CALIFORNIA NEW CAR DEALERS ASSOCIATION

DEALER MANAGEMENT GUIDE 16th EDITION

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IMPORTANT NOTICE

The following material consists of a series of chapters, each of which summarizes the basic laws and legal rules and regulations applicable to areas of special interest to franchised new motor vehicle dealers in the State of California.

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The chapters are intended as a guide to the general principles of law which pertain to each subject. Special effort has been devoted to presenting the information in a clearly understandable manner without disturbing, in any way, the correctness and integrity of the content. Consequently, it has become necessary in some cases to recite verbatim the entire text of the statutes, code sections, regulations or other source material; however, in most instances source material has been summarized and presented in a direct and simple manner with emphasis upon the fundamentals. Remote collateral points and side issues have been avoided.

For the complete text of many of the state laws and regulations mentioned in this Guide, the reader may wish to use as a handy reference a paperback publication of the California Department of Motor Vehicles, entitled "Vehicle Code and Other Statutes," available at a modest cost from any of its offices. This DMV publication is revised yearly to keep abreast of changes in the law. The Vehicle Code is also online at: http://www.dmv.ca.gov/pubs/vctop/vc/vc.htm. To find the text of any California statute cited in this Guide online, go to www.leginfo.ca.gov/calaw.html. Check the particular code and click on "Search". Then click on the code section you want to see. For California regulations online, go to www.oal.ca.gov/ and click on California Code of Regulations.

Under no circumstances is any portion of this work intended as, nor should it be received as, legal advice or a substitute for legal advice. For those engaged in the complex world of selling, leasing, and servicing motor vehicles, the number and variety of potentially unique and distinguishable fact situations is infinite. With each variation of fact, there arises the possibility of an entirely different legal opinion.

The reader is cautioned that this Guide is intended as a source of guidance to Dealers and an aid in recognizing and dealing with certain issues. The law is subject to constant change and there may have been developments since the last revision to various chapters.

This 16th edition of the Management Guide has been updated through December 2012

The following material should not, under any circumstances, be considered a substitute for consultation with an attorney, nor as a legal opinion or as any type of official view or position of the authors. Neither the authors nor the Association make any express or implied warranty in regard to the use of the materials set forth. Each dealer and his or her attorney must depend upon his or her own knowledge of the law and expertise in the use of these materials.

USING THIS GUIDE

Organization of Guide: This Guide is organized into chapters, each dealing with a particular subject of concern to members in the management of their dealerships. The initial chapters discuss legal issues pertinent to the dealership's relationship with its customers: sales contracts, leasing, credit reports and decisions, privacy, safeguards, identity theft, and red flags, telemarketing, fax, and email rule, insurance, autobrokers, new and used car warranties, vehicle service contracts, the service department, and liens on vehicles and lien sales. Subsequent chapters discuss the dealer's relationship with other parties such as the Department of Motor Vehicles, the Board of Equalization regarding sales and use tax, the small claims court system, and employees. There are chapters regarding various public signs that are required to be posted at dealerships, posting of notices by employers, dealership opening, closing, and licensing, and records retention. In the Other Important Topics chapter, many topics are discussed on subjects which are important in the operation of an automobile dealership. The subject of dealership advertising is in the California Auto Dealer Advertising Law Manual authored by Manning, Leaver, Bruder & and Berberich and distributed by CNCDA to its members. A discussion of the California New Motor Vehicle Board is in a separate publication on CNCDA's website at www.cncda.org.

Finding a specific topic: The Guide includes several finding aids to assist the reader in locating a specific subject area or legal issue. These include —

- The Summary Table of Contents, beginning on the next page
- The Table of Contents, preceding each chapter
- The Index, found at the end of the Guide

The Summary Table of Contents: Located at the beginning of the Guide, before the text of any chapter, is the Summary Table of Contents. The Summary Table of Contents lists the full title of each chapter and the corresponding page number.

The Table of Contents: Preceding each chapter is a detailed Table of Contents containing a complete listing of each chapter sub-sections and page number references. The detailed Table of Contents can be a valuable aid in locating various topics for each chapter.

The Index: At the end, the Guide contains a complete Index to all chapters. Using the Index is simply a matter of locating the relevant topics and descriptive words and noting the appropriate page number or numbers. An Index entry may contain page references to more than one chapter. In this case, it is recommended that the relevant discussions on each page, even if found within different chapters, be consulted.

SUMMARY TABLE OF CONTENTS

AUTOMOBILE SALES FINANCE ACT

Chapter 1

Contents

AUTOMOBILE SALES FINANCE ACT

OVERVIEW: No law can have a greater impact on automobile dealers than the Automobile Sales Finance Act (ASFA), also known as the Rees-Levering Motor Vehicle Sales and Finance Act, which is contained in California Civil Code Sections 2981 through 2984.5. (These Civil Code sections are printed in the book entitled *Vehicle Code* published by the DMV, which may be obtained at any DMV office.)

Civil Code section 2982 sets forth the disclosures required in every conditional sale contract subject to the Act, and it also mandates that every conditional sale contract contain the disclosures required by Regulation Z issued by the Federal Reserve Board under the federal Truth-in-Lending Act. Thus, to comply with the disclosure requirements of the Automobile Sales Finance Act one must necessarily comply with the disclosure requirements of Truth-in-Lending Regulation Z.

Sales contracts contain numerous insurance disclosures drawn from requirements under the Automobile Sales Finance Act, Regulation Z, and regulations of the California Insurance Commissioner under Title 10 of the California Code of Regulations. This chapter will therefore include discussion of these areas.

A basic understanding of the Automobile Sales Finance Act is absolutely essential for sales and F&I personnel. Violation of its provisions can have drastic consequences to a dealer: violations of most disclosure requirements impose a duty on the dealer to refund the purchase price to the customer and to buy back the contract from the financial institution holding it and cancel all further liability of the customer thereunder. Additional penalties and attorney's fees are also available to consumers.

Not only does the Act cover the form and content of a conditional sale contract, among other things, it also covers what documents must be delivered to the buyer, the use of purchase orders, side-loans, what security can be taken, when a customer's downpayment must be refunded, charging for advances to pay insurance when the buyer fails to provide it, extensions of time, what constitutes a default as a prerequisite to repossession, notice of intent to sell a repossessed vehicle, the buyer's limited right of reinstatement, the sale and disposition of proceeds of a repossessed vehicle, and the consequences of a violation of the Act on the part of a dealer.

Scope And Purpose Of The Act

The Automobile Sales Finance Act (sometimes referred to here as the "Act"), and Regulation Z, apply to purchases involving an extension of credit primarily for personal or family purposes. Civil Code section 2981(a) defines a conditional sale contract as any contract for the sale of a motor vehicle between a buyer and a dealer or leasing company under which possession is delivered to the buyer and title or a security interest is retained by the seller until payment in full is made by the buyer. Civil Code section 2981(k) defines a motor vehicle as any vehicle required to be registered under the Vehicle Code which is bought primarily for personal or family purposes (as opposed to vehicles bought for business or commercial purposes).

Vehicles covered include recreational vehicles and motorhomes, but mobilehomes as defined in Health and Safety Code section 18008 are not covered by the Act. The Health and Safety Code defines a mobilehome as a structure transportable in one or more sections, designed to contain not more than two dwelling units to be used "with or without a foundation system." Trailers sold in connection with a vessel and which come under the definition of "goods" under Civil Code section 1802.1 are also excluded.

Regulation Z is made applicable to credit sales to natural persons primarily for personal, family, household, or agricultural purposes by its sections 226.2(a)(12).

CAUTION

COMPLY UNLESS CLEARLY COMMERCIAL: Unless a sale is clearly commercial, you should comply with the requirements of Civil Code section 2982. Although Regulation Z applies to natural persons, Civil Code section 2982 applies to "persons," the definition of which, under the Civil Code, includes individuals, firms, corporations, partnerships, trusts and other legal entities. While most corporate and business firm purchases might appear to be commercial, the Act envisions that some may nevertheless be primarily for a personal or family purpose. When

you are in doubt as to whether the sale is really a commercial sale, resolve that doubt in favor of compliance with Civil Code section 2982. For example, on the sale of a pickup truck that the buyer frequently uses for both a business and family purpose, prudent practice would dictate that such a sale be treated as one for a personal or family purpose.

NOTE

ON FILLING-IN ALL BLANKS AND SIGNATURE LINES ON CONTRACT FORMS: Allowing any fill-in item to remain blank at the time a conditional sale contract is signed would put the dealer in jeopardy of being in violation of the rule that no customer signature be obtained if the contract contains blank spaces to be filled in after it is signed. Civil Code section 2981.9. Be sure to either complete all blanks or signature lines or, for those that are not applicable, insert "N/A."

The Act is designed to protect the consumer from excessive finance charges and hidden costs by requiring full disclosure of all items of cost. The idea behind Truth-in-Lending is to promote threshold disclosures to allow for effective comparison shopping for credit. In keeping with this purpose it is essential that all of the required disclosures be made in writing before the buyer becomes contractually obligated on a credit sale.

Although the laws discussed here are consumer oriented, their purpose is not punitive. They can serve to keep all dealers on an even footing. The California Supreme Court has described the Act as a shield (protection) and not a sword (to be used against dealers) in the hand of the consumer. It has held that substantial compliance with the Act is sufficient; however, there are few cases interpreting what constitutes substantial compliance.

Purchase Orders

Civil Code section 2981(l) defines the term "purchase order" as "a sales order, car reservation, statement of transaction or any other such instrument used in the conditional sale of a motor vehicle pending execution of a conditional sale contract." The section goes on to state that the purchase order "shall conform to the disclosure requirements of subdivision (a) of section 2982..." and shall contain the contrasting red-printed warning to be initialed by the buyer that unless a charge is made for liability insurance no such coverage is provided.

The temptation often arises during the sales negotiations to get the customer to sign or initial a payment schedule or some other type of "commitment" to buy at various stages of the sales process. However, it is a dangerous practice to obtain the customer's signature or initials on any worksheet or other negotiations paper. If the document truly is a legal commitment to purchase, but it does not contain all of the disclosures of a standard conditional sale contract form, both Civil Code section 2982 and Regulation Z will have been violated. Both Regulation Z and the disclosure requirements of Civil Code section 2982(a) must be made and delivered in a written document the customer may keep prior to a legal commitment.

Moreover, even if the document does not purport to be a legally binding commitment, if it meets the broad definition of "purchase order," it must contain virtually all of the contract disclosures in any case.

CAUTION

REGARDING ACCIDENTAL PURCHASE ORDERS: "Four-Squares," other worksheets, and even F&I menus, depending on their content and how they are used. could be classified as purchase orders that do not comply with purchase order disclosure requirements. For example, an attorney could argue that a four-square signed by the customer is a purchase order since, by summarizing the transaction to be documented on the contract, it is a "statement of transaction" and thus within the definition of a purchase order. Dealers should review each and every document presented to customers during the deal making and delivery process to ensure that none of them risk leave the impression that it purports to set forth the contents of the conditional sale contract to be prepared. The risk of being accused of having an accidental purchase order can be substantially reduced by refraining from obtaining the customer's signature on worksheets or menus and/or to place conspicuous notices on such documents disclaiming that they constitute statements or recapitulations of the vehicle purchase transaction.

Legally compliant purchase order forms do exist. But there is no legal requirement to use them, and they are of little practical value, except if used solely as an order or car reservation. Certainly where the whole transaction is intended to be completed on the same day, the use of a purchase order is totally superfluous and merely creates more paperwork and added room for error.

Forms such as worksheets, "four squares," and F&I menus must be carefully reviewed to ensure that they are not used in a way that would permit

the argument that they are purchase orders that do not comply with the purchase order disclosure requirements.

Establishing Contract Parameters

Finance Participation Caps

Civil Code Section 2982.5 caps the amounts dealers may receive from financing sources accepting assignment of contracts. The law applies to conditional sale contracts governed by ASFA. Excluded from its coverage are contracts for the sale of motorcycles or off-highway vehicles.

The caps apply to amounts paid or credited to dealers that are based on the finance charge received or to be received under the assigned contract. The caps are as follows: 2.5 percent for a contract having an original scheduled term of 60 monthly payments or less and 2 percent for a contract having an original scheduled term of more than 60 monthly payments.

While it is generally true that the cap will not be exceeded so long as the dealer receives only the first 2 or 2.5 points over the buy rate, the actual cap established by the statute is a dollar cap that can be calculated without reference to the buy rate by using the 2 percent and 2.5 percent maximums. To calculate the cap, replace the contract's actual APR with 2 percent for 60 month-plus contracts or 2.5 percent for all others. The "finance charge" that would be calculated for such a contract is the maximum that the dealer may be paid by the finance source based upon the contract's actual finance charge.

The caps do not apply to assignments with full recourse or under other terms requiring the seller to bear the entire risk of financial performance of the buyer – such as "unconditional guaranties," nor to assignments taking place more than six months following the date of the conditional sale contract.

The law provides a safe harbor whereby violations resulting from bona fide errors would be excused if the seller maintains reasonable procedures to guard against any errors and promptly, upon notice of the error, remits to the assignee any consideration received in excess of that permitted under the caps.

NOTE

NO CAPS ON CONSIDERATION UNRELATED TO FINANCE CHARGE. Section 2982.10's caps apply only to consideration furnished to the dealer that is based on the contract's finance charge. Payments to the dealer of the contract's face value – the amount financed or "par" – are obviously not limited. Similarly, consideration earned by the dealer by some measure not based on the finance charge or annual percentage rate is not restricted or capped. This was confirmed in the letter to the Assembly Journal by the author of AB 68 of 2005 which enacted Section 2982.5, which specifically noted some examples of consideration not subject to the caps, such as the volume or percentage of the seller's contracts assigned to the assignee, the longevity of the seller's relationship with the assignee, or the seller's utilization of flooring or other products offered by the assignee. For example, this section would not prohibit the seller from accepting an additional $20 flat fee from the assignee once the seller assigns in excess of 100 contracts to the assignee, or agrees to participate in the assignee's flooring or vehicle service contract programs.

Simple Interest Or Precomputed Finance Charge

Civil Code section 2981(n) and (o) define the two methods of computing the finance charge, namely on a "simple interest basis" or "precomputed basis." A simple interest contract is one in which the finance charge is determined by applying a constant interest rate (generally on a daily basis) to the unpaid balance as that balance changes from time to time. A precomputed contract is one in which the finance charge is computed at the inception, by applying a percentage rate to the entire unpaid balance for the entire scheduled term of the contract. Simple interest contracts are favored by the law: as discussed below, most simple interest contracts have no statutory maximum interest rate, and their use is mandatory on contracts lasting 62 months or more.

Currently, only precomputed contracts, and a small percentage of simple interest contracts, are subject to maximum finance charges. All simple interest contracts having original balances of more than $2,500 are exempt from the maximum finance charge.

NOTE

ON NO MAXIMUM INTEREST RATE FOR MOST SIMPLE INTEREST CONTRACTS: Simple interest contracts having original balances of more than $2,500 are excluded from the maximum finance charge applicable to precomputed contracts. Moreover, these contracts (and all other installment sales contracts) are not subject to the State's usury law, (See Southwest Concrete Products v. Gosh

Construction Corp.). However, interest rates that are so high as to shock the conscious of a judge may be stricken under legal rules against unconscionable contracts. (See Civil Code § 2983.2 – "The notice [of default] prescribed by this section shall not affect the discretion of the court to strike out an unconscionable interest rate in the contract for which the notice is required, nor affect the court in its determination of whether the rate is unconscionable.")

Under Civil Code section 2982(j) the maximum finance charge for simple interest contracts having original balances of $2,500 or less, and for all precomputed contracts, is one and one-half percent on so much of the unpaid balance as does not exceed two hundred twenty-five dollars ($225), 1 1/6 percent on so much of the unpaid balance in excess of two hundred twenty-five dollars ($225) as does not exceed nine hundred dollars ($900) and 5/6 of 1 percent on so much of the unpaid balance in excess of nine hundred dollars ($900) as does not exceed two thousand five hundred dollars ($2,500), or one percent of the entire unpaid balance multiplied by the number of months (computed on the basis of a full month for any fractional month period in excess of 15 days) elapsing between the date of the contract and the due date of the last installment.

When a contract provides for unequal or irregular payments, or payments on other than a monthly basis, the maximum finance charge is the effective rate provided for in Civil Code section 2982(j), having due regard for the schedule of installments.

Simple interest contracts written today must assume a 365 day year, and may impose finance charges only for the number of days which have actually elapsed prior to payment.

Precomputed Contracts Only: Rule of 78s, Actuarial Method, Or Sum Of The Digits Method

When the finance charge is calculated on precomputed basis, the contract must disclose the method used to calculate the unearned portion of the finance charge, which must be given to the buyer as a credit, if the contract is prepaid in full. Civil Code §2981(f)(1). Under this statute, a comprehensive mathematical explanation of the method is not required in the case of the Rule of 78's or the actuarial method. If either of these methods is used, disclosure may be accomplished simply by identifying the method by name in the contract. The statute also permits disclosure of the method by name for the sum of the digits method and the sum of the periodic time balances method, which, together with the Rule of 78's, are all deemed equivalent for disclosure purposes.

CAUTION

REGARDING RULE OF 78'S EQUIVALENTS: Civil Code section 2982(f)(1) deems the following methods of calculating prepayment refunds equivalent "for disclosure purposes": the Rule of 78's, the sum of the periodic time balances, and the sum of the digits. Although similar, these methods generally do not yield the same mathematical results. It is therefore the better practice to identify the particular method being used, rather than to rely on the statute's concept of "equivalent for disclosure purposes," the meaning of which has yet to be explained by a reported court decision.

Whichever method is used determines the type of prepayment notice to be included in the contract under Civil Code section 2982(g). This section sets forth three possible prepayment notices which must be included in the contract depending upon which basis the finance charge is computed. For example, if the finance charge is determined on the precomputed basis and any finance charge credit is computed using the Rule of 78's or other non-actuarial method, the notice must include advice to the customer that due to the manner the refund is figured, the timing of the prepayment may increase the ultimate cost of credit under the agreement.

As evidenced by the repeal of most rate-ceilings for simple interest contracts, but not for precomputed ones, for years there has been pressure in the Legislature and by the courts to abolish the use of the Rule of 78's. In *Drennan v. Security Pacific National Bank* decided by the California Supreme Court in 1981, Justice Mosk called the Rule of 78's a "hidden charge," but nevertheless acknowledged its legality. However, this pressure has caused many lenders to limit their purchases to simple interest contracts only.

Simple Interest Basis Mandatory On 62 Month Or Longer Contracts

All contracts entered into between a buyer and a seller shall provide for the calculation of the finance charge on the simple interest basis if the date on which the final installment is due, according to the original terms of the contract, is more than 62 months after the date of the contract.

This section coupled with the prescribed prepayment notice contained in Civil Code section 2982(g)(3) has the effect of eliminating the use of the Rule of 78's in computing refunds on 62 month or longer contracts.

Hidden Finance Charges

A dealer who raises the price of a vehicle in order to compensate a finance company for purchasing a contract with a customer who has poor credit runs the risk of having the price increase recharacterized as a hidden finance charge. This situation can arise when a dealer starts out with a known credit-risk customer and charges that customer more for the price of the vehicle than the same customer would have had to pay if paying cash. Or, sometimes in the course of negotiations the dealer may raise the price of the vehicle when the customer's adverse credit becomes known. Both of these practices may lead to liability on at least two counts.

First, charging a higher cash price for a vehicle sold on credit might be considered a violation of the Federal Truth-In-Lending Act. If a dealer is a "creditor" under Regulation Z and charges a higher cash price for a vehicle sold on credit, the extra consideration may be considered as a "hidden finance charge" and subject the dealer to recovery by the buyer of twice the amount of the finance charge (not to exceed $1,000), plus accrued damages and costs. A dealer is considered a "creditor" when the customer signs a conditional sale contract, even though all parties know that the contract will be immediately assigned to a finance company.

Second, Vehicle Code section 11713.1(k) provides that it is unlawful for a dealer to "Require a person to pay a higher price for a vehicle and related goods or services for receiving advertised credit terms than the cash price the same person would have to pay to purchase the same vehicle and related goods or services." The "cash price" mentioned in this subdivision is defined in the Act as: "'Cash price' means the amount for which the seller would sell and transfer to the buyer unqualified title to the motor vehicle described in the conditional sale contract, if the property were sold for cash at the seller's place of business on the date the contract is executed, and shall include taxes to the extent imposed on the cash sale and the cash price of accessories or services related to the sale, including, but not limited to, delivery, installation, alterations, modifications, improvements, document processing charges, a service contract, a vehicle contract cancellation option agreement, and payment of a prior credit or lease balance remaining on property being traded in." A violation of Vehicle Code section 11713.1(k) is grounds for license suspension or revocation. The penalty for a violation of the Act (inflation of the sales price to cover the cost of credit) is that a willful violation is considered to be a misdemeanor (Civil Code section 2983.6) and may also be grounds for license suspension or revocation. Moreover, pursuant to Civil Code section 2983, the contract itself may be unenforceable and subject a dealer to rescission and a refund to the customer of all monies and (value of trade-in) paid under the contract if the violation is not corrected in the manner and within the time period set forth in Civil Code section 2984. In addition, any business violating these laws could also be sued by the Attorney General or an injured individual acting for his or her own interests or as a class representative under California's Unfair Competition Law (Bus. & Prof. Code section 17200) which authorizes actions for injunctive and restitutionary relief.

If a dealer's sales records show a consistently higher cash price charged to credit customers over cash customers, a governmental agency or private attorney investigating the matter could argue that the records were proof of a hidden finance charge and of the violation of the code sections discussed above. Because of the severe repercussions to a dealer if any of the above violations were proven, dealers should be very cautious when dealing with this area.

NOTE

CHOICE OF REBATES OR LOW APR. Some factory incentives give the customer the choice between a low APR and a cash rebate. Can it be argued that the requirement to forego the rebate to receive the APR is equivalent to imposing a charge for the low APR, and was thus a hidden finance charge? No, according to the U.S. Court of Appeals for the Ninth Circuit. According to the court, there is no hidden finance charge imposed on customers foregoing a factory rebate in exchange for a low APR, and therefore no violation of TILA. The court concluded that the low APR, like the rebate ,were promotions to sell vehicles and not designed to encourage buyers to forego buying on credit. [Varichacks v. University Ford (2005) 410 F. 3d 579.]

Used Vehicle Contract Cancellation Option

Vehicle Code section 11713.21 requires any dealer selling a used vehicle to offer the buyer the right to purchase an agreement (contract cancellation option agreement) that gives the buyer the option to cancel the purchase agreement within two days and return the vehicle for a full refund. The law applies to cash and credit sales alike.

The law does not apply to vehicles sold for more than $40,000; vehicles sold solely for commercial or business purposes; motorcycles, off-highway vehicles, recreational vehicles, and vehicles not subject to registration (e.g., vehicles exported out of

state). Vehicles purchased by anyone who, within the preceding 30 days, had exercised a cancellation option with the same seller are also excluded.

If financed or otherwise included in a conditional sale contract, the price of the cancellation option must be included in the pre-contract disclosure discussed in the next section, and in the itemization of amount financed in the conditional sale contract. However, the law requires a separate contract cancellation option agreement to be entered into if the buyer elects to purchase the option. Note that the law provides that the fact that this document is separate from the conditional sale contract will not be considered a "single document rule" violation (see the discussion of the rule below under the heading "Single Document Rule").

The price of the cancellation option is capped by law and is based on the cash price of the vehicle (as disclosed under Civil Code § 2982(a)(1)(A)). The caps are –

- $75 if cash price at or below $5,000;
- $150 if over $5,000 but at or below $10,000
- $250 if over $10,000 but at or below $30,000
- 1% if over $30,000 but below $40,000

Exercise of the cancellation option may be conditioned on payment of a restocking fee. The amount paid to purchase the option is deducted from the restocking fee. Restocking fees are also capped based on the cash price. The restocking fee caps are –

- $175 if cash price at or below $5,000
- $350 if over $5,000 but at or below $10,000
- $500 if over $10,000 but below $40,000

The restocking fee may be increased if the buyer was the former lessee of the same vehicle. The increased fee would be equal to the excess mileage and wear and tear charges that would have been owed if the vehicle were turned in as a lease return.

To exercise the option, the buyer must personally deliver the following to the selling dealer:

- Written notice exercising the right to cancel the purchase, which may take the form of a copy of the cancellation option agreement signed by the buyer on a signature line required to be included for that purpose at the bottom of such forms;
- Any restocking fee reduced by the cancellation option purchase price;
- Original documents given by the dealer to the buyer, including the contract cancellation option agreement, the vehicle purchase contract and related documents, and all vehicle titling and registration documents; and
- The vehicle, with added miles not to exceed the mileage limitation, and in the same condition as when it was delivered, except for reasonable wear and tear and manifestations of pre-existing defects or mechanical problems not caused by the buyer.

The vehicle must be returned free of all liens and encumbrances, other than purchase related liens or encumbrances, which include those created by or incident to the conditional sale contract, any loan arranged by the dealer, or any purchase money loan obtained by the buyer from a third party. The dealer is required to cancel any conditional sale contract or dealer assisted loan. Purchase related liens held by third parties supplying purchase money can be discharged by the dealer by disbursing the refund proceeds directly to the third party on the buyer's account.

The dealer is required, no later than the second day following the day on which the option is exercised, to cancel the contract and provide a full refund. The full refund need not include any portion of the cancellation option purchase price. However, any restocking fee must be reduced by the amount of the cancellation option purchase price. For example, if a dealer chooses not to impose a restocking fee, none of the contract option purchase price would be refunded. If the dealership received payments from third parties on the consumer's account when the vehicle was purchased (such a credit card payment or a draft from a direct-lending credit union), those sums may be refunded directly to the third party for credit to the buyer's account.

This rule that allows the refund to be deferred until the second day following exercise of the option does not apply to returning the trade-in. It must be returned by the day following exercise of the option. The value of the trade may be given in lieu of its physical return only if the dealer provided the cancellation option at no charge. In all other cases, the dealer must hold the trade-in to be ready to physically return it to the buyer if the option is exercised.

Up until the exercise of the option, the buyer is considered the owner of the vehicle and has the same responsibility as would any other owner for insurance, accidents, parking citations, and other liabilities. The law provides that the existence or exercise of the cancellation option will not change this allocation of responsibility.

Pre-contract Disclosures

Mandated Disclosure Statement

Civil Code section 2982.2 identifies six types of charges that must be disclosed to the buyer in writing before a conditional sale contract is signed. The

six charges are those for a contract cancellation option agreement, insurance, service contracts, GAP, "surface protection products," and "theft deterrent devices" (as the latter two terms are defined in section 2981(q) and (r)). If charges for any of those items will be included in the contract, Section 2982.2 requires that the buyer be given and sign a written pre-contract disclosure that identifies the charges for each item, a total, and a disclosure of the amount of the regular monthly installment payment including the listed items and the amount of the regular monthly installment payment excluding the listed items.

Section 2982.2 provides:

Prior to the execution of a conditional sale contract, the seller shall provide to a buyer, and obtain the buyer's signature on, a written disclosure that sets forth the following information:

(a)(1) A description and the price of each item sold if the contract includes a charge for the item.

(2) Paragraph (1) applies to each item in the following categories:

(A) A service contract.

(B) An insurance product.

(C) A debt cancellation agreement.

(D) A theft deterrent device.

(E) A surface protection product.

(F) A vehicle contract cancellation option agreement.

(b) The sum of all of the charges disclosed under subdivision (a), labeled "total."

(c) The amount that would be calculated under the contract as the regular installment payment if charges for the items disclosed pursuant to subdivision (a) are not included in the contract. The amount disclosed pursuant to this subdivision shall be labeled "Installment Payment EXCLUDING Listed Items."

(d) The amount that would be calculated under the contract as the regular installment payment if charges for the items disclosed under subdivision (a) are included in the contract. The amount disclosed pursuant to this subdivision shall be labeled "Installment Payment INCLUDING Listed Items."

(e) The disclosures required under this section shall be in at least 10-point type and shall be contained in a document that is separate from the conditional sale contract and a purchase order.

Whether charges for "surface protection products" and "theft deterrent devices" Are involved depends on the statutory definitions of those terms. They are defined as follows in Section 2981 (q) and (r):

(q) "Surface protection product" means the following products installed by the seller after the motor vehicle is sold:

(1) undercoating.

(2) rustproofing.

(3) chemical or film paint sealant or protectant.

(4) chemical sealant or stain inhibitor for carpet and fabric.

(r) "Theft deterrent device" means the following devices installed by the seller after the motor vehicle is sold:

(1) a vehicle alarm system.

(2) a window etch product.

(3) a body part marking product.

(4) a steering lock.

(5) a pedal or ignition lock.

(6) a fuel or ignition kill switch

NOTE

ON DEFINITIONS OF SURFACE PROTECTION PRODUCT AND THEFT DETERRENT DEVICE. The definitions of surface protection product and theft deterrent device only encompass products installed by the seller "after the motor vehicle is sold." While open to a number of interpretations, a conservative compliance policy would err on the side of treating the product as within the definition and disclosing it accordingly, except in cases where the product was already installed and functional when negotiations first started and was included in the negotiated price of the vehicle from the inception of price discussions. In addition, such products are often preinstalled, but "activated" or "registered" (for a fee) at the time of sale. Where this is the case, the conservative approach would be to treat the product as coming within the definition and disclosing it accordingly.

NOTE

ON LOJACK. An opinion by the California Attorney General declares that vehicle tracking devices, such as LoJack, are "Theft Deterrent Devices" within the meaning of Civil Code Section 2981(r). Prior to the Attorney General opinion, there had been some controversy over whether LoJack met the definition. The manufacturer of LoJack strongly argued that the product did not meet the definition, and therefore could be sold to car buyers without being listed on the pre-contract written disclosure form, and without being listed on the lines for Theft Deterrent Device in retail installment contract forms. Now,

however, those disclosures should be made for Lojack and similar products.

Mandatory EV Charging Station Precontract Disclosure

Civil Code section 2982.11 requires, prior to the execution of a conditional sale contract that includes a charge for an electric vehicle charging station, that the seller shall provide the buyer with, and obtain the buyer's signature on, a written disclosure that includes a description and price of each of the following: (1) the electric vehicle charging station device; (2) any materials and wiring; (3) any installation services included in the total charge.

The disclosures required under section 2982.11 must be in at least 12-point type and in a form separate from the contact itself or any purchase order.

Payment Packing Preventive Disclosures

Vehicle Code section 11713.19, designed to prohibit payment packing, provides that it is unlawful for a dealer to negotiate the terms of a purchase contract and then add charges to the contract for any goods or services without previously disclosing to the consumer the goods or services to be added and obtaining the consumer's consent. This statute also prohibits a dealer from inflating the monthly payment or down payment amounts or extending the maturity of a contract for the purpose of disguising the actual charges for goods or services to be added by the dealer to the contract. For purposes of this statute, "goods and services" are defined as any type of good or service, including but not limited to insurance and service contracts.

The mandated Civil Code section 2982.2 disclosure statement provides excellent evidence against allegations of "packing" of any of the six items required by that statute to be disclosed. There is no requirement that written disclosure be secured for items outside of the six specified by section 2982.2, It may, however, be helpful to secure evidence that can be used to defeat a packing claim unrelated to these six items. When used in conjunction The Reynolds and Reynolds Company Due Bill Form (Form LAWCA-412Q) (where accessories and work provided in connection with a vehicle purchase can be disclosed), The Reynolds and Reynolds Company Pre-Contract Disclosure Form (Form LAWCA-PCD) not only handles the mandated disclosure under section 2982.2, but also provides good evidence against claims that other items were "packed," such as the document processing charge, or a charge for an electric vehicle charging station.

Credit Score and Risk-Based Pricing Disclosure

Pursuant to California Vehicle Code Section 11713.20, if a dealer obtains a credit score from a credit reporting agency for use in connection with an individual's application for credit to purchase vehicle for personal, family or household use, the individual must be given written notice of that credit score and certain related information prior to the contract being signed. Most dealers choose to comply with both California law and the federal Risk-Based Pricing Rule using the same credit score disclosure form. See the discussion of this notice requirement in the Chapter entitled "Credit Reports and Decisions."

Conditional Sale Contract Contents

Conditional Sale Contract Forms

Civil Code section 2982 is the heart of ASFA. It incorporates the Regulation Z / Truth-In-Lending Act disclosure requirements and adopts the Regulation Z definitions of such terms as "finance charge" and "total of payments." It will not be our intention to go through all of the disclosure requirements of Civil Code section 2982.

If your dealership is using a conditional sale contract form which has been approved as being in compliance with the Act, such as The Reynolds and Reynolds Company LAW® Retail Installment Sale Contract Form (LAWCA-553), the various special notices and the order and relative emphasis to be given the disclosures will be taken care of by the conditional sale contract form itself. We will briefly list the disclosures and, as listed, comment on matters of particular significance. The disclosures required by Civil Code section 2982(a) and then the disclosures required by Regulation Z will be set forth followed by comments on miscellaneous provisions of the section.

Civil Code Section 2982(a) Disclosures

The disclosures required by Civil Code section 2982(a) are required to be made together and in the sequence as set forth below:

1. The cash price, exclusive of document processing charges, charges to electronically register or transfer the vehicle, taxes imposed on the sale, pollution control certification fees, prior credit or lease balance on property being traded in, the amount charged for a service contract, the amount charged

for a theft deterrent system, the amount charged for a surface protection product, the amount charged for an optional debt cancellation agreement, and the amount charged for a contract cancellation option agreement.

2. Document processing charge (formerly preparation fee). The contract shall contain a disclaimer that the fee is not a governmental fee. The fee shall not exceed $80 (assuming the dealer is enrolled in the DMV Business Partner Automation Program (BPA) as required by law for all new car dealers.

3. The fee charged by the seller for certifying that the motor vehicle complies with applicable pollution control requirement. This fee shall not exceed $50. See Vehicle Code section 11713.1(b).

4. The charge for a theft deterrent device.

5. The charge for a surface protection product.

6. The total amount charged for an electric vehicle charging station (includes only the charges for the charging device, materials and wiring, and installation services). The total amount shall be labeled "EV Charging Station."

7. Taxes imposed on the sale.

8. Electronic Vehicle Registration or Transfer Charge (formerly “Optional DMV Electronic Filing Fee”). New vehicle dealers are required process all eligible registration transactions electronically using an authorized service provider (first line service provider) and “pass through” the actual amount charged for providing license plate processing, postage, and the fees and authorized BPA services to the consumer. Dealers, however, are not authorized to charge customers for internal dealer costs, charges from registration services, or amounts charged by a first line service provider for additional goods or services. This charge may not be represented as a governmental fee.

