

The Consumer Finance Podcast: FTC Notice of Proposed Rulemaking for Voluntary Products in Automobile Finance Transactions

Aired: September 29, 2022

Host: Chris Willis

Guests: Alan Wingfield and Brooke Conkle

Chris Willis (00:04):

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services regulatory practice. And we have a great topic for you about a really groundbreaking development in the auto finance industry, namely the Federal Trade Commission's Notice of Proposed Rulemaking related to auto finance and auto sales. But before we jump into that topic with two great guests, let me remind you to visit and subscribe to our blog at consumerfinancialserviceslawmonitor.com. And don't forget to check out our other podcasts. We have lots of them. We have a credit reporting podcast, *FCRA Focus*. We have *The Crypto Exchange*, which is for all things crypto, and we have our privacy and data security podcast called *Unauthorized Access*. And all of those are available on all the popular podcast platforms. And if you like this podcast, let us know. Leave us a review on your podcast platform of choice.

So, as I mentioned, today we're going to be talking about a really important development in the auto sales and auto finance industry, and that is the Federal Trade Commission's recent Notice of Proposed Rulemaking. And joining me to talk about that, are two of my colleagues, Alan Wingfield, and Brooke Conkle, both of whom do lots of auto finance work for our consumer financial services clients. So, Brooke, Alan, welcome to the podcast. And thanks for being here today. We're going to talk about this Notice of Proposed Rulemaking, and it's probably important first to just give the listeners a sense of what it says, and I haven't read it either. So maybe you can tell me about it, too. Alan, would you mind starting to talk to our listeners about what is the Federal Trade Commission actually proposing in this Notice of Proposed Rulemaking.

Alan Wingfield (01:35):

Thematically, what the Federal Trade Commission is proposing, is a continuation of what might be called the war on fees, that's going on from multiple regulators right now, federal and state. A large part of the Notice of Proposed Rulemaking, is focused on what they call add-ons in this particular context, but really is an effort to regulate how and what can be charged as fees in an automobile finance transaction. We'll be unpeeling that onion a little bit, Brooke and I, later on, as we go through this to sort of reveal this theme as we go through the presentation, but that's a biggie.

What it does in broad brush is exercise the FTC's rulemaking authority under Section 5 of the FTC Act, to govern the sales practices of motor vehicle dealers. Obviously, there are implications for auto finance companies, as well, who buy paper, as Chris, much of the auto finance in America's done by retail installment contract, which is originated by the dealer in the sales process and then sold to a finance company. That means the finance companies have skin in the game on the compliance that happens in the sales process. So, we'll talk more about that as well.

The Notice of Proposed Rulemaking governs both advertising practices, has prohibitions on misconduct in sales processes, and then it imposes a whole set of new requirements in the sales process, in part, to provide additional disclosure requirements for financing terms, but really the big ticket item here is how add-ons are sold in the auto sales practice. And add-ons are things such as extended warranties, service plans, Gap, which is a product that covers people against uninsured losses in a total loss situation for the vehicle, and other ancillary products and services that are sold as part of the sales process for our motor vehicle.

A couple key concepts that's going to come up today... one is this concept of offering price. So basically, the FTC is proposing to impose a uniform national regulation, the price at which motor vehicles can be offered to consumers in advertising, and in sales paperwork. When a dealership talks about the sales price of a vehicle, it's got to disclose the offering price, which includes, not only the base price of the vehicle, but any other mandatory charge in association with the sale of the vehicle.

Chris Willis (03:57):

Like doc fees, for example, Alan?

Alan Wingfield (03:59):

Doc fees, a great one, transportation costs, charges, and for new vehicles, those are good examples. Only thing can be excluded because it's mandatory, are government fees and expenses. Those are imposed directly on the consumers part of their transactions. So that'd be like licensing and titling type fees. Anybody that reads the newspaper, those five of you left that read newspapers and see the ads, you need to see the car prices and you see the asterisks and you see the footnotes. Well, the FTC's going to come in and impose a requirement that those prices that are shown on a newspaper are all based on a uniform standard. And more importantly, and less, humorously, on the internet. Consumers do a lot of price shopping on the internet. Consumers are very sensitive to differences in prices on the internet, and the FTC's going to come in and impose this uniform standard for what prices would be displayed on vehicles to make them comparable amongst dealers, etcetera.

The second key concept that's coming up, is this idea of an add-on list. An add-on list is essentially a comprehensive closed-in universe of the products and services that a dealer might sell on an optional basis to a consumer in the sales process. The dealership is required to compile this thing. It's got to have the prices and the dealer is going to be required to post it on the internet, if they have a website, required to post it in-store. And then in advertising, they're required to disclose a link to allow consumers to go visit this add-on list.

