

**RIP-OFF NATION:
AUTO DEALERS' SWINDLING OF AMERICA**



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Public Citizen
1600 20th St. N.W.
Washington, D.C. 20009
(202) 588-1000

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I. SUMMARY

This report takes a hard and detailed look at the unfair tactics automotive dealerships use to manipulate consumers during a new or used vehicle purchase, and at the types of unethical and illegal practices that have become second nature to one of the largest industries in the United States. Sales projections indicate that Americans will purchase more than 16 million *new* vehicles over the next year alone: the fraudulent practices described in this report are likely to affect millions of those buyers.

Duane Overholt, an auto dealer insider with more than 20 years of experience working in several auto dealerships in Florida, believes that fraud has now reached epic proportions in the industry. "I cheated, I stole, I swindled," he admits. "They taught me how to do it, and then I had no choice – except to quit." After winning a wrongful termination suit against Sonic Automotive Group in 2001, Duane has made it his mission to expose the underhanded dealings that allowed him, and continue to allow others, to bilk thousands of dollars from an unwitting vehicle buyer.

While many consumers likely suspect that auto dealerships do not always operate on the up-and-up, the size of the purchase, the flurry of paperwork, and the complicated financial relationships make car buyers particularly vulnerable to the schemes developed by dealerships to squeeze the maximum profit from every sale. Many of the arrangements lack transparency—for example, although buyers have a direct relationship with the lending institutions that finance vehicle purchases through dealerships, most never see the paperwork maintained at the bank, which may describe a different loan than was negotiated in the sale at the dealer.

Little-noticed "extra" charges at every stage of the sale inflate dealer profits at little value to the consumer. These extras add up for dealers, leading to the accumulation of millions, and even perhaps billions, of additional dollars industry-wide. Our research, in Appendix A, indicates that auto dealer fraud is rampant both geographically and in the number of consumers affected, and that these practices may be commonplace among many of the largest auto dealership conglomerates.

Customers in California, Florida and at least 37 other states have been defrauded in what the Minnesota Attorney General's Office calls "industry-wide practices" ranging from inflating the cost of warranties to contract stuffing and racial discrimination. In addition to state law violations, there are numerous federal laws which in any particular case may be violated by dealer action, such as the Fair Credit Reporting Act, the Truth in Lending Act, and numerous consumer protection and tax laws.

Massive consolidation in the auto dealership industry has altered the relationships, and leverage, of the industry, in relation to both financial and lending institutions and vehicle manufacturers. Many of the types of activities revealed in this report also suggest that banks and manufacturers, alongside consumers, are being defrauded. The report additionally raises

questions about the extent of tacit or actual involvement of all three industries in the fraud, as well as facilitation by company lawyers and accountants. While national conglomerates and franchise chains are a relatively new phenomenon, many independent dealerships may also use similar profit-generating techniques to remain competitive in a marketplace awash in ill-gotten gain.

The body of this report attempts to walk through the process and opportunities for ethical and legal breaches from the consumer's point of view. The documents are redacted to remove the names of consumers and dealerships, and the report makes no allegations or claims about the legality of specific transactions or dealership paperwork. Instead, we hope that by outlining the process, and the opportunities that it currently generates for deception, to give law enforcement a blueprint for investigations, and to educate consumers who purchase vehicles.

Graft is not necessary for auto dealers, as an industry, to remain economically viable. The last section of the report suggests legislative remedies that would greatly enhance the transparency and accountability of auto dealerships to consumers and financial institutions. There are doubtless other remedies that would be desirable in addition to those described, and we encourage innovation and thoughtful crafting of consumer remedies in any civil or criminal actions seeking redress on these issues.

II. HOW THE FRAUD OCCURS: ENTICE, DELUDE, AND DOUBLE-CROSS

A. Before the customer enters the dealership...

Step One: Adding to the Manufacturer Suggested Retail Price (MSRP) on a Dealer Addendum Sticker

Pricing terms on vehicles can be very complicated. Below are some common terms:

- **Invoice Price** is the manufacturer's basic charge to the dealer. This is typically higher than the cost listed on the dealer's sticker because dealers receive rebates, allowances, discounts, and incentive awards. Generally, the invoice price includes "freight" (also called "destination and delivery"). Consumers buying a new car based on an invoice price (for example: "at invoice", "\$100 below invoice") that includes freight charges, should make sure freight is not added again to the sales contract.
- **Base Price** is the cost of the vehicle without options, but with standard equipment and factory warranty.
- **Monroney Sticker Price, or Manufacturer Suggested Retail Price (MSRP)**. The so-called "Monroney sticker" is required by federal law to be located on the window and shows the base price of that model, including all standard equipment and warranties; manufacturer-installed options and their retail prices; transportation or freight charges; and the total manufacturer's suggested retail price. Under law, this label may be removed

only by the purchaser.¹ (Though illegal, some dealers removed this sticker under the guise of having the vehicle cleaned, so numbers on price cannot be compared.)

- **Dealer Sticker Price**, usually on a supplemental sticker, is the Monroney sticker price (or invoice cost of a vehicle) *plus* the suggested retail price of dealer-installed options, such as additional dealer markup (ADM) or additional dealer profit (ADP), dealer preparation, and undercoating or other add-ons. This reflects the dealer's profit over the invoice cost and includes any products or services dealers may add to the vehicle before negotiating a sale.



Before a consumer steps onto a dealership lot, the dealer's sticker prices are likely to show modifications by the dealer to increase profits.

Attachment 1 is a copy of a manufacturer's invoice sent to the dealer. The "Invoice Amount" column reflects a total invoice cost of \$21,030.22. The "Suggested Retail Price" column reflects the MSRP of the vehicle before the manufacturer adds on soft or hard items.

