note. Dealers get a larger kickback for putting consumers in a more expensive loan than they qualify for. Such markups often have a disparate impact on minorities. The practice itself reduces transparency and competition in the market and should be prohibited by the FTC as unfair.

Even without an outright prohibition, the discriminatory impact of this practice calls for enforcement actions by the regulatory agencies. Both the FTC and the DOJ have enforcement authority under the Equal Credit Opportunity Act (ECOA) to address such issues. Despite the existence of the ECOA and the enforcement authority of the FTC and DOJ, discrimination in auto financing has continued. While changes outside these agencies that I will discuss later may make their job of enforcing the ECOA easier and more effective, both agencies should increase enforcement in this area.

The National Highway Traffic Safety Administration (NHTSA)

The Motor Vehicle Information and Cost Savings Act (MVICSA) outlaws odometer fraud, requires important disclosures, and regulates the method of transferring a vehicle's title.[17] Over 20 years ago, the National Highway Traffic Safety Administration (NHTSA) created an exemption from many of these requirements for vehicles over 10 years old and also vehicles with gross vehicle weight ratings over 16,000 pounds.[18]

At the time, cars over 10 years old were thought to have such little value that odometer tampering would have little impact on the vehicle's price. But today 10 year old cars are better built and have significantly longer useful lives. Many still have significant market value after ten years if they are low-mileage, so fraudulent dealers and wholesalers have an economic incentive to roll back the odometer. Thus these older cars today are targets of odometer fraud which can cause considerable consumer injury. Buyers of these cars need the same protection under MVICSA as buyers of newer used cars.

The 16,000 pound exclusion was drafted to exempt commercial buses and trucks, which are often sold with much more extensive maintenance records than private vehicles, providing a check against odometer tampering. But today this exemption also applies to larger recreational vehicles (RVs). The higher market value of these RVs makes them even more tempting targets for odometer fraud than passenger cars, and there is no reason to exempt RVs purchased for consumer use from MVICSA's protections. All motor vehicles for consumer use should be covered by MVICSA.

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[17] For more information about the MVICSA see National Consumer Law Center, Automobile Fraud § 4 (3d ed. 2007).
[18] 49 C.F.R. § 580.17.

The NHTSA exemptions should be amended to provide coverage under MVICSA for vehicles less than twenty years old and all vehicles for consumer use, regardless of weight.

In addition, a number of courts, taking a strained view of MVICSA's legislative language, have found that consumers can sue dealers who intentionally violate the Act only if the dealers' fraudulent intent was to sell cars with spun odometers, not a fraudulent intent to sell cars with undisclosed salvage, daily rental, or other serious titling defects. This makes no policy sense, and should be changed by a statutory amendment to clarify language that other courts have correctly read—that parties are liable under MVICSA if they violate the Act with intent to defraud, even if the fraud takes a form other than odometer tampering.

LEGISLATIVE REFORM

There are a number of steps that Congress could take to address abuses in the used car market. Some are simple fixes to update existing protections. Some changes would better enable agencies to address the abuses. Others would simply prohibit the abusive practices. Some would enable consumers to better address the abuses through private actions.

Adjust TILA's Jurisdictional and Statutory Damage Amounts for Inflation

The Truth In Lending Act (TILA) requires creditors to disclose credit terms of auto finance and other credit transactions. While TILA's promise of enabling consumers to shop for credit has not been as successful as it could have been, it does give consumers essential information about a transaction's credit terms before they bind themselves to those terms.

But today TILA contains an enormous loophole. It applies to car transactions only if the amount financed is $25,000 or less. Dealers need not provide TILA disclosures if the amount financed exceeds $25,000. The $25,000 cap was part of the 1968 bill that became TILA, and has not been updated in the 41 years since then.

While $25,000 was a large amount in 1968 and would have covered almost any conceivable car purchase, today TILA does not apply to many transactions involving rather modest cars. Moreover, because the limit applies to the amount financed and not the car's sale price, negative equity from a trade-in, expensive service contracts, and other add-ons can bring the amount financed above $25,000 even if the car's sale price is well under that amount. For a large and growing percentage of car sales, federal law no longer requires that even the most basic disclosures about the credit terms be given to the buyer.

TILA also provides for statutory damages when key disclosure requirements are violated. These minimum damages encourage the buying public to help enforce the Act's important protections. This is critical, since a disclosure violation is likely to be repeated in thousands of other transactions. In order for the statutory damages to provide an incentive for consumers to help police the marketplace and discourage dealers and lenders from violating the Act, the damages must be sufficiently high. Unfortunately, the $1000 statutory damages amount for car loans has also remained unchanged since 1968 (although the amount has increased for mortgage loans).