I think the idea there is to make the existence of add-ons and their pricing more transparent to consumers, and reduce the chances of consumer being surprised and taken aback by offerings of add-on products at the dealership in the sales process itself.

Chris Willis (05:41):

They'll require the dealer to charge a uniform price for each add-on product, or is there still opportunity for individualized pricing?

Alan Wingfield (05:49):

The concept behind the offering price and add-on list is to provide a stated top line number. Interestingly, the regulation doesn't do anything about negotiation and about dealer margins or markups on these products. Those are not regulated. And as your question begs, a lot of these products are negotiable. Price is negotiable to dealership, as is often for many dealers, the offering price of the vehicles itself. So, the regulation doesn't prohibit or regulate that in any direct way. These are all about the top line stated rack rates for the goods and services. So those are some that are two big ticket items and the regulation in terms of really focusing on the advertising side.

Chris Willis (06:28):

Okay. And I know that the proposed rule also contains provisions about what disclosures auto dealers need to make when they're consummating a vehicle sale transaction. Brooke, do you mind telling their listeners about that?

Brooke Conkle (06:42):

Certainly. Just as Alan mentioned, there are a number of new requirements for advertising vehicles and telling consumers what the price is going to be, and what the price of add-ons are going to be. And just as Alan mentioned, regulators do not like add-ons. And they've made that very clear with the additional disclosures that are required for add-on products. Alan covered what happens when consumers are shopping for a car, and I'm going to cover what happens when consumers are in the dealership and are ready to sign on the dotted line. And what the FTC wants dealers to do now, and is telling dealerships they must do, is for all cash and finance sales, where consumers are purchasing an add-on product, dealers have to provide a standalone written form that provides the cash price of the vehicle, and that cash price can include any government charges, but cannot include any add-on or additional fees.

So that cash price, and the consumer has to specifically say, no, I do not want to buy the vehicle for that price. I want my add-ons and here I'm signing this disclosure saying that I don't want to pay the cash price. I want to pay more. So once that's signed and filled out, then the dealer has to provide another form to the consumer in cash and finance sales. And those forms will lay out the cash price and separately itemize any add-on product to arrive essentially at the final price that the consumer will be paying as part of the transaction.

And what's interesting is, that all of these additional forms are subject also to the FTC's heightened record keeping requirements. So, there's all of this new paper and there's a two-year requirement for dealers to keep all of this, keep track of it, be able to show that they are complying with the FTC's requirements. And what's curious and contradictory, when we look at this rule, the FTC starts out by saying, hey, there's already too much paper in car transactions, consumers don't quite understand all of this paper that's being thrown at them. What will solve that problem? More paper. So that's kind of inherent contradiction in the proposed rulemaking that is tough to square frankly, this idea that more paper is going to solve the problem of too much paper.

Chris Willis (09:09):

Maybe we should suggest to the Commission that they ought to treat it like a real estate closing, because there's plenty of documentation on that. And Brooke, really the requirement of this sort of extra standalone disclosure that's signed by the consumer, that's in the proposed rule that you just finished telling the audience about, strikes me as eerily reminiscent of a provision that was in a consent order between the Massachusetts Attorney General, and an auto finance company. That was in 2021, which I think we probably all remember, where there was a requirement that for any sale of a particular voluntary protection product, I think it was extended service contract in that one, that there had to be a separate standalone form signed by the customer that said, I want this product essentially, with the disclosure of the price. And it seems like what the FTC has come up with is very similar to that, don't you think?

Brooke Conkle (09:54):

Chris, I agree completely. The regulators really look at add-on products, and those can be... whether it's Gap insurance, or extended warranties, products, that in many ways could be considered consumer friendly, and regulators have looked at those products and have said, consumers are not getting the benefit of the bargain. They're paying too much money for something that may not be of use to them in the long run. And so, they're really cracking down on the sale and marketing of those products and specifically requiring consumers to say, yes, I understand I am being charged for this. And yes, I do want this product.

Chris Willis (10:35):

And it really seems Brooke, like they're trying to increase the friction associated with someone buying those products. But Alan, what's your take on this part of the proposed rule?

Alan Wingfield (10:44):

What I want to do is focus on the springs of legal authority behind this rule. And picking up on your point that pieces of this are already embedded in the common law of UDAP. So, the FTC is acting pursuant to its authority, to enforce Section 5 of the FTC Act, which prohibits unfair and deceptive acts and practices, UDAP, very general standard. Historically they've done most of their work, won case by case enforcements. If you go through the Notice of Proposed Rulemaking, you'll see many citations to exercise that authority, covering many pieces of this Notice of Proposed Rulemaking. What that means is, that this Notice of Proposed Rulemaking is sort codifying a view of UDAP of general applicability, perhaps. The way UDAP works in America is the FTC Act, that's enforced exclusively by the FTC. There's no private civil cause of action.

