

Loan Discrimination At The Auto Dealership: Current Cases, Strategies and The Case For Intervention By Attorneys General

Imagine walking into an auto dealership with the intention of purchasing a new car. After walking the showroom floor and test-driving a mid-sized sedan, you tell the salesperson that you'd like to purchase the car but, in order to do so, you will need financing. The salesperson hands you some papers to fill out which request the routine personal and financial questions, such as your income and current debt. The form includes a provision which authorizes the dealership to retrieve your credit report. The salesperson then asks you to wait while she obtains approval for the interest rate on the loan for the car you are about to purchase. When she returns, she informs you that for a \$15,000 loan, to be paid over 5 years, the interest rate is 8 percent. She assures you that it's "the best she can do." You agree and leave the dealership with a brand-new car. Now imagine a second customer walks into the showroom. The second customer wants to buy the same car and borrow the same amount of money, payable over 5 years. The second customer's credit score is the same as the first customer's score. This time, however, the salesperson informs the customer that his interest rate is 12 percent. Why is the interest rate for the second customer so much higher than the first, given that their credit scores were identical? One explanation relates to a fact left out of this hypothetical; the first customer was white and the second was black.

For more than a decade, researchers have suspected that car dealerships, and the finance corporations that back the auto loans the dealers offer to customers, have charged minority customers a higher interest rate than similarly situated, white customers. Until recently, however, auto dealers and finance corporations have largely avoided the ire of the public and even the customers that are victims of discriminatory interest rate mark-ups. In the last few years, as evidence of discriminatory practices has emerged, a few key class-action lawsuits have been filed, alleging discriminatory lending based on customers' race. Although these suits have been moderately successful, especially in bringing attention to the problem, much more can be accomplished.

This paper argues that auto dealerships and finance corporations continue to charge minority customers higher interest rates on their auto loans. To attack this act of overt discrimination, state attorneys general ("AG") should pursue class action lawsuits against auto dealers and finance corporations that discriminate in the calculation of a customer's interest rate. Action by AGs is desirable because the problem is wide-spread and attorneys general are well situated to bring this issue the attention it deserves. A multi-state action, led by AGs will exact the maximum amount of leverage from defendants that charge illegal markups. This paper is divided into five parts. The first part lays out the basic nuts and bolts of auto financing. The second part details empirical evidence of unlawful loan markups. The third part of the paper explores past and current legal efforts to tackle the problem. The fourth part argues for a multi-state lawsuit brought forth by AGs. Finally, the paper offers a few concluding remarks.

I. The Anatomy of Auto Financing

About 70 percent of new automobile buyers require some kind of financing, a loan, to purchase an automobile.¹ Consumers have a variety of options available to them for financing a new automobile. For the purposes of this paper, it is best to create two types, or classes, of finance institutions. In one class, are the auto dealerships, which rarely have the capital to finance their own vehicle sales. Most auto dealerships have a contract with an auto finance institution which provides the loans for the cars sold by the dealership. The General Motors Acceptance Corporation, for example, finances loans on automobiles bought at dealerships across the country. In another class, are financial institutions which have no connection to an auto dealership but offer auto loans. Your local bank or credit union is a good example.

About one-third of all buyers rely on the first class, auto dealers, to finance their new car.² Few prospective buyers obtain their own financing, *prior* to setting foot inside the showroom floor. For those that obtain prior financing, they have the significant advantage of “shopping” around for a low interest rate at various financial institutions.³

Before explaining how a particular customer’s interest rate is determined, a brief explanation of the relationship between the dealer and the auto financier is appropriate. Typically, a dealer would contact a financier and expresses an interest in offering loans at the dealership from the financier. The financier then decides whether the dealer can participate in the financier’s loan program. Dealers approved by the financier are authorized by the financier to provide finance information to the customer, including information regarding terms, rates and the general policies of the financier. The dealer is required to adhere to all of the financier’s policies, including those regarding markups. Financiers typically compensate dealers for approved loans. The relationship between the financier and the dealer is therefore one of financial privity, the dealer and financier both benefit from dealer financing, especially in the case of markups.

Customers that seek financing from the dealer are required to fill-out forms which request standard financial information from the customer such as income, current debt and authorization for the dealer to check the customer’s credit score.⁴ The dealer uses all of this information in order to calculate the customer’s interest rate, called the annual percentage rate, or “APR.”⁵

¹ Carolyn Said, *Minorities Charged Higher Rates For Car Loans*, THE SAN FRANCISCO CHRONICLE, Jan. 26, 2003, at G1.

² Said.

³ The Internet has made interest rate “shopping” much easier; consumers can go to sites such as <http://www.bankrate.com> or <http://www.carconsumers.com> to compare interest rates on loans in their area.

⁴ The complaint in *Pakeman v. American Honda Finance Corporation* alleges that Honda “considers numerous risk-related factors, including credit bureau histories, anticipated loan payment amounts, the customer’s payment-to-income ratio, debt ratio and various other risk-related attributes or information.”

⁵ The APR is the total finance charge equal to the sum of (a) the non-discretionary buy rate plus (b) the discretionary finance charge markup, if any, plus, in some cases, (c) miscellaneous non-discretionary charges such as insurance charges.