9. The amount charged for a service contract.

10. The prior credit or lease balance remaining on property being traded in. The disclosure shall be labeled "prior credit or lease balance (see downpayment and trade-in calculation)."

11. The charge for any optional debt cancellation agreement (GAP).

12. Any charge for a used vehicle contract cancellation option agreement (see discussion in this chapter under “Contract Cancellation Option Agreements.”)

13. The total cash price, namely the sum of (1) through (12) inclusive.

14. Amounts paid to public officials for the following three items, each item listed and itemized separately:

(i) License;

(ii) Registration/transfer/title; and

(iii) California tire fees.

15. The aggregate amount of insurance premiums for policies of insurance included in the contract, excluding the amount of any insurance premium included in the finance charge.

16. Smog certificate or exemption or waiver fee paid to the State. The smog certificate fee is fixed by the state in accordance with rises in the Consumer Price Index in accordance with Health and Safety Code section 44060 and the California Code of Regulations (16 C.C.R. 3340.35.1). This line of the contract is also the location to itemize the exemption or waiver fee of Vehicle Code section 4000.1(d)(7) (fixed by that statute at $8) for vehicles four or fewer model years old and that thereby are exempt from the smog certification otherwise required upon transfer.

17. A subtotal representing the sum of items (1) through (16) above.

18. The downpayment itemized as follows:

(a) The agreed value of property being traded in.

(b) The prior credit or lease balance, if any, owing on the property being traded in.

(c) The net agreed value of the property being traded in, which is the difference between the amounts disclosed in a and b, above. If the prior credit or lease balance of the property being traded in exceeds the agreed value of the property, a negative number shall be stated.

(d) The amount of any portion of the downpayment to be deferred until not later than the due date of the second regularly scheduled installment under the contract and which is not subject to a finance charge.

(e) The amount of any manufacturer's rebate applied or to be applied to the downpayment.

(f) Remaining downpayment paid or to be paid by the buyer.

(g) The total downpayment. If the sum of c to f, above, is zero or more, that sum shall be stated as the total downpayment. But if the sum is less than zero, then that sum, expressed as a positive number, shall be stated as the prior credit or lease balance under the itemization of the total cash price, and zero shall be stated as the total downpayment.

19. The amount of any administrative finance charge. (Most contract forms do not even leave a space for such a charge since it has no relevance unless you determine the finance charge by the simple interest basis and waive the right to collect a minimum finance charge.)

20. The amount financed labeled as such, which will be the difference between item (16) and item

(17) based on the assumption that no administrative finance charge is charged.

NOTE

ON DOCUMENT PROCESSING CHARGES: It is frequently asked whether a dealer who charges a charge for document processing is required to also make a similar charge on cash sales. The answer is "yes" If the document processing charge is only charged on installment sales it then becomes a charge imposed as an incident to the extension of credit and therefore falls within the definition of finance charge as defined in Regulation Z, section 226.4(a). This section, which defines a finance charge, excludes any charges of a type payable in a comparable cash transaction.

Negative Equity and Overallowances

Dealers are prohibited from using overallowances offset by an increase in purchase price to disguise negative equity, according to *Thompson v. 10,000 RV Sales, Inc.* The court found that such an overallowance inflates the cash price of the vehicle purchased, and this, in turn, results in slightly more sales tax. The court considered the increased tax to be a "hidden finance charges" because the facts of the case suggested that it would not have been imposed in a cash transaction. The court also suggested that ASFA requires disclosure of negative equity being financed in a conditional sale contract, and that the freedom to haggle over sales prices and trade-in allowances cannot be used to avoid this disclosure. Even though ASFA requires disclosure only of the "agreed value" of the trade-in, the court held that where negative equity is involved, the parties cannot agree to use a "straw" number to hide the negative equity. Some language in the *10,000 RV* decision suggests that the law allows the flexibility to negotiate the trade's "agreed value" in "good faith." But in other passages, it is unclear whether this flexibility is available only after the dealer discloses to the customer the "true value" accepting the trade would have to the dealer. Other passages appear to disallow this flexibility entirely whenever using it would reduce or eliminate a "negative equity" disclosure – that is, reduce or eliminate from the itemization of amount financed any "prior credit or lease balance" amount.

Dealers should evaluate their trade-in valuation practices to ensure that overallowances are not being used to offset negative equity on trade-in vehicles where the overallowance is rolled into the cash price of the vehicle being sold. Except in unusual cases where it can be firmly established that the overallowance did not increase the cash price or other costs (e.g., sale of an advertised vehicle at the advertised price or true one-price stores), if a trade-in appraises at an amount that is less than its payoff balance, the dealer should use only the appraised value as the "agreed value" of the trade. By doing so, and by following the instructions next to each blank space on the conditional sale contract form, other negative equity disclosures will be made properly. Specifically, a negative number will be disclosed as the net agreed value of the trade and, except to the extent the cash downpayment and other upfront credits (such as rebates) setoff the trade's negative net agreed value, the downpayment will be zero and a "prior credit or lease balance" will be disclosed in the itemization of amount financed. Any deviation from the initial appraised value should be documented by a revised appraisal that documents facts about the vehicle that support a change in valuation.

Trade-In Payoff Rules, Deadline

Under Vehicle Code section 11709.4, you are effectively required in the conditional sale contract to specify the amount of the prior credit or lease balance on the trade-in and to agree to pay that amount to the holder of the prior credit or lease balance. If your contract fails to do so, section 11709.4 may obligate you to pay off the entire prior credit or lease balance regardless of its amount. That statute also requires you to actually tender the payoff amount within 21 days of the date of sale or lease. Other rules apply as well. Please see the section entitled "Trade-In Payoff: 21 Day Deadline and Other Rules" in the Other Important Topics Chapter of this Management Guide.

Disclosures Required By Regulation Z

Regulation Z requires that the following described disclosures be clearly and conspicuously disclosed and segregated from other matters and further requires that the terms "finance charge" and "annual percentage rate" be more conspicuous than any other disclosure. 12 CFR 226.17(a)(2), 226.18(a). It is important not to attempt to cram other disclosures or contract terms within the area reserved for these disclosures because Regulation Z requires these disclosures to be separated from other terms and provisions of the contract.

a. **Annual Percentage Rate** together with descriptive phrase "The cost of your credit as a yearly rate."

b. **Finance Charge** together with descriptive phrase "The dollar amount the credit will cost you."

c. **Amount Financed** together with descriptive phrase "The amount of credit provided to you or on your behalf."

d. **Total of Payments** together with descriptive phrase "The amount you will have paid when you have made all scheduled payments."

e. **Total Sale Price** together with the descriptive phrase "The total price of your purchase on credit, including your downpayment of ." (Fill in the total amount of the downpayment including any deferred downpayment in the blank space and then fill in the amount of the total sales price.)

f. The **Payment Schedule** setting forth the number, amount and due date of payments is likewise included in the segregated Regulation Z disclosures.

g. **Informational disclosures** setting forth information about certain specific matters, including the contract documents, the property securing the customer's obligations, late payment fees, and prepayment provisions.

Negative downpayments violate Regulation Z. Be absolutely sure than no such negative number appears on any "total downpayment" line, nor on the "including your downpayment of" line.

Identifying and Handling Deferred Downpayments

A deferred downpayment or "pickup payment" is a payment to be made after vehicle delivery that covers a portion of the downpayment. Deferred downpayments are subject to rules requiring them to be documented in the contract in a very specific way. But what types of payments are subject to these rules?

The rules apply to any portion of the downpayment that is not paid or to be paid "at or prior to delivery." (Civil Code § 2981(f)). In other words, the rules apply whenever it is agreed that some of the downpayment may be paid after delivery. For example, if a customer is short on cash, an F&I manager might tell the customer to drive off with the new vehicle but to bring in a check for the downpayment within 48 hours. As a result, the entire downpayment is deemed a deferred downpayment and the deferred downpayment disclosures must be given. Arguably, the same would be true if the F&I manager told the customer he should tender a personal check for the downpayment before driving off with the new vehicle, but that the check would be held to allow time for funds to be deposited to allow the check to clear.

On the other hand, if, prior to entering into the contract, the dealer does not agree to defer the downpayment, the rules would not apply. For example, a dealer who meets with a customer the day after a vehicle is sold and delivered in an attempt to collect on a bounced downpayment check might agree to give the buyer 5 days to make the check good before resubmitting it to the bank. Since the dealer expected the bounced check to be good in the first place and never agreed otherwise at the time the contract was signed, this 5 day allowance would not trigger the deferred downpayment disclosures. The buyer and dealer agreed the downpayment was due prior to or at delivery; once this agreement is in place, subsequent events do not change it.

Once a payment has been identified as a deferred downpayment, the rules for disclosure are straightforward. The disclosures can be divided into three primary disclosures, each of which is made in the following specific sections of the conditional sale contract form: (1) the downpayment itemization; (2) the schedule of payments; and (3) the Total of Payments.

The first disclosure is made in the portion of the itemization of amount financed that deals with the trade-in and downpayment. This can be found in Section 6, line D of the The Reynolds and Reynolds Company "LAW" Form No. 553-CA (the "553"). The disclosure takes the form of a single line item representing the sum total of all pickup payments, and is labeled "Deferred Downpayment". Obviously, the line used for the cash portion of the (Line 6.G in the 553) should be net of the deferred downpayment. For example, where the total to be paid as a downpayment is $2,000 in cash plus two $750 pickup payments, Line 6.G should reflect $2,000 and Line 6.D should reflect $1,500, while Line 6 – the total downpayment – should reflect $3,500.

The second disclosure is made in the schedule of payments section of the contract – which appears as a table in the 553 under the heading "Your Payment Schedule Will Be." All contracts have payment schedules that read essentially as follows:

One payment of	$__	due ____
One payment of	$__	due ____
__ Payments of	$__	due ____
One final pay't of	$__	due ____

Dealers are required to list the amount and due date of each pickup payment in this payment schedule (Civil Code § 2982(c)). There is no requirement that the pickup payments be labeled as such in the payment schedule. Pickup payments can be disclosed in the first two "one payment of" lines of the payment schedule. Practical problems will arise if there is no room on the schedule to list all of the pickup payments. Since the rules for the layout of the payment schedule are complex, dealers facing such space limitations should consult legal counsel.

The third disclosure takes the form of adding the sum total of all pickup payments into the "Total of Payments." This disclosure is found in a box near the top of the contract under the heading "Federal Truth in Lending Disclosures". Normally,

the Total of Payments box contains the total of all regular installment payments to be paid to holder of the contract, and does not the downpayment. However, California law requires the deferred downpayment to be included along with all other scheduled payments in the Total of Payments box (Civil Code §2981(j). For example, if the total of payments in a transaction without pickup payments were $24,000, a second transaction with exactly the same terms except for a one week deferral of $1,000 of the downpayment must list a total of payments of $25,000.

Hold check agreements and other side agreements that permit all or any portion of the downpayment to be deferred are not only insufficient legal substitutes for the above disclosures, but may very well violate the single document rule as well (Civil Code § 2981.9 [all payment terms must be in the conditional sale contract document itself] – see the discussion of the rule below under the heading "Single Document Rule"). By properly spotting pickup payments and disclosing them in the contract, dealers will comply with both the deferred downpayment law and the single document rule.

Two additional important rules apply to pickup payments. First, no interest or other finance charge may be imposed on any pickup payment. And all pickup payments must come due no later than the due date of the second regularly scheduled installment payment.

CAUTION

REGARDING HOLD-CHECK AGREEMENTS AND OTHER DOWNPAYMENT DEFERRAL AGREEMENTS: Hold-check agreements and side agreements regarding deferral of the downpayment can violate the single document rule if not physically attached to the contract and properly incorporated into the contract by reference and cannot substitute for proper compliance with the deferred downpayment disclosure requirements discussed in the preceding Note.

CAUTION

REGARDING HOLD-CHECKS: Even if no written hold check or other side agreement is used, dealers should still carefully review with their legal counsel the practice of requiring a buyer to furnish checks to be held by the dealer pending the due dates of deferred downpayments, as many open questions exist in this unsettled area, including whether the practice conflicts with the requirements of the single document rule and Regulation Z's mandated disclosure of collateral and security interests.

Additional Civil Code Section 2982 Requirements And Provisions

Civil Code section 2982(d) contains a requirement regarding DESCRIPTION OF TRADE-IN. **It provides that the contract shall contain a brief description of any property traded in**.

Civil Code section 2982(k) provides for a **delinquency charge and collection costs**. The contract may provide for a delinquency charge in the amount of 5% of each delinquent installment, which amount may be collected only once on any installment regardless of the period during which it remains in default. Payments timely received under an extension or deferral agreement (whether written or oral) shall not be subject to a delinquency charge unless the charge is permitted by section 2982.3 as explained below in the section of this chapter entitled "EXTENSION AGREEMENTS PERMISSIBLE CHARGES" under "CONTRACT MODIFICATION AND SIDE LOANS". The contract may also provide for reasonable collection costs.

Civil Code section 2982(l) sets forth the methods of computing refund credits in the event of pre-payment or a repossession. (The Rule of 78's is still one of the methods.) Of particular interest is 2982(l)(5) which provides that in determining the buyer's outstanding obligation following a repossession, it shall be computed as of the date the holder recovers the value of the motor vehicle through sale thereof or as of the date a judgment is entered.

Civil Code section 2982(p) permits a provision to be included in the contract giving the seller or holder of the contract the right to charge and collect a $15 fee for the return of a dishonored check or negotiated order of withdrawal.

Changes To Payment Terms And Consumer Complaint Notice

Civil Code section 2982(h) which requires that all conditional sale contracts contain the following language in at least 8 point boldface type:

"If you have a complaint concerning this sale, you should try to resolve it with the seller.

"Complaints concerning unfair or deceptive practices or methods by the seller may be referred to the city attorney, the district attorney, or an investigator for the Department of Motor Vehicles, or any combination thereof.

"After this contract is signed, the seller may not change the financing or payment terms unless you agree in writing to the change. You do not have to agree to any change, and it is an unfair or deceptive practice for the seller to make a unilateral change.

_____*Buyer's Signature'*

No Cooling Off Contract Language And Signs

Civil Code section 2982(r) provides that the contract shall contain a notice with a heading in at least 12-point boldface type and the text in at least 10-point boldface type, circumscribed by a line, immediately above the contract signature line, that reads as follows:

> THERE IS NO COOLING-OFF PERIOD UNLESS YOU OBTAIN A CONTRACT CANCELLATION OPTION.
> California law does not provide for a "cooling-off" or other cancellation period for vehicle sales. Therefore, you cannot later cancel this contract simply because you change your mind, decide the vehicle costs too much, or wish you had acquired a different vehicle. After you sign below, you may only cancel this contract with the agreement of the seller or for legal cause, such as fraud.
> However, California law does require a seller to offer a 2-day contract cancellation option on used vehicles with a purchase price of less than forty-thousand dollars ($40,000), subject to certain statutory conditions. This contract cancellation option requirement does not apply to the sale of a recreational vehicle, a motorcycle, or an off-highway motor vehicle subject to identification under California law. See the vehicle contract cancellation option agreement for details.

Vehicle Code section 11709.2 requires that every dealer must conspicuously display a notice, not less than eight inches high and 10 inches wide, in each sales office and sales cubicle of a dealer's established place of business where written terms of specific sale or lease transactions are discussed with prospective purchasers or lessees, and in each room of a dealer's established place of business where sales and lease contracts are regularly executed, which states virtually the same as the above disclosure regarding No Cooling Off Period.

New/Used Disclosure

Civil Code section 2982(q) provides that the contract shall disclose on its face, by printing the word "new" or "used" within a box outlined in red, that is not smaller than one-half inch high and one-half inch wide, whether the vehicle is sold as a new vehicle, as defined in section 430 of the Vehicle Code, or a used vehicle, as defined in section 665 of the Vehicle Code. A parallel provision also exists in the Vehicle Code. Vehicle Code section 11713.1(v) provides that it is unlawful for a dealer to enter into a contract for the retail sale of a motor vehicle unless the contract clearly and conspicuously discloses whether the vehicle is being sold as a new vehicle or a used vehicle, as defined in the Vehicle Code.

Demonstrators are defined as used cars in the Vehicle Code and therefore must be sold as "used" and disclosed as such in the disclosure box.

New vehicles that have been previously sold and then returned to a dealer because of a default or rescission, must be resold as "used" and disclosed as such in the disclosure box. However, if the contract for sale of the new vehicle is subject only to being "rewritten" due to an inability to obtain financing, and the original buyer(s) and only the original buyer(s) (i.e., no new co-buyer) are reflected on the rewritten contract, the DMV has clarified that the second contract may show that the vehicle was sold as new, since this accurately reports that the status of the vehicle at the time it was sold and delivered. (See DMV Memo VIN 2007-4.)

All vehicles that have been previously registered, whether to the dealer or someone else, must be sold as "used" and disclosed as such in the disclosure box.

Disclosure Of Payment Of Autobroker Fee

Vehicle Code section 11713.1(x) requires that there be disclosed in any contract for the retail sale of a new motor vehicle a clear and conspicuous statement in at least 10-point boldface type on the face of the contract whether the transaction is, or is not, subject to a fee received by an autobroker from the selling new motor vehicle dealer and the name of the autobroker, if applicable.

Contract Documentation Requirements

The Single Document Rule

Requirements and Problem Avoidance

An extremely important provision of the law that can have unexpected consequences is the requirement contained in Civil Code section 2981.9 that

every conditional sale contract **"...shall contain in a single document all of the agreements of the buyer and seller with respect to the total cost and the terms of payment for the motor vehicle..."** If you complete all the spaces on the conditional sale contract form you should not have any problem with the disclosure requirements. But the single document rule's insistence that all agreements with respect to the cost and terms of payment be included in the contract causes other problems. This does not mean that all of the agreements must be on the front and back of a single piece of paper, but agreements that are not should be physically attached to and conspicuously referenced on the face of the conditional sale contract form.

Many different types of single document rule violations exist. For example, some dealers have their customers sign a separate rescission agreement whereby the customer agrees to return the vehicle to the dealer in the event the dealer is unable to assign the contract to one of the financial institutions with which the dealer regularly does business. Because the separate agreement relates to the terms of payment and is not part of the conditional sale contract itself, using the separate document violates the rule. If the separate document were eliminated in favor of having its terms and conditions directly included in the conditional sale contract, no rule violation would result.

Civil Code section 2983.5 provides that the assignee of a contract shall have recourse against the seller for any liability incurred by the assignee based on defenses or equities of the buyer against the seller, which would include those arising from a violation of the single document rule.

NOTE

REGARDING AGREEMENTS SEEMINGLY NOT COVERED BY THE SINGLE DOCUMENT RULE: Although agreements unrelated to the total cost and the terms of payment for the motor vehicle are, by definition, outside the scope of the single document rule for retail contracts (as opposed to leases), it is unclear how far, if at all, the law goes in regulating agreements that are silent as to the contract terms and amounts, but might have some indirect affect on the total cost of the transaction. For example, while a trade-in payoff agreement might appear to leave unchanged the dollar terms set forth in the contract, a customer called upon to make good on such an agreement might argue that it forces payment of a higher overall cost. Similarly, an agreement indemnifying the dealer against any hidden damage or improper use of the trade-in vehicle might be considered to raise the cost of the transaction if the customer is asked to actually provide such indemnity. While the law's use of the phrase "cost and the terms of repayment for the motor vehicle" suggests that matters pertaining to the trade-in are not covered, dealers are advised to exercise caution in this area.

CAUTION

REGARDING GAP: GAP agreements, known also as debt-cancellation agreements, may also be subject to the single document rule. Under GAP, the dealer agrees, for a fee, to waive amounts owing under the contract in the event the vehicle becomes a total loss and the insurance proceeds are insufficient to satisfy the unpaid contract balance. GAP can also be written to cover other contingencies, such as death or disability. Under Regulation Z, charges for GAP are not treated as hidden finance charges, so long as certain disclosure and signature requirements are met. Moreover, ASFA specifically recognizes GAP, and provides for a place in the itemization of amount financed to set forth the fee charged for GAP. However, all GAP programs have standard terms and conditions governing what is covered and how claims must be made. Because GAP is generally not sold as insurance, but instead as an agreement between buyer and seller regarding the buyer's payment obligations, these detailed GAP terms and conditions generally boil down to agreements to waive a portion of the contract balance under certain circumstances, and thus appear to affect the terms of repayment of the vehicle, making those terms subject to the single document rule. As such, those terms should be considered part of the conditional sale contract, and either printed in or incorporated into the sales contract. Many GAP documents are entitled "Addendum" to reflect the fact that they are to be incorporated into the conditional sale contract itself. Dealers who sell GAP are therefore urged to consult their legal counsel, retail finance sources, and, if applicable, GAP administrators, as to the mechanical details that should be followed to incorporate the GAP documentation into the conditional sale contract.

CAUTION

REGARDING OTHER CONSEQUENCES OF SINGLE DOCUMENT RULE VIOLATIONS: Failure to fully comply with the single document rule may not only give the customer an opportunity if buyer's remorse sets in to rescind the contract, even more significantly, violation of the rule, especially on a regular and routine basis, could also result in a lawsuit under California's Unfair Competition Law (Bus. & Prof. Code section 17200) (subject to the limitations imposed by "Proposition 64")

and/or a class action lawsuit. Noncompliance may also cause the bank or other financial institution to whom you sell your paper to demand that you buy back the offending contracts. Practically all assignments of contract, whether with or without recourse, expressly provide that the dealer warrants that the contract complies with all applicable laws or is legally enforceable or contains all the agreements between the parties. Failure of the dealer to ensure compliance with the single document rule would violate these terms of the assignment and make you vulnerable to a demand by your assignee to buy back such contracts.

CAUTION

REGARDING OVERLAP BETWEEN FOREIGN LANGUAGE RULES AND SINGLE DOCUMENT RULE: As discussed later in this Chapter, dealers are required to provide contract documents translated into Spanish and four Asian languages when the negotiations are primarily in those languages. Where forms or other papers are to be incorporated by reference into the contract to comply with the single document rule, it is important to remember that those forms and papers, as part of the contract, must be translated if the foreign language rules would apply to the underlying contract itself.

Single Document Rule and Multi-Page Documents and Attachments

For years, questions were raised over whether the single document rule prohibits the use of multiple sheets of paper and requires the contract be printed on one (very long) form – a "single page" requirement. An opinion of the California Attorney General addresses those questions and rejects a single page requirement. (Opinion of Attorney General Edmund G. Brown Jr., No. 08-804, December 31, 2009.)

The Opinion reaches the following conclusion (as to both retail installment sales and leases): "The single document requirement for automobile sales contracts is satisfied if the document consists of multiple pages that are attached to each other and integrated by means such as inclusive sequential page numbering (e.g., "1 of 4," "2 of 4," etc.)."

Opinions of the Attorney General are not binding on courts, but are given great weight by the courts. Given the absence of case law or other authority interpreting whether a single-page requirement exists under the single document rule, courts are expected to adopt and follow the Attorney General's position.

In an area that usually constrains innovative practices, the Opinion provides a needed measure of flexibility. For example, the Opinion opens the door for contracts to be designed around multiple pages in lieu of the ever increasing and almost aircraft-carrier-like length of installment contracts and leases – the Opinion noted that vehicle installment contracts are now approximately 24 inches long.

By disclaiming a single-page requirement, the Opinion also confirms that – if done right – adding additional pages to existing form contracts (such as GAP addenda) will not violate the single document rule. However, the Opinion identifies certain key steps to be followed for multiple-page contracts to satisfy the single document rule.

First, the pages must be attached to one another. This can be accomplished by using staples or some other secure means of attachment.

Second, the pages should be integrated with one another. That is, some reference or notation in the contract should reflect that the pages are actually part of the same document. The Opinion cited sequential page numbering (e.g., "1 of 4," "2 of 4," etc.) as an example of proper integration, but did not state that this was the only means of integration. For example, nothing in the Opinion would prohibit integrating a GAP Addendum attached to the contract by specific language in the contract incorporating the GAP terms and conditions, such as the language found in most form contracts being used today.

By rejecting a single page requirement, the Opinion provides a welcome measure of certainty. However, the Opinion itself will be scrutinized by attorneys and finance and leasing companies, which may lead to various best-practices ideas on how to respond to the Opinion. For example, it is unknown whether one or more retail finance sources or leasing companies might require documents attached to contracts or leases (such as GAP addenda) to be "sequentially numbered" just to be sure that the exact example of proper integration included in the Opinion is followed. It is important, therefore, to watch for any new "attachment," "addendum," "rider," or similar requirements coming from your retail finance or leasing providers.

Of important note is that the Opinion deals only with the single document rule and the absence of a single-page requirement; it does not address other legal requirements governing what may be included in a conditional sale contract or lease or where various disclosures and other elements must appear on the contract. For example, several items must appear on the "face" (that is, first) page of the contract. Other items must follow specific format and/or wording requirements. Still other provisions are completely prohibited from being included in a retail contract or lease, such as certain waivers or disclaimers of customer rights. Therefore, the Opinion cannot be taken as permission to attach any and

every dealer or vendor supplied form to retail contracts or leases, even if properly attached and integrated. In every case, items that you attach need to be reviewed by your legal counsel and should conform to the requirements of your retail finance and leasing providers

Delivery Of Contract And Other Required Documents To Buyer

Civil Code section 2981.9 further requires that the conditional sale contract or purchase order be signed by the buyer and by the seller and that an exact executed copy of the conditional sale contract or purchase order (or both if you use both) be delivered to the buyer prior to delivery of the vehicle.

In 2002, The Federal Reserve issued Comment 17(b)- 3 to resolve a split of authority among various court decisions concerning whether a separate copy of the contract must be given torn from the multipart stack and given to the buyer before the buyer signs the contract. The comment provided that no extra pre-contract copy is required. The comment upheld the standard practice of most dealers and included the following example: "A creditor gives a consumer a multiple-copy form containing a credit agreement and TILA disclosures. The consumer reviews and signs the form and returns it to the creditor, who separates the copies and gives one copy to the consumer to keep. The creditor has satisfied the disclosure requirement."

Other language in the Comment focused on the two key requirements for complying with the copy rules: (1) that the consumer be allowed to have possession of the contract before signing and (2) that the consumer receive his or her own copy right after signing. As to the first element, the Comment notes that is not enough to merely show the contract to the consumer – such as where the F&I manager keeps one hand on the contract as he or she shows it to the consumer. Instead, the consumer must be free to take possession of and review the contract in its entirety – front and back – before signing. As to the second element, the Comment states that the consumer copy must be provided immediately after the consumer signs. Dealers are therefore prohibited from telling a consumer that his or her contract copy will be provided at a later time, such as when the dealership signs the document or when the financing source approves it. Moreover, California law requires the consumer to receive a copy of the contract that bears the selling dealer's signature. As a result, dealers should ensure that all F&I managers and others involved in contract preparation understand their obligation to "hand off" to the consumer the entire contract set before the consumer signs and to give the consumer a copy of the contract showing the consumer's and dealer's signatures immediately after the consumer signs.

While the Comment specifies the sequence of events necessary to comply with the copy requirements in typical transactions, it does not specifically address all scenarios and permutations. For example, what if the customer wants to leave with the contract before it is signed? The dealer should allow the customer to do so, but can ask if the customer would take only one of the copies, and leave the remainder of the copies with the dealer for the dealer's records. Some F&I managers worry that allowing the customer to leave with a completed but unsigned contract gives the customer the right come back at a later time and demand the same deal.

CAUTION

REGARDING DELIVERY OF DOCUMENTS: In addition to delivery of the conditional sale contract and purchase order, Civil Code section 2981.9 also requires that you deliver to the buyer any vehicle purchase proposal or any credit statement which the buyer has signed during the contract negotiations. This would include any worksheets and F & I menus the customer has signed or initialed at your request.

Civil Code section 2984.3 provides as follows:

"Any acknowledgment by the buyer of delivery of a copy of a conditional sale contract or purchase order and any vehicle purchase proposal and any credit statement that the seller has required or requested the buyer to sign, and that he or she has signed, during the contract negotiations, shall be printed or written in size equal to at least 10-point boldface type and, if contained in the contract, shall appear directly above the space reserved for the buyer's signature or adjacent to any other notices required by law to be placed immediately above the signature space. The buyer's written acknowledgment, conforming to the requirements of this section, of delivery of a completely filled-in copy of the contract, and a copy of the other documents shall be a rebuttable presumption of delivery in any action or proceeding by or against a third party without knowledge to the contrary when he or she acquired his or her interest in the contract. If the third party furnishes the buyer a copy of the documents, or a notice containing the disclosures identified in subdivision (a) of section 2982, and stating that the buyer shall notify the third party in writing within 30 days if a copy of the documents was not furnished, and that notification is not given, it shall be conclusively presumed in favor of the third party that copies of the documents were furnished as required by this chapter."

Co-Buyer Notice Requirement

Notice Required to be Given to Co-Buyers: Civil Code section 1799.91 provides that unless the persons are married to each other, each dealer who obtains the signature of more than one person on a conditional sale contract governed by Civil Code section 2982 is required to deliver to each person who does not in fact receive the motor vehicle described in the contract, prior to that person's becoming obligated on the contract, a special notice in English and Spanish in at least 10-point type. The notice warns such person that he or she is guaranteeing the debt, should think carefully before doing so, should be sure he or she can afford to pay if he or she has to and wants to accept the responsibility, that he or she can be sued, that wages may be garnished and that if the contract is in default, such fact may become a part of his or her credit file. The exact language of the notice is set forth in the statute.

Furthermore, if such notice is required to be given and the conditional sale contract is written in a language other than English or Spanish, the notice must be given in English and in the language in which the contract is written.

The notice may be included in the contract, in which case it must be placed immediately above the signature space reserved for such person's signature or above or adjacent to any other notices required by law to be placed immediately above the signature space and shall be contained in a box formed by a heavy line. If the notice is not included within the text of the conditional sale contract, it shall be on a separate sheet which shall not contain any other text except as necessary to identify the seller and the conditional sale contract to which the statement refers and it must provide for the date and the person's acknowledgment of receipt. Each person entitled to notice under Civil Code section 1799.91 must also be delivered a copy of the conditional sale contract.

CAUTION

Separate Co-Buyer Copy of Contract. If the co-buyer notice is required, then a separate copy of the contract must be given to the co-buyer – one shared copy will not suffice, even if both buyer and co-buyer verbally agree otherwise.

CAUTION

CO-BUYER MAY HAVE NO LIABILITY: Neither the selling dealer nor the assignee of the selling dealer may bring any action, nor shall any security interest be enforced, against any person, however designated, who is entitled to notice under Civil Code section 1799.91 and who does not in fact receive the motor vehicle described in the contract unless the above provisions are complied with fully.

Spanish and Other Foreign Language Contract Translations

Civil Code section 1632 provides that whenever a dealer negotiates a sale or lease covered by Civil Code section 2982 or the Leasing Act primarily in the Spanish language or in any of four Asian languages (Chinese, Korean, Vietnamese, and Tagalog), the dealer must furnish the purchaser with a foreign-language translation of the contract prior to the execution of the conditional sale contract. The dealer is also required to conspicuously display a translated-language notice at the time and place where the agreement is entered into advising the customer that the dealer is required to provide a translated-language contract. **Failure to comply with this section entitles the purchaser to rescind the contract and compels the dealer incident to the rescission to buy back the contract from its assignee**.

If the customer uses his or her own interpreter in the transaction, then the translated language copy requirements of this law do not apply. The customer's own interpreter means a person, not a minor, able to speak fluently and read with full understanding the English and the foreign languages, and who is not employed by, or whose service is made available through, the dealer. However, because providing a translated-language copy of the contract is relatively easy, many dealers have simply adopted the practice of providing such a copy even when the customer uses his or her own interpreter.

Of importance to dealers with buy-here-pay-here operations or who might occasionally hold a contract, the court in *Reyes v Superior Court* held that the translation requirement extends not only to the initial documentation that is signed at the time a vehicle is delivered, but also to any notice sent under the contract thereafter in the nature of post-repossession and deficiency notices.

CAUTION

BLANKS ON TRANSLATION MUST BE COMPLETELY FILLED-IN, TRANSLATED: THE TRANSLATED COPY HAVE ALL BLANK SPACES COMPLETED, AS IN THE ORIGINAL CONTRACT, AND THOSE FILL-INS MUST BE TRANSLATED INTO THE FOREIGN LANGUAGE UNLESS THEY FALL WITH THE FOLLOWING ELEMENTS WHICH NEED NOT BE TRANSLATED: Names and titles of individuals and other persons, addresses, brand names, trade names, trademarks, registered service marks, full or abbreviated designations of the make and model of goods or services, alphanumeric codes, numerals, dollar amounts

expressed in numerals, dates, and individual words or expressions having no generally accepted non-English translation.

PRACTICAL TIP

In each instance of furnishing a translated language contract, double check the following compliance issues. Does the preprinted form used for the translation correspond to the specific English language form being used, down to the revision date and form number? Are all names and addresses filled in completely and correctly on the translated contract? Are all information blanks (dollar amounts, dates, etc.) completely and accurately filled-in on the translated contract? Has all text, even text used to fill-in blanks, been translated as required? Have you furnished the translated contract before having the English language contract signed?

CAUTION

POSSIBLE TRANSLATION REQUIREMENT FOR GAP AND OTHER ADDENDA: As discussed in an earlier "Caution" in this Chapter, many GAP programs apply the title "addendum" to documents setting forth GAP terms and conditions. As a result, the GAP terms and conditions become part of the contract itself and, arguably, subject to the translation requirement of Civil Code section 1632. Dealers should ensure that these and any other documents treated as addenda or amendments to the conditional sale contract be treated as a part of the contract for purposes of complying with the foreign language translation requirements.

Foreign Language Posted Sign

Subdivision (f) of Civil Code section 1632 provides that "[a]t the time and place where a contract [negotiated in one of the languages] is executed, a notice in any of the languages specified in subdivision (b) in which the contract or agreement was negotiated shall be conspicuously displayed to the effect that [dealer] is required to provide a contract or agreement in the language in which the contract or agreement was negotiated …."

This requirement does not specify exactly how many signs a given dealership needs to purchase, or exactly where they should be posted. However, the statute is open to the interpretation that foreign-language customers should not be asked to execute a contract or lease unless a sign is displayed within view. To avoid having to have special locations for foreign-speaking customers to use to sign contracts (and to avoid oversights that might result in a failure to use such special locations), dealers should consider displaying signs sufficient to allow all customers to see one of the signs at the time they sit down to sign contracts or leases. Note that the statute would arguably be violated if the sign is mounted on a wall that can be seen only when the foreign-speaking customer is exiting the location where contracts are signed.