Add-ons are reflected in the dealer's addendum sticker to the original window sticker and are generally marked up to an uncompetitive retail price, even if the cost for the addition is minimal to dealers. Changes may also be added after the window sticker has been printed and negotiated with the customer during the sale. For examples, Attachments 2A and 2B, are both versions of window stickers. Attachment 2A shows an original MSRP of \$16,005 increased to \$17,896 after the addition of remote security systems, paint and fabric guard protection, new wheels, etc. Similarly, the sticker addendum in Attachment 2B shows an original MSRP increased from \$29,270 to \$33,161.15 after addition of leather seats, tires, and a "savings package."

Dealers may add both hard items (stereos, "special" wheels and tires, hitches, detailing accents, etc.) and soft items (warranties, maintenance programs, paint sealant, undercoating, etc.) to a vehicle at this stage. In the past, only hard items were added to addendum stickers, but there is a new trend of adding "soft" items as well.

By minimally increasing the base cost of the vehicle to the dealer, but substantially increasing the retail asking price, add-ins on top of the MSRP increase profits in many ways:

- The hard and soft add-ons to a vehicle can be marked up to full retail or higher, even though the cost of them to the dealer is minimal and profit is consequently high.
- The retail price of add-ons is included in the overall price for the vehicle which a bank will consider financing, yet the add-ons are often products that a bank would not agree to pay for if tacked onto the bank loan agreement/contract during the sale of a vehicle. Therefore, increasing the price for the vehicle allows the dealer a higher bargaining price when negotiating with the bank for a loan. The bank, or other lending body, will advance a consumer a specific percentage of the price of a vehicle based on their credit (*i.e.*,

¹ Average vehicle fuel economy numbers, based upon the Environmental Protection Agency's (EPA) lab-based vehicle fuel economy (miles-per-gallon) tests, are required on all cars and light trucks. This information is usually included on the Monroney label, but will sometimes be found on a separate EPA Fuel Economy Label.

someone with exceptionally good credit will be loaned 120 percent of the MSRP plus the allowed hard add-ons, someone with poor credit will be loaned 85 percent). Because dealers' kickbacks from banks are in part based on a percentage of the overall amount of money that is financed in the sale, increasing the retail price of the vehicle increases a dealer's profits on the financing loan as well.

- Some of products allegedly "added-on" by dealers in fact already are standard equipment from the vehicle, yet the consumer is charged again for them at this point.
- Products added at this step are also ones many consumers would not purchase if given an option.
- "Dealership preparation" entities, most of which are wholly-owned subsidiaries of the dealership, frequently supply these extras, meaning that any "costs" of products added to vehicles by the dealership are actually income for the subsidiary, and may reflect an internal mark-up by the subsidiary as well.
- Commissioned personnel at the dealer receive incentive packages and bonuses from the "dealership preparation" and warranty companies if specific extras are added to a given percentage of all sales contracts sold over a certain period of time (*i.e.*, "maintenance contracts" added to 40% of all purchases). These bonuses and incentives can be very lucrative for personnel, and are also often used in employee evaluations by supervisors.
- Also, as described below, commissioned dealership personnel receive commissions from adding similar hard and soft items during the sale of a vehicle. Adding in extras at this stage means that the dealership need not pay sales managers a commission for these particular sticker "extras" and saves the dealership money.

Increasing the price from the base or MSRP may also allow a dealer to cover the minus equity of a traded-in vehicle.



"Minus equity" is the difference between what a dealer values a possible trade to be worth and what is actually still owed on the vehicle.

Banks will finance consumers with a minus equity situation on a trade-in only if there is no "minus" number on the bank contract, called a "risk document." To cover up the minus number on the "risk document," a dealer may inflate both the retail price and the trade-in value of the vehicle on the sales documents. This in no way affects the actual cash value placed on the trade that continues to have minus equity, yet it appears to do so on the bill of sale, buyers order, or bank "risk" contract.

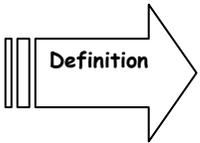
For example, if a dealer knows the customer has a trade-in vehicle worth \$9000, yet the customer owes \$10,000 on the previous vehicle loan (not an uncommon occurrence), the dealer can increase the new vehicle's price by \$1000 (or more) and offer to buy the trade-in for \$10,000 to cover the difference so that the bank will loan the customer the total price of the new vehicle. In this way, the bank does not see the minus equity and thus will finance more of the price of the vehicle.



While consumers think they got more for the trade-in vehicle, in actuality, the numbers have merely been manipulated to fool the bank into financing the sale. If the percentage rate on the new vehicle is higher than the previous vehicle, the consumer will also pay the new compounded interest on the \$1000 added to the MSRP, as well as any sales and state property taxes owed on the higher amount.

The dealer's sticker price typically also does not reflect any manufacturer rebates that are available on a vehicle, and many dealers will not admit to consumers that a rebate exists unless asked specifically about the rebate. If the customer does not know the rebate exists, the dealer may collect it anyway, and collect it as profit. Or, the dealer can manipulate sales documents to reflect the rebate, but pack the contract back up to the total with profitable extras that the consumer never knows they are buying. The dealer also can collect any incentives that are available on the extra products, and the consumer does not know that they could have gotten the vehicle for thousands of dollars less than they paid.

A common add-on product, and one that can be added-on to the addendum sticker, or at a later point in the process, is called "etch." Both Attachment 2A and 2B reflect "etch" was added to the vehicles in question.



"Etch" programs use an acid wash to engrave the Vehicle Identification Number, or VIN, or another unique identifier, on the vehicle windows, supposedly as an anti-theft assurance and recovery device. The physical etching is accompanied by etch insurance, which typically offers a very minimal cash return, such as \$2,500, to consumers whose vehicles are stolen and never returned.

Many companies provide financial incentives to personnel to include such charges in a high percentage of purchases. Etch policies are unregulated and generally can be used as a means to hide profit in the manner described elsewhere in this report. One important clue that etch may be used in this manner: The price of etch on a vehicle varies; in our examples from \$489.46 to \$250.00, for the same service and warranty terms, without any apparent relationship to the price of the vehicle (*see Attachments 3 A, B and C*).