Two components comprise a particular customer's interest rate on an auto loan. The first component is known as the "buy rate." The buy rate is determined by a computerized credit rating system controlled by the lender and based strictly on credit and risk factors. The computerized system gives a minimum interest rate to the dealer which constitutes the lender's authorization to give the customer the loan at that rate. The buy rate can be thought of a risk index on the likelihood of default from the particular customer.

The second component is known as the "markup," which can boost the final interest rate on the auto loan offered to the customer. The mark-up is standardless and discretionary for the dealer, it has nothing to do with the customer's credit-worthiness or the cost of processing the loan. The dealer usually gets to keep about 75 percent of such markups with the remaining 25 percent going to the lender.⁶

These two components create the customer's interest rate on the automobile loan. The buy rate represents the absolute lowest a dealer can go. The "buy rate" in the hypothetical that began this paper is 8 percent. When the dealer tells the second customer that 12 percent is as low as she can go, she is not speaking truthfully.

II. The Prevalence of Interest Rate Mark-Ups In Auto Loans

Minority car buyers across the country are the targets of unlawful auto loan markups, and three key studies confirm this hypothesis. Yale law professor Ian Ayres was the first researcher to demonstrate that auto dealerships were marking-up the interest rates on loans secured by minority lenders.⁷ Ayres' study was conducted in 1991 and tested new car dealerships in Chicago. The study sent "testers," subjects posing as car buyers, to various auto dealerships to negotiate for the purchase of a new car. The testers were of several races and ethnicities. The study's results showed that dealerships offered significantly lower prices to white male testers than to similarly situated black and-or female testers: white female testers were asked to pay 40% higher markups than white male testers; black male testers were asked to pay more than twice the markup of white male testers; and black female testers were asked to pay more than three times the markup of white male testers.⁸

Four years later, Ayres tested the conclusions of his original study, employing a new quantitative method of identifying the causes of discrimination. Ayres' second study included more testers, the testers negotiated for a larger number of cars, and the second test provided for enhanced controls, such as negotiating scripts. The results were similar;

⁶ Caroline E. Mayer, *Car-Loan Rates Marked Up More for Blacks, Report Says*, THE WASHINGTON POST, Oct. 1, 2003, at E01.

⁷ Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 819 (1991) (hereinafter "Ayres I").

⁸ Ian Ayres, *Further Evidence Of Discrimination In New Car Negotiations And Estimates Of Its Cause*, 94 MICH. L. REV. 109 (1995) (hereinafter "Ayres II").

auto dealers were subjectively charging minority customers higher interest rates compared to similarly situated white customers.

Although Professor Ayres' study was groundbreaking, the most comprehensive study of markups was released last year by Vanderbilt business professor Mark A. Cohen. Professor Cohen studied more than 1.5 million General Motors Acceptance Corporations ("GMAC") loans made between 1999 and April 2003.⁹ Cohen's study revealed that African-Americans are three times as likely as similarly situated white customers to be charged an interest rate mark-up on their loans financed by the General Motors Acceptance Corporation. According to the report, discrimination in the GMAC loans was across the board, regardless of the profession of a buyer or model of car purchased. Cohen's report concludes that after conducting "numerous statistical tests" the higher interest rate charged to African-Americans cannot be explained by "creditworthiness or other legitimate business factors."¹⁰

The exact dollar figures in the report are startling. Cohen's report claims that black borrowers paid an average of \$1,229 in extra interest over the life of a loan, compared with the average of \$867 paid by whites.¹¹ Black postal workers paid an average of \$811 more than white postal workers for car loans.¹² Black teachers paid an average of \$595 more than white teachers.¹³ Even black General Motors employees paid more than their white counterparts to get a loan.¹⁴ In addition to higher comparative interest rates, black customers are less likely to be offered preferential interest rates. Thirty-six percent of African Americans received interest-free percent loans and other special financing incentives, compared with 61 percent of white borrowers. Similarly, black college graduates were less likely to be offered below-market interest rates on car loans for recent college graduates.¹⁵ Cohen's report claims that GMAC borrowers were charged a total of \$421.6 million dollars in subjective markups. Nearly 20 percent was paid by blacks even though they were only 8.5 percent of the borrowers.

The statistics for Hispanic car buyers bear the same results in the Cohen study. Sixty-seven percent of Hispanics were charged a markup compared to 47 percent of whites.¹⁶

Interest rate mark-ups are a national phenomenon, although there is great variation among states. The greatest difference was in Wisconsin, where black customers

⁹ Mark A. Cohen, *Report on the Racial Impact of GMAC's Finance Charge Markup Policy*, Aug. 29, 2003, <http://www.consumerlaw.org/initiatives/cocounseling/content/GMAC/CohenReport.pdf>, last visited 12/04/2003 (hereinafter "Cohen Report").