Nor does the statute provide exact wording for the sign, requiring instead that the sign give notice in the foreign language "to the effect that the [dealer] is required to provide a contract or agreement" in the foreign language. For example, the following would appear to suffice: "WE ARE REQUIRED TO PROVIDE A [Language] LANGUAGE CONTRACT OR AGREEMENT IF WE NEGOTIATE (ORALLY OR IN WRITING) A SALE OR LEASE PRIMARILY IN THE [Language] LANGUAGE," where [Language] is replaced, in turn by Spanish, Chinese, Tagalog, Vietnamese, or Korean.

PRACTICAL TIP

No dealer is required to negotiate a sale or lease contract in any foreign language, but if you do negotiate a transaction in one of the five specified languages, you must comply with the law's requirements, summarized as follows:

- *Deliver to the customer, prior to execution of the contract, a foreign language translation of the contract with all of the blanks filled-in making sure the fill-ins are also in the foreign language.*
- *Conspicuously display the sign discussed above.*
- *Both you and the customer should sign the English contract but need not sign the translated contract. This helps confirm that the legally binding contract is the English contract; however, the law permits but does not require the translated contract to be signed.*
- *Obtain a written acknowledgement from the customer, in the language in which the contract was negotiated, that he or she was given a copy of the foreign language translation.*
- *Verify with your banks and finance companies whether they will purchase contracts that are negotiated in one of the five specified languages. Not all banks and finance companies are willing to purchase such contracts and some specifically require the dealer to warrant that none of the contracts assigned to them were negotiated in any language other than English (a breach of the warranty is grounds to make the dealership repurchase the contract). Each time you assign a contract that was negotiated in one of the specified languages, give written notice to the financing source that the transaction was negotiated in*

the foreign language, since substantive modification of the contract after assignment will require the assignee to provide a foreign language translation of the modification.

Documents Required by the Certified Used Vehicle Law

As part of AB 68, the Car Buyers Bill of Rights, effective July 1, 2006, Vehicle Code section 11713.18 will impose a host of requirements applicable to the advertising and sale of used vehicles using the term "certified" or any similar descriptive term that implies the vehicle has been certified to meet the terms of a used vehicle certification program.

Vehicle Code section 11713.18 requires the dealer, prior to sale, to provide the buyer with a completed inspection report indicating all the components inspected as part of the certification program. A detailed discussion of these requirements can be found in Chapter 32 of the 2012 CNCDA F&I Compliance Manual.

CAUTION

REGARDING WARRANTY DISCLAIMERS AND CERTIFIED USED VEHICLES: Under Vehicle Code section 11713.18, dealers who sell a used vehicle advertised or sold as "certified" may not sell the vehicle "as-is," nor may they disclaim any implied warranties of merchantability on the vehicle. Dealers should check all pertinent sales documents to be sure that "as-is" and "no warranty" references do not appear in connection with certified used vehicle sales, noting especially forms of conditional sale contract and used car buyers guides.

Service Contract and Insurance Disclosure Requirements

Requirements relating to insurance are found in three overlapping sources - the Act, Regulation Z, and the Insurance Commissioner's regulations. Although approved conditional sale contract forms contain the necessary notices and warnings to satisfy these laws and regulations, a basic understanding of the requirements is essential to avoid certain pitfalls, particularly with respect to the requirement that disability and credit life insurance be strictly voluntary (or the premium must be included as part of the finance charge) and the requirement that the buyer is not obligated to buy the physical damage insurance through the dealership.

Civil Code section 2982 provides that all of the requirements and limitations of Regulation Z must be met. Although compliance with the Insurance Commissioner's regulations contained in the Code of Regulations can be met by providing a separate Statement of Insurance to the customer, in practice the Statement of Insurance is included in the conditional sale contract forms and thus all of the requirements will be discussed together.

Both Civil Code section 2982 and Regulation Z require that each type of insurance for which a premium is charged be identified and the premiums separately stated, and if the insurance expires before the date of the last scheduled installment the term of the insurance shall be stated. 10 California Code of Regulations section 2114(c) in addition sets forth that in the event the insurance coverage expires prior to or continues after the expiration date of the contract of sale, that fact shall be clearly stated.

Civil Code section 2982(i)(2) provides that any charge for insurance (other than credit life or disability) included in the contract balance which is disbursed more than a year from the date of the contract shall not be subject to a finance charge until disbursed.

Regulation Z includes in its definition of finance charge premiums for insurance unless specifically excluded and then sets forth the conditions for excluding premiums for credit life and disability and physical damage insurance.

a. To exclude life and disability premiums from being considered part of the finance charge, the customer must be advised that the coverage is not required as a condition to the sale, he or she must be advised of the amount of premium, and after being given these disclosures he or she must sign or initial an affirmative written request for the insurance.

b. To exclude the physical damage (comprehensive) premium from being considered part of the finance charge, it must be disclosed that the insurance coverage may be obtained from a person of the buyer's choice.

c. Title 10 of the California Code of Regulations section 2114(c) goes one step further and requires in the Statement of Insurance a notice that no person is required to negotiate or purchase insurance through a particular insurance agent or broker.

NOTE

REGARDING MISREPRESENTATION OF INSURANCE REQUIREMENTS: Violation of Civil Code section 2982

can be used a basis for action by the DMV against a dealer's license. The DMV has brought a number of accusations against dealers alleging that customers of these dealers were told that they had to buy insurance through the dealer and/or had to buy credit life and disability insurance. Many of these cases have involved sales to Spanish-speaking buyers. Since dealers normally pay their insurance personnel on a commission basis, the temptation for overselling is present and it is therefore essential that the dealer exercise a tight control over the method by which his or her insurance personnel induce their customers to buy insurance.

d. The California Code of Regulations (10 C.C.R. 2114) requires that a written "Statement of Insurance" signed by both the purchaser and dealer be furnished the buyer containing a number of the disclosures herein discussed and that such statement be labeled "Statement of Insurance" and shall be either a separate document or a separately executed portion of another document. Approved conditional sale contract forms generally combine all of the required insurance disclosures and notices in a separate box labeled "Statement of Insurance" and provide spaces where signatures are required. Even if no insurance is transacted (in which case n/a should be completed in the product description and price fields), the customer and dealer should sign these signature lines.

e. **Even in commercial sales the dealer is required to furnish the purchaser with an insurance warning.**

Civil Code section 2984.1 requires that every conditional sale contract shall contain a statement in contrasting red print in at least 8-point bold type which reads as follows:

THE MINIMUM PUBLIC LIABILITY INSURANCE LIMITS PROVIDED IN LAW MUST BE MET BY EVERY PERSON WHO PURCHASES A VEHICLE. IF YOU ARE UNSURE WHETHER OR NOT YOUR CURRENT INSURANCE POLICY WILL COVER YOUR NEWLY ACQUIRED VEHICLE IN THE EVENT OF AN ACCIDENT, YOU SHOULD CONTACT YOUR INSURANCE AGENT. WARNING:

YOUR PRESENT POLICY MAY NOT COVER COLLISION DAMAGE OR MAY NOT PROVIDE FOR FULL REPLACEMENT COSTS FOR THE VEHICLE BEING PURCHASED. IF YOU DO NOT HAVE FULL COVERAGE, SUPPLEMENTAL COVERAGE FOR COLLISION DAMAGE MAY BE AVAILABLE TO YOU THROUGH YOUR INSURANCE AGENT OR THROUGH THE SELLING DEALER. HOWEVER, UNLESS OTHERWISE SPECIFIED, THE COVERAGE YOU OBTAIN THROUGH THE DEALER PROTECTS ONLY THE DEALER, USUALLY UP TO THE AMOUNT OF THE UNPAID BALANCE REMAINING AFTER THE VEHICLE HAS BEEN REPOSSESSED AND SOLD.

FOR ADVICE ON FULL COVERAGE THAT WILL PROTECT YOU IN THE EVENT OF LOSS OR DAMAGE TO YOUR VEHICLE, YOU SHOULD CONTACT YOUR INSURANCE AGENT.

THE BUYER SHALL SIGN TO ACKNOWLEDGE THAT HE/SHE UNDERSTANDS THESE PUBLIC LIABILITY TERMS AND CONDITIONS.

S/S _____.

This statement must be initialed by the buyer. (Also see the section entitled "INSURANCE DISCLOSURES" in the chapter on Insurance for other requirements, including a special warning that must be given if a physical damage insurance policy is sold without public liability coverage. (Vehicle Code section 5604.5).)

Special Requirements Relating To The Sale Of Disability Insurance

A dealer who sells disability insurance to a purchaser must deliver to the purchaser at the time of sale a statement in at least 10-point bold type advising the purchaser of his or her rights and duties in the event he or she becomes disabled and of the claim procedure (Civil Code section 1812.402(f)). This statement may either be included in the conditional sale contract or be set forth on a separate document. (See the chapter on Insurance for a full discussion and the right of buyer to cancel disability and credit life insurance.)

Every application for, certificate of, and policy of credit life or credit disability insurance shall set forth a statement in bold capital letters indicating that any pre-existing health condition of the applicant may render the coverage void, if that is the case (Insurance Code section 10127.5). It should be noted that the requirement is not in the alternative, and that each of the documents specified must contain the required statement in bold letters.

Service Contract Sale And - Cancellation Requirements

The chapter of this Management Guide entitled Service Contracts covers important requirements pertaining to the sale and cancellation of service contracts arising under both the Insurance Code and the Civil Code.

Bird Dog Rebates And Commissions

Civil Code section 2982.1 makes it unlawful for a dealer to induce or attempt to induce a person to enter into a conditional sale contract for the purchase of a vehicle by offering a rebate, discount, commission or other consideration (so-called "Bird Dog" fee) in the event the buyer gives information or assistance for the purpose of leading to a sale by the dealer of a vehicle to a third party. See further discussion of bird dog fees in the chapters in this Management Guide entitled AUTOBROKERS AND DEALERSHIP OPENING, CLOSING, AND LICENSING, the section on Bird Dog and Referral Fees.

Contract Modifications And Side Loans

Extension Agreements Permissible Charges

Although of more significance to the holder of the contract, Civil Code section 2982.3 provides that no extension fee can be charged a customer unless there is a written extension agreement signed by the parties. However, the seller or holder may, as an adjunct to or to assist in efforts to collect one or more delinquents installments on the contract, advise one or more obligors on the contract, either in writing or orally, that the due date for one or more installments under the contract shall be extended, with no charge being made for such extension other than any applicable late charge provided for in the contract.

If the contract contains a finance charge on the pre-computed basis, the maximum extension fee is 1% per month simple interest on the installment or installments extended or deferred for the period of the extension or deferral.

If the contract contains a finance charge determined on the simple interest basis, the maximum fee is the lesser of $25 or 10% of the then outstanding balance, but such charge is in addition to any finance charges which accrue because such extended or deferred payments are received at a time other than as originally scheduled.

Requirements Related To Dealer-Assisted Loans

Prohibition Against Other Security

In order to appreciate the scope and meaning of Civil Code section 2982.5, a little background information is necessary, including a discussion of Civil Code section 2984.2. Prior to January 1, 1962 (the operative date of Civil Code 2984.2), there was no prohibition against a dealer taking additional security such as the customer's furniture or real property in connection with the conditional sale of an automobile. But effective January 1, 1962, dealers were – and remain to this day – prohibited from taking any security for the payment of the conditional sale contract other than the vehicle being sold (plus accessories, accessions, certain insurance premium rebates, and the replacements or proceeds thereof).

Because of the prohibition against additional security, between 1962 and 1968 side loans to assist customers in coming up with downpayments and/or pickup payments became extremely common, and since most of these side loans were secured by furniture and/or the purchaser's home and since there was no duty upon the dealer to disclose the details of these loans in the conditional sale contract, some automobile buyers were again being subjected to the potential loss of their home and/or furniture in connection with the purchase of a motor vehicle. Wide publicity as well as a great deal of scrutiny by governmental consumer protection agencies was given to complaints by customers that they really did not understand the full extent of their obligations, namely payments due both under the conditional sale contract and the side loan, and that they did not understand that they were giving additional security, This prompted the passage of Civil Code section 2982.5.

Abolition of Distinction Between Side Loan For Part Payment And Side Loan For Unpaid Balance

Civil Code section 2982.5 basically did two things. Its subdivision (a) affirmed that nothing in ASFA prevented supervised financial institutions such as banks or licensed finance companies from independently – that is, without dealer assistance – making loans to automobile purchasers on any security, the proceeds of which would be used in connection with the purchase of an automobile by the borrower.

But its subdivision (b) added a new legal requirement: if the seller assisted the buyer in obtaining an outside loan, certain details of the loan had to be disclosed on the face of the conditional sale contract.

Under Civil Code section 2982.5(b) if the seller assists the buyer in obtaining a loan upon any security from a third party the proceeds of which are to be used as a part or all of the downpayment or any other payment on a conditional sale contract, the seller shall set forth on the face of the conditional sale contract the amount of the loan, the finance charge, the total thereof, the number of installments to repay the loan and the amount of each such installment, and the contract must set forth that the buyer may be required to pledge security for the loan, which security must be mutually agreed to by the buyer and the lender and notice in at least 8-point type that the buyer is obligated for the installment payments on both the conditional sale contract and the loan. It is not necessary to name the loan company nor describe what security will be required.

The 1980 Court of Appeal decision in *Hernandez v. Atlantic Finance*, 164 Cal. Rptr. 279, held that seller-assisted loans subject to Civil Code 2982.5(b) did not include loans to pay the entire purchase price or the unpaid balance after payment of a downpayment. Instead, such a loan would be subject to all of the requirements of ASFA, even though not made directly by a dealer. In the Hernandez case, the lender took as collateral both the vehicle being purchased and furniture. But while the terms of the loan would normally have been permissible for licensed personal property broker making the loan, they were not within the limitations of ASFA, particularly with respect to the finance charge and security taken. The Court held that such loans were in fact covered by ASFA, even if made by non-dealer lenders, and voided the transaction.

In 1983 the legislature amended Civil Code section 2982.5 (effective January 1, 1984) as a result of the Hernandez decision.

Under the 1983 amendment, dealer-assisted loans, the proceeds of which are used to pay the entire purchase price or any part thereof, are permitted and the finance company making the loan is not subject to the finance charge limitations of ASFA and may take additional security for the loan other than real property. Real property is subject to a special rule whereby it may be taken as security by the finance company only if the dealer-assisted loan is $7,500 or more and the proceeds are used to pay all or any part of the purchase price of a recreational vehicle not less than 20 feet in length.

In connection with these dealer-assisted loans to pay off the entire purchase price or any part thereof, the loan by the finance company is subject to the provisions of Civil Code sections 2983.2, 2983.3 and 2983.4, which means that the third party lender must comply with the ASFA requirements relating to notice of intent to sell a repossessed vehicle, reinstatement privileges, and county or city where suit to enforce the contract must be brought. The lender is also subject to any claims or defenses the buyer has against the seller. Also if the buyer becomes obligated to purchase or receives possession of the vehicle prior to obtaining the loan, the dealer's contract must set forth the amount of the loan, the finance charge, the total thereof, and the number and amount of the installments to repay the loan.

The conditional sale contract must also contain the 8-point type notices described above which are required in connection with a dealer-assisted loan to be used as part or all of the downpayment or any other installment on a conditional sale contract. The seller is likewise prohibited from receiving any commission for assisting the buyer to obtain such a loan.

The 1983 amendment does not apply to state and federally chartered banks and savings and loan associations.

CAUTION

REGARDING ONE-PAY CONTRACTS: Civil Code section 2982.5 applies to all one-pay contracts where the dealer assists the buyer in obtaining a loan from a finance company to pay off the contract balance.

NOTE

REGARDING FINANCE CHARGE ON PICKUP PAYMENTS: Where the seller assists the buyer in obtaining a side loan for a pickup payment and this pickup payment is due on or before the due date of the second regularly scheduled installment under the contract, you cannot under Civil Code section 2982.5 impose a finance charge on the amount of the pickup payment and the pickup payment shall be shown as a deferred downpayment. The pickup payment should also be shown in the schedule of payments.

What constitutes "Dealer Assistance?"

Almost any action of the dealer beyond merely advising a customer that he or she will need outside financing to close a deal would permit the argument that the loan is dealer-assisted. If you take a credit application from the customer and suggest that the customer bring the credit application to a particular source for a side loan, the loan would be dealer-assisted. Even suggesting that a customer go to a particular finance company with whom you do business on a regular basis would appear to make the loan dealer-assisted. Any substantive communication initiated by your dealership with the finance

company regarding the transaction could constitute dealer assistance.

Duty To Refund

Civil Code 2982.5 also provides that if the buyer makes appropriate application for the dealer-assisted loan and is unable to secure such loan, the conditional sale contract shall be deemed rescinded and all consideration shall be returned by the respective parties without demand. In this connection see warning regarding over-allowance on trade-in in the section of this chapter entitled "CIVIL CODE section 2982(a) DISCLOSURES."

Rights And Duties After Executing Contract

Inability Of Buyer To Obtain Financing - Dealer's Inability To Assign Contract

Not only is a conditional sale contract to be deemed rescinded where the buyer cannot obtain a dealer-assisted loan, a conditional sale contract shall also be deemed rescinded and all consideration shall be returned by the parties if the buyer obligates himself or herself to buy and the seller knows the buyer intends to obtain financing from a third party and the buyer is unable to obtain such financing (Civil Code section 2982.9). For example, a customer takes delivery of a new vehicle pursuant to a one-pay contract and tells the dealer that he or she is going to get the balance from his or her credit union or bank. If the customer is turned down by the bank or credit union, the dealer has a duty to take back the vehicle (in which case the dealer now has a used car) and the dealer is obligated to refund to the customer all consideration received. If in the meantime the vehicle has been damaged, the dealer would have a right to an offset to take care of the damage, but the dealer would have no right to an offset simply because the vehicle now has mileage. If there has been excessive mileage in this situation, however, you might consult your attorney regarding the possible right to a setoff.

PRACTICAL TIP

To avoid the risk of having to unwind a deal when the customer does not get the outside financing, particularly where the customer would qualify for a regular contract, it may be worth preparing a regular installment contract and then add on the face of the contract that the buyer has the option to pay off the unpaid balance (amount financed) within a designated number of days (preferably before the due date of the second installment) without payment of any finance charge. In this way the customer is locked into the installment contract even if the customer does not get outside financing. Several conditional sale contract forms include a box and signature line to provide a "one-pay option" to the customer for this purpose.

If the inability of the customer to obtain financing either for a side loan or for the unpaid balance is clearly due to the fault of the buyer, then the buyer does not have a right to rescind and the dealer does not have a duty to refund. For example, if you deliver a vehicle on a one-pay contract to a customer who has furnished you with a credit statement which is clearly strong enough to permit your customer to obtain outside financing as he or she represents he or she intends to obtain, and the statement is materially false so that the customer is turned down; or if after delivery of a vehicle the customer changes his or her mind about the purchase and refuses to submit a credit application for an outside loan, you should consult your attorney regarding your rights. Frequently the situation arises that the customer has gone to the DMV and a DMV Investigator comes to the dealership and demands that the dealership refund a customer's downpayment. The DMV investigator will tell you that you must return the customer's downpayment even though one of the above fact situations exists. You may respectfully decline and seek the opinion of your attorney with respect to your particular fact situation. Where it is the customer's fault the financing is not obtained, you are entitled to an offset against any refund for the customer's use of the vehicle.

CAUTION

WHEN YOU ARE UNABLE TO ASSIGN THE CONTRACT: It is important to distinguish the situation where the customer is unable to obtain financing from the situation where a conditional sale contract is prepared calling for regular monthly payments and you are unable to assign the contract to one of the financial institutions with whom you regularly do business. Unless there is a specific provision in your contract which permits you to unwind the transaction because you cannot assign the contract, you have absolutely no right to repossess the vehicle unless the customer is in default under the terms of the contract.

NOTE

ON REWRITTEN CONTRACTS. If a conditional sale contract for the sale of a new vehicle is "rewritten" due to an inability to obtain financing, and the original buyer(s) -- and only the original buyer(s) (i.e., no new co-buyer) are reflected on the rewritten contract, the DMV has clarified that the second contract may show that the vehicle was sold as new, since this accurately reports that the status of the vehicle at the time it was sold and delivered. (See DMV Memo VIN 2007-4.)

CAUTION

BACKDATING REWRITTEN CONTRACTS: If, several days after a vehicle is delivered, it is determined that a conditional sale contract cannot be financed, but the dealer and customer agree upon a replacement contract, as of what date should the replacement contract be dated? Many dealers opt to backdate the second contract to the date of the first contract. But Regulation Z requires that the actual date of contract signing be used as the contract commencement date for purposes of calculating the annual percentage rate (APR) – the "as of" backdated date cannot be used for this calculation. Since most F&I software uses the date printed on the contract as the contract commencement date for purposes of calculating the APR, backdating the rewritten contract could result in a Regulation Z violation. At least one reported court decision following this logic rejected the argument that backdating was a common industry practice. (See Rucker v. Sheehy Alexandria, Inc., 228 F. Supp. 2d.711 (E.D. Va. 2002)). Trial lawyers have attempted to attack backdating on other grounds as well. While the law may not literally prohibit backdating under all circumstances, the complexity and uncertainly of legally doing so suggest that backdating be avoided.

NOTE

INABILITY TO ASSIGN CONTRACT.: A number of dealers have the misconception that the unfettered right to unilaterally unwind the transaction exists in their favor if they cannot assign the contract. This is a dangerous misconception and you could be held liable for the tort of conversion if you attempt to take the vehicle back from the customer at a time when the customer is not in default. The conditional sale contract must specifically provide that if the dealer is unable to assign the contract to a financial institution with whom the dealer regularly does business on terms acceptable to the dealer, the dealer has the right to rescind the contract and refund the downpayment and/or return the trade-in. Some contracts contain this language, including the 553 Reynolds and Reynolds Form LAW 553-CA and related forms. A number of dealers attach such an agreement to the conditional sale contract and reference the attachment on the face of the contract. (See the risk of using rescission agreements discussed earlier in this chapter in the section entitled "THE SINGLE DOCUMENT PITFALL.") In this connection it does not appear to be sufficient to merely state on the face of the contract "subject to credit approval." This is too ambiguous and the customer could always argue that once the car was delivered he or she had a right to assume his or her credit had been approved.

Duty To Refund - Conditional Sale Contract Is Contemplated But Not Executed

From time to time, a dealer will accept a deposit in connection with the anticipated sale of a vehicle. Dealers should be aware that this approach can raise a number of legal issues, if for whatever reason the customer declines to go forward with the acquisition of the vehicle. The key issue is whether or not under the circumstances of that transaction, the dealer is entitled to retain the deposit as part of a claim for lost profits.

If a customer is acquiring a vehicle for personal or family purposes, the dealer must refund to the customer any payment made pending the execution of conditional sale contract when the conditional sale contract is not executed. (See Civil Code section 2982.7.) Based upon this statute, a customer at any time prior to the signing of a conditional sale contract is entitled to a refund when a conditional sale contract is to be signed later, such as when a deposit is given to hold a particular vehicle, contemplating its eventual purchase; or a deposit is given to reserve a vehicle which it is anticipated will become part of the dealer's stock; or when a deposit is given in connection with signing an order form for a particular vehicle.

Right To Lost Profit and Retention of Deposits - Customer Breaches Agreement To Purchase

The most difficult question is whether a refund is required by California Civil Code Section 2982.7 when a customer seeking to acquire a vehicle for personal use makes a deposit and signs a purchase order which contains the disclosures required for a conditional sale contract, but it is anticipated by both the dealer and the customer that a subsequent conditional sale contract actually will be signed. In such a situation, a strong argument can be made in support of a dealer's claim to retain the deposit to

the extent there are lost profits, but a literal reading of the statute may not be supportive of that position and there are no court cases that give any further guidance.

This requirement to refund a deposit should not apply in those situations where no conditional sale contract is to be signed later, such as when a customer gives a deposit to a dealer and signs a binding sales agreement meeting the requirements of a conditional sale contract, which provides that the customer will pay the remaining purchase price upon the delivery of the ordered vehicle. In that situation, if the customer fails to pay the remaining purchase price upon delivery of the vehicle, the dealer is in a position to claim an amount representing lost profits and any other incidental expenses incurred because of the customer's breach of the agreement, and may retain the deposit to the extent necessary to compensate for those damages. This is true even though the dealer is able to sell the ordered vehicle to another customer for the same price the defaulting purchaser had agreed to pay. In this instance Commercial Code section 2708(2) is applicable, which provides that the dealer is entitled to be put in as good a position as performance would have done. The key factor as to the validity of a lost profits claim is the type of vehicle being sold. If the vehicle is one which is available to the dealer in an almost inexhaustible supply, the fact that the dealer can sell the vehicle to another customer does not eliminate the lost profits claim. Where a large supply of vehicles is available, the dealer should be considered a "lost volume seller", and as acknowledged in the California Appellate Case of *Nat. Controls v. Commodore Business Machine* (1985) 163 Cal.App.3d 688, such a seller is entitled to damages representing prospective profits from a sale which is lost because of the customer's breach.

A claim for lost profits however, would not be available if a dealer has a very limited supply of the type of vehicle being sold and the dealer could reduce any loss by selling that vehicle to another waiting customer. A dealer in this position is legally under a duty to make the sale to the waiting customer to "mitigate" the dealer's lost profits claim. To prove a claim for lost profits, a dealer must establish that a sale was truly lost.

In the instance of the sale of a vehicle to a customer for business purposes, the statutory requirement to refund a deposit also does not apply. However, the dealer's duty to "mitigate" any loss resulting from the default of a business customer by selling the vehicle to another waiting customer still applies, especially where the vehicle's availability is significantly limited. In a non-consumer transaction where there is a limited supply of the type of vehicle involved, authority exists (See Commercial Code section 2718(2)(b)) which allows a dealer under certain circumstances to withhold that portion of a customer's deposit which is 20% of the contract purchase price or $500, whichever is smaller.

Dealers should also be aware that Vehicle Code section 11713 prohibits them from accepting a purchase deposit relative to the sale of the vehicle unless the vehicle is present at the premises of the dealership or available to the dealer directly from the manufacturer at the time the dealer accepts the deposit. Autobrokers may accept deposits when brokering a retail sale in accordance with Vehicle Code sections 11736 and 11737. See the Chapter in this Management Guide entitled Autobrokers for further details.

In the case of *Paul Eidsmore. v. RBB, Inc*., a California Appellate Court construed that statute in a manner favorable to a dealer. In that case, the plaintiff sued a dealer to rescind a contract to purchase a Ferrari F-40 vehicle. In an effort to acquire one of these "unique and exotic" vehicles, the plaintiff gave refundable deposits to several dealers, but with respect to the defendant dealer agreed to a written contract which provided for a non-refundable deposit of $100,000. The arrival of the F-40 model from the manufacturer took several months and during that period, its value drastically declined so the plaintiff attempted to rescind the contract and filed a lawsuit to accomplish that result. The Appellate Court confirmed that the dealer had not violated the applicable statutes and was entitled to retain the deposit as part of the dealer's claim for damages because the F-40 Ferrari was available to the dealer within a reasonable time. The outcome of a dispute involving a customer's deposit is often dependent on the facts of the specific transaction and a dealer should review those facts carefully and consult legal counsel if necessary before making a final decision as to the handling of the deposit.

Rights To Advances To Pay For Insurance And Repairs

Civil Code section 2982.8 sets forth the circumstances under which the holder of a conditional sale contract may make advances for payment of insurance premiums or for repairs, impose a finance charge on the advances, and have payment of the same secured as provided in the conditional sale contract. These provisions coupled with Civil Code section 2983.3 are very beneficial to the holder of the contract or dealer because they clearly set forth the right of the holder of the contract where the customer fails to obtain or maintain insurance required under the contract to either repossess the vehicle or add the amount advanced to the contract and have the amount so advanced secured as provided in the contract. Although it will normally be the holder of the contract that handles such advances, occasion-

ally the dealer may end up being the holder of the contract making such advances. In this event, it is absolutely essential that the dealer review and strictly follow the provisions of Civil Code section 2982.8. These provisions require a special written notice be given the buyer extending to the buyer various options to repay amounts advanced for insurance premiums.

The notice required by section 2982.8 must also contain a special warning in contrasting red print in at least 8-point bold type advising the buyer of his or her duty to maintain liability insurance, the consequences of his or her failure to do so, and that the insurance acquired by the holder does not satisfy the requirements of the Financial Responsibility Law.

Default As Prerequisite To Acceleration

Civil Code section 2983.3 originally provided that in the absence of default by the buyer in the performance of any of his or her obligations under the contract, the holder of the contract could not accelerate the maturity of the amount owing and could not repossess the vehicle. The initial purpose of this section was to prevent the holder from repossessing the vehicle merely on the ground that the holder of the contract felt insecure. As originally enacted, this section left in doubt the holder's right to repossess by reason of the buyer's default under the terms of the contract for reasons other than the non-payment of installment payments when due. This section now makes it clear that the holder of the contract has the right to repossess where the default is due to the buyer's failure to keep and maintain the vehicle free from liens of every kind, or where the buyer has defaulted in the performance of other terms of the contract. In order to cure the default under the right of reinstatement granted to the buyer under this section, the buyer is obligated to reimburse the holder of the contract for the amount of advances made by the holder and for all reasonable costs and expenses incurred in connection therewith.

Pre-Repossession Written Notice of Delinquency to Cosigner

Pre-repossession notices must be given to certain parties liable on the contract. Civil Code section 2983.35 requires that, prior to repossession, the holder of a contract subject to the Act give each cosigner of that contract written notice of delinquency.

Under this law, a cosigner is a person who signed a conditional sale contract at the request of the seller or finance company, but who did not, "in fact," receive possession of the vehicle. Whenever there is a likelihood that someone is using the vehicle to the exclusion of one of the signers on the contract, it is prudent to assume that such a signer is a cosigner under this law, and to send that person a written notice of delinquency. The law's use of the words "in fact receive" may mean that a failure to send a notice will not be excused on grounds of a lack of knowledge on the part of the dealer or finance company concerning which of the signers actually received possession of the vehicle.

The law does not specify the contents of the notice of delinquency. It can be assumed from its title, however, that the notice identify, at a minimum, the contract in question, each individual default, and the amount necessary to cure all defaults – or a statement that the defaults are not subject to cure if, consistent with other legal constraints discussed in the following section, the holder is taking that position.

The notice of delinquency may be personally served or sent by certified mail, return receipt requested, or by first-class mail, postage prepaid. If mailed, it is to be directed to the last known address of the cosigner. If the last known address of the buyer and the cosigner are the same, a single written notice of delinquency given to both the borrower and cosigner prior to repossession satisfies the cosigner notice requirement.

If a dealer or other holder fails to give the notice of delinquency when required, costs and charges associated with the repossession may not be collected from the cosigner. But, as with other provisions of the act, noncompliance can also be deemed a misdemeanor, and grounds for action against a dealer's DMV license.

Buyers Right Of Reinstatement

Civil Code section 2983.3 also provides that the buyer or any other person liable on the contract shall have a right of reinstatement to bring the contract current unless the seller or holder reasonably and in good faith determines that any of the following has occurred:

a. The buyer or any other person liable on the contract provided materially false or misleading information on his or her credit application;

b. The buyer, any other person liable on the contract, or any permissive user in possession of the motor vehicle, in order to avoid repossession has concealed the motor vehicle;

c. The buyer, any other person liable on the contract, or any permissive user in possession of the motor vehicle, has committed or threatened to commit acts of destruction or has failed to take care of the motor vehicle in a reasonable manner so that the motor vehicle has or may become substantially impaired in value;

d. The buyer, or any other person liable on the contract has committed, attempted to commit, or

threatened to commit criminal acts of violence or bodily harm against an agent, employee, or officer of the seller or holder in connection with the seller's or holder's repossession of or attempt to repossess the motor vehicle;

e. The buyer has knowingly used the motor vehicle, or has knowingly permitted it to be used in connection with the commission of a criminal offense, other than an infraction, as a consequence of which the motor vehicle has been seized by a federal, state, or local agency or authority pursuant to law;

f. The motor vehicle has been seized by a federal, state, or local public agency or authority for the illegal transportation of drugs or aliens or other illegal use which makes the vehicle subject to forfeiture, and the seizing authority, as a precondition to the return of the motor vehicle to the seller or holder, prohibits the return of the motor vehicle to the buyer or other person liable on the contract or requires the termination of the property rights in the motor vehicle of the buyer or other person liable on the contract.

The exercise of such right to reinstate shall be limited to once in any twelve month period and twice during the term of the contract. In order to reinstate, the buyer is also obligated to reimburse the seller or holder for all reasonable and necessary collection and repossession costs and fees incurred, including attorney's fees and legal expenses expended in retaking and holding the vehicle.

If the dealer or holder of the contract denies the right of reinstatements, the dealer or holder has the burden of proof that the denial was reasonable and made in good faith. Failure to sustain this burden of proof will not only preclude any right to a deficiency, but may subject the dealer or holder to damages for conversion; however Civil Code section 2983.3 does provide that it shall not be presumed that the buyer is entitled to damages by reason of the failure of the dealer or holder to sustain such burden of proof.

Sale of Vehicle After Repossession

Requirements For Notice Of Intent To Sell Vehicle

Except where the motor vehicle has been seized as described above in paragraph (f) of the section entitled "BUYERS RIGHT OF REINSTATEMENT," no deficiency judgment may be obtained against any party liable under a conditional sale contract unless at least fifteen days written notice of intent to sell the repossessed vehicle is sent by certified mail (twenty days if mailed out of state) return receipt requested, or the parties liable on the contract are personally served with such notice. Notices may not be combined on the same document except in the case of married couples living at the same address. (The risk of changed marital status supports sending separately addressed notices in every case.)

This notice also must be served or mailed within sixty days of the date of the repossession as a further condition to obtaining a deficiency.

Civil Code section 2983.2 and Commercial Code section 9614 prescribe what must be set forth in said notice. Since this notice is in practice usually sent by the holder of the contract following repossession these requirements will not be detailed herein. On those occasions where the bank or finance company does not send the notice it is suggested that you request your bank to furnish you with its form for your use or that you have your attorney draft a notice for you since there are a great number of required provisions and formatting requirements, and if your notice does not contain them all, it will be defective and you will lose your right to a deficiency. Not only does the dealer or holder of the contract who fails to give a proper notice of intent to sell a repossessed vehicle lose his or her right to a deficiency, the dealer or holder of the contract may also be liable to the purchaser for damages for conversion.