Several other types of deception and profiteering are also rampant regarding etch. Consumers' signatures may be forged on etch forms and many consumers may never learn they have paid for the service, and thus never use it to locate a stolen vehicle or submit a claim. The typical "cost" to dealers of the service and warranty is \$100, although the real cost is hard to determine given the relationship between the dealer preparation subsidiaries and dealerships. Yet "etch" is often marked up to \$500 or even substantially higher. Consumers may also be charged for "etch" in cases where the vehicle marking is never actually done. Consumers should also check to see if vehicles at home have been marked in this manner and check whether the charge is recorded in the sales contract or other documentation.

The sales of "etch"-type products for amounts as high as \$1,000 (as was paid by Florida class action plaintiff Brenda McCarthy) appears particularly outrageous when we consider that federal law regarding VINs requires the same information, and far better theft protection, to be provided by the manufacturers on the dash and in numerous locations throughout the vehicle *free*

of charge to all American vehicle purchasers. Federal regulation, at 49 CFR § 565.4 and .5, provides that the VIN for all vehicles manufactured in, or imported into, the U.S. be “located within the passenger compartment” and “readable...under daylight conditions by an observer having 20/20 vision whose eye-point is located outside the vehicle adjacent to the left windshield pillar.”²

Another federal safeguard, the “Federal Motor Vehicle Theft Prevention Standard,” requires VIN markings in numerous areas to discourage “chop shop” burglary and dismantling of vehicles.³ The government notes that the official purpose of the rule is to “reduce the incidence of motor vehicle thefts by facilitating the tracing and recovery of parts from stolen vehicles,” *see* 49 CFR Part 5412, and the rule therefore takes a far more thorough approach to the problem than do “etch” programs, which mark only the easily removable windows and windshield of the vehicle.

Another common technique is to push the purchase of extra service, e.g., so-called vehicle “care” or “maintenance,” contracts from the dealer. These contracts are offered by manufacturers, dealers, or independent companies and *may or may not* provide any coverage beyond the manufacturer’s warranty. Consumers should be sure that any service contract provides coverage that is needed and in addition to the warranty, and ascertain the contract’s precise terms and coverage. Many service contracts also provide special conditions for use, or duplicate services, such as oil changes, that are available far more cheaply elsewhere.



The key point is that “etch” and other extras, such as maintenance contracts that promise six oil changes for \$1000, are not really products at all. They are mainly just placeholders for dealers to square the extra profit they have negotiated into the deal with the paperwork on the sale. This explains why comparisons show a wide range in prices for different consumers *on the same product or services*. The additions and extras are shells in a shell game, and little more.

B. While the customer is with the salesperson...

Step Two: Obtaining and Misusing Personal Credit Information

Unethical sales personnel who seek the highest possible profit from a sale may gather information on a consumer’s credit history by pulling their credit report from a credit reporting agency, even without a consumer’s permission. Firsthand whistleblower accounts reveal that a widespread industry practice is to pull credit reports on consumers without the customer’s permission or knowledge by obtaining identifying information (including name, address, phone

² The initial rule requiring VINs was issued by Joan Claybrook, now President of Public Citizen, when she was Administrator of the National Highway Traffic Safety Administration.

³ Rules at 49 CFR § 541.5 require all passenger motor vehicles to be affixed with a non-removable VIN label in each of the following 18 areas: 1) Engine; 2) Transmission; 3) Right front fender; 4) Left front fender; 5) Hood; 6) Right front door; 7) Left front door; 8) Right rear door; 9) Left rear door; 10) Sliding or cargo door(s); 11) Front bumper; 12) Rear bumper; 13) Right rear quarter panel; 14) Left rear quarter panel; 15) Right-side assembly; 16) Left-side assembly; 17) Pickup box and/or cargo box of light-duty trucks; 18) Rear doors, decklid, tailgate or hatchback.

number, date of birth, and sometimes even Social Security Number) from consumers in one of the following ways:

1. Through a consumer's drivers license taken and copied before a test drive;
2. On an appraisal slip for a vehicle given to the dealer as a trade-in;
3. From the notice to acquire a payoff on the remainder of a loan on a trade-in;
4. From documents previously filed with the dealer from a past sale (dealerships usually keep documents from previous sales for up to ten years); or
5. After a customer fills in a work sheet as a prelude to discussing a sale.

Most consumers will provide Social Security Numbers when asked. Even if they do not, a dealer is often able to enter a false general number (such as 111-11-1111), along with other information, to obtain a credit report.



Under the Fair Credit Reporting Act, dealerships are required by law to acquire a customer's written permission to obtain a credit report under most circumstances⁴ but firsthand accounts and court documents show that these signatures are often forged or omitted from forms.

Why do dealerships pull a customer's credit history? The availability of as much information as possible about the financial position of a customer provides dealers with a substantial upper-hand in purchase negotiations. Pulling credit reports allows a dealer to:

1. Learn the customer's credit score (called alternatively "beacon score," "bank rate score" or "bureau score") which allows the dealer, matched with a bank rate sheet, to compute the loan amount that banks will most likely offer to that customer. The bank rate sheets, shown in Attachment 5A and Attachment 5B, provide the "term" (or interest rate and number of months) for the loan that a bank will offer to a consumer based on his or her beacon score and the year of the vehicle s/he is leasing or purchasing. A consumer seeking financing at the dealer, rather than an outside lender, is therefore at a tremendous disadvantage, as they have no knowledge of these rate sheets and thus no idea of the rate and loan amount a bank is likely to offer. Because of this information gap, the dealer can negotiate payment options with the upper hand.
2. See the consumer's previous auto loans and the terms of those loans (*i.e.*, \$350 for 60 months). Dealers often use these numbers as a baseline on which to add additional money and months to begin payment negotiations.
3. Access the balances of a consumer's credit cards. Knowing how much credit a consumer has available gives the dealer an upper hand when negotiating down payment. If, for example, a consumer balks at a high down payment, a dealer who knows that the consumer has \$2000 open on a credit card can suggest that the