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

paid five times as much as white customers in loan mark-ups. California, by way of comparison, suffered from a 1.3 percent markup.¹⁷

Richard Voith, senior vice president of Econsult, a financial-research firm in Philadelphia, has found results similar to those in the Cohen report. Voith's study was limited to Hispanic car buyers in Chicago. The study, based on millions of Ford Motor Credit loans made between 1997 and 2001, found that buyers with Hispanic surnames paid an average of about \$ 266 more per loan than did non-Hispanics with similar credit histories.¹⁸ The study also found that the average loan mark-up for borrowers with Hispanic surnames was 3.46 percentage points.¹⁹ The average non-Hispanic customer got a 2.78 percentage point mark-up.²⁰ Ford Motor Company has denied the conclusions of the Voith report, claiming that the study was methodologically flawed and that Voith overstated bias and ignored evidence contradicting possible discrimination.

Dealers frequently justify markups as an insurance policy against default on the loan. Dealers claim that when a customer defaults, and files for bankruptcy, the dealer is shielded from collecting the loan from the customer. The "default risk" argument, however, is flawed because the vast majority of dealer-financer arrangements place the risk of default on the financer, not the dealer. Regardless of the merits of this justification for markups, if the fear of bankruptcy truly motivates markups, there is reason to expect that the practice will continue. To compete with overseas automakers, Ford, General Motors and Daimler Chrysler have recently decided to extend their loans from 5 years to 6 years.²¹ The number of 6 year loans will rise to 300,000 within 3 years from 34,000 in 2001.²² The extension means that the American automakers will take-on additional default risk. Car buyers are more than twice as likely to default on a 6 year loan compared to a 5 year loan.²³ Even longer loan repayment terms may not be far from becoming a reality; some banks have begun to offer 7 year loans.²⁴ The incentive for dealers to markup auto loans should, therefore, grow in the future.

III. Legal Strategies To Address Auto Loan Discrimination

This section discusses a few key cases regarding auto loan markups. In the last several years, there have been eleven class action lawsuits filed alleging unfair markups. The cases discussed in this section should guide attorneys general in mounting a multi-state lawsuit against dealers and financers. The following lessons can be distilled from

¹⁷ *Id.*; For a state-by-state analysis of finance markups, see <http://www.consumerlaw.org/initiatives/cocounseling/gmacreportbystate.shtml>.

¹⁸ Tony Pugh, *Ford Disputes Claims Alleging Hispanic Car Buyers Paid More for Their Loans*, KNIGHT RIDDER WASHINGTON BUREAU, Jun. 26, 2002.

¹⁹ Pugh.

²⁰ Pugh.

²¹ Jeff Green, *GM, Ford lend over six years to attract car buyers*, Feb. 28, 2003, http://www.auto.com/industry/iwird28_20030228.htm, last visited 12/04/2004.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

the cases. First, state claims are superior to federal claims. State law tends to be more favorable to the plaintiff compared to federal law. Second, seeking a change in business practices as the primary goal, instead of monetary damages, is important to certifying a class of plaintiffs. And, third, coordination and publicity are essential to obtain maximum leverage for the AG. Auto dealers and finance companies tend to settle quickly, AGs should use this to their advantage.

A. The GMAC Lawsuit

The GMAC lawsuit was filed in 1998, the suit alleged discriminatory markups and the primary relief sought were monetary damages. After the initial lawsuit against GMAC was filed, the company changed its markup policies, first limiting them to 4 percent above the interest rate based on creditworthiness and other objective factors. The lawsuit continued, however. Last year, Professor Cohen released his report exposing GMAC markups. In response, GMAC insisted that it does not tolerate discrimination, but other than this likely rebuke, GMAC's public response to the Cohen report has been limited. GMAC spokesman James Farmer claimed that the Cohen report contains numbers and figures that GMAC is unfamiliar with. Farmer said that GMAC does not ask for borrower's race on any of its credit applications. Farmer also said that although Cohen had access to 6.2 million GMAC transaction records, Cohen limited his study to the 1.5 million in which race could be determined, suggesting strongly that GMAC would challenge Cohen's research methods at trial.²⁵

Prior to the Cohen report, the GMAC lawsuit suffered a setback when a federal appeals court broke-up the class because the lawsuit was improperly certified under Federal Rule of Civil Procedure 23(b)(2).²⁶ In July 2002, the court held that because the lawsuit primarily sought monetary damages, the class could not be certified under Rule 23(b)(2).²⁷ Rule 23(b)(2) requires that "the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole."²⁸ The court reasoned that the advisory committee's notes explain that this subdivision "does not extend to cases in which the appropriate final relief relates exclusively or predominantly to money damages."²⁹ The class therefore, was decertified. The court declined to reach a decision on any other aspect of the class which may have been defective, such as typicality, a requirement under Rule 23(a).³⁰ In a case against Ford Motor Company, a federal district court held that a class composed of Hispanic car buyers satisfied the requirements of Rule 23(a), but because the suit sought monetary awards, class certification was improper due to the individualized nature of each plaintiff's claim³¹

²⁵ Mayer.

²⁶ Fed. R. Civ. P. 23(b)(2).

²⁷ *Coleman v. GMAC*, 296 F.3d 443, 447 (6th Cir. 2002).

²⁸ Fed. R. Civ. P. 23(b)(2).

²⁹ Fed. R. Civ. P. 23(b)(2) advisory committee's note.

³⁰ Fed. R. Civ. P. 23(a).