The notice must advise the parties liable on the contract of their right to reinstate discussed in the previous Section or if not, why not, and of their right to redeem and provide an itemization of the amounts required to reinstate or redeem along with an estimate of the credit for unearned finance charges or canceled insurance. The notice must also advise the parties liable under the contract of their right upon written request to extend by ten days the right of reinstatement if given and the right of redemption. The notice must include a telephone number that may be called to determine the amount necessary to redeem the vehicle. A telephone number and/or address must be include in the notice from which may be obtained additional information concerning the disposition of the collateral and the secured obligation.

The notice must advise the parties liable on the contract that upon the disposition of the motor vehicle, they will be liable for the deficiency balance plus interest at the contract rate, or at the legal rate of interest pursuant to Civil Code section 3289 if there is no contract rate of interest, from the date of disposition of the motor vehicle to the date of entry of judgment. The notice should also reflect that an explanation of the calculation of the deficiency is to be provided within 14 days following receipt by the holder of the customer's request.

CAUTION

NOTICE MUST SET FORTH PRECISE DOLLAR AMOUNT NEEDED TO REINSTATE: Consumer attorneys have charge some post-repossession notices with being too vague regarding the exact steps a customer must take – and exact amounts he or she must pay – to reinstate a contract after repossession. According to one court decision, the notice must give those in default information on how to reclaim their vehicles without need for further inquiry, and that this requires the notice to include the sum of all amounts payable, to whom the payments must be made, their names and addresses and any additional payments that would come due before the running of the reinstatement deadline. Use of statements such as "plus repossession expenses," or "attorney fees," should be avoided in favor of exact dollar amounts for such costs. See Juarez v. Arcadia Financial, Ltd. (2007) 152 Cal. App. 4th 889.

NOTE

ON PRIVATE VS. PUBLIC SALES: The information required in the post-repossession notice depends in part upon whether the sale will be a public sale or a private sale. This results from the operation of Division 9 of the California Uniform Commercial Code. Even though Division 9 was rewritten effective July 1, 2001, these rules appear unchanged. If the repossessed vehicle is sold at a public sale, the post-repossession notice must advise the retail consumer of the exact date, time and place of the sale. For a private sale, the notice need only state the date on and after which the vehicle will be sold. Whether a sale is considered public or private depends on the circumstances surrounding the sale. Auctions open to the general public could be public sales, but auctions open to dealers only would have a good chance of being considered private.

Accounting Of Proceeds Of Sale

The notice of intent to sell must advise the parties liable on the contract that upon written request made at anytime within one year from the date of the sale of the repossessed vehicle that the seller or holder of the contract must provide a written accounting of the sale proceeds.

Must I sell the repossessed vehicle at retail?

Aside from strict procedural constraints, the only substantive requirement imposed upon the holder or seller is that the repossessed vehicle be sold in a commercially reasonable manner. Under Commercial Code section 9610 the fact that a better price could have been obtained by a sale at a different time or in a different method from that utilized by the seller is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner, and the Commercial Code further provides that if you have sold in conformity with reasonable commercial practices among dealers in the type of property sold, you have then sold in a commercially reasonable manner. Although the factors involved in whether a sale is commercially reasonable are myriad, it is safe to say that if the repossessed vehicle is of a type that new car dealers would routinely sell at wholesale, it would then be commercially reasonable to wholesale it. Depending on a particular dealer's inventory, even good clean cars that one would normally retail could be sold at wholesale. Also, where it would appear that the repossessed vehicle could be sold at a surplus by a retail sale, since that sale will necessarily eat into a profit you could otherwise make, we would argue that it would be commercially reasonable to wholesale the repossessed vehicle.

NOTE

ON OBTAINING WRITTEN BIDS: When you sell to wholesalers be absolutely sure to obtain a number of written bids and retain them in your files. Before selling the unit at an auction it would also be advisable to obtain some written bids.

What are the consequences of not selling in a commercially reasonable manner?

You will be liable to the party liable on the contract for any loss he or she has suffered as a result of your failure to sell in a commercially reasonable manner. Not only will this limit the amount your might recover on a deficiency, more importantly it may make you liable for actual damages.

If the party liable on the contract has a substantial equity in the repossessed vehicle and you do not sell it in a commercially reasonable manner so that no surplus results, you could be liable to the customer for the amount of the surplus that would have resulted from a commercially reasonable sale, plus attorney's fees. Any type of reciprocal arrangement one dealer might have with another dealer whereby each sells to the other its repossessed vehicles which might generate a surplus at a bargain price would constitute a flagrant violation of the law and could lead to even greater penalties. For example, a Bankruptcy Court Judge imposed a $5,000 penalty on a dealer for dumping a repossessed vehicle, the sale of which should have resulted in a substantial surplus.

What expenses can a dealer charge against the sales proceeds of a repossessed vehicle?

This question frequently comes up, since a dealer has a duty to return any surplus derived from the sale of a repossessed vehicle. Only direct expenses may be deducted, such as reasonable repossession costs, attorneys fees if actually incurred in connection with the retaking, the reasonable cost of repairs, and direct sales expenses including commissions actually paid.

NOTE

ON CHARGING A FIXED PERCENTAGE OF OVERHEAD: You cannot charge a fixed percentage of your overhead or cost of doing business or a percentage of your advertising.

What if the party liable on the contract files bankruptcy prior to a repossession sale?

Once a party liable on a contract files any type of proceeding in the U.S. Bankruptcy Court, an automatic stay immediately goes into effect suspending any affirmative action on the part of a creditor to pursue its security. This automatic stay goes into effect on the date of the filing of the proceeding and enjoins both repossession of a vehicle under a conditional sale contract and, if the vehicle has already been repossessed, it enjoins resale of the vehicle pursuant to a notice of intent to sell. Lack of notice on the part of the creditor does not prevent a sale from being a violation of the stay order and the sale at the option of the trustee in bankruptcy may be set aside. In order to proceed with a repossession sale after the filing of a bankruptcy proceeding, it is necessary to obtain relief from the stay from the Bankruptcy Court or an abandonment of the vehicle by the trustee approved by the court.

CAUTION

REGARDING SUITS FOR A DEFICIENCY: We recommend that before turning any file over to a collection agency for the filing of an action for a deficiency that either you or your attorney carefully screen the file to make sure that your personnel from the inception of the deal through the repossession have dotted all the "i's" and crossed all the "t's" in conformity with the Act. Even assuming you have done that, there is still no assurance that you will not receive a cross-complaint from the customer alleging some type of violation of the Act and you may end up spending more money than is warranted by the potential benefit to be derived if you should obtain a judgment. Due to the liberal exemptions available to a judgment debtor one should realistically assess the possibility of collection assuming you get a judgment. As you will see in the next section, the potential penalties for violation of the Act are substantial and attorneys fees go to the prevailing party. If you provoke a cross-complaint from a potentially judgment proof customer who is perhaps the beneficiary of free legal aid or a contingency-fee attorney, it will be your money that is at risk.

Assignee Takes Subject To Buyer's Rights Against Seller

Closely related to the enforcement provisions of the Act to be discussed in the section below entitled "DEALER'S LIABILITY FOR VIOLATIONS OF THE ACT," are the provisions of Civil Code section 2983.5 and the FTC's Holder-In-Due-Course Rule. The effect of each of these provisions is to make the bank or financial institution to whom the dealer has assigned a conditional sale contract subject to all equities and defenses that the buyer might assert against the dealer. Under Civil Code section 2983.5 the assignee's liability may not exceed the amount of the obligation owing at the time of the assignment of the contract whereas under the FTC rule the assignee's liability shall not exceed the amount paid by the buyer under the contract, which would also include the downpayment, and this latter provision would control over the Civil Code section. Of course the Holder-In-Due-Course Rule requires that a notice of the rule must be set forth in 10-point bold type on the conditional sale contract, and the notice will be found usually on the back of all approved forms. It is significant to note that Civil Code section 2983.5(b) specifically provides that irrespective of whether the contract was assigned with or without recourse that the assignee has recourse against the seller for any liability incurred by the assignee by reason of the Holder-In-Due-Course Rule.

The Holder-In-Due-Course Rule May Not Be Waived

Under Civil Code section 2983.7, the rules, set forth in the section directly above, cannot be waived by the buyer and any provision in a contract containing such a waiver would constitute a violation of the Act and would be void.

Other Waivers Prohibited

Under Civil Code 2983.7, a conditional sale contract cannot provide for a waiver of any rights a buyer might have against the seller or arising out of the sale, under the contract, or in connection with illegal collection activities or wrongful repossession.

Dealer's Liability For Violations Of The Act

Although a violation of the ASFA constitutes a misdemeanor, if willful, under Civil Code section 2983.6 and may constitute a ground for suspension or revocation of a dealer's license under Vehicle Code section 11705(a)(12), criminal or disciplinary proceedings are relatively rare and only invoked in flagrant cases or in the event of repeated violations.

It is the right given to a buyer against a seller under Civil Code section 2983, which when coupled with the recourse given the assignee against the seller under Civil Code section 2983.5(b) and the right to attorneys fees in favor of the prevailing party, which poses the greatest threat to a dealer.

Furthermore, liability under Civil Code section 2983 is not the buyer's exclusive remedy, and some of the violations which give rise to liability under that section may also constitute a violation of Truth-in-Lending for which a customer is entitled to additional damages.

Liability Under Civil Code Section 2983

Civil Code sections 2983 and 2983.1 deal with the liabilities of the seller and the holder of a conditional sale contract, which liabilities depend upon the type of violation and further depend on whether the holder of the contract had knowledge of the violation. These sections are poorly drafted and contain apparent contradictions and are further complicated by court interpretations of earlier versions of these sections. Space will not permit us to go into the myriad factual situations that might arise under these two sections so that it is extremely important that you seek legal advice at the earliest moment you become aware of any claim that you are in violation of the Act.

Under Civil Code section 2983 if the seller violates the provisions of Civil Code section 2981.9 discussed earlier in this chapter in the sections entitled "THE SINGLE DOCUMENT PITFALL" and "DELIVERY OF CONTRACT AND OTHER DOCUMENTS TO BUYER," or subdivisions (a), (j) or (k) of Civil Code section 2982 discussed in the section entitled "CIVIL CODE section 2982 DISCLOSURES," the contract shall not be enforceable and the buyer may recover from the seller the total amount that he or she paid pursuant to the terms of the contract to the seller or his or her assignee. Thus, if the contract does not contain all the agreements between the buyer and the seller, or the seller does not deliver a copy of the contract, purchase order, credit statement, or other documents he or she is required to deliver to the buyer under Civil Code section 2981.9, or the seller fails to make the disclosures required by Civil Code section 2982(a) or charges in excess of the finance charge permitted by subdivision (j) of Civil Code section 2982 (other than by an accidental or bona fide error in computation), the seller may be required to refund all sums paid by the buyer to either the seller or the seller's assignee. In this connection, the trade-in will be valued at the fair market value at the time the contract was entered into or the value as shown in the contract, whichever is greater. CNCDA successfully sponsored legislation to provide a reduced remedy violations involving disclosure of Registration, Transfer, and Tilting Fees; Vehicle License Fees; and the California Tire Fee, for contracts executed on or after January 1, 2012. For such violations, the contract is not made unenforceable, and the consumer is entitled to actual damages.

Dealer's Right Of Offset

Although the buyer always has the option of keeping the vehicle and continuing to make payments, if the buyer asserts a violation and seeks a return of all consideration paid by him, he or she is obligated to return the vehicle to the holder of the contract or the seller. If the vehicle so returned has extensive mileage or damage, or both, the dealer is getting back a vehicle worth considerably less than what it was worth at the time of sale.

Assuming there has been a violation of the Act on the part of the dealer, is the dealer entitled to some offset against the sums the dealer will be required to refund the buyer?

Civil Code section 2983.1 states that the value of the vehicle so returned shall be credited as restitution by the buyer without any decrease which results from passage of time. As interpreted in the 2010 case of *Nelson v. Pearson Ford Co*., this section implies that some decrease other than from the passage of time in the value of the vehicle being returned shall be taken into consideration as an offset against sums the seller will be required to return to the buyer; however, exactly how such an offset will be calculated has not been clearly identified by the courts.

EXAMPLE

Assume that a customer has paid $3,500, but the vehicle has depreciated $2,500 solely by reason of the miles placed on the vehicle prior to its return to the dealer, plus another $1,000 based on depreciation due to the passage of time; arguably, the dealer would be entitled to set-off the $2,500 and refund only $1,000. Also,

see the subsection below regarding the outcome where the holder of the contract had no knowledge of the violation.

Dealer Liability - Civil Code Section 2983.1

If the seller or holder violates subdivision (l) of Civil Code section 2982, that is, the holder or seller fails to give proper credit for unearned finance charges in the event of pre-payment or refinancing by the buyer, the buyer may recover from such person three times the amount of any finance charge paid to that person.

Civil Code section 2983.1 also states that if the holder of the contract had knowledge of the type of violations specified in Civil Code section 2983, namely violation of Civil Code section 2981.9 or subdivisions (a), (j) or (k) of Civil Code section 2982, the contract shall likewise not be enforceable and the buyer may recover from both the holder of the contract and the seller; however, since the holder would still have recourse against the seller, the ultimate loss would fall upon the seller.

It gets more complicated, however, if the bank or finance company to whom the contract was assigned had no knowledge of such violations. Civil Code section 2983.1 then states that the holder can enforce the contract against the buyer, but that the buyer is excused from payments of the finance charge. This is highly unlikely to happen since normally when the violation is asserted the bank or finance company will insist that the dealer buy back the contract rather than attempt to enforce the contract without collection of the finance charge. Assuming, however, that in this event the bank or finance company elected to enforce the contract less the finance charge, would the purchaser still be entitled to sue the dealer and recover under Civil Code section 2983? The sections are in apparent conflict and although the dealer could make a strong argument that such a claim should be denied, the danger nevertheless exists.

Dealer Liability - Violation Of Truth-In-Lending

In the event the dealer violates any of the provisions of Regulation Z of the Truth-in-Lending Act, the buyer is entitled to recover from the dealer twice the amount of the finance charge, but not to exceed $1,000 and actual damages sustained, with an overall cap of $500,000 in class action cases. 15 U.S.C. section 1640. In most instances, where there has been a violation of Regulation Z, there will also be a violation of the Civil Code and the customer will thus have both remedies available to him or her.

Limited Right To Correction - Civil Code section 2984

A dealer or the holder of the contract has a limited right to correct a failure to comply with the Act and avoid any potential liability. Generally, the correction must be made within thirty days of the execution of the contract or within twenty days of the assignment of the contract, whichever is later, or within 10 days from receiving notice by the buyer of an error. The big problem is that any correction which will increase the amount of the contract balance or the amount of any installment shall not be effective unless the buyer concurs in writing to the correction. Because of this provision, this section cannot help in many cases. Of course, if the correction involves reducing the amount of the contract balance or the amount of any installments, or some other error not resulting in an increase in these categories, a corrected version of the contract should be sent to the buyer within the appropriate time limitations. Any amount improperly collected by the holder from the buyer is to be credited against the indebtedness evidenced by the contract or returned to the buyer. In this instance there is no need to obtain the customer's signature. A somewhat similar provision for making corrections which do not increase amounts owed is contained in section 130 of the Truth-in-Lending Act (15 U.S.C. section 1640). We would suggest that if you discover an error in the contract that you immediately notify your attorney and seek his or her advice relative to correcting the contract.

By reason of the drastic consequences that may occur by reason of violations of the Act together with the limited right of correction available, the importance of having your personnel thoroughly familiar with the requirements of the Act is apparent

Binding Arbitration Clauses

Class action lawsuits against dealers alleging violations of the ASFA have become common in recent years. These suits are especially problematic because they raise the possibility that the contract rescission remedy of ASFA will be applied on a classwide basis, with the potential of the dealer being required to repurchase hundreds or thousands of vehicles, depending on the size of the class.

While substantive and procedural legal defenses may apply to prevent such class action remedies, there is no guarantee that a judge will side with the dealer in a given lawsuit. To reduce the risk of class

action litigation, many dealers (and other businesses) have adopted a policy of only selling vehicles on contracts that include a binding arbitration clause.

The right of a party to invoke an arbitration clause to stop a lawsuit from proceeding as a class action and to instead have it proceed as a single-party arbitration case was strongly upheld in the 2011 U.S. Supreme Court decision in *AT&T Mobility v. Concepcion.* In that case, the U.S. Supreme ruled that federal law (the Federal Arbitration Act) preempts efforts by California and other states to avoid or limit the enforceability of arbitration clauses, and specifically outlawed state courts (specifically, the California Supreme Court) from declining to enforce arbitration clauses on public policy grounds, such as the importance of the class action remedy.

However, in *Sanchez v. Valencia Holding Company, LLC,* a California Court of Appeal held in 2011 that the arbitration clause contained in the LAW Form 553-CA-ARB was "unconscionable" and therefore unenforceable. The California Supreme Court has accepted a petition to hear the *Sanchez* case, which means that the Court of Appeal decision in that case has no current force or effect. As of publication of this Guide, a decision is still pending. In any event, the LAW Form 553-CA-ARB form has been revised in an effort to overcome the issues upon which the court based its opinion in the *Sanchez* case.

CONSUMER AUTOMOBILE LEASING

Chapter 2

Contents

CONSUMER AUTOMOBILE LEASING

OVERVIEW: The leasing of motor vehicles by consumers is a popular alternative to the purchase of motor vehicles either for cash or on a conditional sales basis. Both the state and federal governments are actively involved in policing the practices employed in the leasing business. There are also state and federal agencies which are empowered to issue regulations applying to consumer lease transactions. The primary purpose of these statutes and regulations is to insure that consumers are aware of what their ultimate liability is under a lease before they sign. Lease transactions involving vehicles primarily used for business or agricultural purposes are not covered by these statutes and regulations and are not discussed in this chapter except for comparison purposes.

Key California statutes covered in this chapter include the California Vehicle Leasing Act (referred to in this chapter as the "California Leasing Act") (Civil Code sections 2985.7 through 2993). The key federal statutes covered include portions of the Truth-In-Lending Act (Title 15 United States Code (hereinafter "U.S.C.") sections 1601 et seq.) designated as the "Consumer Leasing Act" (15 U.S.C. sections 1667 through 1667(e)). Regulation M (12 Code of Federal Regulations (hereafter "C.F.R.") sections 213.1 through 213.9) which is the regulation issued by the Board of Governors of the Federal Reserve System to implement the Consumer Leasing Act is also discussed extensively in this chapter.

Historically, the requirements of the California Leasing Act and the Consumer Leasing Act have been similar. While federal law is controlling in the case of an inconsistency, any California law provision which gives greater protection to a consumer is not considered inconsistent with federal law and therefore should be followed (15 U.S.C. section 1667e(a)).

NOTE

ON UNIFORM COMMERCIAL CODE: All leases, including consumer leases, are subject to the provisions of Division 10 of the California Commercial Code sections 10101 et. seq. However, the more stringent requirements of the California Leasing Act and the Consumer Leasing Act are controlling (California Commercial Code section 10104). Therefore a dealer complying with the California Leasing Act and the Consumer Leasing Act should be in compliance with the applicable California Commercial Code provisions regarding consumer leases.

Leasing Acts Applied to Consumer Transactions

Meaning of "Lease Contract"

Both the California Leasing Act and the Consumer Leasing Act govern only consumer lease transactions. By definition, the California Leasing Act (originally known as the Moscone Automobile Leasing Act) regulates "lease contracts" which are defined to mean any contract for the lease or bailment for the use of a motor vehicle, and the purchase of services incidental thereto, by a natural person for a term exceeding four months, primarily for personal, family or household purposes, whether or not it is agreed that the lessee bears the risk of the motor vehicle's depreciation (Civil Code section 2985.7(d)). A lease for agricultural, business or commercial purposes, or to a legal entity or government or governmental agency or instrumentality, is not included in this definition.

NOTE

ON RENTAL PURCHASE AGREEMENTS: If a dealer rents or leases a vehicle to a customer for personal, family, or household purposes for an initial term not exceeding four months and the customer acquires an option to purchase the vehicle, this "rental-purchase agreement" is subject to certain disclosure and other statutory requirements set forth in the Karnette Rental-Purchase Act (Civil Code sections 1812.620 et. seq.). Dealers engaged in such transactions should review this Act to make sure they are in compliance with its requirements.

Under the Consumer Leasing Act, the term "consumer lease" is defined as "a contract in the form of a lease or bailment for the use of personal property by a natural person for a period of time exceeding four months, and for **a total contractual obligation not exceeding $50,000, primarily for personal, family, or household purposes**, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease" (15 U.S.C. section 1667(1)). This thresh-

old amount is subject to annual CPI adjustment (see comment 9 to section 213.2(e), Reg. M official staff commentary). By statutory definition, a lease for agricultural or business purposes or entered into with a corporation, trust, estate, partnership, cooperative, association, or government or government agency or instrumentality is not subject to the requirements of the Consumer Leasing Act or Regulation M (15 U.S.C. section 1667(1) and Reg. M, section 213.2(e)).

PRACTICAL TIP

"USE ACKNOWLEDGMENT" PROVISIONS: It is strongly recommended that a "use acknowledgment" provision be a part of the lease contract form used by a dealer. This provision, usually initialed by the lessee, should clearly indicate whether or not the vehicle being leased is to be used primarily for business purposes or for personal, family or household purposes. As mentioned previously, if the leased vehicle is to be used primarily for business purposes both the California Leasing Act and the Consumer Leasing Act do not apply to the lease transaction.

CAUTION

REGARDING "PRIMARY PURPOSE" OF A LEASE: With respect to each lease transaction, a lessor should determine whether the leased vehicle will be used primarily for personal, family, or household purposes or other purposes. This inquiry should be made prior to the consummation (meaning the time a contractual relationship is created between the lessor and lessee) of the lease transaction and should be determined as accurately as possible. If the lessee is to be an individual and the possibility exists that the primary purpose of the leased vehicle will be personal in nature, it is strongly recommended that the requirements of the California Leasing Act and Consumer Leasing Act be followed.

Both "open-end" and "closed-end" lease contracts may be subject to the requirements of the California Leasing Act and the Consumer Leasing Act. An "open-end" lease is defined as a lease contract under which the lessee's liability at the end of the lease term is based on the difference between the residual value of the leased vehicle and its realized value (Reg. M, section 213.2(i)). A "closed-end" lease (which is the type of lease predominantly used by dealers in consumer leasing transactions) is defined as a consumer lease contract which is not an open-end lease (i.e., the lessee is not responsible for the residual value of the leased vehicle at the end of the lease term) (Reg. M, section 213.2(d)). As discussed later in this chapter, there are certain disclosure requirements which must be made in connection with an open-end lease which are not necessary for a closed-end lease.

Meaning of "Lessor" and "Lessee"

Under the California Leasing Act, the term "lessor" is any individual, partnership, corporation, limited liability company, estate, trust, cooperative, association or any other legal entity engaged in the business of leasing, offering to lease or arranging the lease of a motor vehicle (defined to be any vehicle required to be registered under the California Vehicle Code) under a lease contract (Civil Code section 2985.7(b)). Under the Consumer Leasing Act, "lessor" simply means any person "who is regularly engaged in leasing, offering to lease, or arranging to lease under a consumer lease" (15 U.S.C. section 1667(3)). A dealer who for compensation provides or offers to provide a lease contract on behalf of another person (or entity) who will be the lessor or who just has knowledge of the lease terms and participates in the preparation of the lease contract documents on behalf of a lessor is "arranging to lease" and therefore is subject to the requirements of the Consumer Leasing Act (see comment 1 to section 213.2(h), Reg. M official staff commentary).

A "lessee" under both the California Leasing Act and the Consumer Leasing Act refers to a natural person (meaning an individual rather than any legal entity such as a corporation or partnership) who leases or is offered the lease of a motor vehicle under a lease contract (Civil Code section 2985.7(c) and 15 U.S.C. section 1667(2)).

Bailor/bailee: Under both federal and California law, the definition of a lessor and a lessee should be construed to include a "bailor" and a "bailee", respectively. A contract for bailment is generally described as an agreement whereby personal property (such as a motor vehicle) is delivered by the owner (the bailor) to another party who is not the owner (the bailee) for a specific purpose and the personal property is to be returned to the owner after that purpose is accomplished(*Gebert v. Yank* (1985) 172 Cal.App.3d 544). Specifically, the term bailment is often used to describe the gratis loaning of a motor vehicle for the borrower's use; the commercial leasing of a motor vehicle for a fee; the delivery of a motor vehicle to a repairperson for the purpose of having it repaired; and the delivery of a motor vehicle to a parking attendant for storage.

The Acts Do Not Apply to Credit Sale Transactions

The California Leasing Act does not apply to lease transactions which are considered to be condi-

tional sales and which are regulated by the California Automobile Sales Finance Act (also known as the Rees-Levering Act) (Civil Code section 2990). For example, a contract which provides for the lessee to pay a sum for the use of the leased vehicle which is substantially equivalent to the aggregate value of the vehicle at the time the contract is executed and which provides the lessee with the option to become the owner of the vehicle for nominal or no additional consideration, is considered a conditional sales transaction. Such a contract must comply with the requirements of the California Automobile Sales Finance Act. For a more detailed discussion of those requirements, see the chapter entitled "Automobile Sales Finance Act" in this Management Guide.

The Consumer Leasing Act similarly does not apply to a lease transaction falling within the federal definition of a credit sale. Such a transaction would include a lease (unless terminable without penalty at any time by the consumer) where the lessee pays compensation for the use of the vehicle which is substantially equivalent to or minimally in excess of the total value of the vehicle and then after fulfilling the terms of the lease becomes or has the option to become the owner of the vehicle for nominal or no additional consideration (15 U.S.C. section 1602(g) and Reg. Z, section 226.2(a) (16)).

Lease Form Disclosure Requirements-Federal Law

The disclosure requirements of Regulation M significantly impact lease contracts. In general, these disclosure requirements are summarized as follows:

1. The format for lease disclosures requires the segregation of certain key disclosures.

2. A disclosure is required showing how the lease payment is calculated using the terms "gross capitalized cost," "capitalized cost reduction," and "adjusted capitalized cost". "Gross capitalized cost" is defined to mean "the amount agreed upon by the lessor and the lessee as the value of the leased property and any items that are capitalized or amortized during the lease term, including but not limited to taxes, insurance, service agreements, and any outstanding prior credit or lease balance." "Capitalized cost reduction" is defined to mean "the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost." The "adjusted capitalized cost" is defined to be "the gross capitalized cost less the capitalized cost reduction, and is the cost amount used by the lessor in calculating the base periodic payment" (Reg. M, section 213.2(f)).

3. A "total payments" disclosure is required indicating to the lessee the total amount to be paid by the end of the lease.

4. A warning to the lessee is required that early termination charges could be substantial.

5. Any reference to a percentage rate requires a warning to the effect that the rate may not be a true measure of financing costs.

NOTE

REGARDING ITEMIZATION OF GROSS CAPITALIZED COST: Under Regulation M, the lessee is entitled to request a separate written itemization of the gross capitalized cost components (Reg. M, section 213.4(f)). California Civil Code section 2985.8(c)(2)(G) requires that an itemization of the gross capitalized cost be provided to the lessee even when no request is made.

Specifically under section 213.4 of Regulation M, the lessor is required to disclose the following information as applicable:

"a. **Description of Property**. A brief description of the leased property sufficient to identify the property to the lessee and lessor.

b. **Amount due at leasing signing or delivery.** The total amount to be paid prior to or at consummation or by delivery, if delivery occurs after consummation, using the term 'amount due at lease signing or delivery.' The lessor shall itemize each component by type and amount, including any refundable security deposit, advance monthly or other periodic payment, and capitalized cost reduction; and in motor vehicle leases, shall itemize how the amount due will be paid, by type and amount, including any net trade-in allowance, rebates, noncash credits, and cash payments in a format substantially similar to the model forms… .

c. **Payment schedule and total amount of periodic payments.** The number, amount and due dates or periods of payments scheduled under the lease, and the total amount of the periodic payments.

d. **Other charges.** The total amount of other charges payable to the lessor, itemized by type and amount, that are not included in the periodic payments. Such charges include the amount of any liability the lease imposes upon the lessee at the end of the lease term; the potential difference between the residual and realized values referred to in paragraph (k) of this section is excluded.

e. **Total of payments.** The total of payments, with a description such as 'the amount you will have paid by the end of the lease.' This amount is the sum of the amount due at lease signing (less any refundable amounts), the total amount of periodic payments (less any portion of the periodic payment

paid at lease signing), and other charges under paragraphs (b), (c), and (d) of this section. In an open-end lease, a description such as 'you will owe an additional amount if the actual value of the vehicle is less than the residual value' shall accompany the disclosure.

f. **Payment calculation.** In a motor vehicle lease, a mathematical progression of how the scheduled periodic payment is derived, in a format substantially similar to the applicable model form…., which shall contain the following:

(1) **Gross capitalized cost.** The gross capitalized cost, including a disclosure of the agreed upon value of the vehicle, a description such as 'the agreed upon value of the vehicle [state the amount] and any items you pay for over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance),' and a statement of the lessee's option to receive a separate written itemization of the gross capitalized cost. If requested by the lessee, the itemization shall be provided before consummation.

(2) **Capitalized cost reduction.** The capitalized cost reduction, with a description such as 'the amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost.'

(3) **Adjusted capitalized cost.** The adjusted capitalized cost, with a description such as 'the amount used in calculating your base [periodic] payment.'

(4) **Residual value.** The residual value, with a description such as 'the value of the vehicle at the end of the lease used in calculating your base [periodic] payment.'

(5) **Depreciation and any amortized amounts.** The depreciation and any amortized amounts, which is the difference between the adjusted capitalized cost and the residual value, with a description such as 'the amount charged for the vehicle's decline in value through normal use and for any other items paid over the lease term.'

(6) **Rent charge.** The rent charge, with a description such as 'the amount charged in addition to the depreciation and any amortized amounts.' This amount is the difference between the total of the base periodic payments over the lease term minus the depreciation and any amortized amounts.

(7) **Total base periodic payments.** The total of base periodic payments with a description such as 'depreciation and any amortized amounts plus the rent charge.'

(8) **Lease payments.** The lease payments with a description such as 'the number of payments in your lease.'

(9) **Base periodic payment.** The total of the base periodic payments divided by the number of payment periods in the lease.

(10) **Itemization of other charges.** An itemization of any other charges that are part of the periodic payment.

(11) **Total periodic payment.** The sum of the base periodic payment and any other charges that are part of the periodic payment.

g. **Early termination-**

(1) **Conditions and disclosures of charges.** A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term; and the amount or a description of the method for determining the amount of any penalty or other charge for early termination, which must be reasonable.

(2) **Early-termination notice.** In a motor vehicle lease, a notice substantially similar to the following: 'Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.'

h. **Maintenance responsibilities.** The following provisions are required:

(1) **Statement of responsibilities.** A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, together with a brief description of the responsibility;

(2) **Wear and use standard.** A statement of the lessor's standards for wear and use (if any), which must be reasonable; and

(3) **Notice of wear and use standard.** In a motor vehicle lease, a notice regarding wear and use substantially similar to the following: 'Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use.' The notice shall also specify the amount or method for determining any charge for excess mileage.

i. **Purchase option.** A statement of whether or not the lessee has the option to purchase the leased property, and:

(1) **End of lease term.** If at the end of the lease term, the purchase price; and

(2) **During lease term.** If prior to the end of the lease term, the purchase price or method for determining the price and when the lessee may exercise this option.

j. **Statement referencing nonsegregated disclosures.** A statement that the lessee should refer to the lease documents for additional information on early termination, purchase options and maintenance re-

sponsibilities, warranties, late and default charges, insurance, and any security interests, if applicable.

k. **Liability between residual and realized values.** A statement of the lessee's liability, if any, at early termination or at the end of the lease term for the difference between the residual value of the leased property and its realized value.

l. **Right of appraisal.** If the lessee's liability at early termination or at the end of the lease term is based on the realized value of the leased property, a statement that the lessee may obtain, at the lessee's expense, a professional appraisal by an independent third party (agreed to by the lessee and the lessor) of the value that could be realized at sale of the leased property. The appraisal shall be final and binding on the parties.

m. **Liability at end of lease term based on residual value.** If the lessee is liable at the end of the lease term for the difference between the residual value of the leased property and its realized value:

(1) **Rent and other charges.** The rent and other charges, paid by the lessee and required by the lessor as an incident to the lease transaction, with a description such as 'the total amount of rent and other charges imposed in connection with your lease [state the amount].'

(2) **Excess liability.** A statement about a rebuttable presumption that, at the end of the lease term, the residual value of the leased property is unreasonable and not in good faith to the extent that the residual value exceeds the realized value by more than three times the base monthly payment (or more than three times the average payment allocable to a monthly period, if the lease calls for periodic payments other than monthly); and that the lessor cannot collect the excess amount unless the lessor brings a successful court action and pays the lessee's reasonable attorney's fees, or unless the excess of the residual value over the realized is due to unreasonable or excessive wear or use of the leased property (in which case the rebuttable presumption does not apply).

(3) **Mutually agreeable final adjustment.** A statement that the lessee and lessor are permitted, after termination of the lease, to make any mutually agreeable final adjustment regarding excess liability.

n. **Fees and taxes.** The total dollar amount for all official and license fees, registration, title, or taxes required to be paid in connection with the lease.

o. **Insurance.** A brief identification of insurance in connection with the lease including:

(1) **Through the lessor.** If the insurance is provided by or paid through the lessor, the types and amounts of coverage and the cost to the lessee; or

(2) **Through a third party.** If the lessee must obtain the insurance, the types and amounts of coverage required of the lessee.

p. **Warranties and guarantees.** A statement identifying all express warranties and guarantees from the manufacturer or lessor with respect to the leased property that apply to the lessee.

q. **Penalties and others charges for delinquency.** The amount or method of determining the amount of any penalty or other charge for delinquency, default, or late payments, which must be reasonable.

r. **Security interest.** A description of any security interest, other than a security deposit disclosed under paragraph (b) of this section, held or to be retained by the lessor; and a clear identification of the property to which the security interest relates.

s. **Limitations on rate information.** If a lessor provides a percentage rate in an advertisement or in documents evidencing the lease transaction, a notice stating that 'this percentage may not measure the overall cost of financing this lease' shall accompany the rate disclosure. The lessor shall not use the term 'annual percentage rate,' 'annual lease rate,' or any equivalent term."

CAUTION

REGARDING AMOUNT DUE AT LEASE SIGNING: The full amount to be paid at lease signing by a lessee should actually be paid at that time, as no authority exists to defer it or any part of it to a later date.

