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It Takes Two to Tango: Steps a Finance Company Can Take to Protect Its Toes from a Dealership Partner with Two Left Feet

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Finding a good dance partner can be difficult. If all goes well, your and your partner's steps and turns are in sync, and you both are happy with the resulting dance. But occasionally, your dance partner may make a misstep or, worse, just step on your toes, leaving you limping. You must deal with the pain while your partner, at best, buys you a band-aid and, at worst, moves on without you.

As a finance company, your business is dependent on dealerships with which the consumer has the primary or sole contact during the vehicle purchase. The Federal Trade Commission's Holder Rule puts the creditor "in the shoes of the seller" such that a finance company's pocketbook may be impacted by a dealer's wrong step. If the consumer is successful in prosecuting his or her claims arising from dealer conduct against the creditor as the "holder" of the contract, the creditor may face the pain of the dealer's misstep through joint and several liability for the judgment. Perhaps the dealer has indemnified the finance company and pays the entirety of the judgment. But perhaps the dealer is insolvent or has disappeared. A recent California case establishes that the creditor's exposure under the Holder Rule *includes* the consumer's attorneys' fees if there is a state statute that provides for such fee-shifting, meaning that your dance partner never mattered more.

Tania Pulliam bought a certified used vehicle from HNL Automotive, Inc., and financed the purchase with a retail installment contract. The contract, as required by the Holder Rule, contained the following notice:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

HNL Automotive assigned the contract to TD Auto Finance, LLC. A couple of months after purchasing the car, Pulliam sued HNL Automotive and TD Auto, alleging that the car did not meet the requirements of the Certified Pre-Owned program or have the advertised features. The jury awarded Pulliam $21,957 in damages, and the trial court awarded her

$169,602 in attorneys' fees. TD Auto objected to its liability for attorneys' fees, arguing that the Holder Rule limited Pulliam's recovery from TD Auto to the amount she paid under the contract. The trial court rejected TD Auto's arguments. The appellate court affirmed the trial court's award.

The California Supreme Court also affirmed the trial court's award of attorneys' fees. The supreme court rejected TD Auto's arguments that: (1) the Holder Rule's plain language capping "recovery" to "amounts paid by the debtor" limits a plaintiff's ability to recover attorneys' fees against the "holder"; and (2) in the alternative, if the Holder Rule's language is ambiguous, the "FTC's interpretation in its Rule Confirmation is entitled to deference and precludes recovery of attorney's fees." The supreme court determined that the language of the Holder Rule cap is ambiguous and that the rule's history and purpose and the FTC's intent reflected no limitation on recovery as to attorneys' fees. While the Holder Rule's limitation extends to recovery of the amount paid by the debtor under the contract, the Holder Rule does not limit the recovery of attorneys' fees where state law provides for such recovery.

The supreme court highlighted that the FTC's "primary concern" underlying the Holder Rule was "the distribution or allocation of costs occasioned by seller misconduct in credit sale transactions." In other words, who is in the better position to remedy seller misconduct during a consumer transaction? The supreme court concluded that, as between the consumer and the creditor, the creditor is in the better position. The creditor has experience and knowledge in credit transactions, whereas the consumer infrequently deals with such transactions. The creditor has access to resources and information, which are often unavailable to the consumer. The creditor has the ability to obtain recourse from a seller in a relatively cheap and automatic process, whereas a consumer comparatively may have to jump through significant hoops to obtain skilled counsel, locate and serve the seller, prosecute his or her case, and obtain satisfaction of any judgment.

The supreme court emphasized that one of the biggest hurdles a consumer faces is that successfully initiating and prosecuting claims "depends on obtaining skilled counsel" and having the resources to handle heavy expenses related to discovery and litigation. Based on the rule's history, the supreme court concluded that the FTC intended the Holder Rule cap as a national floor. The FTC acknowledged and anticipated that states have enacted or would enact consumer laws authorizing additional awards of damages or attorneys' fees against a seller or holder. The supreme court rationalized that a Holder Rule cap precluding the recovery of attorneys' fees would prevent consumers from truly being able to vindicate their rights. A lawsuit would be "financially infeasible for many consumer buyers if attorney's fees were not recoverable."

Financial companies' businesses depend on their relationships with dealerships. You've gotta keep dancing, so how do you protect your toes from partners that turn out to have the occasional two left feet? In other words, how can creditors reduce potential exposure from consumer litigation?

- Reassess and update your vendor management processes. How much do you know about the dealership's vitals, such as customer satisfaction management and service and vehicle characteristics? How often do you review your relationships? What does your review entail?

- Review and update your agreements with dealers. What, if any, obligations do you want to place on the dealer to resolve consumer disputes and notify you of the resolution? How do you allocate the costs of litigation arising from a consumer dispute over the vehicle sale between you and the dealer? How will you enforce those obligations?
- Reassess the value of contracts given the potential exposure. Does increased potential exposure change the value of the retail installment contract you're purchasing? Does increased potential exposure impact an aspect of the credit you're willing to extend in direct auto loans?
- Assess the attorney-fee-shifting statutes of the states in which you do business. While the *Pulliam* case is binding only on California courts, courts in other states may reach the same conclusion. Is statutory fee-shifting available to consumers in the states in which you do a lot of business?

It all comes down to your relationships. If all goes well, finance companies' relationships with dealerships will be long, and your customers will continue to perform on their contracts. Take the time to check out your partner (the dealer) and the dance floor (state laws), and make sure you're comfortable with the steps you both are taking in this dance to navigate potential exposure (vendor management and dealer agreements).

Pulliam v. HNL Automotive, Inc., 2022 Cal. LEXIS 2914 (Cal. May 26, 2022).

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