³¹ *Rodriguez v. Ford Motor Credit Co.*, 2002 U.S. Dist. LEXIS 7280 (N.D. Ill. 2002).

Following this ruling, the plaintiff's lawyers dropped their request for monetary damages, seeking declaratory and injunctive relief. Surprisingly, GMAC settled the lawsuit. In August 2002, one month after GMAC won in federal court, GMAC reduced the markup cap to 3 percent. The 3 percent cap appears to have been drawn from the Nissan settlement, discussed in the next section, which also settled on a 3 percent cap. GMAC also agreed to make a \$100,000 donation to the Rainbow/PUSH coalition to educate consumers about auto loan finance.

The following lessons can be distilled from the GMAC case. First, federal courts are hostile to class actions that primarily seek monetary damages. The GMAC suit faced procedural difficulties because the primary remedy sought were monetary damages. The Nissan suit suffered a similar fate. Second, the GMAC case shows that auto financiers do not want bad press. Once the class was decertified, and the lawsuit modified to ask for injunctive relief, GMAC was willing to settle. If faced with dozens of similar suits across the country, GMAC may be persuaded to concede even more. After all, GMAC only keeps twenty-five percent of the markup, the dealer keeps the lion's share. Finally, the GMAC settlement contained a provision for consumer education, a valuable part of any settlement, which will be explored later in this paper.

B. The Nissan Lawsuit

In 2002, a class action lawsuit was filed against Nissan Motor Acceptance Group (NMAG). The Nissan suit suffered from the same procedural defect in the GMAC case, the plaintiff's demands for monetary damages, and specifically for the "disgorgement of profits," dominated the request for injunctive and declaratory relief. The federal district court, therefore, broke-up the class as to the monetary relief but allowed the class to pursue injunctive and declaratory relief.³² Significantly, however, the court did not consider its prior ruling that the class met the requirements of Fed. R. Civ. P. 23(a).³³

The plaintiffs in the Nissan lawsuit hired Professor Ian Ayres to testify that Nissan's markups targeted minority customers. His testimony claimed that NMAG did not charge a markup to over half of all white customers while over half of African American paid a markup of more than \$700, allowing markups in some cases as high as five percentage points.³⁴

In February of last year, the suit against NMAG was settled. As part of the settlement, Nissan agreed to tell consumers that interest rates on loans are negotiable; Nissan set a 3 percent cap on markups; and Nissan agreed to offer pre-approved credit, with no markups, to 675,000, African Americans and Hispanic car buyers over the next five years.

³² *Cason v. Nissan Motor Acceptance Corp.*, 212 F.R.D. 518 (M.D. Tenn. 2002)

³³ *Id.*

³⁴ Said.

The Nissan case was a victory for the minority consumer. The settlement's focus was on changing Nissan's practices, not on monetary awards. As with the GMAC, keeping the focus of the lawsuit on injunctive and declaratory relief is critical to keeping the class in order. The Nissan settlement also educated consumers, a valuable aspect of the settlement. In the end, however, Nissan can charge up to 3 percent more on any car loan. Hopefully, the effect of this settlement will be that Nissan and Nissan approved dealers will refrain from marking up minority customers' loans. If Nissan had felt the pressure of a coordinated, national attack from thirty or forty AGs, perhaps Nissan's concessions may have been greater.

C. The Lief Cabraser Lawsuits

This year, attorneys at Lief Cabraser Heimann & Bernstein LLP filed a statewide class action complaint against American Honda Finance Corporation, the lender for the Honda Motor Company³⁵; WFS Financial, Inc., one of the nation's largest independent auto loan lenders³⁶; and Toyota Motor Credit Corporation, the lender for Toyota Motor Company.³⁷ The plaintiffs in the suit against Honda are African-American and Hispanic customers³⁸; the plaintiffs are African-American and Hispanic in the suit against WFS Financial³⁹; and in the suit against Honda, the plaintiffs are Hispanic.⁴⁰

The cases are filed under two California statutes: the Unruh Civil Rights Act, which prohibits discrimination in lending against persons on the basis of race, color, or national origin, and includes provision for award of damages, with a minimum of up to \$4,000 per incident of discrimination⁴¹, and the Unfair Competition Law, which prohibits businesses from engaging in illegal or unfair practices, and provides for restitution of money obtained through such practices.⁴² The complaints in all three cases name finance corporations as defendants. Dealers, however, are also a fair target for a lawsuit. After all, it's the dealer that makes the decision to markup a loan; finance companies either encourage the practice or turn a blind eye to the practice. Dealers cannot hide behind the finance corporation to shield them from liability, at least on federal district court has denied an auto dealer's motion for summary judgment on these grounds.⁴³

All three lawsuits describe the auto financing process in a manner similar to the description offered in Section I. An essential component of the complaint is establishing that markups are standardless, and not related to any objective economic or financial

³⁵ *Pakeman v. American Honda Finance Corp.*, Case No. RG03088920, Complaint filed in Superior Court of the State of California, County of Alameda, Mar. 27, 2003.

³⁶ *Thompson v. WFS Financial, Inc.*, Case No. RG03088926, Complaint filed in Superior Court of the State of California, County of Alameda, Mar. 27, 2003.