NOTE

REGARDING RENEGOTIATED OR EXTENDED LEASES: Under federal law, if a lease is renegotiated or extended, the lease form disclosures must be made again unless: (1) There is a reduction in the rent charge; (2) There is a deferment of one or more payments, whether or not a fee is charged; (3) The extension of the lease is not more than six months on a month to month basis or otherwise; (4) There is a substitution of the leased motor vehicle, with the substituted motor vehicle having a substantially equivalent or greater value than the original leased motor vehicle and no other lease terms are changed; or (5) There is an agreement resulting from a court proceeding (Reg. M, sections 213.5(a) and 213.5(d)).

NOTE

REGARDING DISCLOSURES WHICH ARE ESTIMATES: Under the Consumer Leasing Act, any amount

which must be disclosed in a lease contract may be given in the form of a reasonable estimate where the lessor is not in a position to know exact information after having made a reasonable effort to ascertain it. However, any estimated amount must be clearly identified as an estimate. (Reg. M, section 213.3(d)). Because disclosure of an estimated amount is authorized by Reg. M, it is valid under California law. (Civil Code section 2985.8(c)(1)).

Lease Form Disclosure Requirements-California Law

Consumer lease contracts are required by California law to comply with the disclosure requirements of Regulation M in all instances (even when the contractual lease obligation exceeds the threshold amount which is $50,000 plus any applicable CPI adjustment) (Civil Code section 2985.8(c)(1)). However, California law also requires certain additional disclosures beyond those required by Regulation M. These additional disclosure requirements are as follows:

1. The words "LEASE CONTRACT" or "LEASE AGREEMENT" must appear at the top of the contract in at least 12-point bold face type.

2. Immediately following or directly adjacent to the disclosures required to be segregated by Regulation M, a separate statement labeled "Itemization of Gross Capitalized Costs" which is circumscribed by a line which must appear on the contract and include: the agreed-upon value of the leased vehicle as equipped at the time of signing the lease; the agreed-upon value and a description of each accessory and item of optional equipment the lessor agrees to add to the vehicle after signing the lease; the premium for each policy of insurance; the amount charged for each service contract; any charge for an optional debt cancellation agreement (GAP); any outstanding prior credit or lease balance; and an itemization by type and agreed-upon value of each good or service included in the gross capitalized cost other than those already disclosed.

3. The vehicle identification number of the leased vehicle.

4. A brief description of each vehicle or other property being traded in and the agreed-upon value thereof if the amount due at the time of signing the lease or upon delivery is paid in whole or in part with a net trade-in allowance or the "Itemization of Gross Capitalized Cost" includes any portion of the outstanding prior credit or lease balance from the trade-in property.

5. The charge, if any, to be retained by the lessor for document processing, which should not exceed $80 (this assumes the lessor is enrolled in the DMV business partner automation program) and should not be represented as a governmental fee.

6. The amount of any charge to electronically register or transfer a vehicle, which should not be represented as a governmental fee (Civil Code section 2985.8(c)).

Additional Provisions under California Law

Required Lease Contract "Warning" Provisions

Additionally, pursuant to the California Leasing Act, a lease contract must include the following notices which must be at least 8-point boldface type:

"(1) Do not sign this lease before you read it or if it contains any blank spaces to be filled in; (2) You are entitled to a completely filled in copy of this lease; (3) Warning - Unless a charge is included in this lease for public liability or property damage insurance, payment for that coverage is not provided by this lease."(This notice must be above the space provided for the lessee's signature and circumscribed by a line) (Civil Code section 2985.8(d)).

"THERE IS NO COOLING OFF PERIOD. California law does not provide for a "cooling-off" or other cancellation period for vehicle leases. Therefore, you cannot later cancel this lease simply because you change your mind, decide the vehicle costs too much, or wish you had acquired a different vehicle. You may cancel this lease only with the agreement of the lessor or for legal cause, such as fraud" (This notice must be on the first page of the lease contract and circumscribed by a line (Civil Code section 2985.8(e)).

"You have the right to return the vehicle, and receive a refund of any payments made if the credit application is not approved, unless non-approval results from an incomplete application or from incorrect information provided by you." (Civil Code section 2985.8(f)).

If the contract does not contain GAP coverage, the following notice in at least 8-point boldface type on the first page: "GAP LIABILITY NOTICE In the event of theft or damage to the vehicle that results in a total loss, there may be a GAP between the amount due upon early termination and the proceeds of your insurance settlement and deductible. THIS LEASE PROVIDES THAT YOU ARE LIABLE FOR THE GAP AMOUNT. Optional coverage for the GAP amount may be offered for an additional price." (Civil Code section 2985.8(j)).

Trade-In Payoff Rules, Deadline

California Vehicle Code section 11709.4 basically requires a dealer who is taking a vehicle in trade as part of a lease transaction to specify in the lease the amount of the prior credit or lease balance to be paid by the dealer. The failure to specify this amount in the lease could obligate the dealer to payoff the entire credit or lease balance due on the trade-in, regardless of the amount. The statute further requires a dealer to tender the payoff to the legal owner of the trade-in within 21 days of the trade-in being acquired. See the section entitled "Trade-in Payoff: 21 Day Deadline and Other Rules" in the Other Important Topics chapter of this Management Guide for a further discussion of the rules relating to handling trade-in vehicle payoffs.

CAUTION

REGARDING FEDERAL AND STATE DISCLOSURES: If a lessor fails to comply with federal and state requirements for disclosures in a lease transaction, the lessor may be liable for substantial damages. See the detailed discussion later in this chapter of the penalty/damage provisions of the California Leasing Act and the Consumer Leasing Act.

CAUTION

REGARDING SINGLE DOCUMENT RULE: California law requires that every lease contract (which must be printed in at least 8-point type) "contain in a single document all of the agreements of the lessor and lessee with respect to the obligations of each party." (Civil Code section 2985.8(a)) (See also Kroupa v. Sunrise Ford (1999) 77 Cal.App.4th 835). In the Kroupa case, the Kroupas leased a truck from a dealer and traded in two vehicles as part of the transaction. The trade-in forms specified that the negative proceeds from the trade-ins would be applied to the lease (and thus resulted in higher payments). These forms were separate from the lease itself and the lease did not refer to the charge back to the Kroupas of the negative equity. When the Kroupas chose to terminate their lease, they discovered that the lease pay-off was much higher than expected, and sued. The California Court of Appeal found that the lease violated the single document rule because the trade-in agreements were not contained in the lease document as required. All dealers should review any documents which they have customers sign separately from a lease and have their own attorney advise them whether any such documents violate the single document rule. If there are any documents a dealer believes are necessary for the transaction, but which could violate the rule, then the following steps should be taken: (1) the document should be clearly described on the first page of the lease; (2) it should be noted after the description of the document that it is "attached and made a part of this agreement"; and (3) the original document should then be attached to the original lease and a copy of the document should be attached to the copy of the lease given to the customer. Based upon a December 31, 2009 California Attorney General opinion interpreting the single document rule, multiple pages that are attached to a lease contract can be integrated as part of the contract by sequential page numbering such as "1 of 4", "2 of 4", etc. Dealers should check with the leasing companies with which their dealerships do business to determine if they require a specific approach to incorporate additional pages as part of a lease contract.

CAUTION

REGARDING HANDLING OF TRADE-IN VEHICLES: Dealers should be very careful as to how they handle trade-in vehicles in connection with lease transactions. A dispute on the pay-off amount due on a trade-in vehicle often leads to litigation (for example, see the Kroupa case discussed previously) and the claim that a dealer has not properly disclosed the trade-in vehicle as part of the lease transaction. If a trade-in vehicle is received by a dealer in connection with a consumer lease, a brief description of that vehicle and its agreed upon value must be disclosed on the lease contract (Civil Code section 2985.8(c)(4)). This disclosure should occur regardless of whether the trade-in vehicle's value results in a positive balance being applied toward the lessee's lease obligation or a negative balance which is included in the gross capitalized cost amount of the new lease. California law also provides that in the event a lease is breached by a lessor where the lessee has a trade-in vehicle, and that vehicle is not available for return, the lessee may recover (without waiving other applicable remedies) either the fair market value of the vehicle or its value as stated in the lease contract, whichever is greater (Civil Code section 2986.13(b)(c)).

NOTE

REGARDING BLANK BOX FOR INDIVIDUALIZED AGREEMENTS: Civil Code section 2992 states: "A prospective assignee that provides a lessor under a lease contract with a preprinted form for use as a lease contract shall design the form in such a manner so as to provide on its face sufficient space for the lessor to include all disclosures and itemizations required pursuant to Section

2985.8 and shall also contain on its face a separate blank space no smaller than seven and one-half square inches for the lessor and lessee to memorialize trade-in, turn-in, and other individualized agreements." Such individualized agreements which may not be covered in the standardized form, include, for example: terms of a payoff agreement ("If the pay-off on the vehicle you traded in is more than $_____, you agree to pay us the excess upon demand."); or, terms of a turn-in agreement ("Dealer agrees to deliver your turned in lease vehicle to ABC Leasing Company and pay it the sum of $_____. Any excess mileage, wear and tear, or other obligations owing to ABC Leasing Company are your responsibility."). Dealers should carefully consider and state as clearly as possible the terms of any individualized agreement and should avoid any agreements (for example, changing a due date) which are inconsistent with the mandated disclosures of a lease form.

NOTE

REGARDING AGREEMENTS NOT REQUIRED TO BE PART OF THE LEASE: Civil Code section 2985.9 provides that the following documents and agreements are not required to be contained in a lease contract:

a. Express written warranties under which the manufacturer or dealer undertakes to preserve or maintain the utility or performance of the vehicle.

b. Titling and transfer documents utilized to register, title, or transfer ownership of vehicles described in the lease contract.

c. Insurance policies, service contracts, and optional debt cancellation agreements.

d. Documents that memorialize the sale or lease of goods or services, relating to the leased vehicle, between the provider of those goods or services and the lessee – provided that those items are separately itemized as to type and amount in the "Itemization of Gross Capitalized Cost" section of the lease.

NOTE

REGARDING PROHIBITION AGAINST PAYMENT PACKING: Pursuant to California Vehicle Code section 11713.19, it is unlawful for a dealer to negotiate the terms of a lease contract and then add charges to the contract for any goods or services, without previously disclosing to the consumer the goods or services to be added and obtaining the consumer's consent. This statute also prohibits a dealer from inflating the monthly payment or down payment amounts or extending the maturity of a lease contract for the purpose of disguising the actual charges for goods or services to be added by the dealer to the contract. For purposes of this statute, "goods and services" are defined as any type of good or service, including but not limited to insurance and service contracts.

Lessee's Right to Rescind Under California Law

The notice required in a lease contract by Civil Code section 2985.8(f) acknowledges that the lessee has the right to in effect rescind a lease he or she has signed if the credit application is not approved. However, this right to rescind does not automatically apply to the lessor under the same circumstances. In fact, a dealer who signs a lease as the lessor and is unable to assign the lease to a financial institution as intended (because of the denial of the lessee's credit application) is obligated to honor the terms of the lease as lessor. This obligation may be avoided if the lease form used by the dealer specifically provides the lessor a right to rescind in the event the dealer is unable to assign the lease within a reasonable period of time (i.e. 10 days) to financial institutions with which the dealer normally conducts such business.

Dealers should also be aware that pursuant to Civil Code section 2988.7, the failure of the lessor to disclose the information required in a lease transaction may allow the lessee to rescind the lease contract. In such a situation, a lessee has a right of rescission when the failure to comply on the part of the lessor is willful or when the correction necessary for compliance increases the amount of the lessee's obligation and the lessor refuses to waive collection of the increased amount.

Prohibited Lease Contract Provisions

The California Leasing Act specifically prohibits a lease contract from containing any provision by which:

a. An assignment of wages is given or a power of attorney is given by the lessee to confess judgment in California or to an assignment of wages.

b. The lessee waives any right of action against a lessor or the holder of the lease contract or their agents for any illegal acts committed in the collection of payments under the lease contract or in the repossession of the leased vehicle.

c. The lessee relieves the lessor from any liability for any legal remedies which the lessee may have against the lessor under the lease contract or any

other documents executed in connection with the lease transaction.

d. The lessor or holder of the lease contract is given the right to commence a lawsuit on a contract in a county of California other than the county in which the lease contract was actually signed by the lessee, the county in which the lessee resides at the commencement of the action, the county in which the lessee resided at the time the lease contract was entered into, or the county in which the leased vehicle is permanently garaged (Civil Code section 2986.3).

CAUTION

REGARDING PROHIBITION OF LIENS ON OTHER PROPERTY: The California Leasing Act makes unenforceable any agreement made in connection with a lease contract that provides for the inclusion of title to or a lien upon any personal or real property, other than the leased vehicle, or its accessories, or special and auxiliary equipment used in connection with the leased vehicle, as security for the payment of the lease contract obligations. A lessor however, may require a security deposit or advance payment of rent or other cash prepayment as part of a lease contract (Civil Code section 2986.6).

Executing a Lease Contract

For a lease contract to be properly executed under the California Leasing Act, it must be signed by the lessor or the lessor's authorized representative and by the lessee or his or her authorized representative and an exact copy of the signed lease contract must be furnished to the lessee when the lease contract is signed. (Civil Code section 2985.8(g))The delivery of this fully executed copy of the lease contract to the lessee must occur before delivery of the leased vehicle (Civil Code section 2985.8(h)).

A dealer should never have a lessee sign a lease contract which contains blank spaces which are to be filled in later. This is a clear violation of California law which renders the lease contract subject to legal challenge and most likely ineffective (Civil Code sections 2985.8(i) and 2988.7).

PRACTICAL TIP

DELIVERY OF LEASE CONTRACT TO LESSEE: To minimize compliance issues, a dealer should use a lease contract form which contains an acknowledgment provision which the lessee signs to acknowledge that he or she has received a copy of the lease contract, vehicle lease proposal, credit statement or any other document which he or she has been requested by the dealer to sign. The California Leasing Act requires that any such acknowledgment provision be in at least 10-point bold type and positioned directly above the space reserved for the lessee's signature. If a dealer uses a written acknowledgment provision which complies with the California Leasing Act, it creates a rebuttable presumption in favor of any third party (without knowledge to the contrary) who is assigned the lease contract that the lessee properly received copies of the executed documents (Civil Code section 2986.4).

NOTE

REGARDING REFUNDS WHEN LEASE CONTRACT NOT EXECUTED: In the event that a lease contract is not executed, the California Leasing Act requires that any payment made by a potential lessee to a lessor pending the execution of the lease contract be refunded (Civil Code section 2986.13(a)).

NOTE

REGARDING DISCLOSING ADDITIONAL INFORMATION: A lessor has the option to disclose additional information beyond what is required under both federal and state law. However, a lessor may not disclose additional information which will confuse a lessee or distract his or her attention from the required information(Reg. M, section 213.3(b)).

CAUTION

REGARDING FOREIGN LANGUAGE LEASE CONTRACT TRANSACTIONS: A consumer lease transaction which is negotiated (either orally or in writing) primarily in Spanish, Chinese, Tagalog, Vietnamese, or Korean in addition to complying with the California Leasing Act, must also comply with the requirements of California Civil Code section 1632. This statute requires that prior to the execution of the lease contract, a dealer must deliver to the lessee an unexecuted translation of the lease contract with all blanks filled in. Furthermore, at the dealership, a foreign-language notice must be conspicuously displayed which in effect states that the dealer is required to provide an unexecuted translated contract. Failure by a dealer to comply with this statute gives the lessee a basis to rescind the lease contract. For a further discussion of this statute, see the section entitled, "Spanish and Other Foreign Language Contract Requirements" in the Automobile Sales Finance Act chapter of this Management Guide.

NOTE

FORMS FROM FINANCE SOURCE. Financial institutions which provide preprinted lease contract forms to a dealer are, upon the request of the dealer, required by California law to make available to the dealer a Spanish language translation of the lease contract form (Civil Code section 2991).

Co-Lessor Notice

A key requirement of California law regarding lease transactions is that any person signing a lease contract who is not married to the lessee and who does not receive possession of the leased vehicle, must prior to signing the lease be given a special notice in English and Spanish in at least 10-point type. The notice basically warns the person that he or she is guaranteeing the debt and so should think carefully before signing. The notice further advises the person to consider whether he or she can afford the obligation; that the person may be sued and have wages garnished; and that a lease default may become part of the person's credit record. (Civil Code section 1799.91(d)).This notice is the same notice required to be given to certain co-buyers in connection with the retail purchase of a vehicle (Civil Code sections 1799.90 and 1799.91). For a more detail discussion of this notice, see the chapter entitled "Automobile Sales Finance Act" in this Management Guide.

NOTE

REGARDING CREDIT SCORE DISCLOSURE: Pursuant to California Vehicle Code section 11713.20, if a dealer obtains a credit score from a credit reporting agency for use in connection with an individual's application for credit to lease a vehicle for personal, family or household use, the individual must be given written notice of that credit score and certain related information prior to the lease being signed. See the discussion of this notice requirement in the Chapter entitled "Credit Reports and Decisions" in this Management Guide.

Lease Advertising and Solicitation

General Principles

The general rule under both federal and California law regarding advertising consumer lease transactions is that "an advertisement for a consumer lease may state that a specific lease of property at specific amounts or terms is available only if the lessor usually and customarily leases or will lease that property at those amounts or terms" (Reg. M, section 213.7(a), see also Civil Code section 2985.71(c)).

Statutes in both the California Vehicle Code and the California Business and Professions Code prohibit a lessor from making, disseminating or causing the making or disseminating of any statement which is untrue or misleading (or which by the exercise of reasonable care should be known to be untrue or misleading) to the public by oral representation or any advertising device. This prohibition applies to all lease advertising, including advertising relating to non-consumer lease transactions which are not subject to the California Leasing Act (California Vehicle Code sections 11614(a) and 11713(a)).

NOTE

REGARDING DEFINITION OF ADVERTISEMENT: Under Regulation M, an advertisement is defined as "a commercial message in any medium that directly or indirectly promotes a consumer lease transaction" (Reg. M, section 213.2(b)). Included within this definition are Internet communications.

Required Federal Disclosures

Under federal law, when an advertisement for a consumer lease includes a statement of the amount of any payment or a statement that any or no initial payment is required prior to or at the time of delivery of a vehicle, the advertisement must also clearly and conspicuously state (as applicable):

"(i) That the transaction advertised is a lease;

(ii) The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation;

(iii) The number, amounts, and due dates or periods of scheduled payments under the lease;

(iv) A statement of whether or not a security deposit is required; and

(v) A statement that an extra charge may be imposed at the end of the lease term where the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term." (Reg. M, section 213.7(d); see also 15 U.S.C. section 1667(c)).

NOTE

REGARDING DISCLOSURE REQUIREMENTS RELATING TO MERCHANDISE TAGS: Under Regulation M, a merchandise tag which advertises the amount of any payment or makes a statement of any capitalized cost reduction or other payment required prior to lease consummation or that no payment is required does not have to disclose the additional items designated as (i) through (v) above, if the merchandise tag refers to a sign or display prominently posted in the dealership which contains a table or schedule of the required disclosures (Reg. M., section 213.7(e)).

CAUTION

REGARDING PROMINENT DISPLAY OF DISCLOSURES: Except for the statement of a periodic payment, if a dealer makes any affirmative or negative reference to a charge that is part of the total amount due at the lease signing, that reference must not be more prominent than the disclosure of the total amount due at lease signing (Reg. M, section 213.7(b)(1)). The official staff commentary to Reg. M recognizes that only the total of amounts due at lease signing or delivery is required, not an itemization of the component parts of that total amount (see comment 1 to section 213.7(b)(1), Reg. M official staff commentary). Additionally, if a lease advertisement makes reference to a percentage rate, that reference should not be more prominent than any of the other Reg. M disclosures which are contained in the advertisement other than the notice stating that "this percentage may not measure the overall cost of financing this lease." This notice must however, be placed in close proximity to the rate reference. In advertising such a rate, a lessor may not use the term "annual percentage rate," "annual lease rate" or any equivalent term (Reg. M, section 213.7(b)(2)).

NOTE

REGARDING DISCLOSURE OF THIRD PARTY FEES: In disclosing the total amount due at lease signing, the Federal Reserve Board official staff commentary recognizes that this amount may exclude third party fees which vary such as taxes, license and registration fees as long as the fact that such fees are excluded is disclosed.(see comment 1 to section 213.7(d)(2), Reg. M official staff commentary).

Required California Disclosures

Section 2985.71 of the California Leasing Act sets forth the required disclosures under California law relating to any solicitation to enter into a lease contract. These disclosures are similar to those required by federal law, but are more extensive in certain respects. Specifically, if a solicitation includes the amount of any payment or a statement of any cost reduction or other payment (or that no capitalized cost reduction or other payment is required) the amount of any payment or that no payment is required prior to or at the lease consummation or by the vehicle's delivery, if delivery occurs after consummation, there must be a clear and conspicuous statement of the following items:

"1. All of the disclosures prescribed by Regulation M set forth in the manner required or permitted by Regulation M, whether or not Regulation M applies to the transaction.

2. The mileage limit after which mileage charges may accrue and the charge per mile for mileage in excess of the stated mileage limit.

3. The statement 'Plus tax and license' or a substantially similar statement, if amounts due for use tax, license fees, and registration fees are not included in the payments."

Television/Radio Lease Advertisements

Under Reg. M, a somewhat abbreviated disclosure approach for radio and television lease advertising is authorized (Reg. M sections 213.7 (f)). This approach is also valid under California law (Civil Code section 2985.71 (b)(1)). However, this disclosure method has limited practical application as the only Reg. M disclosure not required to be made specifically in the radio or television ad copy is whether or not a security deposit is required (i.e. the ad still needs to state the transaction is a lease; the number of monthly payments and the monthly payment amount; and the amount of any payment required at the inception of the lease). Although the security deposit disclosure does not need to be part of such ad copy, that copy would need to make reference to the toll free telephone number or written advertisement used for making the complete disclosures. To comply with California law, the ad copy should still include any applicable mileage limit and excess mileage charge and the "plus tax and license" disclosure.

A lessor using the toll free telephone number for disclosures must establish the toll free number not later than the date on which the advertisement including the referral is broadcast; maintain such telephone number for a period not less than 10 days, beginning on the date of such broadcast; and provide all disclosure information (including those

items actually disclosed in the radio or television ad) to any person who calls the toll free number. Additionally, a consumer must be given the option to request the lease disclosure information in written form. If the radio or television ad refers to a written advertisement for the lease disclosures, the lessor who offers the consumer lease must publish a written advertisement in a publication of general circulation in the community served by the radio or television station in which the advertisement is broadcast during the period beginning 3 days before the broadcast and ending at least 10 days after the broadcast. The written advertisement should include all the required disclosures (15 U.S.C. section 1667c(c), Reg. M, section 213.7 (f)).

CAUTION

REGARDING REQUIRED DISCLOSURES: Consumer lease advertising routinely draws the attention of law enforcement agencies. Dealers should carefully review their lease advertisements to verify that all required disclosures are made and presented in a clear and conspicuous manner. In discussing the clear and conspicuous standard, the Federal Reserve Board official staff commentary states that disclosures in an advertisement must be reasonably understandable and that very fine print in a television advertisement or detailed and very rapidly stated information in a radio advertisement does not meet the clear and conspicuous standard if consumers cannot see and read or hear and cannot comprehend the information required to be disclosed (see comment 1 to section 213.7(b), Reg. M official staff commentary).

NOTE

REGARDING LEASE ADVERTISING ON THE INTERNET: Dealers should be aware that the Federal Trade Commission ("FTC") takes the position that consumer protection laws and regulations, including Reg. M, are applicable to Internet advertising. In fact, the FTC has issued guidelines entitled "DOT Com Disclosures: Information about Online Advertising" that among other things address how required disclosures should be made in a "clear and conspicuous" manner. Dealers using the Internet for lease advertising purposes should become familiar with these guidelines. Regarding electronic advertisements which feature one of the trigger terms discussed in this chapter in the section entitled "Required Federal Disclosures", the Federal Reserve Board official staff commentary recognizes that the term triggering additional disclosures may be accompanied by a link that directly connects the consumer to the additional information (see comment 2 to section 213.7(c), Reg. M official staff commentary).

Further Advertising Rules Under California Law

With respect to advertising lease transactions, California law further provides:

a. That any lessor's advertisement to lease a specific motor vehicle in inventory, must include its vehicle identification number or license number (Civil Code section 2989.4(a)(2)).

b. That a lessor may not "refuse to lease a vehicle to any creditworthy person at the advertised total price, exclusive of sales tax, vehicle registration fees and finance charges" (Civil Code section 2989.4(a)(3)).

CAUTION

REGARDING BIRD DOGGING: Under California law, a lessor may not induce a person to enter into a lease contract by offering a rebate, discount, commission or other consideration which is conditioned upon that person giving information or assisting the lessor in either leasing or selling a motor vehicle to another person (Civil Code section 2986.12).

NOTE

REGARDING FAILURE TO COMPLY WITH CALIFORNIA LAW APPLICABLE TO LEASE SOLICITATIONS: The failure of a lessor to comply with the provisions of the California Leasing Act regarding lease solicitations does not affect the validity of the leasing contract entered into by the parties (Civil Code section 2985.71(d)). However, any person knowingly and willfully violating any provision of the California Leasing Act is guilty of a misdemeanor (Civil Code section 2989.8).

Early Lease Termination

The California Leasing Act also includes Civil Code section 2987 which sets out the requirements for the handling of early lease terminations. Basically, this statute includes the following provisions:

Formula

A lessee has the right to terminate a lease contract at any time prior to the scheduled expiration date and is subject to a reasonable formula that establishes the maximum liability amount a lessor may charge for early lease termination. The formula specifies that a lessee's liability may not exceed the sum of the following: (a) All unpaid periodic lease payments that have accrued up to the date of termi-

nation; (b) all other amounts due and unpaid by the lessee under the lease contract, other than excess wear and mileage charges (i.e. parking tickets); (c) any charges that may be assessed under the lease contract in connection with termination, not to exceed in the aggregate the amount of a reasonable disposition fee disclosed in the lease contract; (d) in the event of default, reasonable fees paid for reconditioning and reasonable and necessary fees paid in connection with the repossession and storage of the leased vehicle; and (e) the difference, if any, between the adjusted capitalized cost disclosed in the lease contract and the sum of (1) all depreciation and other amortized amounts accrued through the date of early termination (calculated in accordance with the constant yield method or other generally accepted actuarial method), and (2) the realized value of the vehicle.

Realized Value

The realized value of the vehicle, used for purposes of determining a lessee's early termination liability, is calculated as follows: (1) if the vehicle is insured and totaled as a result of theft or damage, the amount of insurance proceeds plus any insurance deductible unless a higher amount is agreed to by the holder of the lease contract; (2) if the lessee elects to have an appraisal conducted as provided in Reg. M, the value determined upon appraisal; (3) if the holder of the lease contract elects to retain ownership of the vehicle for use or to lease to a subsequent lessee, the wholesale value as specified in the current edition of a recognized used vehicle value guide customarily used by California dealers (for example, the Kelley Blue Book Auto Market Report); or (4) under all other circumstances, the higher of (A) the price paid for the vehicle upon disposition, or (B) any other amount established by the lessor or the lease contract.

Notice

At least 10 days prior to disposing of the leased vehicle, the holder of the lease must provide written notice, (either by personal service or first-class or certified mail to each lessee's last known address) which must include: (a) the time and place of any public sale, the time on or after which a private sale or other intended disposition is to be made, or the date by which the value of the vehicle will be determined by a used vehicle value guide; (b) an itemization of each of the components of the "formula" discussed previously which collectively make up the "Gross Early Termination Amount" (the amount owing by the lessee prior to an offset for the realized value of the vehicle); and (c) the applicable statutory statement (one of two statements is used depending on how the realized value of the vehicle is to be determined) advising the lessee that he or she will not be liable for more than the difference between the Gross Early Termination Amount and the calculated value of the vehicle. A failure by the lessor (or holder of the lease contract) to give this notice properly (with certain exceptions relating to a "bona fide error") releases a lessee from any liability for early termination of the lease contract.

Vehicle Purchase or Trade-in

If a lessee terminates a lease contract early and purchases the leased vehicle or trades it in as part of the purchase or lease of another vehicle, the selling price of the leased vehicle, exclusive of taxes and other charges incidental to the sale, shall not exceed the sum of the following and shall relieve the lessee of any further liability under the lease contract: (1) All unpaid periodic lease payments accrued through the date of early termination; (2) All other amounts due and unpaid under the lease, other than excess wear and mileage charges and unpaid periodic lease payments; (3) Any charges that may be assessed under the lease contract in connection with termination and the acquisition of the vehicle, not to exceed in the aggregate amount of a reasonable purchase option fee disclosed in the lease contract; and (4) The adjusted capitalized cost disclosed in the lease contract less all depreciation and other amortized amounts accrued through the date of early termination, calculated in accordance with the constant yield or other generally accepted actuarial method.

Other Requirements

Lessors (including holders of lease contracts) are required to act in good faith and in a commercially reasonable manner when disposing of leased vehicles in connection with the early termination of a lease contract. A lessor's failure to comply with these requirements also releases a lessee from any liability for early termination of the lease.

The use of the Rule of 78 to calculate accrued rent charges is prohibited.

A lessor is required to credit any security deposit or advance rental payment against any early termination liability of a lessee under a lease contract.

A lessor is prohibited from providing adverse credit information to a consumer credit reporting agency regarding a lessee's early termination of a leased contract, if the lessee timely pays all sums due as a result of the early termination.

NOTE

REGARDING APPLICATION OF LEASE TERMINATION PROCEDURES: A maximum liability threshold applicable to the early termination of lease contracts provides a consumer with a level of cer-

tainty regarding such transactions and offers a "safe harbor" to lessors who might otherwise be accused of imposing excessive early termination charges.

NOTE

REGARDING RIGHT OF MILITARY SERVICE MEMBERS TO TERMINATE MOTOR VEHICLE LEASES: Pursuant to 50 U.S.C. App. section 535, if a lessee signs a vehicle lease and then enters military service, he or she may terminate the lease. If a lessee is already in military service at the time the lease is executed, it may be terminated by the lessee when that individual receives military orders for a permanent change of station (basically involving going from a location in the continental U.S. to one outside the continental U.S.) or to deploy with a military unit for a period of not less than 180 days. This statute further provides that lease amounts unpaid for the period preceding the lease termination are to be paid on a prorated basis and the lessee remains obligated for taxes, title and registration fees and other reasonable charges, including excess wear, use and mileage that are due from the lessee and unpaid at the time of the termination.

Lessee's Liability on Open-End Leases

Presumption that Liability is Limited to Three Monthly Payments

Both the Consumer Leasing Act and the California Leasing Act contain provisions which reflect a specific concern on the part of Congress and the California Legislature to protect a consumer lessee from being liable for a high deficiency in connection with a lease contract where the lessee bears the risk of the leased vehicle's depreciation (i.e. an open-end lease). Generally, a lessor is charged with the duty to act in good faith and to have competent evidence to support the amount of the estimated residual value given to the leased vehicle at the inception of the lease contract. Under both federal and state law, a legal inference exists that the "estimated residual value" amount under a lease is unreasonable to the extent that it exceeds the "actual residual value" of the leased vehicle by more than three times the average payment allocable to a monthly period under the lease (15 U.S.C. section 1667b(a); Civil Code section 2988). While this inference can be challenged by contrary evidence (this inference is often called a "rebuttable presumption"), it clearly is designed to minimize a consumer lessee's liability under an open-end lease. In addition, under federal law a further rebuttal presumption is established that the lessor's estimated residual value of a leased vehicle is not in good faith when it exceeds the actual residual value by more than three times the average payment allocable to a monthly period under the lease. This presumption bars the lessor from collecting from the lessee any amount which is in excess of the total of three monthly payments unless the lessor brings a successful lawsuit to establish that excess liability on the part of the lessee. In such an action, the lessor is obligated to pay the lessee's reasonable attorney's fees (15 U.S.C. section 1667b(a)).

Effect of Excessive Wear and Use

Both the California Leasing Act and the Consumer Leasing Act recognize that the presumptions applying to the liability of a lessee under an open-end lease do not apply to the extent that the difference between the estimated residual value and actual residual value is in excess of the total of three monthly payments due to physical damage to the leased vehicle which is beyond reasonable wear and use, or to excessive use. A lease contract may set standards for such wear and use, if they are not unreasonable (Civil Code section 2988(b),15 U.S.C. section 1667b(a)).

Determining "Realized Value"

As defined by federal law, the "realized value" of a leased vehicle means: the price received by the lessor for a leased vehicle at disposition; the highest offer for disposition of the leased vehicle; or the fair market value of the vehicle at the end of the lease term (Reg. M, section 213.2(m)). Under the Consumer Leasing Act, the lessee on an open-end lease may obtain, at his or her own expense, a professional appraisal of the leased vehicle by an independent third party agreed to by both the lessee and the lessor to determine the realized value of a leased vehicle. Such an appraisal shall be final and binding on both the lessee and lessor (15 U.S.C. section 1667b(c)). It should be pointed out that this Act specifically provides that none of its provisions prohibit a lessor and a "willing" lessee from entering into any mutually agreeable final adjustment with respect to excess residual liability, provided that agreement is reached after the termination of the lease (15 U.S.C. section 1667b(a)).

Commercially Reasonable Standard

Pursuant to the California Leasing Act, a lessor under an open-end lease is obligated to act in a commercially reasonable manner in selling or establishing the fair market value of a leased vehicle at the expiration of a lease contract (Civil Code § 2989.2 (a)).

PRACTICAL TIP

To make a strong case that the lessor has acted in a "commercially reasonable manner" in disposing of a leased vehicle, it is recommended that a lessor obtain at least three bids from independent parties on the vehicle to be sold or valued.

Written Notice Regarding Sale

Prior to the sale of a leased vehicle by a lessor at the termination or the expiration of an open-end lease, a lessor should give notice to the lessee of the lessor's intent to sell the vehicle. To comply with California law, this notice must be personally served or sent by certified mail, return receipt requested, to the lessee at the address shown on the lease contract unless the lessee has given notice in writing of a different address. The notice must also set forth as separate items any charges or sums due and state that "the lessee will be liable for the difference between the amount of liability imposed on the lessee at the expiration of the lease term and the actual cash value of the motor vehicle when it is sold." The notice must also state that the lessee has the right to submit a cash bid for the purchase of the leased vehicle (Civil Code section 2989.2).

When written notice is not required: A written notice to the lessee regarding the sale of the leased vehicle is not required by California law in the event that an agreement is reached by the lessor and the lessee as to the amount of the lessee's liability under the lease contract after the return of the leased vehicle (Civil Code section 2989.2).