⁴ According to Fair Credit Reporting Act § 604, [15 U.S.C. § 1681b] and a letter from the FTC to the Texas Auto Dealers Association (included as Attachment 4), dealers may only acquire a credit report without permission under narrowly defined conditions:

Only in those circumstances where it is clear both to the consumer and to the dealer that the consumer is actually initiating the purchase or lease of a specific vehicle and, in addition, the dealer has a legitimate business need for consumer report information may the dealer obtain a report without written permission.

consumer use the credit card to secure their sale. This allows a dealer to ask for a larger down payment, as well.

It is important to remember that dealerships do not have the authority to offer loans or to act as bank agents. In fact, the fine print on the back side of sales contracts frequently indicates that the sale is conditioned upon approval of the loan or financing agreement by the *lender*, indicating, as in our example, that transactions including a finance or lease are “conditioned upon approval of Purchaser’s retail installment sale contract or lease by a financial source.” See Attachment 6.

Even though many dealers discuss loans, claiming to act as the agent of the customer and asserting that they will negotiate with the bank for the lowest payment and rate, they usually do so in a manner that maximizes their profit, not the consumer’s benefit. This position may enhance a dealer’s authority with buyers.



It is important for consumers to be aware *that the only factor a dealer can legitimately negotiate during the sale of a vehicle is the retail price of the vehicle and any items added on during the sales process.*

Step Three: Exploiting Special Relationships with Banking Institutions

Today’s market has allowed for special relationships between major lenders and dealerships. Dealers send a high volume of business to large banks, particularly those with whom they have lending relationships, and some of these banks, in turn, may offer the dealer a cut of the financing and offer loans to risky customers who might otherwise be denied loans. According to the June 11, 2003, deposition of Lyssa Carter, Financing and Insurance Regional Director for Sonic Automotive, these lending relationships came about due to a symbiotic give-and-take, in which the banks would agree to accept customers with less favorable credit in exchange for a steady stream of business from dealerships. (See Attachment 7.)



When banks and dealerships have special lending relationships, the banks may set up deals with the dealership through which they will pay the dealership a percentage of the income from financing the consumer’s loan. This is typically accomplished by increasing the original percentage rate of the loan sold to customer (the “buy rate” for the dealership) by a few points (usually between 2 and 5 percentage points, costing the consumer thousands of dollars) from what the bank would regularly offer (the “sell rate” from the dealer to the consumer) and paying the dealership the difference. All of this occurs before the loan is sold and before the percentage on the loan is told to the consumer.

As shown in Attachments 5A and 5B, both financial institutions have deals with a dealership conglomerate to inflate the original buy rate by 3 points (this is called, in the forms, the “reserve cap”). For example, in Attachment 5A, if a customer had a 650 credit score (in the 640-679 range) and was purchasing a 1998 vehicle on a 66 month lease, the bank guideline would generally be to sell the loan to the customer at 10.80 percent. However, the sheet

indicates that the lender will sell the loan at a “reserve cap” of up to 3 points higher (for a total interest rate of 13.80 percent). The extra three percentage points go directly to the dealer.

In contrast, if the loan is sold to the consumer at the actual buy rate, the dealer will be paid 1 percent of the total amount financed by the bank, costing the bank 1 percent on the loan. So, using the example above, the consumer would be charged 10.80 percent to finance their loan: 1 percent to be paid to the dealer and 9.8 percent paid to the bank. While this is a win for the consumer, it is a loser for both the dealer and the bank. Because of this dynamic, the real buy rate is generally not the rate offered to vehicle purchasers. Consumers seeking financing outside the dealership, on the other hand, are typically awarded a financing rate that is equal to, or even better than, the buy rate.

But financing through a dealership is a different story— and dealerships have a strong incentive to push sales with financing through them. Some financial institutions offer specific incentives to both corporate headquarters and dealerships for financing a bulk of their contracts. These arrangements can be set out on a percentage basis, as incentives for “pools” of managers or sales representatives, or on a per-contract basis over a given period of time. The payment per contract can also be directed to the corporate headquarters of a conglomerate, rather than the region or franchise level, and in turn be incorporated into incentive or other management programs administered at the corporate level.

And the auto manufacturer’s lending programs may also be manipulated by dealers to benefit the dealerships and lending source to the detriment of the customer. Often, manufacturers’ loan incentive programs are offered in advertisements as including *either* a low interest rate *or* a rebate. The low interest rate is the bait, and the rebate is the switch. The rebates distract consumers, who take the cash and accept the higher interest rate, allowing the manufacturers’ lending programs to sell loans at a significantly higher rate than the consumer would find elsewhere.



In other situations, dealers may not even inform consumers that a special interest rate from the manufacturer is available, because providing that interest rate, rather than the rebate, will not permit the dealer to make any money on the financing “reserve” from the lender.

Step Four: Manipulating Customers During the Sales Process to Pay More Than Originally Agreed

Generally, by the time a customer actually sits down with a sales person at a dealership to discuss their purchase, the sales person already knows the customer’s credit information and what the bank is likely to offer as a financing rate. This gives the dealer a leg up in negotiations. While, as noted above, a dealer cannot offer specific terms of a loan, the sales personnel often attempts to negotiate conditions of a loan with a customer at this stage in the process.

The Sales Worksheet

Attachment 8, a sales worksheet, is the first document a consumer and a dealer will work on together. As shown, the purchase price for this vehicle is set at \$14,900, which was probably the number on the window sticker and any addendum sticker that the customer has already seen. This is the only number that the dealer can legitimately negotiate. As shown in this document, however, dealers can begin at this stage in the process to talk to the consumer about monthly payments and loan conditions, here \$360 (between \$360 and \$369) for 57 months.