³⁷ *Herra v. Toyota Motor Credit Corp.*, Case No. RC-03-419230, Complaint filed in Superior Court of the State of California, County of San Francisco, Mar. 27, 2003; Collectively referred to as "Complaints."

³⁸ *Pakeman*.

³⁹ *Thompson*.

⁴⁰ *Herra*.

⁴¹ Cal. Civ. Code §§ 51 and 52.

⁴² Cal. Bus. & Prof. Code § 17200.

⁴³ See *Osborne v. Bank of Am., N.A.*, 234 F. Supp. 2d 804 (M.D. Tenn. 2002) (holding that a dealer, even if acting as the assignee of the loan, is a "creditor" and subject to federal lending law).

factor. To assert this point, the complaints alleged that, “In setting the finance charge markup, dealers do not consider vehicle status (e.g., new/used, model, etc.), trade-in being made, financing period, the customer’s financial variables (e.g., credit worthiness, income, occupation, etc.), or any other risk-related factor, because [the defendant] already considered those factors when it determined the customer’s credit worthiness tier and resulting buy rate.”⁴⁴ The complaints go on to allege that the defendant’s knew or should have known that approved dealers disproportionately markup minority customer’s loans.

The Nissan case, which was settled prior to the filing of these cases, is cited by all three complaints for two propositions. First, the complaints argue that the study relied on in the Nissan case can be used by the plaintiff to infer racial profiling in these cases.⁴⁵ Second, the plaintiffs argue that the Nissan case should have put the defendants on notice of the markup issue.⁴⁶ In addition to the Nissan case, the complaints cite a State of New York Banking Department noticed, issued in 2001, which warned “automobile finance entities” of the possible discriminatory misuse of loan markups.⁴⁷

Finally, the suits ask the court to grant “equitable relief, including an injunction” barring the “discriminatory business practices, restitution[,] disgorgement of profits” and “damages.”⁴⁸ The lawsuit is pending and has received significant national newspaper coverage following the filing of the lawsuit.

D. The Viability of Federal Claims

Federal claims, based on racial discrimination, are more difficult to prove in the auto loan context. Attorneys general should pursue state claims against auto financiers instead of federal claims. State law, like that of California, tends to be more favorable to the plaintiff, usually because of a lower burden of proof. This section comments on two common federal consumer protection laws, 42 U.S.C. §§ 1981 and 1982.

Sections 1981 and 1982 mandate that all people shall have the same rights "to make and enforce contracts" and to "purchase . . . personal property," respectively, "as is enjoyed by white citizens."⁴⁹ To make a case for discrimination under either Section 1981 or 1982, the plaintiff claiming disparate treatment must prove that the defendant intentionally discriminated against them and caused them an identifiable injury.⁵⁰ Plaintiffs can prove discrimination in one of two ways, first, they can show that the defendant intentionally discriminated against them on the basis of race, or, the plaintiff can submit evidence of disparate treatment that infers discriminatory intent.⁵¹

⁴⁴ See Complaints, *supra* 34,35,36.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ Ayres I.

⁵⁰ *Id.*

⁵¹ The second method of proof was borrowed from the Title VII context, for a more complete discussion of burden shifting and the technical aspects of disparate treatment, see Ayres I.

Using Professor Ayres' study as an example, which employed testers as potential buyers, the plaintiff would have to persuade a court to accept two arguments. First, the plaintiff would have to show that the study was sufficiently controlled.⁵² Second, the plaintiff would have to persuade the court that the instances of preferential treatment were too numerous to be explained by anything other than race, ethnicity or national origin.⁵³ If successful on these two points, the burden would then shift to the defendant to prove a legitimate, nondiscriminatory explanation for why it treated white buyers and black buyers differently.

When Professor Ayres published the results of his study in 1991, he was cautious to suggest that lawsuits could be successfully pursued under Section 1981 and 1982. By the time he wrote his 1995 law review piece he had all but retreated from his earlier stance on the effectiveness of litigation in general, and the likely success of Section 1981 and 1982 lawsuits in particular.

Section 1981 and 1982 suits are difficult to prove in the automobile context because disparate treatment claims require the showing of intent to discriminate. Disparity in treatment alone is insufficient, and dealers can resort to a number of possible explanations which may admit disparate results but deny "intentional" discrimination. Disparate treatment, a theory not actionable under Sections 1981 and 1982, by way of comparison, does not require the plaintiff to demonstrate intent to discriminate by the defendant. Courts have guarded this principle closely and have hindered the success of loan markup cases. Employers also have at their disposal number of defenses which are difficult for the plaintiff to breach. Employers can attribute markups to individual deficiencies in bargaining skill or general ignorance of the financing process. The new car industry, unlike the mortgage or housing market, has traditionally tolerated aggressive sales tactics and shrewd bargaining.

IV. The Case For Intervention By Attorneys General In Auto Loan Markup Cases

This section argues that attorneys general should pursue legal action against lenders that markup auto loans on the basis of race. The advantages of a multi-state AG action are discussed.