Liability for Failure to Comply with the Law

Penalty/Damage Provisions

If a lessor fails to comply with any provisions of the Consumer Leasing Act with respect to any person, the lessor may be liable to that person in an amount equal to the sum of:

a. Any actual damages sustained by such a person;

b. In a lawsuit brought by an individual, damages representing twenty-five percent (25%) of the total of the monthly payments under the lease contract (this amount cannot be less than $100 or more than $1,000);

c. In a class action lawsuit, damages as the court may determine appropriate based upon such factors as actual damages awarded, the frequency and persistence of failures of compliance by the lessor, the resources of the lessor, the number of persons adversely affected by the lessor's conduct, and the extent to which the lessor's failure of compliance was intentional (this amount may not exceed the lesser of $500,000 or one percent (1%) of the net worth of the lessor);

d. Costs and attorney's fees (15 U.S.C. section 1640(a)).

Under the California Leasing Act, a lessor may be liable for basically the same damages as allowed under federal law when a lessor fails to make the disclosures required in a lease transaction and/or fails to comply with the requirements regarding the limitation on the liability of a lessee on an open-end lease (Civil Code Section 2988.5). Additionally, a lessor who knowingly and willfully violates any provision of the California Leasing Act is guilty of a misdemeanor (Civil Code section 2989.8).

NOTE

ON ATTORNEY'S FEES UNDER CALIFORNIA LAW: Under California law, reasonable attorney's fees and costs will be awarded to the prevailing party in any action brought in connection with a lease contract which is subject to the provisions of the California Leasing Act, regardless of whether the action is instituted by the lessor, lessee, or an assignee. If a defendant alleges in an answer that he or she has tendered to the plaintiff the full amount to which the plaintiff is entitled, and thereupon deposits that sum in the court, the defendant will be deemed the prevailing party if that allegation is found to be true (Civil Code section 2988.9).

Correction of Bona Fide Errors

Both the Consumer Leasing Act and the California Leasing Act provide that there shall be no liability on the part of any lessor for a failure to comply with statutory requirements if the lessor within a limited period of time after the discovery of the error (fifteen days under the California Leasing Act and sixty days under the Consumer Leasing Act) notifies the lessee of the error and makes whatever adjustments are appropriate to insure that the lessee is not required to pay any amount in excess of the amount that should have been correctly disclosed. Such a notification to the lessee must also be prior to the institution of an action by the lessee or the receipt of written notice of the error from the lessee to be effective (Civil Code section 2988.5(c), 15 U.S.C. section 1640(b)). This procedure should also be followed to correct non-monetary errors such as a mistake in the disclosure of the model year of a leased vehicle.

Furthermore, both the California Leasing Act and the Consumer Leasing Act provide that a lessor is not liable for statutory violations if the lessor shows by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid any such error. Examples of bona fide errors include clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to a lessee's obligation is not a bona fide error (Civil Code section 2988.5(d),15 U.S.C. section 1640(c)).

Liability of a lessor's assignee: A lessee may bring a lawsuit to enforce the provisions of the California Leasing Act or the Consumer Leasing Act against not only the dealer as lessor, but also against the financial institution to which a lease is assigned. Specifically, an action can be maintained against an assignee of the lessor where the violation is apparent on the face of the lease contract assigned, unless the assignment is involuntary (Civil Code section 2988.5(e),15 U.S.C. section 1641).

Rights of a lessee to offset: A lessee may not offset any amount owed to a lessor against the potential liability of the lessor under an action brought for a violation of the California Leasing Act, unless the amount of the lessor's liability has been determined by a judgment in a court of competent jurisdiction (Civil Code section 2988.5(f)).

Similarly under federal law, a lessee may not offset any amount owed to the lessor against the potential liability of the lessor in an action brought for a violation of the Consumer Leasing Act. However, it should be pointed out that a lessee who is in default under a lease contract is not barred from asserting a lawsuit or defense based upon the lessor's violation of the Consumer Leasing Act (15 U.S.C. section 1640(h)).

State and Federal Statutes of Limitations

Under California law, any action brought against a lessor for failure to comply with the requirements of the California Leasing Act must be brought within one year of the termination of the lease contract (Civil Code section 2988.5(i)).

Federal law also requires that an action brought under the Consumer Leasing Act must be filed within one year of the termination of the lease contract (15 U.S.C. section 1667d(c)).

Multiple violations of the acts: Under both the California Leasing Act and the Consumer Leasing Act, a multiple failure to disclose information required in a lease contract in connection with a single lease transaction entitles the lessee to a single recovery, but a continued failure to disclose after a recovery has been granted does give the lessee the right to additional recoveries (Civil Code section 2988.5(h),15 U.S.C. section 1640(g)).

Production and Retention of Records

Under California law, a lessor who is presented with an affidavit from the Department of Motor Vehicles ("DMV") that states a consumer complaint has been made is required to produce the records relevant to the transaction which is the subject of the complaint. Additionally, if the DMV has reasonable cause to believe there is a pattern of conduct or common scheme in similar transactions, all records relevant to such similar transactions must be produced (Civil Code section 2989.5(a)). If a lessor does not voluntarily comply with this duty to produce records, the DMV is empowered to seek a court order for the production of those records and to be awarded reasonable attorney's fees and costs if it successfully obtains such an order (Civil Code section 2989.5(b)).

Under federal law, a lessor is required to maintain all records of evidence of compliance with Regulation M (except advertising requirements) for a period of not less than two years after the date of disclosures made in connection with a lease transaction (Reg. M, section 213.8).

NOTE

NEED TO RETAIN RECORDS: Although lessors are required to keep records evidencing compliance with the requirements of Regulation M for not less than two years, it is recommended that a dealer retain copies of leases and related documents for at least five years. The reason for this recommendation is the four year statute of limitations that applies to actions based on written agreements.

Miscellaneous California Statutes

California Licensing Requirements for Lessors

California law requires that any lessor who makes retail sales of previously leased vehicles must have either a dealer license or lessor-retailer license issued by the DMV. One of these licenses is not required if the sale of the previously leased vehicle is to the lessee of the vehicle, or the person who, for a period of at least one year, has been designated by the lessee as the driver of the vehicle covered by a

written lease agreement, or if the buyer is obtaining the vehicle for agricultural, business or commercial purposes (California Vehicle Code section 373). The main difference between a dealer license and a lessor-retailer license is that a lessor operating under a lessor-retailer license is restricted to selling at retail only vehicles which have been previously leased, bailed or rented or acquired or contracted for lease or rental by the lessor (California Vehicle Code section 11615(e)). Additionally, a lessor-retailer licensee is not required to maintain a showroom display area or to license sales personnel as a licensed dealer must. For more detailed information regarding application procedures and requirements pertaining to lessor-retailer licenses, see California Vehicle Code sections 11601 through 11620.

Leases Interpreted to be Security Agreements

A lessor should be aware that California courts and also federal bankruptcy courts have determined on occasion that a lease contract is in fact a disguised security agreement or conditional sale contract. In making such a determination, courts will focus on the facts of each case guided by certain factors stated in California Commercial Code section 1203 (see for example the California case of *Addison v. Burnett* (1996) 41 Cal.App.4th 1288). Basically the statute provides that a transaction creates a security interest if the consideration the lessee is to pay the lessor for the use of the goods is an obligation which may not be terminated by the lessee and any of the following conditions apply: (a) the original term of the lease is equal to or greater than the remaining economic life of the goods; (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal consideration; or (d) the lessee has the option to become the owner of the goods for additional consideration or nominal additional consideration. A potentially serious consequence of a determination by a court that a lease contract is really a security agreement is that the lessor would have to comply with the applicable notice requirements of the Automobile Sales Finance Act (with respect to an agreement involving a consumer) or the California Commercial Code (with respect to a non-consumer agreement) in selling the leased vehicle at lease termination in order to be able to pursue the lessee for any resulting deficiency under the lease contract.

Registration

Pursuant to the California Leasing Act, a lessor is under a statutory duty to register a vehicle which is the subject of a lease contract (Civil Code section 2989.4). In registering a leased vehicle, both the lessor and the lessee are to be shown on the registration card with the designation of "lessor" and "lessee" on both the registration card and ownership certificate. At the election of the lessor, the address designated on the registration card and ownership certificate may be either that of the lessor or the lessee. If the lessee's address is not designated, the lessor is required to provide the DMV with a form disclosing the address or name and address of the lessee (this information is to be used only for law enforcement purposes). With respect to the transfer of a leased vehicle, California law allows a lessor to transfer ownership without the necessity of a signature by the lessee on the application for transfer (California Vehicle Code section 4453.5).

Transfer of Ownership Disclosures

Before executing any transfer of ownership document, a lessor is required to give written notice to the lessee that the lessee must provide an odometer disclosure statement to the lessor. The disclosure statement must contain:

- Vehicle identification number, make, model, body type and year
- Odometer reading (no tenths) and a statement that the mileage:
  (1) is the actual mileage;
  (2) is not the actual mileage, or;
  (3) exceeds the odometer mechanical limits.
- Printed names and signatures of the transferor and transferee.
- Printed name of the agent signing for a company as transferor or transferee.
- Date.
- Certification statement.
- The date the lessor notified the lessee.
- The date the disclosure statement was received by the lessor.
- Lessee certification as to the accuracy of the odometer mileage reading.

Equipment Requirements for Leased Used Vehicles

The California Leasing Act specifically prohibits any lessor from leasing a used motor vehicle for operation on California highways which does not meet all of the equipment requirements of Division 12 of the California Vehicle Code. However, this requirement does not apply to an extension or a subsequent lease of the same motor vehicle to the same lessee (Civil Code section 2986.5(a)). It is also noteworthy that a leased vehicle which is sold to the original lessee is exempt from the requirements of the Cali-

fornia Health and Safety Code with respect to emission control compliance certificates (California Vehicle Code section 4000.1(d) (5)).There is also an exemption from the safety inspection requirements with regard to the sale of a leased vehicle to the lessee if the lessee is in possession of the vehicle immediately prior to the time of the sale and the vehicle is registered in California(California Vehicle Code section 11713(i)).

Liability for Permissive Use

Under California law dealing with permissive use liability, a lessor who leases a vehicle to a lessee pursuant to written agreement can be liable as the owner of the vehicle for damages resulting from the negligent operation of the vehicle. However, this liability is limited to $15,000 for the death or injury to one person in any one accident, to $30,000 for the death or injury to more than one person in any one accident, and to $5,000 for property damage in any one accident (California Vehicle Code section 17151). For a more detailed discussion of the insurance issues relating to the lessor/lessee relationship, see the chapter entitled “Insurance” in this Management Guide.

Liability for Repair and Storage Liens

Under California law applicable to repair and storage liens, a lessor, as legal owner of a leased vehicle, can generally be liable for repair and storage charges pertaining to that vehicle of up to $2,750 without having given any consent (Civil Code section 3068). To avoid the possibility of further exposure for repairs to a leased vehicle, it is recommended that a lessor use a lease contract form which includes a provision which specifically denies the lessee any authority to contract for repairs to the leased vehicle on behalf of the lessor. For a more detailed discussion of repair and storage liens, see the chapter entitled “Liens on Vehicles and Lien Sales” in this Management Guide.

CREDIT REPORTS AND DECISIONS

Chapter 3

Contents

CREDIT REPORTS AND DECISIONS

OVERVIEW: Credit transactions involving the right to defer payments relating to the sale or lease of motor vehicles are an important part of an automobile dealership's business. Another area involving credit information which may be of importance to a dealership's operation is the use of credit reports for employment purposes. As would be expected, the handling of credit transactions and credit information, especially involving consumers, is heavily regulated at both the state and federal level. In fact, the applicable statutes and regulations present a serious challenge in terms of compliance, as many of them are highly technical in nature. Under these circumstances, it is critical for dealers to develop appropriate policies regarding credit matters and closely monitor dealership operations regarding compliance to minimize exposure to significant claims of damages and penalties for violation of these statutes and regulations.

This chapter focuses on the key requirements of the statutes and regulations which apply to consumer credit matters that normally arise in the operation of a dealership. The federal statutes and regulations of primary concern are the Fair Credit Reporting Act as amended by the Fair and Accurate Credit Transaction Act (15 United States Code (hereinafter "U.S.C.") sections 1681 through 1681x), the Equal Credit Opportunity Act (15 U.S.C. sections 1691 through 1691f), Federal Reserve Board Regulation B (hereinafter "Reg. B") (12 Code of Federal Regulations part 202) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (herein after "Dodd-Frank Act" (12 U.S.C. section 5301 et. seq.)). The important California statutes include the Consumer Credit Reporting Agencies Act (Civil Code sections 1785.1 through 1785.36), the Investigative Consumer Reporting Agencies Act (Civil Code sections 1786 through 1786.60), and the Holden Credit Denial Disclosure Act of 1976 (Civil Code sections 1787.1 through 1787.4).

NOTE

REGARDING FAIR AND ACCURATE CREDIT TRANSACTION ACT OF 2003: The Fair and Accurate Credit Transaction Act of 2003 ("FACT Act") renewed the provisions of the Fair Credit Reporting Act which basically preempted states from enacting their own credit report/credit bureau requirements. The FACT Act additionally amended the Fair Credit Reporting Act by establishing certain new requirements relating to such matters as credit reporting, information sharing among affiliates, creditor use of consumer reports (including identity theft protections) and a "risk-based pricing notice". These requirements are discussed generally in this chapter (the requirements relating to identity theft are discussed in the chapter entitled "Privacy, Safeguards, Identity Theft, and Red Flags" in this Management Guide). As the preemption effect (meaning federal law is controlling) of the FACT Act is difficult to fully determine, dealers should look to comply with applicable California laws of a more restrictive nature and consult legal counsel as needed.

Credit Reports

A dealership's use of credit reports is subject to both the California Consumer Credit Reporting Agencies Act (hereinafter "CCRAA") and the federal Fair Credit Reporting Act (hereinafter "FCRA"). The FCRA references in this chapter are intended to include the Fact Act amendments which are designed to regulate credit reporting agencies and their customers (for example, dealerships) to protect consumers regarding the confidentiality, accuracy, relevancy and proper utilization of credit information. It is noteworthy that the California legislature has recognized that the extension of credit is a "privilege" and not a right so that the denial of credit is legally possible if done in compliance with the applicable laws and regulations. However, because of the strong public policy involved in protecting consumers regarding credit matters, it is not possible to legally waive the provisions of the CCRAA (Civil Code section 1785.36).

Key Definitions

As is the case with many consumer protection statutes, a comprehension of certain key terms used in the CCRAA is critical to an understanding of how that series of statutes may actually apply to a dealership's business. These terms, which for the most part are similar to the terms used in the FCRA, are basically defined as follows:

"Consumer" means "a natural individual" (Civil Code section 1785.3 (b)).

"Consumer credit report" means "any written, oral, or other communication of any information by

a consumer credit reporting agency bearing on a consumer's credit worthiness, credit standing, or credit capacity, which is used or is expected to be used, or collected in whole or in part, for the purpose of serving as a factor in establishing the consumer's eligibility for:

(1). credit to be used primarily for personal, family, or household purposes, or

(2). employment purposes, or

(3). hiring of a dwelling unit, as defined. . .[by statute], or

(4). other purposes authorized…[by statute]" (Civil Code section 1785.3(c)).

Certain reports or communications which are not considered a consumer credit report, include the following:

"(1) any report containing information solely as to transactions or experiences between the consumer and the person making the report;

(2) any communication of that information or information from a credit application by a consumer that is internal within the organization that is the person making the report or that is made to an entity owned by, or affiliated by corporate control with, that person; provided that the consumer is informed by means of a clear and conspicuous written disclosure that information contained in the credit application may be provided to these persons; however, where a credit application is taken by telephone, disclosure shall initially be given orally at the time the application is taken, and a clear and conspicuous written disclosure shall be made to the consumer in the first written communication after the application is taken;

(3) any authorization or approval of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device;

(4) any report by a person conveying a decision whether to make a specific extension of credit directly or indirectly to a consumer in response to a request by a third party, if the third party advises the consumer of the name and address of the person to whom the request was made and the person makes the disclosures to the consumer required ...[by statute];

(5) any report containing information solely on a consumer's character, general reputation, personal characteristics, or mode of living which is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on, or others with whom he is acquainted or who may have knowledge concerning those items of information;

(6) any communication about a consumer in connection with a credit transaction which is not initiated by the consumer, between persons who are affiliated [as defined by statute] by common ownership or common corporate control [as defined by statute], if either of those persons has complied with [the applicable statute]…with respect to a prequalifying report from which the information communicated is taken and provided the consumer has consented to the provision and use of the prequalifying report in writing; or

(7) any consumer credit report furnished for use in connection with a transaction which consists of an extension of credit to be used solely for a commercial purpose" (Civil Code section 1785.3(c)).

NOTE

REGARDING FINANCIAL INSTITUTIONS: Financial institutions which receive credit applications from dealers use the exemption stated in item (4) above to avoid having their credit decision communications fall within the definition of a "consumer credit report." For this reason, these financial institutions will routinely have dealers commit in writing to require dealership employees to inform a consumer of the name and address of the financial institution to which his or her credit application will be submitted.

CAUTION

REGARDING "INVESTIGATIVE CONSUMER REPORTS": A report of the type designated in item (5) above is defined under California law as an "Investigative Consumer Report" and is subject to the significant notice and disclosure requirements of the Investigative Consumer Reporting Agencies Act (Civil Code section 1786.16). Under the FCRA, such a report is treated as a subset of a "consumer report" which is basically defined as any communication of information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living used in establishing a consumer's eligibility for employment or credit (15 U.S.C. section 1681a(d))(see discussion of investigative consumer reports later in this chapter).

NOTE

REGARDING COMMERCIAL CREDIT: As a result of the exemption stated in item (7) above, the CCRAA does not apply to transactions involving credit for commercial purposes only. Additionally, the CCRAA does not apply to "commercial credit reports" which are basically defined by statute

as "any report provided to a commercial enterprise for a legitimate business purpose, relating to the financial status or payment habits of a commercial enterprise which is the subject of the report" (Civil Code sections 1785.41 and 1785.42(a)). The FCRA also does not apply to transactions solely involving commercial credit.

"Consumer credit reporting agency" means "any person who, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the business of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer credit reports to third parties, but does not include any governmental agency whose records are maintained primarily for traffic safety, law enforcement or licensing purposes" (Civil Code section 1785.3(d)). The FCRA definition of the similar term "consumer reporting agency" states that interstate commerce in some form is used to prepare or furnish the report (15 U.S.C. section 1681a(f)).

Permissible Purposes for Credit Reports

To comply with the CCRAA and FCRA, it is essential for dealers to understand when a consumer credit report may be properly obtained by dealership personnel. Under the CCRAA and FCRA, a consumer credit reporting agency is only authorized to provide a consumer credit report to a dealership for certain limited purposes. The specific purposes most relevant to the operations of a dealership are summarized as follows:

1. Where the consumer to whom the credit report relates has given the dealership written authorization;
2. Where the dealership intends to use the information in connection with a credit transaction involving the consumer as to whom the credit report relates and involving the extension of credit to the consumer;
3. Where the dealership intends to use the information in connection with the collection of an account of the consumer to whom the credit report relates;
4. When the dealership intends to use the information for employment purposes; and
5. Where the dealership otherwise has a legitimate business need for the information in connection with a business transaction initiated by the consumer (Civil Code section 1785.11(a); 15 U.S.C. section 1681b(a)).

CAUTION

REGARDING "LEGITIMATE BUSINESS NEED": The issue of whether a dealership may have some "legitimate business need" which authorizes the dealership to obtain a credit report on a consumer should be carefully considered. Courts which have decided this issue in the context of litigated claims have for the most part determined that to be legitimate, the business need must be one related to those permissible purposes specifically identified by statute (*Mone v. Dranow *(9th Cir. 1991) 945 F.2d 306).

CAUTION

REGARDING "ELECTRONIC AUTHORIZATION OF CREDIT REPORT": A consumer's electronic authorization by email may be sufficient to constitute written authorization for a dealership to obtain a credit report on that individual. However, the position of the Federal Trade Commission (hereafter "FTC") on this issue as stated in a May 24, 2001 letter suggests that a dealership must be able to reproduce that electronic authorization and retain it as a record.

CAUTION

REGARDING ORAL AUTHORIZATION OF CREDIT REPORT: In the absence of a purpose permitted by statute, a consumer's credit report may not properly be obtained by a dealership based upon the consumer's oral authorization. In such a situation, the consumer's written authorization is required.

FTC Position on use of Credit Reports

In a February 11, 1998, letter to the Texas Automobile Dealers Association, the FTC stated its position on the proper use of consumer credit reports by dealers. In this letter, the FTC staff indicated that a dealership may obtain a consumer's credit report without that consumer's written permission only in those circumstances where it is clear to both the dealership employee and the consumer that the consumer is initiating a purchase or a lease of a specific motor vehicle, and the dealership has a legitimate business need for information contained in the credit report. These circumstances would include where the credit report is appropriate to arrange financing on a specific motor vehicle requested by the consumer, and also where the consumer has tendered a personal check for payment before taking possession of the motor vehicle.

The FTC letter further indicated, however, that a dealer should not obtain a consumer's credit report,

without the consumer's written authorization, in the following instances:

1. When a consumer is paying cash (or presumably paying by cashier's check) for a motor vehicle;
2. When the consumer wants to take a motor vehicle out on a test drive;
3. When the consumer asks general questions about financing and prices; or
4. When the dealership wants to obtain information for negotiating purposes.

According to the FTC staff, items 2, 3 and 4 above do not necessarily involve an intent by the consumer to purchase or lease a specific motor vehicle, and so there is no legitimate business need for the dealership to have the credit report information.

NOTE

REGARDING FTC OPINION/CONSUMER FINANCIAL PROTECTION BUREAU: Although an opinion of the FTC on the proper use of credit reports by dealerships does not have the force of law, it should be considered as an important guideline regarding the practical application of the FCRA. Dealers should be aware that the federal Dodd-Frank Act created the Consumer Financial Protection Bureau as a new regulatory agency intended to handle all regulations providing financial protection for consumers. However, because of a specific statutory exclusion, this agency does not have jurisdiction over dealers predominantly engaged in the sale, leasing and servicing of motor vehicles.

REGARDING BAD CHECKS: The FTC has taken the position that a dealership is authorized under the FCRA to obtain a credit report on a consumer for purposes of collecting the amount due on a bad check given by that consumer to the dealership.

Penalties for Misuse of Credit Information

The wrongful accessing of consumer credit information may have severe legal consequences, including claims for actual and liquidated damages, attorney's fees and costs, injunctive relief, penalties (up to $2,500 per violation under California law), punitive damages and even criminal charges (fines and/or up to 2 years in prison) (15 U.S.C. sections 1681n, 1681o, 1681q; Civil Code section 1785.19 and 1785.31). With respect to claims brought under the CCRAA and FCRA, there is basically a 2 year statute of limitations (15 U.S.C. section 1681p; Civil Code section 1785.33).

Prescreened Lists

At times, dealers may wish to obtain credit information from a consumer credit reporting agency on a group of consumers for purposes of a mass marketing effort. Obtaining credit information for this purpose is permitted under the CCRAA and FCRA (15 U.S.C. section 1681b(c); Civil Code section 1785.11(b)). However, there are extensive statutory requirements which must be complied with to properly access and use this type of information. First of all, a consumer credit reporting agency may release such information to a dealer, in connection with a credit transaction which is not initiated by the consumer, **only** if the consumer authorizes it or the proposed transaction involves a "firm offer of credit". The term "firm offer of credit" under the FCRA basically means "any offer of credit or insurance to a consumer that will be honored if the consumer is determined, based on information in a consumer report on the consumer, to meet the specific criteria used to select the consumer for the offer" (15 U.S.C. section 1681a (1); see also Civil Code section 1785.3(h)). The federal statute further provides that the offer may be conditioned on three specific requirements as follows: (i) the creditor may apply additional pre-selected criteria bearing on the consumer's credit worthiness; (ii) verification that the consumer continues to meet the specific criteria used to select the consumer for the offer; and (iii) the consumer furnishing any collateral that was both established before the selection of the consumer for the offer and disclosed to the consumer in the offer (15 U.S.C. section 1681a(1)(1), (2) and (3)).

The actual information or "prequalifying report" that a consumer credit reporting agency may provide to a dealer concerning consumers for mass marketing purposes is limited to the name and address of the consumer and information which pertains to the consumer that is not identified or identifiable with a particular consumer (15 U.S.C. section 1681b(c)(2); Civil Code section 1785.11(b)(2)). Consumer credit reporting agencies must also maintain a notification system to allow a consumer to elect to have his or her name excluded from any such list (15 U.S.C. section 1681b(e)).

Dealers obtaining a pre-screened list of consumer names for mass marketing purposes must not only provide a firm offer of credit, but also state clearly and conspicuously in any solicitation to such consumers the following: (i) information contained in the consumer's report was used in connection with the transaction; (ii) the consumer received the offer of credit or insurance because the consumer satisfied the criteria for credit worthiness or insurability under which the consumer was selected for the offer; (iii) if applicable, the credit or insurance may not be extended if, after the consumer responds to

the offer, the consumer does not meet the criteria used to select the consumer for the offer or any applicable criteria bearing on the credit worthiness or insurability, or does not furnish any required collateral; (iv) the consumer has a right to prohibit information contained in the consumer's file with any consumer reporting agency from being used in connection with any credit or insurance transaction that is not initiated by the consumer; and (v) the consumer may exercise the right referred to in [(iv)] by notifying a notification system established under section 1681b(e) of this title (15 U.S.C. 1681m(d)(1); see also Civil Code section 1785.20.1(a)).

Pursuant to the FACT Act, these disclosures must be made in a manner that is simple and easy to understand, as well as being clear and conspicuous. The FTC's final rule (16 C.F.R. part 642) on this subject provides guidelines as to how the required disclosures should be made. This rule, which provides model forms, directs a layered notice approach (basically breaking the disclosures into two portions), with very technical requirements for the placement, type size and other formatting features relating to the notice text.

CAUTION

REGARDING PRESCREENED CREDIT OFFERS: Dealers engaged in advertising prescreened credit offers should carefully assess those offers to make sure that they are of value to a consumer and not just a "sham offer" designed to gain access to consumer credit information (see* Oneta S. Cole v. U.S. Capital, *(7th Cir.2004) 389 F.3d 719). Advertisements making such credit offers should display the required disclosures in a manner which is in compliance with the FTC rule. The rule is available for review on the FTC's website at www.ftc.gov/opa/2005/07 /prescreenoptout.shtm.

NOTE

REGARDING PRESCREENED SOLICITATIONS: Based upon a Federal Reserve Board amendment of Regulation B (12 C.F.R. section 202.12(b)(7)), dealers obtaining prescreened lists of consumer names for mass-marketing purposes are required to retain records relating to the text of the solicitation, the criteria used to select potential customers for prescreened solicitations, and correspondence relating to consumer complaints for a period of 25 months.

Agreements/Procedures Involving Consumer Credit Reporting Agencies

Normally, consumer credit reporting agencies require a dealer to sign an agreement stating the terms under which credit reports will be provided to a dealership. Because of the CCRAA and FCRA, this agreement will include language whereby a dealer certifies that the purposes for which the credit information are obtained by dealership personnel are proper and that the information will not be used for any other purposes. To the extent that a dispute develops as to whether a consumer credit report has been obtained for a proper purpose, a consumer credit reporting agency will use that language as a shield against the consumer's claim and to shift the focus of the consumer's claim onto the dealership involved. Consumer credit reporting agencies are required by statute to provide a dealer with a notice (this may be a copy of the applicable statutes) stating the dealer's obligations under the CCRAA and FCRA (Civil Code section 1785.14(d); 15 U.S.C. section 1681e).

Consumer Identification

Additionally, to protect against credit fraud, consumer credit reporting agencies are required to have dealership personnel comply with certain procedures designed to confirm the identity of a consumer for whom a credit report is being requested. When asking for a credit report on a consumer who has personally appeared at the dealership, dealership personnel are required to find out certain identifying information from the consumer (at least three categories) which matches information maintained by the consumer credit reporting agency. Categories of identifying information may include, but are not limited to, first and last name, month and date of birth, driver's license number, place of employment, current residence address, previous residence address, or social security number. Information not to be obtained for this purpose is the consumer's mother's maiden name (Civil Code section 1785.14(a)(1)). To further comply with its legal duty under the CCRAA, a consumer credit reporting agency will require a dealer to certify in writing that dealership personnel are instructed to inspect a photo identification of a consumer at the time he or she makes an in person application for credit at the dealership (Civil Code section 1785.14(a)(2)).

NOTE

REGARDING REQUIREMENT FOR DEALERSHIP TO CHECK TERRORIST LIST: Dealers should be aware of a dealership's obligation under federal law to refrain from engaging in business with any per-

sons or entities designated as terrorists. Because of this prohibition, a dealership must check a potential customer's name against a list maintained by the Office of Foreign Assets Control. For a more detailed discussion of this compliance requirement, see the section entitled "Office of Foreign Assets Control ("OFAC") Compliance" in the Other Important Topics chapter of this Management Guide.

Fraud Alerts/Personal Information Discrepancies

Both federal and California law place certain duties on persons or entities such as dealerships using consumer credit reports for credit approval purposes where potential "identity theft" situations exist. The FTC final rule under the FACT Act defines "identity theft" as: "a fraud committed or attempted using the identifying information of another person without authority" (16 C.F.R. section 603.2(a)). Consumers who suspect they are victims of identity theft are authorized to place an "Initial Fraud Alert" or "Extended Fraud Alert" in their consumer file (15 U.S.C. section 1681c-1). Any dealership using a credit report that contains an "Initial Fraud Alert" must contact the consumer at the telephone number specified on the fraud alert, as part of taking reasonable steps to verify a consumer's identity before credit may be extended. If a credit report contains an "Extended Fraud Alert," dealership personnel must contact the consumer in person, by phone, or by another reasonable contact method specified by the consumer in the fraud alert to verify his or her identity before credit may be extended to the consumer.

California statutes also address potential identity theft situations relating to the use of consumer credit reports. California Civil Code section 1785.20.3 requires that if a dealership employee discovers that the first and last name, address or social security number on a credit report do not match the name, address, or social security number listed on the credit application by the consumer requesting credit, reasonable steps must be taken by the dealership to verify the name, address and social security number to confirm that the transaction is not the result of identity theft. This statute also requires that if a dealership receives notification from a consumer credit reporting agency that information in a requested report has been blocked because of a reported identity theft, the dealership must not extend credit without taking reasonable steps to verify the consumer's identity. California Civil Code section 1785.11.1 requires that a dealership that has been made aware of "security alert" notice (the notice from a consumer to a credit reporting agency that consumer information may have been used for a fraudulent purpose) take reasonable steps to verify the consumer's identity prior to the completion of a credit transaction, including contacting a specific telephone number, if the consumer has included such a number in the security alert notice.

As a result of the Address Discrepancy Rule issued by the FTC under the FACT Act, a consumer credit reporting agency is required to provide the user of a consumer credit report with a notice that informs the user that there is a substantial difference between the address for the consumer that the user provided to request the consumer credit report and the address(es) in the agency's file for the consumer. When a dealership receives such a notice, it is required under the Address Discrepancy Rule to not use the consumer credit report received unless the dealership can form a reasonable belief that the consumer credit report relates to the consumer about whom the dealership requested a report.

PRACTICAL TIP

Determining what "reasonable" steps are is not always clear and will vary depending upon the circumstances, but certain ones should be considered in most transactions where the consumer's identity may not be verified by calling the consumer at the phone number specified in the fraud alert. Regarding a credit applicant who is physically present at the dealership, dealership employees should consider examining his or her driver's license to determine whether: (i) the applicant appears to be the person in the photo; (ii) the license appears to have been issued by an authorized issuing agency and does not appear to have been tampered with; and (iii) the information on the license matches the information on the credit application and the credit report. If these steps do not confirm the applicant's identity, additional documentation may be requested, including another form of government-issued identification, utility bill, etc.

A dealership's failure to comply with the investigative requirements of these statutes can have a significant legal impact. For example, Civil Code section 1785.20.3 provides that a failure to comply with that statute's investigative requirements can result in liability for a consumer's damages, court costs, attorney's fees, and even punitive damages up to $30,000 for each violation. As the issue of the FACT Act preempting the California statutes relating to identity theft is not totally clear, dealerships should continue to comply with the applicable California statutes, especially to the extent they have more stringent requirements than the federal regulations.

NOTE

REGARDING IDENTITY THEFT RED FLAGS: A team of federal banking agencies and the FTC have issued a regulation known as the "Red Flags Rule" which requires businesses, such as dealerships, that extend credit to develop an internal written plan to detect, prevent and mitigate identity theft. See further discussion of this topic in the section entitled "Identity Theft and Red Flags" in the Privacy, Safeguards, Identity Theft, and Red Flags chapter of this Management Guide.

NOTE

REGARDING MILITARY PERSONNEL: Under the FTC rule regarding identity theft, active-duty military personnel are authorized to place an "Active-Duty Alert" in their credit file. Similar to the situation involving an "Initial Fraud Alert," when an "Active-Duty Alert" is present in a credit report, a dealership should contact the consumer at the telephone number specified as part of taking reasonable steps to verify the consumer's identity before credit is extended.

NOTE

MISUSE OF A CONSUMER'S CREDIT INFORMATION: Dealers should understand that if a financial institution which has purchased a lease or retail contract becomes aware of the fact that there has been a misuse of credit information, that institution is likely to require the dealership to buy back the lease or contract involved under the terms of the applicable dealer agreement.

PROVIDING CREDIT REPORTS TO CONSUMERS: Dealership employees are not prohibited by the FCRA or CCRAA from providing a copy of a credit report, or otherwise disclosing its contents to the consumer who is the subject of the report if adverse action may be taken based on the report (Civil Code section 1785.14(c)).

Requirements where Dealers Provide Credit Information

For the most part, dealers do not normally supply information to consumer credit reporting agencies regarding specific transactions or experiences. However, to the extent that a dealership does supply such information, significant statutory requirements apply. It is a basic rule that information should not be furnished to a consumer credit reporting agency on a specific transaction or experience if it is known or should have been known that the information is incomplete or inaccurate (15 U.S.C. section 1681s-2(a); Civil Code section 1785.25(a)). Additionally, if a dealership in the ordinary course of business regularly and routinely furnishes information to a consumer credit reporting agency, that dealership has an obligation, if it determines the information is incomplete or inaccurate, to promptly notify the consumer credit reporting agency and correct or supplement the information previously provided (15 U.S.C. section 1681s-2(a); Civil Code section 1785.25(b)).