However, every state has its own form of UDAP. Most states have a general prohibition such as the FTC Act has. And most of those states say, that in interpreting their state UDAP, the states will consult with, and strive to conform to, the standards of UDAP as promulgated under the FTC Act. So, when the FTC sneezes, the state law catches a cold, right? So, the standards of conduct on sale of add-on products and charging of fees is becoming increasingly articulated, both enforcement actions, and now this rule really might be viewed as a generalized interpretation of what UDAP requires in many different sales contexts, beyond auto sales. And at that... so this is a part of what I mentioned before, is the war on fees. And I know Brooke has some things to say about that.

Chris Willis (12:27):

Let's go ahead and get to that because you alluded to that both just now and earlier in the podcast, Alan. Brooke, what is there in this Notice of Proposed Rulemaking, and the FTC sort of associated statements with it, that draws some parallels to this sort of overall war on fees that Alan was mentioning?

Brooke Conkle (12:43):

Chris, that's exactly right. And we've talked about the CFPB's call for comments, that came out in early 2022 using this umbrella term, junk fees. And the Bureau is using that term to shoehorn absolutely every potential fee, is now considered a junk fee, whether it's legitimate or not. And the FTC is absolutely riding on those coattails, and they're using the exact same term, junk fees. We've also seen it in the Bureau's general advisory on pay-to-pay fees. And the FTC really is embodying those concepts in the Notice of Proposed Rulemaking. And the rule itself is a bit ambiguous and potentially that's probably intentional on the FTC's part.

But what we're seeing is the likelihood that the FTC intends for any potential fee that could be associated with a transaction, including fees that could be imposed later on down the line, by an auto finance company, those fees are supposed to be included and disclosed in the deal itself. So, when the dealer is sliding that piece of paper across the table to the customer, it's supposed to include any potential, what the bureau would call, pay-to-pay fees, any convenience fees, any servicing charges, all of that has got to be included in the paper that's pushed across the table to the customer.

Chris Willis (14:15):

And Alan, what's your take on the parallels between what the FTC is doing in this proposed rule, and the more generalized regulatory environment around fees of all kinds, that the regulators like to pejoratively call junk fees?

Alan Wingfield (14:28):

Chris, I think what's going on here is, that regulation in the United States as to fees, is taking a little bit of a turn. In the past, regulation of fees, and in fact, regulation of a lot of things, is based on concepts of clear disclosure and consumer consent. Now regulators are actually saying, no, it's just bad. You should not be allowed to do it.

One of the parts of the Notice of Proposed Rulemaking is an outright prohibition on charges, for goods or services, which have no value to the consumer... just have a flat prohibition, okay? Who decides that the add-on charge, or whatever, has no value to consumers? That's not defined in the rule, but clearly there's an effort by the regulators to create some sort of concern, tension, fear, to drive people away from charging fees at all, on types of products that a regulator might deem to be insufficient amount of benefit to consumers, to warrant even being charged at all. That is a notable turn. You see that in the pay-for-pay commentary, that in other areas where regulators are increasingly coming to the view of, we're just going to outright prohibit certain charging for certain things, opposed to the traditional response of, well, make sure it's transparently disclosed to consumers and get their consent.

Chris Willis (15:45):

Got it. Alan, let me stay with you for a minute. And let's assume for a moment, that the proposed rule becomes effective, that it's finalized. And I might say just as an aside, a lot of government agencies have come to grief by opposing the auto industry. So I don't want to predict that the rule will go through as proposed, because there's a powerful political force at play there, but let's assume that it does go in, in roughly the form that the FTC has proposed it, what do auto finance companies, who aren't directly covered by the rule, but who buy paper from the auto dealers who are, need to worry about in terms of potential legal and regulatory issues that will arise for them?

Alan Wingfield (16:22):

Thank you, Chris. There are two buckets, as you mentioned, one is civil litigation exposure to consumers, and second is a regulatory bucket. I would probably argue that the regulatory bucket in this situation is the more significant one, for a lot of finance companies to consider. However, and I'm going to ask Brooke to really chime in on this because this is one of her specialties, there is increased risk in this base, of civil litigation, particularly what's going on with the Holder Rule, but let me focus first on the regulatory bucket. So, as I mentioned earlier, most auto financing paper in America's generated at the dealership, and then sold to the finance company, and the finance company inherits paper, that's originally signed by the dealer and inherits any regulatory issues, at least according to regulators attached to the paper. Now there's a whole new set of requirements and very specific requirements that may come into effect with this Notice of Proposed Rulemaking. And so, the compliance or non-compliance of that paper, regulators would like to visit that compliance or non-compliance on the finance company, not just the dealer.