A. The Authority And Desirability Of Attorneys General To Act

Every state has a consumer protection law, or a lending law, which prohibits discrimination in lending on the basis of race. Attorneys general can bring claims, such as those in the Lieff Cabraser suit in California, under those statutes. Additionally, consumer protection is a well defined and recognized function of the AG who acts as "*parens patriae*," literally "parent of the country," in his or her office. "Several kinds of state laws, including unfair and deceptive practices laws, can be viewed as statutory

⁵² Ayres I.

⁵³ Ayres I.

embodiments of *parens patriae* principles.”⁵⁴ Attorneys General, therefore, are well within their powers to bring lawsuits against auto lenders for unlawful markups.

Bringing AGs into loan markup discrimination will exact greater leverage for the plaintiffs in these lawsuits. The AGs office, when working with other AG offices, is a powerful legal and social force which can use its leverage to exact larger concessions, both in number and size. As Tom Miller, the Attorney General of Iowa, has said, "What we've found is that by coming together, the dynamics of the cases change... . When a corporation discovered it had to face 30 states, instead of one, it suddenly became much more serious about dealing with the issue."⁵⁵ Coordinated AG action should, therefore, not only pave the way for a uniform, national solution to auto loan markups, the added force of coordinated action should result in greater concessions from defendants.

B. Unfair and Deceptive Business Practices

An alternative approach to the current race-based litigation would be for AGs to pursue lawsuits based on unfair and deceptive trade practices. In addition to avoiding the socially charged issue of racial discrimination, consumer protection law may prove to be a more certain path to victory in the courtroom. This section recommends AGs to include an unfair business practices cause of action in any complaint against an auto lender.

Federal and state laws prohibit deceptive and unfair business practices. The Federal Trade Commission (“FTC”) is responsible for enforcing federal law. Every state has enacted an Unfair and Deceptive Trade Practice (“UDAP”) statute. These statutes are largely modeled after federal consumer protection laws such as the 1938 Wheeler-Lea Amendments to the Federal Trade Commission Act (“FTCA”) and the Uniform Deceptive Trade Practices Act.⁵⁶ The primary purpose of these state “little FTC acts” was to protect “the public - that vast multitude which includes the ignorant, the unthinking and the credulous.”⁵⁷ Because the state protections borrow heavily from federal statutes, state courts largely rely on the federal courts’ and the FTC’s interpretation of what constitutes an unfair or a deceptive trade practice.

The federal statute defining deceptive trade practices is expansive. And unlike Section 1981 or 1982, the plaintiff does not need to prove intent to deceive under federal consumer deception law. “The FTC’s current standard for determining a deceptive trade practice is that the act or practice must be likely to deceive or mislead consumers acting reasonably under the circumstances. Many federal courts also agree that any business practice that offends established public policy and is immoral, unethical, oppressive,

⁵⁴ Theodore Eisenberg & Richard P. Ieyoub, *Class Actions In The Gulf South Symposium: State Attorney General Actions, The Tobacco Litigation, And The Doctrine Of Parens Patriae*, 74 TUL. L. REV. 1859 (2000).

⁵⁵ Jason Lynch, *Federalism, Separation Of Powers, And The Role Of State Attorneys General In Multistate Litigation*, 101 COLUM. L. REV. 1998 (2001).

⁵⁶ Michael Flynn and Karen Slater, *All We Are Saying Is Give Business a Chance: The Application of State UDAP Statutes to Business-to-Business Transactions*, 15 LOY. CONSUMER L. REV. 81(2003).

⁵⁷ *Id.*

unscrupulous, or causes substantial injury is an unfair trade practice.”⁵⁸ Federal and state law, therefore, offer an AG a broad sword with which to strike-down unfair and deceptive trade practices.

The Supreme Court of Hawaii, for example, has explained that the state’s unfair and deceptive business practices statute, “as its federal counterpart in the FTC Act, was constructed in broad language in order to constitute a flexible tool to stop and prevent fraudulent, unfair or deceptive business practices for the protection of both consumers and honest businesspersons.”⁵⁹ Hawaii, therefore, adopted a broad definition of unfair practices, relying on a federal appeals court opinion, which held that “[a] practice is unfair when it offends established public policy and when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.”⁶⁰

In some instances, state law may be superior to federal law because a state’s consumer protection may go beyond what the federal law protects. Maryland, for example, has gone beyond the scope of federal protections, giving consumers greater powers to sue unscrupulous business practices. The Maryland Code prohibits:

“(1) False, falsely disparaging, or misleading oral or written statement, visual description, or other representation of any kind which has the capacity, tendency, or effect of deceiving or misleading consumers;”⁶¹ and,
 “(3) Failure to state a material fact if the failure deceives or tends to deceive[.]”⁶²

Maryland courts have interpreted the state’s Consumer Protection Act broadly, stating that “a material misrepresentation involves information that is important to consumers, and, hence, likely to affect their choice of a product.”⁶³ A liberal consumer protection law, like the law in Maryland, will assist AGs in pursuing a lawsuit against auto lenders.