Where the completeness or accuracy of information on a specific transaction or experience furnished by a dealership to a consumer credit reporting agency is subject to a continuing dispute involving the consumer, the dealership may provide the information to the consumer credit reporting agency only if there is an accompanying notice that the information is disputed (15 U.S.C. section 1681s-2(a)(3); Civil Code section 1785.25(c)).

In the instance where information reported by a dealership to a consumer credit reporting agency is disputed by the consumer involved, the dealership does have statutory obligations to investigate the information further. For instance, if the dealership receives a dispute notice from a consumer credit reporting agency, the dealership is obligated to review the relevant information submitted, complete an investigation, and then report to the consumer credit reporting agency the results of that investigation within 30 days from the date the notice of dispute is received (15 U.S.C. section 1681s-2(b); Civil Code section 1785.25(f)).

Additionally, the FACT Act provides a consumer the right to directly dispute information provided by a dealership or other creditor. The applicable FTC regulations require furnishers of information to establish and implement reasonable written policies and procedures regarding the accuracy and integrity of the information relating to consumers that is furnished to consumer credit reporting agencies. These policies and procedures should take into account certain guidelines which are part of the regulations and be periodically reviewed and updated as necessary to continue their effectiveness. The FTC regulations may be reviewed at www.ftc.gov/opa /2009/07/fact.shtm

The FACT Act also provides that if negative information (meaning information concerning a customer's delinquencies, late payments, insolvency, or any form of default) is provided by a business, such as a dealership, to a consumer credit reporting agency, the business must give written notice to the consumer that negative information is being supplied. Regulations developed by the Federal Reserve Board (12 C.F.R. part 222) include a model form which may be used for this purpose. The model form language reads as follows:

"We may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report."

This notice must be provided to the consumer prior to, or no later than, 30 days after the negative credit information is supplied to the consumer credit reporting agency (15 U.S.C. section 1681-2(a)(7)). In this case, the FACT Act appears to preempt California law (Civil Code section 1785.26) which would also require a business reporting negative information regarding a consumer, to give a written notice to the consumer (15 U.S.C. section 1681t(b)(1)(F)).

NOTE

REGARDING REPORTING REQUIREMENTS OF REG. B: A dealership furnishing credit information to a consumer credit reporting agency regarding a contract for the sale or lease of a motor vehicle where both the husband and wife sign the contract, must report the participation of both spouses (Reg. B section 202.10).

Credit Decisions

To the extent that dealership personnel make a decision, based upon the contents of a consumer credit report, that in effect denies credit or increases the cost of credit to a consumer relating to his or her purchase or lease of a motor vehicle, the dealership is obligated to comply with certain disclosure requirements under the CCRAA and FCRA. These disclosure requirements are triggered when a decision is made or other conduct is engaged in regarding a consumer which constitutes an "adverse action." In the context of credit transactions, the term "adverse action" under the CCRAA basically means "a denial or revocation of credit, a change in the terms of an existing credit arrangement which is adverse to the interests of the consumer, or a refusal to grant credit in substantially the amount or on substantially the terms requested" (Civil Code section 1785.3).

NOTE

REGARDING WHAT IS NOT "ADVERSE ACTION": Under the CCRA, adverse action does not include "(A) a refusal to extend additional credit to a consumer under an existing credit arrangement if (i) the applicant is delinquent or otherwise in default under that credit arrangement or (ii) the additional credit would exceed a credit limit previously established for the consumer or (B) a refusal or failure to authorize an account transaction at a point of sale" (Civil Code section 1785.3(a)(3)).

CCRAA and FCRA Notice and Disclosure Requirements

If based upon the content of a credit report, dealership personnel deny or increase the cost of credit to a consumer, a dealership is required under the combined requirements of the CCRAA and FCRA to provide to the consumer a written notice of the adverse action which also includes:

1. The name, address, and telephone number (toll-free number if applicable) of the consumer credit reporting agency which furnished the report to the dealership;
2. A statement that the dealership's decision to take adverse action was based in whole or in part upon information contained in a consumer credit report;
3. A statement that the consumer credit reporting agency did not make the decision to take the adverse action and is unable to provide the consumer specific reasons why the adverse action was taken;
4. A statement of the right of the consumer to obtain within 60 days a free copy of the consumer's credit report from the consumer credit reporting agency identified by the dealership and from any other consumer credit reporting agency which compiles and maintains files on consumers on a nationwide basis; and
5. A statement of the right of the consumer by statute to dispute the accuracy or completeness of any information in a consumer credit report furnished by the consumer credit reporting agency (15 U.S.C. section 1681m; Civil Code section 1785.20).

Additionally as of July 21, 2011, if a credit score is involved in the decision, the Dodd-Frank Act requires that the following disclosures be included in an adverse action notice under the FCRA:

1. The consumer's credit score;
2. The date of the credit score;
3. The range of possible credit scores (taking into account the credit score model used);
4. The four key reasons that adversely impacted the credit score (five reasons must be disclosed if one reason is the number of inquiries made regarding the credit report); and
5. The name of the entity (or person) providing the credit score.

Note that this requirement is separate and distinct from the federal and state Credit Score Disclosure requirements described below under "Risk-Based Pricing Rule."

CAUTION

REGARDING ADVERSE ACTION NOTICES: Adverse action notice requirements not only exist under the CCRAA and FCRA, but also under the Equal Credit Opportunity Act ("ECOA"), Reg. B and Holden Credit Denial Disclosure Act (See discussion later in this chapter in the section entitled "ECOA/Reg. B Notices and Disclosures.") Basically these notice requirements apply to creditors who "regularly participate in a credit decision" which includes establishing terms of credit. Court decisions that have interpreted the applicable regulations have come to different conclusions as to whether automobile dealers, even those who simply submit credit applications to financial institutions for evaluation and decision purposes, "regularly participate" in making credit decision. For this reason, it is prudent for dealers to develop a solid compliance strategy relating to adverse action notice requirements and consult dealership counsel in that regard as necessary. In some situations, the notices and disclosures required by the various statutes may be combined. The NADA Management Guide publication entitled "A Dealer Guide To Adverse Action Notices" which is available at www.nada.org/nadauniversity/resourcetoolbox, is a valuable compliance resource regarding adverse action notices.

CAUTION

REGARDING DEALERSHIP PRACTICES TRIGGERING AN ADVERSE ACTION NOTICE: If a salesperson, based upon the review of a credit report, communicates to a consumer that he or she will not qualify for an advertised finance rate requested by the consumer on a particular motor vehicle, this communication in effect denies credit to the consumer. As a result, the dealership would need to give an adverse action notice to the customer. As part of maintaining a bright line compliance strategy, a dealership should also give an adverse action notice to a consumer when the dealership elects to rescind a sale or lease of a vehicle that has been spot delivered because an acceptable finance source cannot be found. If a rewritten contract is voluntarily signed by the customer after the notice of rescission, the dealership may take the position that an adverse action notice is unnecessary because the rewritten contract constitutes an accepted counter offer.

NOTE

REGARDING PREPARING ADVERSE ACTION NOTICES: Given the complexities of the legal disclosure requirements for adverse action notices, many dealers contract with credit reporting agencies or other venders to provide adverse action notices as part of a credit service package. Dealers should, however, carefully consider such an arrangement and, as appropriate, conduct a review of the process and the form of notice being provided to dealership customers.

Risk-Based Pricing Rule

Since 2011, dealers have been required to comply with rules issued by the FTC under the FACT Act which generally require a creditor to give a written notice to some customers who as part of their transaction receive less than the best credit terms. Specifically, in connection with credit transactions for personal, household or family purposes, a creditor must provide a risk-based pricing notice to a consumer when the creditor uses a consumer credit report to grant or extend credit to the consumer on material terms that are "materially less favorable than the most favorable terms available to a substantial portion of consumers" from or through that creditor. The term "risk-based pricing" refers to the practice of adjusting the price and other terms of credit offered to a consumer to reflect the risk of non-payment by that consumer. The FTC rules specifically conclude that automobile dealerships engage in this practice based upon their use of consumer credit reports to set interest rates for consumers relating to their purchase of vehicles by means of installment sale contracts. This conclusion is not altered by the fact that dealerships typically assign installment sale contracts to other financial institutions. It is noteworthy that all lease transactions and installment sale contracts involving vehicles purchased for business purposes are not subject to these rules.

The risk-based pricing notice requirement of the rules is designed to complement the existing adverse action notice provisions of the FACT Act and the rules provide that a person receiving an adverse action notice is not required to receive a risk-based pricing notice. The FTC's goal in requiring a risk-based pricing notice is to improve the accuracy of consumer credit reports by having consumers alerted to the existence of negative information on those reports so consumers can, if they choose, check the reports and correct inaccurate information.

The rules recognize several methods by which a creditor can determine when credit is being offered under terms that are materially less favorable. Such a determination may be made by a direct comparison of terms on a case by case basis. Two alternative methods that are also allowed which do not involve a direct comparison of terms are the "credit score proxy" method and the "tiered pricing" method. The complexity of these methods makes it very difficult for dealers to develop practical strategies to comply with these rules. For this reason, dealers should consider a compliance approach that takes advantage of an exception recognized by the rules which avoids the requirement of giving a risk-based price notice. Specifically, the rules allow a dealership to give all consumers who apply for credit a written notice that discloses the consumer's credit score, as well as certain additional information that provides an understanding of the relevance of the credit score, in lieu of giving risk-based pricing notices. As part of the rules, the FTC has generated a model credit score disclosure form ("Exception Notice"), as well as risk-based pricing notice forms. These model forms and the rules can be reviewed at www.ftc.gov/opa/2009/12/ rbpricing.shtm.

A compliance strategy which utilizes an Exception Notice should be attractive to dealers not only because it avoids the complicated analysis of determining which consumers should receive a risk-based pricing notice, but also because it can satisfy the written notice requirements of California Vehicle Code section 11713.20. This statute, which predates the federal regulations, requires a dealership to give written notice to a consumer regarding credit scores used by the dealership and obtained from a credit reporting agency in connection with the consumer's application for credit to buy or lease a vehicle for personal, family or household use. CNCDA successfully proposed legislation to harmonize the previously discordant federal and state notices, allowing a dealership to comply with the statute's notice requirement by using the Exception Notice. Because of the complexities of the information contained in this notice form, dealers typically contract to have them provided by credit score vendors in connection with a dealership's purchase of credit scores. The NADA Management Guide publication titled "A Dealer Guide to the Risk-Based Pricing Rule" which is available at www.NADA.org/nadauniversity/resourcetoolbox, is a valuable compliance resource regarding the risk-based pricing rule. Dealers having compliance questions regarding this rule and California Vehicle Code section 11713.20 should consult legal counsel.

NOTE

REGARDING CREDIT SCORE DISCLOSURE REQUIREMENTS: As discussed previously, California Vehicle Code section 11713.20 represents a separate legal requirement from federal law that a dealership must comply with involving the disclosure of credit score information obtained by the dealership regarding a consumer. The additional requirements of California law include: (1) giving the notice in connection with lease transactions; and (2) giving the notice regarding each credit score obtained and used by the dealership. Also, the best practice for a dealership in complying with this California law is to give the notice even if a vehicle is not purchased or leased. Although not required, having a consumer sign the notice form to confirm its receipt is also a good practice. A copy of any notice form used to disclose credit score information should be retained by a dealership for at least seven years.

CAUTION

REGARDING PRESCREENED APPLICANTS: If a salesperson, based upon a review of a credit report, communicates to a consumer that he or she will not qualify for an advertised finance rate requested by the consumer on a particular motor vehicle, this communication in effect denies credit to the consumer. As a result, the dealership would need to give an adverse action notice to the consumer.

NOTE

REGARDING CONSUMERS OUTSIDE CALIFORNIA: The notice and disclosure requirements of the CCRAA do not apply to consumers who have a mailing address outside of California (Civil Code section 1785.6). However, dealers should be aware that the similar notice and disclosure requirements of the FCRA and other federal laws would be applicable to such consumers.

Credit Decisions Based on Information Received from Third Parties

If dealership personnel make a credit decision constituting adverse action based either in whole or in part on information obtained from a person other than a consumer credit reporting agency, and this information bears upon the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living, the dealership is obligated to give notice and make certain disclosures to the consumer under the CCRAA and FCRA. Specifically, a dealership is

required to clearly disclose to the consumer the adverse action taken and clearly and accurately disclose to the consumer his or her right to make a written request for the reasons for the adverse action. If the consumer makes such a written request within 60 days after learning of the adverse action, the dealership must disclose the nature of the information to the consumer (15 U.S.C. section 1681m(b)(1); Civil Code section 1785.20(b)).

Penalties for Noncompliance with CCRAA/FCRA Notice Requirements

Violations of the notice and disclosure provisions of the FCRA or CCRAA may expose dealers to significant legal consequences including claims of damages, penalties and attorney's fees and costs. However, recent court cases (see for example *Putkowski v. Irwin Home Equity Corporation,* 423 F. Supp. 2d 1053 (N.D. Cal. 2006)) have concluded based on 15 U.S.C. section 1681m(h)(8) that individual consumer actions asserting such violations are barred. Generally, if a dealer can show that the dealership maintained reasonable procedures to comply with the notice and disclosure requirements, liability may be avoided (15 U.S.C. section 1681m(c); Civil Code section 1785.20(c)).

Other Legal Requirements relating to the Credit Application/Decision Process

It is of critical importance that dealers be aware that certain statutes and regulations apply to the credit application and decision process whether or not consumer credit reports are involved. Under federal law, the Equal Credit Opportunity Act (hereinafter "ECOA") and Reg. B, which is designed to implement the ECOA, are applicable. Under California law, the Holden Credit Denial Disclosure Act of 1976 (hereinafter "HCDDA") applies to applications for credit primarily for personal, family or household purposes. Essentially, the notification and disclosure requirements of these statutes apply when a consumer has provided a completed credit application to a dealership.

ECOA/Reg. B

Basically the ECOA and Reg. B provide that it is unlawful for any "creditor" to discriminate (including discouraging a person from making a credit application) against a person in the context of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, on the basis that the applicant's income derives from any public assistance program or on the basis the applicant has in good faith exercised any right under the Consumer Credit Protection Act (15 U.S.C. section 1691; Reg. B sections 202.1, 202.4 and 202.5(a)). This prohibition of discrimination applies to any credit transaction, including those not involving consumers. For purposes of the ECOA, a "creditor" means "any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew or continue credit" (15 U.S.C. section 1691a(e)). The Federal Reserve Board's definition of "creditor" in Reg. B refers to a person who "regularly participates in a credit decision" (Reg. B section 202.2(1)).Basically, dealers should consider that their dealerships are within the scope of these "creditor" definitions and are subject to the provisions of the ECOA and Reg. B. This is clearly the case for purposes of the discrimination prohibitions of the ECOA and Reg. B, because in that context the term "creditor" includes a "person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made" (Reg. B section 202.2(l)).

CAUTION

REGARDING DISCOURAGING CREDIT APPLICATIONS: Dealership personnel are prohibited by the ECOA and Reg. B. from discouraging in any manner, a consumer from making or pursuing a credit application based upon any of the protected factors (i.e. race, color, religion, etc.) (Reg. B section 202.4(a)).

NOTE

REGARDING MARITAL STATUS RELATING TO CREDIT TRANSACTIONS: California Civil Code sections 1812.30 through 1812.35 prohibit discrimination against persons based upon marital status or sex relating to credit transactions. These California statutes basically provide that a person having a certain type of credit and managing and controlling a certain amount of earnings and other property should receive equal treatment with a person who is unmarried or of the opposite sex having the same type of credit and managing and controlling the same amount of earnings and other property. A dealer violating these statutes may be liable for actual damages, punitive damages up to $10,000 for individual claims, civil penalties, and attorney's fees. Injunctive relief and class-actions are also possible remedies for violations of these statutes.

Handling Credit Applications

Included in the regulatory scheme of Reg. B are certain rules which restrict the information that may

be requested of an "applicant" in connection with taking a credit application. The term "applicant" under Reg. B basically means "any person who requests or who has received an extension of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit" (Reg. B section 202.2(e)). The restrictions on requesting information are basically summarized as follows:

1. Information as to a spouse (or former spouse) may not be requested of a consumer except where the spouse will be contractually liable for the purchase or lease of a motor vehicle; the spouse's income (including alimony, child support or separate maintenance payments from a former spouse) is being relied upon as a basis for repaying the credit requested; or the consumer is a resident of a community property state such as California.
2. Dealership employees may inquire about a consumer's marital status, but may only use the terms "married, unmarried and separated" to describe that status. It may be explained to a consumer that the category "unmarried" includes single, divorced and widowed persons.
3. Information may not be requested as to whether income stated in an application is derived from alimony, child support or separate maintenance payments, unless it is disclosed to the consumer that such income need not be revealed if the consumer does not want it to be considered in determining the consumer's creditworthiness.
4. Information may not be requested as to the sex of a consumer. An application may request a designation of title such as Ms., Miss, Mr. or Mrs., if the form discloses that the designation of a title is optional.
5. Information may not be requested as to a consumer's birth control practices, intentions concerning the bearing and rearing of children or capability to bear children. Dealership employees may inquire about the number and ages of a consumer's dependents or about dependent related financial obligations or expenditures, provided such information is requested without regard to sex, marital status or any other prohibited basis.
6. Information may not be requested about the race, color, religion or national origin of a consumer. Dealership employees may inquire about a consumer's permanent residence and immigration status (Reg. B section 202.5).

CAUTION

REGARDING HANDLING CREDIT APPLICATIONS: Dealers should carefully review the procedures used by dealership employees in handling credit applications for several reasons. First of all, the information provided by consumers to complete applications is private and confidential and should only be disclosed to the appropriate persons. A failure to maintain this confidentiality exposes the dealership to potential legal claims, including the invasion of a consumer's right to privacy as established by Article I, section I, of the California State Constitution. Additionally, if credit applications are not completely or accurately filled out, other problems may arise. If material information provided to complete a credit application is not accurate, there technically is a default under the contract for the lease or purchase of the motor vehicle involved. To the extent dealership employees are aware of inaccurate information used to complete a credit application, the financial institution to which the lease or purchase contract involved was assigned may seek to have the contract repurchased by the dealership. Also when credit application information is inaccurate and a dispute develops between the financial institution and the consumer (for instance when a repossession occurs), a consumer may allege that dealership personnel knew of the situation and engaged in or contributed to the fraud which was in effect perpetrated on the financial institution.

NOTE

REGARDING PRIVACY: In connection with the Gramm-Leach-Bliley Act (15 U.S.C. sections 6801-6809), the FTC has developed regulations applicable to "financial institutions" which conduct business with consumers. The definition of a "financial institution" for purposes of this statutory scheme is quite broad and includes entities significantly engaged in leasing and credit activities such as automobile dealerships. The regulations require a disclosure of the financial institution's privacy procedures and practices with respect to confidential consumer information (including whether the information is shared with other entities) and that reasonable steps be taken to protect such information. Several recently enacted California laws are also designed to protect confidential consumer information. See the chapter in this Management Guide entitled "Privacy, Safeguards, Identity Theft, and Red Flags" for a further discussion of these regulations and statutes.

ECOA/Reg. B Notices and Disclosures

Generally under the ECOA and Reg. B (and also California's HCDDA), when dealership personnel

receive a credit application from a consumer, notice of the decision on the application must be given. If the decision constitutes "adverse action" (for the purposes of the ECOA, "adverse action" basically means a denial or revocation of credit, or refusal to grant credit in substantially the amount or on substantially the terms requested by the consumer), the dealership is required to give certain notices and disclosures to the consumer involved (15 U.S.C. section 1691(d); Reg B section 202.2(c); see also Civil Code section 1787.2(e)(2) defining the term "credit denial"). Specifically a dealership is obligated to within 30 days of the receipt of a "completed application" (basically defined as an oral or written request for an extension of credit where the dealership has received all the information that it regularly obtains and considers in evaluating such applications (Reg. B section 202.2(f))) to do the following:

1. Notify the consumer of the decision on the credit application; and
2. If the decision constitutes adverse action, provide the consumer with a written statement which includes:

(a) A statement of the action taken;

(b) The name and address of the dealership;

(c) A statement of the ECOA policy prohibiting discrimination (the form statement developed by the FTC should be used to fulfill this requirement);

(d) The name and address of the FTC office which regulates compliance (for example: Federal Trade Commission, Equal Credit Opportunity, Los Angeles Regional Office, 10877 Wilshire Blvd., Suite 700, Los Angeles, CA 90024); and

(e) Either

(i) A statement of specific reasons for the denial of credit; or

(ii) A disclosure that the consumer has a right to receive a statement of reasons from the dealership within 30 days of making such a request (the request needs to be made within 60 days after the consumer's notification of the adverse action). This disclosure must identify by name, address and telephone number the person or office from which such a statement of reasons may be obtained. In response to such a request, dealership personnel may provide a statement of reasons orally, but only if the consumer is informed of his or her right to receive written confirmation of the reasons within 30 days of making such a confirmation request (Reg. B section 202.9(a)).

NOTE

REGARDING COUNTEROFFERS: Under Reg. B, a dealership must give notice (including the information described above) to a consumer where dealership personnel have communicated a counteroffer of credit to that consumer which is not accepted. Specifically, that notice must be given within 90 days of the counteroffer being made to the consumer (Reg. B section 202.9(a)(1)(iv)).

REGARDING TELEPHONE APPLICATIONS: If dealership personnel take credit applications by telephone and adverse action is taken, dealership personnel must request the consumer's name and address in order to provide the required written notice as discussed above. If the consumer declines to provide this information, a dealership has no further notification responsibility (see comment 7 to section 202.9(a)(1) Reg. B official staff commentary).

CAUTION

REGARDING REG. B NOTIFICATION AND DISCLOSURE REQUIREMENTS: As discussed previously in this chapter, a dealership should be able to independently give the required adverse action notice and disclosures (see* Tonya Treadway v. Gateway Chevrolet Oldsmobile, Inc *(7th Cir. 2004) 362 F.3d 971).

REGARDING STATEMENT OF REASONS: To comply with the statement of reasons requirement of Reg. B, the reasons given by a dealership must be specific and indicate the principal reason(s) for adverse action. General statements indicating an applicant did not have a qualifying score on a credit scoring system or that the decision was based on internal standards are not satisfactory for compliance purposes (Reg. B section 202.9(b)(2)).

REGARDING REG. B NOTICES FOR BUSINESS CREDIT TRANSACTIONS: The notice and disclosure requirements of the ECOA and Reg. B do apply to credit transactions for business, commercial or agricultural purposes. However, these notice and disclosure requirements are technically different from the requirements applicable to consumer credit transactions (Reg. B section 202.9(a)(3)). Dealers involved in credit transactions for business purposes (for example parts sales) should develop the appropriate procedures to comply with these specific Reg. B. requirements.

Incomplete Applications

Under Reg. B, if a dealership receives a credit application which is incomplete regarding information that the consumer can complete, the dealership must do one of two things within 30 days of receipt of the application. Specifically, the dealership must either give the consumer notice of the action taken on the application as discussed previously, or a written notice that identifies the additional information needed, designates a reasonable time period for the information to be supplied, and also indicates that if the information requested is not provided, no further consideration will be given to the application (Reg. B section 202.9(c)).

Incidental Credit

As defined by Reg. B, "incidental credit" basically means an extension of consumer credit which is not made pursuant to the terms of a credit card account, does not include a financial charge, and does not involve an agreement of payment for a term of more than 4 installments. Incidental credit is exempted from many of the requirements of Reg. B, including those relating to notices and records retention (Reg. B section 202.3(c)).

Withdrawn Applications

If a consumer submits an application which is approved and it is contemplated by the parties that the consumer will inquire about the application and no inquiry is made within 30 days, a dealership may treat the application as withdrawn and have no further obligation to notify the consumer (Reg. B section 202.9(e)).

NOTE

REGARDING APPLICATIONS SUBMITTED TO MULTIPLE FINANCIAL INSTITUTIONS: It is quite common for dealership personnel to submit credit applications to more than one financial institution for approval. If one of the financial institutions agrees to extend the credit requested in connection with a consumer's lease or purchase of a motor vehicle, the other financial institutions are not required to give any notification of action taken. If no financial institution approves the credit request, each must give the required notices (Reg. B section 202.9(g)).

Records Retention

One of the more imposing obligations of Reg. B is the requirement that a dealership retain extensive records (these should include materials and notices received from financial institutions) pertaining to credit transactions. Records relating to consumer credit transactions must be retained for at least 25 months from the date the application is submitted or from the date the creditor notifies the applicant of the action taken on the application. The records to be retained include a copy of any credit application, all materials associated with the evaluation of the application, copies of any written notifications to consumers, and copies of any written statements of consumers alleging violations of the ECOA or Reg. B. Because the Fact Act extends the statute of limitations for violations of the FCRA, dealerships should retain such records for at least 5 years. Where a dealership is the subject of an FTC investigation or a lawsuit regarding ECOA or Reg. B matters, the pertinent records should be retained indefinitely (Reg. B section 202.12).

NOTE

REGARDING RETENTION OF RECORDS UNDER CALIFORNIA LAW: Pursuant to California Civil Code section 2984.5, dealers are obligated to retain the following documents for 7 years or the length of the conditional sale contract, whichever is longer: (1) a copy of each buyer's conditional sale contract; (2) any documents relied upon by the dealership to determine the buyer's credit worthiness, including, but not limited to, any consumer credit report or any other document containing a buyer's credit score (for example, W2s, tax returns, payroll stubs, phone/utility bills, etc.); and (3) if the conditional sale contract is sold, assigned, or otherwise transferred, a copy of the terms of that sale, assignment or transfer.

Penalties for Failure to Comply with ECOA/REG B/HCDDA

A dealership's failure to comply with the ECOA, Reg. B or California's HCDDA can have significant legal consequences, including liability to consumers for actual damages, attorney's fees and even punitive damages (up to $10,000 per violation or in the case of a class action up to $500,000 or 1% of the net worth of the dealership, whichever amount is less) where the violations are willful (15 U.S.C. section 1691e; Civil Code section 1787.3). The FTC may also bring an action seeking injunctive relief and civil penalties. The statute of limitations applicable to an action by a consumer against a dealership for violations of the ECOA, Reg. B or the HCDDA is usually 2 years from date of any alleged violation (15 U.S.C. section 1691e(f); Civil Code section 1787.3(e)).

Credit Reports Used for Employment Purposes

As discussed previously, the use of a credit report for "employment purposes" is a permissible purpose under both the CCRAA and FCRA (Civil Code section 1785.11(a)(3)(B); 15 U.S.C. section 1681b(a)(3)(B)). The phrase "employment purposes" in this context basically means that the consumer credit report will be used for the "purpose of evaluating a consumer for employment, promotion, reassignment, or retention as an employee" (Civil Code section 1785.3(f); 15 U.S.C. section 1681a(h)). It must be pointed out, however, that use of credit information for this purpose is heavily regulated.

Most importantly, before a credit report may be obtained for employment purposes under federal law, a dealer must do the following:

1. Clearly and conspicuously disclose in writing, in a document consisting solely of this disclosure, to the employee or applicant involved that such a report may be procured for employment purposes;
2. Secure the employee's or applicant's written authorization to obtain the credit report (this authorization can be part of the disclosure document referred to in item 1. above); and
3. Certify to the credit reporting agency that items 1. and 2. above have been complied with and that if adverse action is taken (see discussion of this topic later in this chapter), the dealer will comply with the applicable statutory duties (15 U.S.C. section 1681b(b) (2)(A)).
4. Notify the individual in writing of the basis under Labor Code section 1024.5 for permissibly using the consumer credit report (*e.g.* company is exempt from Labor Code section 1024.5, because the individual is applying for or holds a managerial position, etc.) (Civil Code section 1785.20.5).

Prior to obtaining a consumer credit report for employment purposes under California law, a dealer must give written notice of the request to the consumer and that notice must identify the source of the credit report and contain a box that the employee or applicant may check off to receive a copy of the credit report. If the employee or applicant checks this box, a dealer is obligated to request that the consumer credit reporting agency involved provide a copy of the consumer credit report to the employee or applicant at no charge at the same time the report is provided to the dealer (Civil Code section 1785.20.5(a)).

Investigative Consumer Reports

The use of an investigative consumer report (under federal law, this is a subset type of consumer report (15 U.S.C. section 1681a(e)) which includes information on the consumer's character, general reputation, personal characteristics or mode of living) for employment purposes is heavily regulated under the California Investigative Consumer Reporting Agencies Act (hereinafter ICRAA) (Civil Code sections 1786 through 1786.60) and the FCRA. Pursuant to Civil Code section 1786.16(a)(2) of the ICRAA, a dealer may obtain an investigative consumer report for employment purposes only if all of the following conditions are met:

1. The consumer has authorized in writing the procurement of the investigative consumer report.
2. Prior to the report being made, there is a clear and conspicuous written disclosure (in a document containing only this disclosure) to the consumer that states:
   (a) An investigative consumer report may be obtained;
   (b) The permissible purpose of the report;
   (c) That information on the consumer's character, general reputation, personal characteristics, and mode of living may be included;
   (d) The name, address and telephone number of the investigative consumer report agency conducting the investigation; and
   (e) A description of the nature and scope of the investigation being requested and a summary of the provisions of Civil Code section 1786.22 which relate to the rights of a consumer to inspect an investigative consumer reporting agency's files and information.

Additionally, under California law, a dealer seeking an investigative consumer report for employment purposes must provide to the consumer a written form (which may be part of the written disclosure form discussed above) which includes a box to be checked indicating that the consumer wishes to receive a copy of any investigative consumer report that is prepared (Civil Code section 1786.16(b)). If the consumer wishes to receive a copy of the report, the dealer must send the copy to the consumer within 3 business days of the date the report is provided to the dealer regardless of whether the dealership decides to hire the applicant or not. The copy of the report must contain the name, address and telephone number of the person issuing the report.

The notice and disclosure requirements of the FCRA applicable to investigative consumer reports are also extensive. In an opinion letter dated June 9, 1998, the FTC stated its position

that since investigative consumer reports are a type of consumer report, those employers using such reports must comply with the FCRA requirements applicable to all consumer reports (see discussion of these requirements earlier in this chapter), including the requirement of securing the employee's written authorization prior to obtaining the report. Dealers using investigative consumer reports must also comply with additional FCRA requirements specifically applicable to this type of report which include the following:

1. Written notification to the consumer that such a report may be obtained.

2. The disclosure or notice must either be mailed or otherwise delivered to the individual not later than 3 days after the date the report was first requested.

3. This written notice must include a statement informing the consumer of his or her right to request additional information regarding the nature and scope of the investigation and a written summary of the rights of the consumer under the FCRA (15 U.S.C. 1681d(a)).

Federal law allows a consumer to make a written request within a reasonable period of time after receiving this notice for information on the nature and scope of the investigation. In response, a dealer must make a disclosure of that information in writing and mail or otherwise deliver it to the employee or applicant not later than 5 days after the date on which the request was received or the investigative consumer report was first requested, whichever is later (15 U.S.C. 1681d(b)).

NOTE

REGARDING EMPLOYEE MISCONDUCT INVESTIGATIONS: The extensive notification and disclosure requirements provided for by California law relating to the use of investigative consumer reports are not applicable if such a report is sought for employment purposes due to suspicion held by a dealer of wrongdoing or misconduct by the person under investigation (Civil Code section 1786.16(c)). Additionally, the newly enacted FACT Act creates a similar exemption from the applicable federal notice and disclosure requirements when the investigation is based on any of the following: (1) suspected misconduct related to employment, (2) compliance with laws and regulations, or (3) compliance with the employer's written policies.

REGARDING INFORMATION OBTAINED WITHOUT THE USE OF AN OUTSIDE PROVIDER: Additional notification and disclosure requirements provided for by California law relating to the use of investigative consumer reports are still applicable if such a report is sought for employment purposes even if no outside provider is used. Dealers should contact employment counsel about compliance if the dealer obtains background information without using an outside agency, such as doing in-house web-based searches or accessing government websites.

CAUTION

REGARDING RECORDS MORE THAN SEVEN YEARS OLD: California employers may not rely on records that predate the background check report by more than seven years. Moreover, because a criminal background check report qualifies as an investigative consumer credit report under California law, the person obtaining and using the report must go through the procedural hoops – notice to the consumer, providing the consumer with a copy of the report, etc. – required to legally obtain and use the information.

REGARDING RECORDS AVAILABLE ON THE INTERNET AND OTHER PUBLIC SOURCES: With the Internet, unprecedented access to personal and public information is available with a few keystrokes or clicks of a mouse. Dealers may be tempted to look into a prospective employee's history over the Internet, use that information to deny employment, discipline or terminate the employee, and think nothing of it. BUT BEWARE. This type of self-help sleuthing may be illegal. This type of private sleuthing is still covered by various legal requirements and poses a very real risk of liability (both civil and criminal) for violating the private sleuthing restrictions. For example, Internet sites are available to the public to check convictions for sex crimes (e.g., California's "Megan's Law" website) to determine whether prospective employees are registered sex offenders. The suggestion has some foundation, but there are legal pitfalls to browsing the Internet and using information you may find. Self-Help can be dangerous. Any person who collects information on an employee's character or general reputation that are matters of public record – such as the criminal records on the Megan's Law website – and uses that information for employment purposes, must follow the strict disclosure rules of the ICRAA. Under the ICRAA, if a person takes adverse action against an employee as a result of receiving consumer information, the person must provide the employee with a copy of the public record. Also, the employer must give the employee the opportunity to elect not to get a copy of the report by using a box to check on the application for employment or some other document. Also, consider the fact that the "Megan's Law" website

did not provide the dates of conviction. We believe the law prohibits obtaining any information more than seven years old even if you obtain it yourself, as opposed to obtaining it through an agency. Even more troubling is the fact that the "Megan's Law" website contains a serious disclaimer explaining that the information contained on the website may not even be accurate. The website also states that it is illegal to use the information for employment purposes unless the information is used to "protect a person at risk." Violation of the Megan's Law use restriction is a crime.

NOTE

REGARDING THIRD PARTY SERVICE PROVIDERS: To limit your liability, use third-party service providers to conduct background checks. Also, if you collect consumer information about a current or prospective employee that makes you want to discipline or terminate the employee, contact labor and employment counsel to ensure you're complying with the law.

Public Records Investigation

In a situation where a dealer does not use the services of an investigative consumer reporting agency, but is involved in any collection, assembly, evaluation, compilation, report, transmittal, transfer or communication of information from "public records" on a consumer's character, general reputation, personal characteristics or mode of living for employment purposes, the dealer must comply with the requirements of California law as stated in Civil Code section 1786.53. This statute requires that any related public record information must be provided to the consumer within 7 days after the dealer receives the information, regardless of whether the information is received in a written or oral form. Nothing in this statute requires a dealer to provide the same information to any consumer on more than one occasion. For purposes of this statute, the term "public records" is defined to mean "records documenting an arrest, indictment, conviction, civil judicial action, tax lien or outstanding judgment."