The monthly payment negotiated at this stage is generally much higher than a consumer is willing to pay for a vehicle and is typically used as the “peak” amount suggested by the dealer in the negotiating process. Also note that the customer has not signed the worksheet at Attachment 8. Under law, customers cannot be asked to sign forms agreeing to bank terms that are not generated by a bank.

The worksheet also provides information about “options and features” negotiated during the sales process. These are either hard or soft add-ons that the consumer may agree to purchase. Worksheets such as the one shown as Attachment 8 are becoming more and more obsolete and in their place dealers are using “menu selling.”

Attachment 9 is an example of the menu-style worksheets salespeople may use with customers to shorten the worksheet process, and which can be used to hide the costs of specific additions. None of the additions listed in the attached menu is associated with a specific price. Instead, each package is negotiated, and accepted or rejected, based on specific loan terms (that is, loan terms that the dealer cannot assure).

The menu worksheet shows a sale of a vehicle at an initial price of \$20,200, with options that will increase the amount the consumer will pay over the life of a 72-month loan to nearly \$30,000 (with interest), increasing the total cost of owning the vehicle by 50 percent. (The total payment, including compounded interest, from the monthly payments for 72 months at a 5.9 interest rate, was added by us in text boxes on the worksheet.) It is virtually impossible, given a menu without prices and without a compound interest rates calculator, for consumers to assess how much they are being asked to pay for specific items within these packages of products, or even to understand how much they will actually pay for their vehicle.

For example, given merely the information that a “Basic” package costs \$22.40 a month more than the base payment (of \$341.36 for 72 months), a consumer unarmed with a compound interest rate calculator cannot easily determine that this package will in fact cost almost \$1500 more over the time of the loan or that the \$73.83 a month more for the “Preferred” package, with interest, will end up costing the consumer a total of \$4656, including interest, on top of the price of the base vehicle and options.

The Purchase Order

During a vehicle purchase, the next stage of the process is typically filling out the handwritten buyer's order (See Attachment 10). This is generally the first time a consumer signs a contract that includes any agreement on the selling price of the vehicle. The buyer's order often includes add-ons from negotiations on the vehicle sale. The selling price of the vehicle on the buyer's order should match the selling price of the vehicle on the worksheet and on the window sticker (plus or minus explicit add-ons agreed to and described in the documents). Yet often these numbers do not match.



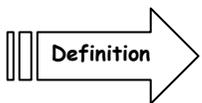
Unless the purchaser explicitly agrees that additional products or services may be added to the vehicle later in the sales process, the retail price listed on the buyer's order should be the total sum of what the consumer owes (excluding interest on the loan, if applicable).

It is also important to note that the buyer's order includes the amount a dealer pays a consumer on a trade-in vehicle. As noted above, lenders will offer a specific percentage of the MSRP of a vehicle to a consumer based on his/her credit rating score (as well as the age of the vehicle). As detailed above, a dealer wishing to sell a vehicle to customers who will not be offered the full MSRP by the bank because of a poor credit rating may inflate both the payment for the trade-in and the retail price of the vehicle to increase the amount of money the bank will lend without decreasing the dealer's profit.

Comparing the "used car" allowance noted on the buyer's order to the dealer's accounting documents that show the amount paid on the trade-in vehicle will reveal these discrepancies, if they exist. If dealers fail to claim the true cost incurred to purchase a trade-in vehicle on corporate tax forms (using the inflated price on tax forms although that is not what the consumer in fact paid given the accompanying increase in the buying price for the trade-in), they may end up claiming a higher tax deduction than should be claimed.

The Transmittal Sheet

The transmittal sheet, as shown in Attachments 11 A, B and C, contains information about the sales negotiation, as filled out by the salesperson and given to the Finance and Insurance (F&I) manager, who then uses the information to finalize the deal. The transmittal sheet shows the payment rate and terms, the cost of the vehicle to the manufacturer, the retail cost of the vehicle to the consumer, the gross profit to the dealership, etc.

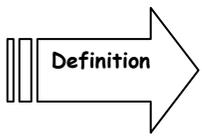


The "gross" is the profit at the particular loan terms offered preemptively by the dealer to the customer, which may be different from the actual profit if the bank does not agree to the specific loan terms.

Often the payment quoted on the transmittal sheet is above the payment that would be necessary, given the terms of the lease and the sales price of the vehicle, to actually pay for the vehicle, including interest. This math, which is likely too complicated for most customers to do

on the spot, can be done immediately by putting the numbers on the transmittal sheet into a balance sheet for compounded interest payments.

Look at the "Notes" section on Attachments 11B and 11C. The dealer's handwritten notes on transmittal sheet (Attachment 11B) indicate that the deal provides \$7.00 "in room to work" and quotes the terms of the loan (the financing rate offered by the manufacturer's financing arm, monthly payments and term of the loan). This "room to work" is the dollar amount per month above what is actually needed to pay for the vehicle under the terms of the loan, including interest. While this consumer's vehicle could be paid back, according to the sales manager who filled out this form, at \$372 a month, the consumer has evidently agreed in negotiations, most likely unwittingly, to pay \$379. Thus, \$7 of the \$379 a month is extra – yielding a \$504 over-payment in total. On Attachment 11C, this over-payment is \$40 a month.



The money that consumers pay above what it would take to pay off the agreed-to sales price of their vehicle is called “leg” by dealers. *Dealers can play fast and loose with the numbers because most consumers negotiate the amount of the monthly payment that they can afford, and not the price of the vehicle.*



Leg, as negotiated by the sales department of a dealership, may then be used by the F&I manager to use to cover additions to the sales contract. The hard and soft add-ons inserted into the contract following the sales portion of the deal are rarely seen by the consumer and the retail cost for them is unregulated, giving an unscrupulous dealer the “legroom” to further fleece customers.