Common law theories of usury and fraud may also be of assistance to AGs in markup cases. In Maryland, for example, a plaintiff seeking redress under theories of fraud and deceit must demonstrate five facts:

- 1) that the defendant made a false representation to the plaintiff,
- 2) that its falsity was either known to the defendant or that the representation was made with reckless indifference as to its truth,
- 3) that the misrepresentation was made for the purpose of defrauding the plaintiff,
- 4) that the plaintiff relied on the misrepresentation and had the right to rely on it, and
- 5) that the plaintiff suffered compensable injury resulting from the misrepresentation.⁶⁴

⁵⁸ *Id.*

⁵⁹ *Hawai’i Cmty. Fed. Credit Union v. Keka*, 94 Haw. 213, 228 (Haw. 2000) (citations omitted).

⁶⁰ *Id.*

⁶¹ Md. Commercial Law Code Ann. § 13-301 (2002).

⁶² *Id.*

⁶³ *Luskin’s, Inc. v. Consumer Protection Div.*, 726 A.2d 702 (Ct. App. Md. 1999).

⁶⁴ *Nails v. S & R*, 639 A.2d 660 (Ct. App. Md. 1994).

If a car salesman tells a customer, after marking up her interest rate, that the rate offered to the customer is “the best I can do,” as is often the claim, an auto dealer may have committed fraud in the state of Maryland. In this hypothetical, the salesperson knowingly marked up the interest rate and falsely told the customer that it was the best price she could offer the customer, making out the first two elements of the tort. Knowing that the customer’s “buy rate” is lower than the quoted rate, the dealer may be viewed as defrauding the customer, especially if a similarly-situated customer, independent of race, is offered a lower rate. This would satisfy the third element. The customer’s reliance on the dealer’s representation, which ultimately lead the consumer to accept the higher interest rate leads to the customer paying more for the loan than others in his position, establishing the final two elements of the tort.

For AGs to pursue an unfair and deceptive business practices cause of action, a complaint would be required to allege that dealers have defrauded their customers. This would require amending the Lief Cabraser complaints, for example, to include the dealer as a defendant. The case for pursuing an unfair business practices claim is strongest against the dealer because she is the entity making the misrepresentation or misleading the consumer. The finance entity, however, may also be reached under this theory if the complaint alleges, as the Lief Cabraser complaints do, that the finance entity knew or should have known of the dealers unfair tactics.

Federal, but especially state consumer protections laws, therefore, are a valuable tool for AGs in auto loan markup cases. These powerful, consumer-driven laws should maximize the AG’s bargaining power and produce sizable settlements.

C. Multi-State AG Action Will Mobilize Public Opinion

Attorneys general are well suited to achieve needed public and legislative awareness to fully address the auto loan markup problem. As one observer noted, “Before the tobacco settlement, most people were only vaguely aware of the role of their state A.G... . But now the A.G.'s have a national awareness, and a positive one at that. That's a powerful tool. And you can't underestimate that.”⁶⁵ An educated consumer is best able to protect him or herself. Putting loan markups on the “radar” screen of the national news may help the drive towards legislative solutions to the problem, as was the case in California where AG Lockyer took an important interest in the auto loan discrimination issue.

Social activists have already expressed concern over markups. In February of last year, black religious and civic leaders announced plans for a national boycott of Chrysler products based on claims of discriminatory markups in a federal lawsuit.⁶⁶ The group, lead by the Reverend Jesse Jackson, was instrumental in bringing the markups issue to the front page of newspapers such as the Chicago Tribune and New York Times. Attorneys general can build on this momentum by filing a multi-state lawsuit.

⁶⁵ Lynch.

⁶⁶ Rick Popely, *Bias allegations could be pothole for Chrysler; National boycott set for Saturday*, THE CHICAGO TRIBUNE, Mar. 11, 2003, at 1.

Virtually every dealer or finance corporation facing charges of discrimination has denied the charges, and all have capitulated in various lawsuits, making valuable concessions. Defendants are very concerned for their reputation in the marketplace, and a successful campaign by AGs can exploit this vulnerability. Some financiers, however, are inexperienced with handling the media and this too can help an AG to publicize a case. Take for example, Daimler Chrysler spokesman Martin Geers, who just prior to an announced boycott, told members of the media that the suit against the automaker would have to be “[dealt] with [] in court and not in the media.”⁶⁷ Defendant’s seeking to avoid publicity are likely to capitulate to a national, coordinated AG campaign. Those that wish to fight, may, in the end, find themselves in costly legal battles with very negative publicity.

In the last decade, the US Department of Justice (“DOJ”) successfully prosecuted cases in the home lending context similar to the auto lending cases. Mortgage companies, also driven by commissions and higher profits through mortgage markups, were pursued by the DOJ, resulting in equitable and declaratory relief. Possibly just as important, the DOJ’s efforts were well-publicized and lead to greater consumer awareness and education. As a result, consumers are much better educated and protected by federal and state officials in the area of home loans.

D. Attorneys General Should Focus On Injunctive Relief And Educating Consumers

To effectively tackle the auto loan markup problem, AGs should coordinate efforts to file lawsuits in each AG’s respective home state. One commentator has described the process as filing “virtual mirror images of the same complaint, adjusted if necessary to account for minor differences in state law” in each state.⁶⁸ Three years ago, several AGs employed this technique and obtained a multi-million dollar settlement from Publishers Clearing House.⁶⁹ This approach will allow AGs to pool common resources for each AG’s particular lawsuit. “When states bring actions in their courts that are mirror images of actions being brought by other states, their collective enforcement powers are dramatically enhanced.”⁷⁰ Defendants will face the significant costs of fighting numerous AGs in each state, a costly prospect which makes a national settlement more likely.