If TILA's $25,000 coverage limit were adjusted for inflation since 1968, it today would be over $132,000.[19] The $1,000 statutory damages amount would be over $5,000. Not only should these amounts be increased today to reflect this inflationary change, but this increased amount should also be indexed for future inflation.

Data Reporting

One difficulty faced by policy makers, researchers, and agencies charged with enforcing credit discrimination protections is lack of information. Such information could play an invaluable role in determining the existence of discrimination in auto lending and sales, the availability of credit at fair rates, and other matters of importance to consumers and policy makers.

NCLC and others have demonstrated through litigation that minority car buyers pay significantly higher dealer markups than non-minority car buyers *with the same credit scores*.[20] However such cases are incredibly difficult and expensive.[21] A federal data collection system could address this gap by creating a data from automobile financing transactions similar to the existing federal data collection for mortgage transactions under the Home Mortgage Disclosure Act (HMDA). HMDA data is currently used by the FTC in its enforcement of the ECOA in mortgage cases. Similar data could allow the FTC, DOJ, and private citizens to effectively enforce the ECOA and other existing protections in the area of auto finance.

Ban Arbitration Clauses in Auto Sales and Finance Transactions

Arbitration clauses, inserted in the fine print in many consumer contracts, require that any dispute the consumer may have with the business must be submitted to

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[19] *See* Comments of the National Consumer Law Center to the Board of Governors of the Federal Reserve System, 12 CFR Chap.II [Docket No. R-1180] regarding the Economic Growth and Paperwork Reduction Act "EGRPRA" available at:
http://www.consumerlaw.org/initiatives/test_and_comm/content/egrpra-final.pdf.

[20] See, e.g., Ian Ayers, Expert Report, June 2004, available at http://www.consumerlaw.org/issues/cocounseling/content/AHFCIanAyresReportExhibits.pdf; Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." available at http://ssrn.com/abstract=951827.

[21] See the testimony of NCLC before the House Financial Services Committee on the Need for Race, Age and Sex Data on Non-Mortgage Lending, July 16, 2008, stating that discovery and analysis in a case to prove discrimination under ECOA in auto finance cost over $1,000,000. Available at http://www.consumerlaw.org/issues/credit_discrimination/content/Watt_Regulation_Testimony.pdf.

arbitration rather than court. Car dealers use arbitration clauses not to settle disputes efficiently, but to rob consumers of any effective means to challenge dealer fraud.[22]

Car dealers draft arbitration clauses for the purpose of weakening consumers' ability to bring legal claims. The clause often bans consumers from seeking class-wide relief, prevents them from utilizing remedies granted by state law, and forces them to pay the *dealer's* attorney fees if the arbitrator does not rule for the consumer. Decisions made by arbitrators are typically not public, and are not subject to appeal even if the arbitrator fails to follow the law.

Unlike the nation's court system, which serves the public function of dispensing justice and is supported by public funds, arbitration is a pay-as-you-go system. Arbitration can cost the consumer thousands of dollars a day, as the arbitrator charges the parties hundreds of dollars an hour. It is typically difficult to engage in legal discovery of the dealer's files and practices in arbitration. The dealer also picks the arbitration service provider that picks the arbitrator. Because of the limitations of arbitration, and the costs involved, many consumer attorneys are unwilling to represent consumers if they are bound by an arbitration agreement.

Arbitration clauses also injure the public at large. Unlike court proceedings, arbitration decisions are not matters of public record, and the arbitration hearings are conducted in private. As a result, the public is unable to avail itself of the knowledge of bad actions by dealers and financers. While dealers and finance companies may develop an understanding of the results arbitrations produce because of their repeated involvement in arbitrations, the public and consumers are unable to see if justice is served.

Arbitration clauses are so widespread that it is often impossible to buy a car without signing an agreement giving up one's right to go to court if problems develop.[23] The dealer's arbitration clause also typically applies to the auto lender, eliminating the consumer's ability to sue it as well.

Ironically, new car dealers themselves admitted the unfairness of arbitration clauses when they successfully lobbied Congress to prevent auto manufacturers from imposing arbitration clauses on dealers.[24] The dealers argued that the arbitration clauses deprived them of important rights and that they suffered from unequal bargaining power when negotiating with the manufacturers.