C. Once the Finance Department has the paperwork...

Step Five: The F&I department adds “back-end” products into the sale, increasing profits at consumer expense

The finance department of an auto dealership is generally permitted, and may even be asked, by banks to add so-called “back-end” products into a sales contract at this stage of the process. Bank rate sheets are included as Attachments 5A and 5B. Both of these sheets, sent by financial institutions, spell out a specific back-end allowance that F&I managers may add to a contract covered by the bank. On Attachment 5A, the limit is \$2500; Attachment 5B sets a schedule based on the unpaid cash balance and credit rating score. The rate sheets also explain which types of “back-end” products are allowed and disallowed by a particular lending institution.



Back-end products are supposed to be warranty and insurance products added by the F&I manager within the bounds of the bank’s guidelines and must by law be disclosed to the consumer. However, by manipulating the forms and using available “leg” in a sales deal to cover it up, dealerships are able to add in back-end products that are beyond both the bank’s guidelines and customer knowledge. Customers often do not know that these back-end products exist, and thus may never claim any warranty, or use a maintenance or other service contract, for which they have actually paid.

For example, a dealership may wish to add a \$2500 warranty (or other add-on) package (note that the package may cost them only 1/5 or less of that amount) to a sales contract, to maximize the bank's allowance for back-end products. If the "leg" on a current deal is \$37 a month, the dealer can easily sell the warranty products at an additional \$5 per month. From the consumer's perspective, they are purchasing a warranty package for a mere \$300 (\$5 per month for a 60 month loan, excluding interest). In reality, because the "leg" conceals the real additional cost of the product to the consumer, they are paying \$42 per month, or about \$2,520, plus interest at the percentage rate applicable to the deal.

It may even appear to the consumer that they are out-smarting the dealer by paying \$300 for a package that is listed on their bank contract as costing \$2500. It also may appear to someone comparing the actual cost of the package with the listed price that the dealer took a loss of \$200 on the sale. If a dealer ends up with unused "leg" or "leg" above the amount that can be folded into additional products approved by the bank, a dealer may actually claim to a buyer that they have gotten the consumer a better deal or lower interest rate, although it was the consumer's extra money all along.

"Leg" also may allow dealers to appear to offer costly warranty products to consumers for "free." In the deal above, the F&I manager could easily offer a "free" warranty package worth \$2000 (that only costs the dealer, for example, \$200). The manager could then enter \$2000 worth of warranty products on the bank contract to inflate the vehicle's sale price. Because a \$37 leg over the life of a 60-month loan would yield \$2220 (excluding interest), the dealer is actually earning \$2020 in profit. By adding the \$2000 warranty onto the bank contract, the dealer can earn extra profit in a manner acceptable under the bank's policies, through "leg" that consumers are unaware that they are paying. Such a maneuver assures that the bank contract reflects some value, on paper at least, for the over-payment already worked into the consumer's agreed-upon monthly payment as "leg."

The F&I department could also potentially add a warranty product of a \$2000 value to the customer's contract, which would be integrated into the bank's forms, that customers never see and thus never can use to make claims. During both the sales and the finance process, sometimes consumers are asked to sign blank or generic contracts so that an F&I manager can later falsify a contract that will appear acceptable to the bank and warranty company.

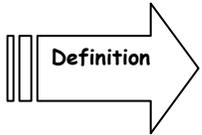
In other cases, the warranty may duplicate the warranty that already comes from the manufacturer on the vehicle. A customer repair under one warranty can be charged to manufacturer's warranty, from which the dealer may collect a reimbursement from the manufacturer and ignore the second warranty altogether.

Many warranty companies maintain close relationships with dealerships. Some warranty companies are actually owned by the same corporate entity that has an ownership stake in the dealership. Others use warranty companies as administrators for warranties that the dealership actually owns, still others split ownership and profit relationships regarding the warranties in various ways. Because the profits of the warranty companies are based on the number of warranty claims made against the policies, this provides a built-in incentive to keep overall claim rates low.



Just as increases above the MSRP benefit dealers by increasing the price of the overall loan, which in turn increases the size of the percentage commission given back to dealerships, incentives to add in back-end products acceptable to banks produce a win-win for dealers and financial institutions at the expense of consumers.

One of the most useful documents for tracking changes made by the F&I manager to a consumer's contract is the "washout" sheet (Attachment 12A, B, C, D, E and F).



A "washout sheet" is the internal receipt generated by the F&I department following the contract signing process that shows the terms of the loan, the cost of additional items added to the price of the vehicle and the profit made on each portion of the deal, including the financing. It also shows corrections made by hand after data is entered by the F&I department into the computer.

Washout sheets are the key to understanding the specific add-ons that dealers pack into sales deals and the profit they are making on these items as well as their relationship with financial institutions. Washout sheets show the different financing rates made available to specific customers and what percentage of the interest will go to the dealer instead of the financing institution.

The six washout sheets included in Attachment 12 also show the high and unregulated profits dealers can make from warranties, gap insurance and etc:

Finance rates: The finance charge sold to the consumer from Washout sheet A for the loan was 14.90 percent, yet the bank is only taking 12.90 percent, leaving 2 percent of the 78-month loan for the dealer. Washout Sheet E shows a sale where the finance rate was bumped 4.01 percent from a bank's offer of 10.99 to the rate that the consumer was sold (the "sell rate" was 15.00 percent.). Sometimes, the dealer receives only a minimal percentage of the reserve cap, as shown in Washout C (0.50 percent). While Washout Sheet B appears to show no percentage at all, the dealership has likely still retained the flat rate payment of 1% on the loan, as explained above.