One of the most important objectives of any litigation should be to educate consumers about auto financing. Consumer education is essential to curbing the practice of dealer markups. Litigation alone is unlikely to deter unscrupulous auto dealers. If consumers are educated about the auto financing process, they stand a better chance of paying a fair interest rate; this is true for minority and non-minority car buyers. To facilitate consumer awareness and greater transparency in the auto financing market, state attorneys general have a number of options at their disposal. The California Department of Consumer Affairs, in cooperation with the attorney general’s office, for example, has

⁶⁷ *Id.*

⁶⁸ Lynch.

⁶⁹ *Id.*

⁷⁰ *Id.*

created a fact-sheet for car buyers.⁷¹ The fact-sheet helps consumers avoid finance markups by educating them about the auto finance process. The fact-sheet also provides contact information for state agencies that can assist consumers if they feel they were the target of an illegal markup. If dealers were required to furnish customers with a fact-sheet similar to the one in California, prior to finalizing a finance contract with the customer, consumers would be better informed to protect their rights.

Professor Ayres is a proponent of education over litigation. He believes that “[m]inor legal changes that improve consumer information may be sufficient to move the market.”⁷² If consumers had more information about the financing process and average sales, consumers would be in a better position to protect themselves from dealers that seek to profit off of a markup. “Dealerships, for example, might be required to reveal the average price for which each make of car is sold. Knowing that the dealership is attempting to charge \$ 3000 more than the average price would allow high-markup consumers to protect themselves.”⁷³ Settlements, therefore, should include provisions for consumer education campaigns and dealer disclosure requirements.

E. Fostering Legislative Solutions

At least three states have enacted legislative solutions to the markup problem. Michigan and Ohio experimented with a 2% cap on dealer markups. In these states the dealers' profits from loan arrangements and the racial disparity found are half those of the unconstrained states.⁷⁴ California recently passed a law which requires auto dealers to keep sales records on file for seven years or the life of a loan, whichever is longer, and to retain information on how a person's creditworthiness was determined. Fines for noncompliance are \$5,000 a violation.⁷⁵

Both approaches are significant improvements over the status quo, but the ultimate goal should be elimination of the practice. The California bill arms the California AG with critical information needed to pursue a lawsuit against dealers and finance companies which illegally charge markups. The California bill was drafted with the intention of assisting the AG with these cases. Then Governor Davis commented that, “This bill will allow the attorney general to end this unfair practice that tacks on thousands of dollars to the price of a car.”⁷⁶ The bill is meant to give the state attorney general's office a paper trail to detect the existence of any abusive practices, which could mean litigation under the state and federal anti-bias laws.

⁷¹ California Department of Consumer Affairs, *Predatory Auto Lending*, Aug. 2003, http://www.dca.ca.gov/r_r/predatory_lending_fact_sheet.pdf.

⁷² Ayres II.

⁷³ *Id.*

⁷⁴ Ian Ayres and Barry Nalebuff, *An Educated Consumer*, FORBES, Jun. 9, 2003, at 95.

⁷⁵ Cal Civ Code § 2984.5 (2003).

⁷⁶ Danny Hakim, *California Takes Aim At Dealer Bias In Car Loans*, NEW YORK TIMES, Jul. 16, 2003, at A12.

F. The Future of Auto Finance

From a consumer's perspective the end game for car buying is a market devoid of haggling. Not only would a no-haggle auto market benefit consumers, it is a more efficient allocation of resources for all involved. Since Professor Ayres published his 1991 study on markups, there has been a significant shift in the new car market. Only three years after the first study was published, the retail car market has seen a dramatic shift away from haggling. "More than 10% of new car dealers currently sell all of their cars at nonnegotiable prices, and more than 70% of dealers sell at least one of their models without dickering. There has also been a dramatic growth in the use of third-party buying services that bargain on behalf of individual consumers - with more than one-quarter of dealerships selling cars through such services."⁷⁷ All indications are that this trend will continue.

The rise of no-hassle car buying is a significant development in the car market because no-haggle dealers do not have an incentive to markup loans. Not only does this help consumers, it is more efficient for the new car market. "No-haggle sales require fewer sales people and fewer dealerships... The overhead at many [] dealerships and the salaries of many salespeople are paid for by a few consumers who pay disproportionately high markups. This is not only inefficient, but also unfair."⁷⁸ By reducing or eliminating a dealer's capacity to charge markups, AGs can help bring the nation's auto market closer to a no-haggle market.

V. Conclusion

State attorneys general should coordinate a multi-state campaign against auto loan markups. Each AG should file a suit in his or her home state alleging violation of state unfair and deceptive business practices and racially motivated price discrimination. A multi-state effort would maximize AG resources by allowing each office to share costs and pool resources. A coordinated effort would also exact maximum leverage on auto dealers and auto financiers, likely paving the way for a national settlement. In addition to injunctive relief, any settlement should include provisions for consumer education.

⁷⁷ Ayres II.

⁷⁸ Ayres II.