Clearly the transaction between the low-income consumer and a car dealer or finance company is even more unequal. The use of arbitration agreements in auto sales

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[22] For more detailed information about the abusive use of arbitration in consumer contracts, *see* National Consumer Law Center, Consumer Arbitration Agreements (5th ed. 2007).

[23] Stephanie Mencimer, *The Quest for a Car, Sans Arbitration Clause*, Mother Jones, December 14, 2007 (describing the author's unsuccessful attempt to buy or finance a car without an arbitration clause).

[24] *See* the testimony of Gene Fondren, President of the Texas Automobile Dealers Association, before a U.S. Senate Subcommittee on March 1, 2000.

and finance agreements should be banned. There is currently pending federal legislation to ban arbitration clauses in auto sales.[25]

Permit Modification of Car Loans in Bankruptcy

The United States Bankruptcy Code allows bankruptcy judges to modify both unsecured and secured loans. The modification may change the payment amount, defer payments, or even eliminate the creditor's lien. Modification may allow the consumer to keep an item that is acting as security on a loan and yet reduce the monthly payment. This in turn may make monthly payments affordable, allowing the consumer to keep property that other would have been taken by the lender.

In 2005, significant changes were made to the Bankruptcy Code, including restrictions on bankruptcy courts' ability to modify auto loans. Before the law changed, if a consumer owed $12,000 on a car loan and the car was only worth $5,000, the creditor's secured claim was reduced to $5,000. This was the amount of the debt that was backed by the collateral that the creditor could take if the debt was not paid. The remaining $7,000 was an unsecured claim, and only a portion of that might be paid through the bankruptcy case. Importantly, the consumer in bankruptcy could retain the car by paying off the $5,000 secured claim. In a chapter 13, that could be paid out over a period of years.

Through the efforts of the auto finance industry, the law was changed so that auto loans made within 910 days of the bankruptcy can no longer be modified in this way. Some courts have even held that negative equity from a prior trade-in may not be modified.[26]

This 2005 change has encouraged reckless lending. Creditors know that a borrower wishing to keep the family car in bankruptcy will have to pay the full $12,000 debt, even though the creditor's collateral is only worth $5000. As a result, creditors are more willing to finance cars at inflated prices--the same practices that contributed to the home mortgage crisis.

Bringing the bankruptcy law back to its pre-2005 language would eliminate the incentive for lenders to overlook consumer overcharges and roll-overs of negative equity. Instead, lenders would be likely to police dealers' unnecessary add-ons and roll-overs of negative equity. Such a change would also keep many consumers in their cars, while still repaying to lenders the actual value of the car. Allowing families to keep their cars would help keep those families self-supporting.

The FTC Should Receive Enhanced Rulemaking and Civil Penalty Authority.

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[25] See H.R. 5312, the Automobile Arbitration Fairness Act of 2008, introduced February 7, 2008. For more information about ongoing efforts to ban arbitration clauses in auto transactions see the website of Consumers for Auto Reliability and Safety: http://www.carconsumers.com.

[26] For more information regarding this issue see: National Consumer Law Center, Consumer Bankruptcy Law and Practice 11.6.1.4 (8th ed. 2006 and Supp.)

The FTC rulemaking efforts have almost stopped since it lost Administrative Procedures Act authority. Without APA authority the FTC is forced to issue rules under the cumbersome Magnuson-Moss Act. As previously discussed, the FTC has failed to effectively use enforcement the address abuses in the used car sales and fiancé market. However, even if the FTC had the will and the resources to greatly increase enforcement, that alone will not end the abuses. Enforcement is ad-hoc, requires a high burden of proof, has a punitive nature, and cannot be used proactively to stop unfair and deceptive practices, clarify statutory ambiguities, or set clear rules for industry.

New, effective and efficient rulemaking is required to address the abuses. The FTC should be given APA rulemaking authority, as well as clear rule-writing authority under the FTC Act and the Fair Credit Reporting Act. The FTC's enforcement authority should also be strengthened by giving it civil penalty authority under Section 5 of the FTC Act.

The FTC Act Should Be Enforceable by Victims of Unfair and Deceptive Practices and by State Attorneys General.

The FTC will always have limited resources and cannot stop every unfair and deceptive practice. The individuals who are harmed by those practices are in the best position to hold wrongdoers accountable, and state attorneys general are also closer to the ground and have the ability to stop practices when they are just starting, before they become national and entrenched. Individuals and attorney generals are essential complements to the FTC's enforcement role.

Conclusion

Thank you for the opportunity to testify today and for holding these hearings and focusing attention such common practices that have a devastating impact on working families. We look forward to working with you to address these problems and ensure that consumers are treated fairly.