Warranties: The warranties (excluding explicit etch and gap policies, described below) written for these five deals range in cost to the consumer of \$1300 (Washout D) to \$659 (Washout B). The profit margin for these warranty policies does not vary directly with cost to the dealer and ranges from \$200 to \$766 (Washouts E and D). One major issue, and one that is rarely addressed by dealers in product conversations with consumers, is exclusions from the warranty coverage, or redundancies between warranties and the manufacturer's standard warranty policy.

Gap Insurance: Gap insurance is written to cover, in the event of a theft or total loss, the balance between the cash value of the vehicle and the amount of the loan. Washout sheets A, D and E each show the purchase of a gap policy. Washout A shows a gap policy being sold for \$500 that costs the dealer \$150 while Washout D shows a gap policy sold for only \$390 that cost the dealer \$190 (a \$150 profit difference). Both

policies were written for used vehicles— but the cheaper policy was written for a vehicle with a longer loan time (7 months) and a higher selling price (\$4320). Note that most gap insurance policies cover only the MSRP, and not any add-ons contained in the dealer price for the vehicle, which can be substantial in price.

Etch: Etch, as described above, is a physical etching on a vehicle combined with a total loss warranty worth \$2,500. As shown in Washouts A, B and C, etch can “cost” the dealer a small amount (such as \$75) and can be sold for a hefty, and unregulated, profit. Take the example of Washout C, a sale where the dealership was making only 0.5 percent on the financing. The etch policy was sold for \$750, even though it only cost the dealership \$100. This \$650 profit accounts for more than one-third of the gross profit for the entire sale.

The final document that must come out of the F&I department on a sale is called the buyer’s order. Examine the Washout Sheet 12 F and the two versions of a buyer’s order (Attachments 13A and B) – all generated for the same sale. The selling price for the deal, according to the washout sheet, is \$11041.76, which is reflected on the first buyer’s order. However, the second buyer’s order does not match – the cost of the vehicle has been increased to \$11500. It appears probable, though still uncertain, that this second buyer’s order was forged by the dealer after the buyer left the dealership in order to submit a buyer’s order that matched the final financing request to the bank or approval by the bank.

The costs of warranties can also be altered during this process. In a deposition (*see Attachment 14*), a dealership agent explained that warranties could have different prices depending on whether the price was written on a form given to the consumer, the bank or the warranty company. As related in the deposition, the warranty was sold to the consumer for \$1,199, and that price was reported to the warranty company, yet the bank was told the warranty cost \$1,594. Some warranty prices are capped under insurance law, but the banks typically do not check to see whether the warranty meets the legal and bank rate requirements for that warranty product.



Consumers should also be aware that many dealer warranty products may be at risk of default by warranty companies that are unlicensed to do business, or otherwise financially insufficient to cover claims, and that dealers, while selling the warranties, are unlikely to cover the warranty or reimburse the warranty in the case of a default by the warranty company.

Not only is it possible to add additional warranties or other back-end items at this stage or to manipulate their costs, it is also possible to change the terms of warranties. One customer claimed, in an affidavit filed in a lawsuit (*see Attachment 15*), that while he signed a 50,000, 48-month contract, he was given a 35,000 mile, 36-month warranty. When the customer became aware of the discrepancy, he paid a visit to the dealership, where his affidavit claims he was “shown a warranty application form that contained a forgery of [his] signature.”

Many sales transactions in auto dealerships occur outside of a bank’s normal hours. This can be a benefit to dealers, particularly those who want to offer customers “on-the-spot” delivery,

because they can ask the consumer to sign generic or blank forms offering to “take care” of filling out the rest and dealing with the bank after the consumer leaves, with their new vehicle. This can also occur when the banks are open, but an excuse is offered to encourage the customer to leave with the vehicle pending loan approval.



In the trade, this is often called a “right of rescission.” Abusive terms written in the fine print permit dealers to alter the terms of the contract, including the number of payments and interest rate, without the customer’s further consent, if the customer receives “spot deliver” of the vehicle by driving it off the lot prior to receiving final approval from the bank. Consumers should avoid spot delivery and should never sign a writ of rescission-type clause or contract.

The F&I manager may also ask the consumer to sign a generic bank contract that spells out a basic term for a purchase (*see Attachment 16*), claiming that they can shop the sale around to different banks to get the consumer the best deal. This generic contract for the same order discussed above, indicates a higher sale price than the final buyer’s order (according to the contract, the total cash price for this deal was \$12,620.79).

Attachments 17A and B are examples of documents that dealerships may have consumers sign without filling out the meaningful information on the forms. They are an application for a certificate of title and an auto insurance agreement. The signatures on these forms “certify” that they are signed “under penalty of perjury” by a customer who understands and verifies the information contained within the form, yet, obviously, consumers cannot verify facts on forms they do not actually sign.

Another major problem arises if, in the flurry of forms, consumers unknowingly or without understanding sign binding agreements to resolve any disputes in arbitration, rather than in the courts. Such clauses, also called “dispute resolution” clauses, are attempts to force consumers into industry-dominated arbitration mechanisms and to strip the meager protections offered under the consumer protection and other laws. By signing the contract, the consumer is agreeing to binding arbitration to settle any future dispute and also waiving the right to sue or appeal— even if the dealership committed fraud. Arbitration can also be very costly to consumers, who must pay at least ½ the cost. Arbitration settlements are also secret, generating no public records of wrongdoing and no precedent for use by other wronged consumers.



Consumers should walk away from any dealership that requires purchasers to sign away their legal rights as part of a mandatory arbitration or dispute resolution agreement.

Even the auto dealers do not really think that mandatory binding arbitration is fair – at least when it comes to protecting their own interests against the manufacturers. Auto dealers actually lobbied for a federal law passed in November 2002 that prevents automobile and truck manufacturers from requiring the use of mandatory binding arbitration to resolve franchise disputes with dealers.⁵

⁵ More information about the harms of mandatory arbitration clauses can be found at www.autoissues.org and www.citizen.org.