The regulators have been increasingly focused on holding the finance companies responsible for things basically that happened at the dealership. We see that in various areas, Gap fee issues, for example, where the regulators are attempting to hold finance companies responsible for a handling Gap fees, when there's been an early termination to the contract, etcetera. Finance companies are going to need to make basically a decision, or in light of this escalating requirements, are they going to do escalation in their compliance efforts, or are they going to impose more requirements on dealers, with respect to add-on charges themselves? Or are they going to scrub paper as it comes in, to see if charges conform to these rules? Are they going to do due diligence on how products are sold by the dealers, knowing that their problems at a dealership level, the regulators might come and call in and attempting to hold a finance company responsible for those issues.

To me, that's the one-two punch of the regulatory side, one, of the regulators directly attempting to hold the finance companies responsible for problems in the origination of the paper, and number two, the need by finance companies to make a decision about whether they're going to ramp up their compliance efforts in light of that risk.

Chris Willis (18:38):

Brooke, let me turn to you, and first get you to address the point that Alan mentioned, which is potential civil liability to consumers for alleged violations of this rule under the FTC Holder Rule. Can you give the audience some sense of how that might work, and what it might mean for an auto finance company that buys paper from a dealer?

Brooke Conkle (18:57):

Certainly, Chris. In terms of the Holder Rule, it is a dangerous time for auto finance companies. The past 12 months have seen some, frankly radical, changes in the underpinnings and understanding of the Holder Rule and what it's supposed to do. Historically, the Holder Rule had really capped an auto finance company's liability to the amount the consumer had paid under the contract. So, if you've got a consumer who's a year into their retail installment sales contract, maybe they've paid a couple of thousand dollars towards the account, but haven't paid that much money yet. In the historic understanding of the Holder Rule, if an auto finance company is engaged in litigation with that consumer later, their liability is capped at that amount that the consumer has paid so far. And in the past 12 months, that understanding really has been turned on its head. We had guidance from the FTC about a year ago that essentially said, actually, that's not true.

So actually, consumers can recover above and beyond what they have paid under the contract from an auto finance company, where that consumer's state law provides for recovery of attorney's fees. And just as Alan mentioned, consumers wouldn't have a private cause of action under the FTC Act, but where they do find their causes of action are in state UDAP statutes. And those statutes, they're going to include attorneys' fees. So, for auto finance companies, historically had really been able to cap their liability. That cap has gone out the window. We saw the Supreme Court of California taking the same position as the FTC, and say under California law, absolutely, you consumer can recover attorney's fees above and beyond that.

So how do auto finance companies protect themselves from civil liability? And really the first line of defense is the dealer agreement. To the extent auto finance companies have not dusted off their dealer agreements in the past few years, now is absolutely the time to do so. And the indemnity provisions in those dealer agreements are going to be of critical importance when civil litigation is right around the corner, having terms in your dealer agreement that provide for dealers, indemnifying the auto finance company, and also potentially picking up any unpaid amounts under the retail installment sales contracts. Having those kind of guardrails built into the dealer agreement will be really critical for auto finance companies.

Chris Willis (21:37):

Thanks, Brooke. And are there any other sort of compliance management steps that auto finance companies might need to think about, to try to protect themselves, both on the regulatory, and the litigation front on this issue?

Brooke Conkle (21:49):

Chris, absolutely. Compliance management is going to be very important for auto finance companies, and one area where auto finance companies might look to strengthen their positions, is really looking at the dealers that they're doing business with. And in those cases, it might be helpful to really look at what the dealer's reputation is with consumers, whether the dealer has consumer complaints, what the dealer's general reputation is for compliance. And that might be one area that could be helpful for auto finance companies. And it's one area that regulators probably would expect auto finance companies to really do some due diligence.

Chris Willis (22:32):

Thanks a lot, Brooke. That's really good advice. And Alan, thank you for being on the podcast today, and sharing your insights as well. And of course, thank you to our audience for tuning into today's episode. Don't forget, of course, to visit us at our blog, consumerfinancialserviceslawmonitor.com, and hit that subscribe button so that you can get all of our daily updates about what's going on in the CFS industry. And head on over to troutman.com and add yourself to our Consumer Financial Services email list, so that you can get our alerts and notice of our industry webinars. And of course, stay tuned for a great new episode of this program every Thursday afternoon. Thank you all for listening.

Automated recorded voice (23:08):

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