D. After the consumer leaves the dealership...

Step Seven: The F&I department responds to the bank's answer on the loan...

After the customer leaves the dealership, the F&I department sends the necessary forms to the bank to secure financing for the consumer. While this transmission used to require a signed application statement, dealerships now have relationships with lenders that allow them to submit the information electronically or via fax, speeding up the process.

The banks then send a “response sheet” back to the dealer giving the F&I department the conditions under which the bank will finance the loan (*see Attachment 18*). Note that in the attachment, the bank has conditionally allowed this financing deal only if it is for a loan under its specific terms and includes only one add-on. If, during the original bank contract, the dealer had specified two add-ons or different terms than granted for the loan, the dealer would now have to write a new contract to fix the discrepancy.

Banks also send back lists of conditional approvals for loans, like those included as Attachment 19. For example, the notations on the first case on Attachment 19 state “Need RO for \$2,122.” With such a request, the bank is asking the dealer to provide documentation that shows that an “RO” or “repair order” has been done that will add a \$2,122 value to the vehicle to adjust the retail price of the vehicle, up to the amount that the bank’s contract is supposed to cover. So-called “repair orders” are really just requests by the bank to raise the price on the vehicle and can be achieved by adding on either soft or hard add-ons. The repair order itself, Attachment 20, is unsigned by the customer. Dealerships also may claim to conduct the repair order without either alerting the customer or ever doing the work.



The consumer sees none of these transactions, and in many cases, is never told of the additional bank specifications or potential increases in the amount of the loan. Consumers should be given access to any changes in the financing or sales contracts that occur after taking possession of the vehicle, and should double-check that the terms of the loan and the number of payments have not been altered from the initial agreement. “Balloon” payments, which impose a final payment of a substantial amount over the monthly payments, may also not be disclosed.

III. SOLUTIONS AND SUGGESTED REMEDIES

A. Federal, state and local authorities should aggressively enforce all available consumer protection and criminal laws.

State Attorneys General and other state and local law enforcement authorities should vigorously enforce consumer protection laws and investigate suspected fraudulent activity by auto dealers. Given the range of cases nationwide, it appears that only the tip of the iceberg has been revealed. Given the deceitful methods used by unscrupulous dealers to defraud customers, it is imperative that law enforcement authorities take swift action to protect consumers and seek civil redress and criminal convictions before valuable evidence is destroyed.

B. Legislative actions at the state and federal level should increase auto dealer disclosure and transparency, including, at a minimum, the following:

1. Mandating that all financial and dealership documents (including handwritten, computer-generated, and printed) be contained in a single file and available to the consumer at the lender and dealership on request;
2. Requiring dealer employees to inform consumers that they do not represent the consumer, but represent the dealer and the dealer's interests;
3. Requiring that the lender's "buy rate" be posted for consumers to view at the dealership;
4. Requiring that purchase payroll records, including original pay stubs or other authenticable documents that show proof of income, be attached to bank loan papers when submitted to the lender, to avoid overestimates of income or falsification of income at dealer request by consumers;
5. Prohibiting, in all spot deliveries, "rights of rescission," the contractual conditions that allow dealers to change the material terms of a contract with the buyer after it is signed;
6. With any option to purchase additional products like extended warranties and service contracts, consumers must be shown both the pre-option sale price and amount of monthly payments, with interest, *and* the total price in sum including options and monthly payments including additional charges for extras, with interest, to allow consumers a true and clear comparison of figures;
7. Requiring that any "balloon" payments as the final payment on a loan be specifically disclosed to the consumer and a written notice of such disclosure be signed by both the consumer and dealer's agent;
8. Requiring that dealers procure a state license to sell warranties and insurance products, and that a condition of licensure be the purchase of insurance coverage to cover a dealership's total liabilities if a warranty company defaults; and
9. Forbidding mandatory arbitration clauses in vehicle purchase or other consumer contracts.

C. Consumer information efforts should be expanded.

While "buyer beware" programs are profoundly inadequate in the face of rampant and systematic fraud, certain steps taken by informed consumers can provide limited safeguards against deceptive dealer practices.

According to Duane Overholt, in advice from The Primer, a guide to auto purchases that is available at www.stopautofraud.com and Remar Sutton, President of The Consumer Task Force For Automotive Issues (at www.autoissues.org), some important tips for prospective car buyers include:

- **Find outside financing first, before entering a dealership.** Financial groups like credit unions generally provide the lowest auto loan price for which consumers qualify, and outside financing reduces the paperwork shuffle at the time of purchase that can conceal fraud. Do not deal with any lending institutions (including credit unions) offered through the dealership.
- **Do not give the dealership written permission to pull your credit information or your personal information (such as Social Security Number)** until you are ready to negotiate the sale of a vehicle.
- **Avoid any dealer that requires signature on a mandatory arbitration or “dispute resolution” clause or agreement.** By signing the contract, the consumer agrees to binding arbitration to settle any future dispute and also waives the right to sue or appeal—even if the dealership committed fraud.
- **Be willing to walk away.** Resist the pressure to buy—and slow down and read the fine print! Ask lots of questions about what is contained in the price and the limitations and exclusions of any services or products. Negotiate away extras and add-ons.
- **Stay away from “spot” deliveries.** Dealers can exploit on-the-spot vehicle purchases through writs of rescission inserted into the purchase contract, allowing a consumer to drive the vehicle off the lot — then changing the material terms of the contract later when, for example, the deal is refused by the lender.
- **Remember that extended warranties can be cancelled, even after the fact.** Written notification of cancellation of extended warranties results under law in a pro-rate refund on the remainder of the cost of the warranty.
- **Remember the price of the new car is not where the dealer makes money.** Dealers may sell their vehicles at “zero profit” — and then make thousands on what they squeeze into the contracts, with or without consumer knowledge. It is important to stay alert to extras, bonuses and alleged freebies. Nothing is free.