Another requirement of the statute is that a dealer must provide on any job application form, or any other written form, a box that if checked by the consumer permits the consumer to waive his or her right to receive a copy of any public record obtained pursuant to this statute. To the extent that a dealer is obtaining a public record for the purposes of conducting an investigation for suspicion of wrongdoing or misconduct by the subject of the investigation, the statute authorizes a dealer to withhold the information until the completion of the investigation. Once the investigation is completed, a dealer is required to provide a copy of the public information within 7 days, unless the consumer has waived his or her right to receive the information.

CAUTION

REGARDING ADVERSE ACTION BASED ON PUBLIC RECORDS: If a dealer takes any adverse action as a result of receiving a public record, the dealer must provide to the consumer a copy of the public record regardless of whether or not the consumer waived his or her right to receive the information (Civil Code section 1786.53(b)(4)). Adverse action for purposes of this statute means a denial of employment or any decision made for an employment purpose that adversely affects any current or prospective employee (Civil Code section 1786.53(a)(1)).

CAUTION

REGARDING WORKPLACE INVESTIGATIONS: Recent court decisions have emphasized that employers should conduct prompt and thorough investigations of harassment complaints to best protect against vicarious liability relating to such matters under Title VII of the Civil Rights Act of 1964 (42 U.S.C. section 2000e et seq.) (see for example the United States Supreme Court decision in* Burlington Industries v. Ellerth *(1998) 524 U.S. 742). However, in conducting such investigations, dealers must be careful to comply with any applicable requirements of the FCRA, CCRAA and ICRAA. Dealers should carefully consider each complaint to properly assess the best investigative approach to be taken and consult legal counsel regarding compliance issues.

Adverse Action regarding Employment

Under federal law, before a dealer can take any adverse action in the employment context (basically meaning a denial of employment or other decision that adversely affects any employee or applicant (15 U.S.C. section 1681a(k)) based in whole or in part on a consumer report (including an investigative consumer report), the dealer must provide to the employee or applicant the following:

1. A copy of the report, and
2. A written description of consumer rights under the FCRA–to satisfy this requirement dealers should use the form developed by the federal Consumer Finance Protection Bureau (the agency now in charge of enforcing the FCRA)

After a reasonable amount of time (enough to allow the employee or applicant to review and challenge the report) has passed, if adverse action is

taken, a dealer must satisfy further notification and disclosure requirements. Basically under the combined requirements of federal and California law, a dealer must provide written notice of the adverse action to the consumer which includes the following information (even though some of it is in effect a duplication of prior information provided):

1. That the adverse action has been taken based in whole or in part on a consumer report received from a consumer reporting agency;
2. The name, address and telephone number (the toll-free number if applicable) of the consumer reporting agency that furnished the report as well as a website address or, if that is not available, a phone number, directing the consumer to information about the consumer reporting agency's privacy practices;
3. A statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the adverse action was taken;
4. A statement that the consumer has the right to obtain a free copy of the consumer report within 60 days of the consumer's receipt of this notice; and
5. That the consumer has the right to dispute with the consumer reporting agency the accuracy or completeness of any information in the report furnished by that agency (15 U.S.C. section 1681m(a); Civil Code sections 1785.20.5(b) and 1786.40(a)).

Also, any time an employee's or applicant's individual numerical credit score is used in whole or in part to deny employment or take adverse employment action, in addition to the above disclosures, the employer must give the individual additional written or electronic notice of:

1. the numerical credit score the employer used when taking the adverse action;
2. the range of possible credit scores under the credit scoring model used;
3. the date on which the credit score was created;
4. the name of the person or entity that provided the credit score or the credit file used to create the credit score; and
5. the key factors, listed in the order of importance, which adversely affected the consumer's credit score in the credit score model used.

Any dealer taking adverse employment action on this basis should consult with counsel before doing so to ensure compliance with these strict disclosure requirements.

CAUTION

A California law took effect in 2012 to further limit the use of credit reports for employment purposes. Under Labor Code 1024.5, an employer or prospective employer may not use a credit report for employment purposes unless a specific exception applies. However, the rule does not apply to entities subject to the federal Gramm Leach Bliley Act's information privacy and safeguard laws–which apply to dealerships that offer credit for consumer vehicle purchases or arrange for consumer financing. Additional exceptions that may apply to dealerships include: (1) managerial positions covered under the exception for executives; (2) positions involving regular access to bank, credit card account, and other confidential or proprietary information; (3) positions authorized to enter into financial contracts on behalf of the employer or who are named signatories on the employer bank or credit accounts; and (4) positions involving regular access to at least $10,000 in case of the employer, customer, or client during the workday. This list is not exhaustive, and other exceptions may apply. Although Labor Code 1024.5 may not apply to most dealerships, any doubts about the applicability of the statute should be discussed with counsel.

NOTE

REGARDING EMPLOYEE MISCONDUCT INVESTIGATIONS INVOLVING ADVERSE ACTION: The newly enacted Federal FACT Act requires that certain disclosures must be made to an employee when adverse action is taken based on an investigative consumer report, even when the employee is suspected of misconduct. Specifically, the employer must provide a summary of the report to the employee describing the nature and substance of the investigation. The summary does not have to include the identity of the sources of the information utilized in the report.

Penalties for Noncompliance / Statute of Limitations

A failure to comply with the various notice, disclosure and authorization requirements of the FCRA, CCRAA, and ICRAA in the context of employment matters, may give rise to significant liability on the part of a dealer. In the event of a violation, an employee or applicant may seek injunctive relief and recover actual or liquidated damages, penalties, attorney's fees and costs, and even punitive damages under appropriate circumstances (15 U.S.C. sections 1681n and 1681o; Civil Code sections 1785.31 and 1786.50). It may be possible for a

dealer to avoid liability for some violations where it can be established by a preponderance of the evidence that at the time of the alleged violation reasonable procedures were maintained by the dealer to assure compliance (15 U.S.C. § 1681m(c); Civil Code section 1785.20.5). The statute of limitations for bringing a claim for violation of the FCRA, CCRAA or ICRAA is basically 2 years. Where there is a willful and material misrepresentation of information that in effect conceals the violation, a legal action may be brought within 2 years of the consumer's discovery of the misrepresentation (15 U.S.C. section 1681p; Civil Code sections 1785.33 and 1786.52).

INSURANCE

Chapter 4

Contents

INSURANCE

OVERVIEW: Insurance is an issue which affects many facets of the dealership business, including vehicle sales and servicing. In this connection, the legal rights and duties of the dealer are defined by the California Insurance Code, California Vehicle Code, and regulations promulgated by the Insurance Commissioner and the Department of Motor Vehicles.

This chapter will summarize a variety of laws which are pertinent to the dealer's rights and duties relating to insurance, and will discuss, where applicable, the practical effect of the law upon the operation of the dealership business.

Insurance Transactions Arising from Vehicle Sales and Leases

Introduction

It is common for the dealer to write various types of insurance coverage for the customer in connection with the sale of a motor vehicle. This can involve coverage for life, disability, or automobile collision and comprehensive. The dealer in this capacity is an insurance agent and is therefore subject to the provisions of California law governing insurance agents. This section shall deal with the provisions of the law pertinent to the dealer as an insurance agent, and will cover the areas of licensing and solicitation. Insurance disclosure requirements in connection with vehicle sales will receive a limited discussion in this chapter. Additional information regarding insurance disclosure requirements is contained in the earlier chapter in this Management Guide entitled “Automobile Sales Finance Act.”

Licensing Requirements

License

Every dealer who enters into a motor vehicle insurance transaction must be licensed to transact insurance as an agent or broker, or both, unless he or she receives no commission, dealer reserve, or bonus dependent directly or indirectly upon insurance, and the insurance is personally transacted by a dealer's subsidiary or other licensee (10 California Code of Regulations section 2110).

For the purpose of this licensing requirement, a motor vehicle insurance transaction is defined as (a) any sale of a motor vehicle which includes in the cash or time-selling price of such motor vehicle, a premium for insurance covering any interest in the vehicle, and (b) any loan where the security for the repayment for all or any portion thereof is a lien or encumbrance upon a motor vehicle and which loan agreement includes a premium for insurance covering any interest of the borrower or mortgagor therein (10 Calif. Code of Regulations section 2109).

There are currently several types of licenses issued by the California Department of Insurance for an insurance agent of broker. First, a fire and casualty broker-agent license which authorizes its holder to act as an insurance agent, except for life insurance (Insurance Code section 1625). Second, a life agent license which authorizes its holder to act as a life agent for purposes of life insurance or accident insurance (Insurance Code section 1626). Third, a Personal Lines Broker-Agent License, which permits the holder to transact automobile insurance as defined in Insurance Code section 660, including insurance for recreational vehicles used for non-commercial purposes, personal watercraft insurance and residential property insurance (Insurance Code section 1625.5). Fourth, a limited lines automobile insurance agent license, which permits the holder to transact only automobile insurance as defined in Insurance Code section 660 (Insurance Code section 1625.55)

Additionally, a credit insurance agent license has been established. This is a license for those who receive a commission for selling credit life insurance, credit disability insurance, credit involuntary unemployment insurance or credit loss-of-income insurance, or credit property insurance for a loan or extension of credit other than a loan for a term not to exceed 10 years and for an amount not exceed $60,000. Employees of the holder of the license can be “endorsed” on the license after completing specified training requirements. For longer terms or higher value loans, an employee would be required to obtain a full agent’s license. Credit insurance agents are required to make specific disclosures to consumers, on a separate form, if the sale coincides with a credit transaction, to be acknowledged in writing by the purchaser. (Insurance Code section 1758.9 et seq.).

NOTE

ON WHETHER INSURANCE LICENSE REQUIRED FOR SALE OF SERVICE CONTRACTS: A service contract will not be deemed insurance – and therefore no insurance license will be required for the sale of that product – if, prior to July 1, 2004, this service contract complies with Insurance Code section 116(c) or 116(d), or after July 1, 2004, the service contract complies with Insurance Code sections 12800.5 et seq.* (Insurance Code section 116). *An expanded discussion of service contracts is contained in the chapter entitled "Service Contracts."

NOTE

ON WHETHER INSURANCE LICENSE REQUIRED FOR SALE OF GAP CONTRACTS: While the California Department of Insurance and CNCDA previously had disagreements on the treatment of GAP contracts under California's credit insurance laws, recent legislation successfully resolved these disagreements. Under Insurance Code sections 1758.96 and 1758.992, a GAP contract is considered a debt cancellation agreement, and not credit insurance, as long as it is included as part of a conditional sale contract or lease agreement for a vehicle sold or leased by a dealer, and meets certain other requirements. Most standard dealer GAP contracts will fall under this exemption, but more exotic GAP contracts should be reviewed by competent counsel before sale.

Dealer's employees: Every employee or salesman of a licensed dealer or dealer's subsidiary must be licensed to transact insurance unless (a) he or she is a regularly salaried administrative or clerical employee who devotes substantially all of his or her services to activities other than the solicitation of insurance from the insuring public and receives no commission on insurance, directly or indirectly; or (b) he or she devotes substantially all of his or her activities to selling merchandise and his or her solicitation of insurance of limited only to the quoting of a premium for insurance, to be included in the purchase price, covering the interest retained in such merchandise by the dealer, and he or she receives no commission on insurance, directly or indirectly. (10 California Code of Regulations section 2112).

NOTE

ON DEALER RESPONSIBILITY FOR VIOLATIONS: Whether the employee is licensed or not, the licensed dealer will be responsible for violations of the Insurance Code committed by the employee if the violations are permitted by the dealer (10 Calif. Code of Regulations section 2113).

Dealer as an organization: If the dealer is an organization (such as a corporation or a limited liability company), the organization will be the holder of the license which is issued, but only the natural persons named on the organization's license will be permitted to exercise the agency or brokerage powers of the organization (Insurance Code section 1627). The natural person named on the organization's license must meet all of the qualifications required for the issuance of that type of license (Insurance Code section 1628).

Application: A license must be applied for and renewed by filing with the Insurance Commissioner a written application on a form supplied by the Commissioner (Insurance Code section 1652). In the case of the dealer corporation, the application must contain the names of all persons who may exercise the power and perform the duties under the license, the names and addresses of all stockholders owning 10 percent or more of the corporation's stock, and the names and addresses of all officers and directors of the corporation (Insurance Code sections 1656 and 1656.1). In the case of a limited liability company, the application must contain the names and addresses of all members owning 10% or more of the membership interests of the limited liability company, and of all managers, officers, and directors, if any, of the limited liability company (Insurance Code section 1656.2).

Penalty for acting without a license: Any person who transacts insurance without a valid license so to act is guilty of a misdemeanor punishable by a fine not exceeding $50,000 or by imprisonment not exceeding one year, or both (Insurance Code section 1633).

Pre-Licensing and Continuing Education Requirements

Fire and Casualty Agent: Applicants for a fire and casualty insurance broker-agent license must complete pre-licensing education of forty (40) hours of classroom study of approved curriculum (Insurance Code section 1749(a)) and twelve (12) hours of study of ethics and the Insurance Code (Insurance Code section 1749(f)). Thereafter, within the first four years after an individual's license has been issued, that individual shall complete courses, programs of instruction or seminars equivalent to a minimum of twenty-five (25) hours of classroom instruction per year (Insurance Code section 1749.3). Once an individual has complied with this requirement, that individual shall complete thirty (30) hours worth of courses, programs of instruction

or seminars prior to the next renewal of his/her license (Insurance Code section 1749.3).

Life Agent: Applicants for a life agent license must complete pre-licensing education of twenty (20) hours of classroom study of approved curriculum (Insurance Code section 1749(c)) and twelve (12) hours of study ethics and the Insurance Code (Insurance Code 1749(f)). Thereafter, within the first four years after an individual's license has been issued, that individual shall complete courses, programs of instruction or seminars equivalent to a minimum of twenty-four (24) hours of classroom instruction per year (Insurance Code section 1749.33). Once an individual has complied with this requirement, that individual shall complete thirty (30) hours worth of courses, programs of instruction or seminars prior to the next renewal of his/her license (Insurance Code section 1749.4).

Personal Lines Broker-Agent: Applicants for a personal lines broker-agent must complete pre-licensing education of twenty (20) hours of classroom study of approved curriculum (Insurance Code section 1749(b)) and twelve (12) hours of study of ethics and the Insurance Code (Insurance Code section 1749(f). Thereafter, the licensed individual shall complete twenty-four (24) hours of classroom study of approved curriculum during each two-year license term (Insurance Code section 1749.31(a)). If the individual is also licensed as a life agent, the requirement is twenty-four (24) hours prior to renewal (Insurance Code section 1749.31(b)).

Limited Lines Automobile Insurance Agent: Applicants for a limited lines automobile insurance agent license must complete pre-licensing education of twenty (20) hours of classroom study of approved curriculum (Insurance Code section 1749(e)) and twelve (12) hours of study of ethics and the Insurance Code (Insurance Code section 1749(g)). Thereafter, the licensed individual shall complete at least twenty (20) hours worth of courses, programs of instruction or seminars prior to renewal (Insurance Code section 1749.32(b)).

NOTE

ON WHETHER APPLICANT SEEKS MORE THAN ONE LICENSE: If an applicant seeks more than one license, it need only complete one 12-hour course on ethics and the Insurance Code **(Insurance Code section 1749(g)).**

Limited Exemption from Continuing Education Requirements

An individual is exempted from the educational requirements if he or she submits acceptable proof to the insurance commissioner that he or she has been a licensee in good standing for 30 continuous years in California and is 70 years of age or older. **This exemption does not apply to any person licensed for the first time on or after January 1, 2010** (Insurance Code section 1749.3(c)).

Termination of License for Failure to Comply with Continuing Education

Any person failing to meet the continuing education requirements outlined above, and who has not been granted an extension of time within which to comply with those requirements, shall have his or her license automatically terminated until the time that the person demonstrates that he or she has complied with all of the continuing education requirements and all other laws applicable thereto. (Insurance Code section 1749.6).

Appointment on File

In addition to obtaining a license, the dealer, before transacting insurance, must also have on file with the Insurance Commissioner a document executed by the insurer or its authorized representative appointing the dealer as its agent in this State (10 Calif. Code of Regulations section 2111).

Display of License Number

All insurance licensees must prominently affix or cause their license number to be printed on business cards, written price quotations, and advertisements distributed in the state for insurance products. The license number must be in type the same size as any indicated telephone number, address, or fax number. If the insurance licensee maintains more than one organization license, one of the organization license numbers is sufficient for compliance. And, effective January 1, 2005, all such business cards, written price quotations, and advertisements must also prominently include the word "Insurance" in type size no smaller than the largest indicated telephone number. The fine for noncompliance is two hundred dollars ($200) for the first offense, five hundred dollars ($500) for the second offense, and one thousand dollars ($1,000) for the third and subsequent offenses (Insurance Code section 1725.5).

Internet Advertising

A person who is licensed in the state as an insurance agent or broker, who advertises insurance on the Internet, and who transacts insurance in California, shall identify all of the following information on the Internet, regardless of whether the insurance agent or broker maintains his or her Internet presence, or if the presence is maintained on his or her behalf:

1. His or her name as it appears on his or her insurance license, and any fictitious name approved by the commissioner;

2. The state of his or her domicile and principal place of business; and

3. His or her license number.

A person shall be deemed to be transacting insurance in California when the person advertises on the Internet, regardless of whether the insurance agent or broker maintains his or her Internet presence or if it maintained on his or her behalf, and does any of the following:

1. Provides an insurance premium quote to a California resident;

2. Accepts an application for coverage from a California resident; or

3. Communicates with a California resident regarding one or more terms of an agreement to provide insurance or an insurance policy. (Insurance Code section 1726).

Change in Licensee's Background Information

A licensee or applicant for a license-whether an individual or a dealer corporation- must notify the insurance commissioner when any "background information" for the applicant or licensee changes after the application has been submitted or license issued. The notification to the commissioner must be in writing and sent within 30 days of the date the applicant or licensee learns of the change in the background information.

For purposes of this requirement, "background information" means a misdemeanor or felony conviction; a filing of felony criminal charges in state or federal court and administrative action regarding a professional or occupational license; a licensee's discharge or attempt to discharge in a bankruptcy proceeding, an obligation regarding any insurance premiums or fiduciary funds owed to any company; in any admission or judicial finding or determination, of fraud, misappropriation or conversion of funds, misrepresentation, or breach of fiduciary duty (Insurance Code section 1729.2).

License Termination

Surrender: A dealer may at any time surrender the license to the Insurance Commissioner for cancellation, or by written notice to the Commissioner, if the license is in the possession of an employee (Insurance Code section 1708).

Denial and Revocation: The Insurance Commissioner may deny, suspend or revoke the license upon a variety of grounds, including the licensee's commission of a felony or a fraudulent act, or violation of the provisions of the Insurance Code (Insurance Code sections 1738, and 1668-1669).

In the case of a dealer which is an organization, such as a corporation or limited liability company, if the wrongful act justifying revocation is committed by the natural person named on the organization's license, the commissioner may revoke the license of the organization (Insurance Code section 1739).

Termination of appointment: Upon cancellation of all appointments of a dealer licensed as an insurance agent, the dealer's license shall not be cancelled but shall become inactive. The dealer cannot transact any insurance until such time as the license is reactivated, through a new appointment or the dealer's applying for a license renewal (Insurance Code section 1704(b)).

Dissolution of corporation or limited liability company: If the dealer is a corporation or a limited liability company, the right of the dealer and its employees to transact insurance will automatically terminate upon the dissolution of the corporation or the limited liability company. The corporation or the limited liability company may, however, continue to transact insurance under an existing license in a different capacity (Insurance Code sections 1711-1712).

Dealer's Legal Duties

Motor Vehicle Insurance

Quotation of rates: Every dealer shall use due care in obtaining full information necessary to the quotation of the rate for the insurance and in the quotation of such rate. No dealer shall knowingly or willfully make any misquotation of a premium or rate, nor quote a premium or rate for a particular kind of insurance or for a particular insurer without a reasonable expectation that such kind of insurance at the rate quoted can be lawfully procured by him or her from such insurer (10 Calif. Code of Regulations section 2114.7).

Adjustments: Every dealer must within a reasonable time after entering into a motor vehicle insurance transaction compare the gross premium, insurance coverage, and the term thereof set forth in the Statement of Insurance (See the section entitled "INSURANCE DISCLOSURES" later in this chapter) with the policy or certificate of insurance issued by the insurer. In the event there is a difference in the coverage or term between the Statement of Insurance and the policy, the dealer must adjust the coverage or term in the policy to conform to the Statement of Insurance by securing any necessary endorsement from the insurer. The dealer must also adjust any difference in the premium by making a refund or additional charge, as the case may be, to

the retail purchaser so that the charge for insurance coverage in the Statement of Insurance conforms to the premium set forth in the policy or certificate of insurance. Any adjustment which involves an increase in the premium is governed by the provisions of Civil Code section 2984. Otherwise any refund herein referred to may be made only in the following ways:

a. By cash or check, immediately,

b. By crediting the next payments due on the purchaser's contract of sale, or

c. By crediting the last payments due on the purchaser's contract of sale; in which event such refund shall include a refund of all finance, interest, time price differential, service charges or other fees properly allocable to the amount of the refund from the inception of the contract.

d. If the contract of sale has been assigned, sold or transferred, by payment to the holder thereof with instructions to credit or pay the refund in any one of the three preceding alternative ways (10 Calif. Code of Regulations section 2115).

Delivery of policy: Where an insurer executes a policy or certificate evidencing insurance and delivers the original or a true copy thereof to a dealer for transmittal to the purchaser, it shall be the duty of the dealer to deliver such original or copy to the purchaser and to each owner of the motor vehicle. Where insurance coverage is evidenced by a policy or certificate executed by the dealer, it shall be the duty of the dealer to deliver the original or a true copy thereof to the purchaser and to each owner of the motor vehicle (10 Calif. Code of Regulations section 2125).

Return premium: Every licensed dealer who, in connection with a motor vehicle transaction, effects the cancellation of an existing insurance policy pursuant to written authority from the purchaser and takes from the purchaser an assignment of the return premium thereon, or who, in connection with such transaction, takes from the purchaser an assignment of any return premium which may develop upon a future cancellation shall, in either event, upon such cancellation apply the full amount of the gross return premium toward the purchase of replacing insurance required by the contract of sale; except that if the amount thereof be in excess of the amount required for replacing insurance, if there be no replacing insurance, or if the premium for such replacing insurance is not included in any contract of sale, such excess or such gross return premium, as the case may be, shall be refunded to the purchaser in one of the following ways:

a. By cash or check, immediately,

b. By crediting the next payments due on the purchaser's contract of sale, or

c. By crediting the last payments due on the purchaser's contract of sale; in which event such refund shall include a refund of all finance, interest, time price differential, service charges or other fees properly allocable to the amount of the refund from the inception of the contract.

d. If the contract of sale has been assigned, sold or transferred, by payment to the holder thereof with instructions to credit or pay the refund in any one of the three preceding alternative ways (10 Calif. Code of Regulations section 2122).

Form of assignment to dealer: The assignment referred to in section 2122 shall be in writing and shall contain, in substance, the following provision:

"In consideration of allowing me credit for the full amount of the gross return premium on Policy No._____ covering my 19__ automobile, I hereby assign to_____ all my right, title and interest in and to such return premium."

A signed copy of such assignment shall be retained by the person taking the assignment in the records and files of his or her insurance transactions (10 Calif. Code of Regulations section 2123).

Remission of premium: A licensed dealer must not enter into any contract or other arrangement pursuant to which a premium for insurance, which is included in the unpaid balance of a contract of sale, is not remitted to the insurer or person entitled thereto within 90 days after the execution of such contract. If the premium is not so actually remitted to the insurer within the 90 days, the dealer will be responsible for the refund to the purchaser of the finance, interest, time-differential, service charge, or any other fee based upon such premium for any period of time prior to the premium's actual remission. Such refund shall be made in the same manner as provided in section 2115 (10 Calif. Code of Regulations section 2121.5).

Record keeping: Every licensed dealer shall maintain, separate from the records of other business transactions, a ledger, book or card record of insurance business transacted under the authority of his or her license, which shall set forth at least the following information:

a. Name of insurer.

b. Policy or certificate number.

c. Name of insured and of purchaser.

d. Effective and termination dates.

e. Kind of coverage.

f. Amount of gross premium.

g. Amount of commission.

h. Amount of net premium.

i. Date of cancellation.

j. Amount of gross return premium and disposition thereof.

k. Any addition or reduction in original premium by reason of endorsement.

l. Names of persons to whom commissions are paid or allowed and the amount of each (10 Calif. Code of Regulations section 2116).

In the event a dealer transacts insurance where the premium is not included in the motor vehicle insurance transaction, the dealer must maintain, in addition to the foregoing information, the dates of payment of premium by the insured and the date of payment of premium to the insurer (10 Calif. Code of Regulations section 2117).

Penalties: Any violation of the foregoing duties on the part of the dealer is grounds for the suspension, revocation or denial of the dealer's insurance agent license (10 Calif. Code of Regulations section 2127).

Credit Life/Disability Insurance

In the event the dealer enters into a retail sales contract with the purchaser which includes credit life or credit disability insurance, the dealer must adhere to certain requirements of the California Insurance Code.

Maximum amounts: The initial amount of credit life insurance must at no time exceed the unpaid amount financed plus earned interest, and, where the indebtedness is repayable in substantially equal installments, the amount of insurance must at no time exceed the greater of the scheduled or the actual unpaid amount financed plus earned interest. The total amount of periodic indemnity payable by credit disability insurance in the event of disability must not exceed the aggregate of the periodic scheduled unpaid installments, and the amount of each periodic indemnity must not exceed the original indebtedness divided by the number of periodic installments (Insurance Code section 779.4).

Delivery of policy: The credit life insurance or credit disability insurance policy must be evidenced by an individual policy or certificate of insurance, and the policy or certificate must be delivered to the purchaser. If the individual policy or certificate is not delivered to the purchaser at the time the insurance commences, a copy of the application for such policy, or a notice of proposed insurance, signed by the purchaser and setting forth all information pertinent to the policy, must be delivered to the purchaser at the time the indebtedness is incurred, or at the time the purchaser applies for the insurance, whichever is later (Insurance Code section 779.7).

NOTE

ON RESPONSIBILITY TO DELIVER POLICY: Although the foregoing code sections are not clear whether the insurance company or the dealer has the burden of delivering the policy or the application for such policy to the purchaser, Insurance Code section 779.7 does state that if it is the application for the policy which is first delivered to the purchaser, the insurance company has the burden of delivering the policy to the purchaser upon acceptance of the insurance by the insurance company and within thirty days of the date upon which (1) the indebtedness is incurred, (2) the application for such insurance is received by the insurance company, or (3) the insurance company determines the evidence of insurability to be satisfactory.

Required statement regarding pre-existing health condition: Every application for, certificate of, and policy of credit life or credit disability insurance shall set forth a statement in bold capital letters indicating that any pre-existing health condition of the applicant may render the coverage void, if that is the case (Insurance Code section 10127.5). It should be noted that this requirement is not in the alternative, and that each of the specified documents must contain the required statement in bold letters.

Delivery of statement of obligations in connection with the sale of disability insurance: Civil Code sections 1812.400 through 1812.409 require that a dealer selling disability insurance give to the customer at the time of sale a statement in writing in at least 10-point type which sets forth the claim procedure to be followed by the customer and his or her rights and duties in the event of a disability during the policy period. The required notice may be given in a separate statement or may be included in the conditional sale contract or purchase money security agreement. Because of the length of the notice and the limited space available on existing conditional sale contract forms, it is anticipated that a separate notice will be utilized. If the contract forms you utilize do not contain the notice, forms of a separate notice should be available from the disability carriers, or in the alternative, the language of the notice is clearly set forth in Civil Code section 1812.402(f)(1).

The above law prohibits a creditor from repossessing a customer's vehicle during a "disability claim period," which is defined as the period beginning on the due date of the first payment not paid by the customer for which the customer claims disability coverage arising from a then current disability and continuing until three calendar months thereaf-

ter or until the insurer pays or rejects the claim, whichever occurs sooner .

If the insurance company pays the claim during the claim period, no late charges may be assessed. If the insurance company rejects the customer's claim or only partially pays it, the customer is given an additional 35 days following receipt of notice of rejection or partial payment to pay the amount owing, during which time repossession is further prohibited, although late charges may be assessed with respect to the amount owing.

A creditor under the law means the seller, lessor, or lender of money who has participated in the sale of disability insurance to the buyer, lessee, or borrower providing indemnity for payments becoming due on a credit transaction and the assignee of the seller, lessor, or lender. Thus, under the law both the dealer and its assignee are creditors prohibited from repossessing a vehicle during a disability claim period.

The law requires a dealer upon receiving notice of a buyer's claim of disability to inform the buyer in writing of the name, address, and telephone number of the insurer or its designated representative from whom the buyer may obtain claim forms. More likely than not, this notice will actually first come to the attention of the assignee of the contract, and the assignee will be the one that will be required to supply this information to the buyer. Civil Code section 1812.401 defines "Notice" to a creditor as written notice deposited in the mail, postage prepaid, to the creditor at the location where payments are required to be made by the buyer. If it should happen that the customer first advises the dealer of his or her claimed disability, however, it would still be advisable for the dealer to give this information to the buyer.

Duty to refund in the event policy is never issued and in the event the policy is terminated: If the purchaser makes any payment for a credit life insurance or credit disability insurance policy, and the policy is never issued, the dealer or the dealer's assignee must give immediate written notice to the purchaser and promptly make an appropriate credit to the next payments due on the purchaser's account (Insurance Code section 779.15). In the event the credit life or credit disability policy is terminated prior to the scheduled maturity date of the indebtedness, any refund of the amounts paid by the purchaser for insurance as calculated in accordance with formulas approved by the Insurance Commissioner must be paid promptly to the person entitled to it or credited to the next payment or payments due on the indebtedness (Insurance Code section 779.14). The appropriate refund formula for the type of policy involved may be found in 10 California Code of Regulations section 2248.38.

NOTE

ON RIGHT TO RESCIND WITHIN 30 DAYS: Insurance Code section 779.14(b) requires individual policies and group certificates of credit life and disability to allow a debtor to rescind the insurance within 30 days of receipt of the policy or certificate or the notice of proposed insurance issued pursuant to Insurance Code section 779.7 and receive a full refund, or credit (if financed) of any premium that has been paid. This Code section requires that the right to rescind shall be disclosed on the face of the policy or certificate or notice of proposed insurance in at least 14-point type, and shall include the disclosure of the Department of Insurance's toll-free telephone number and other disclosures required by Insurance Code section 510.

Purchaser's right to cancel insurance and duty to refund premium: Insurance Code section 779.31 gives the purchaser the right to terminate credit life insurance or credit disability insurance at any time for any reason upon notice to the creditor. A refund shall be paid or credited as provided above in the event of termination of coverage.

Maintaining Insurance Premium Funds

Dealer as fiduciary: All funds received by the dealer as an insurance agent for premiums or returned premiums under any policy of insurance are received and held by the dealer in a fiduciary capacity. In this connection, the dealer will be acting as a fiduciary to both the insurer and the insured (Insurance Code section 1733).

Separate trust bank account: All such fiduciary funds, after receipt by the dealer, must be remitted to the insurer or person entitled thereto or be maintained by the dealer in a separate trust bank account, which may include a checking account, demand account or savings account, so long as it is designated as a trust account. The dealer may place additional funds in the account for the purpose of advancing premiums, establishing reserves or for such other contingencies as may arise (Insurance Code section 1734).

Alternative to trust account: In lieu of maintaining the fiduciary funds in a trust bank account, the dealer may place the funds in United States government bonds and treasury certificates, certificates of deposit of banks or savings and loan institutions, in repurchase agreements collateralized by United States government securities, or in bonds and other obligations of the State of California or of certain, specified local agencies or districts, provided the bonds or obligations have a maturity of not more than one year or give the holder the unilateral right to redeem within one year, and pro-

vided the bonds or obligations contain the minimum ratings set forth by law. A written agreement must be obtained from every insurer, or other person entitled to funds, authorizing the dealer to maintain the funds in this manner and retain any earnings accruing on the funds. Any investment losses are the responsibility of the dealer and the obligation of the dealer to the insurers or other persons entitled to the trust account funds shall not in any way be diminished due to the investment loss. (Insurance Code section 1734.5).

Penalties: Any failure to maintain the insurance premium funds in the manner set forth above may result in the suspension or revocation of the dealer's insurance agent license. Furthermore, any person who diverts or appropriates the funds for his or her own use is guilty of theft and may be punished for theft as provided by law (Insurance Code sections 1733 and 1738).

Insurance Disclosures

Written statement to purchaser: Every licensed dealer must, at the time of each motor vehicle insurance transaction, deliver to the buyer a written statement, denominated a "Statement of Insurance," separate from the insurance policy itself. This statement must be signed by the dealer and the buyer and must specify the following information:

a. The kind of insurance coverage.

b. The amount of the gross premium for each kind of coverage, and the aggregate gross premium.

c. The term of such insurance coverage. In the event the term of any insurance coverage expires prior to or continues after the expiration date of the contract of sale, that fact shall be clearly stated.

d. A notice informing the buyer that he or she need not negotiate or purchase insurance through any particular agent or broker as a condition precedent to financing the purchase of the vehicle.

The statement must be in type not less than 10 point, unless it is included in the same document as the conditional sale contract (which is usually the case), in which event it must be in type not less than 8 point. In those instances where insurance is sold in connection with the cash sale of a motor vehicle, a separate statement of insurance must be provided to the purchaser. The dealer should retain a copy of this statement for his or her insurance transaction records (10 Calif. Code of Regulations section 2114).

Liability insurance disclosure: Civil Code section 2984.1 requires that every conditional sale contract shall contain a statement in contrasting red print in at least 8-point bold type which reads as follows:

THE MINIMUM PUBLIC LIABILITY INSURANCE LIMITS PROVIDED IN LAW MUST BE MET BY EVERY PERSON WHO PURCHASES A VEHICLE. IF YOU ARE UNSURE WHETHER OR NOT YOUR CURRENT INSURANCE POLICY WILL COVER YOUR NEWLY ACQUIRED VEHICLE IN THE EVENT OF AN ACCIDENT, YOU SHOULD CONTACT YOUR INSURANCE AGENT.

WARNING:
YOUR PRESENT POLICY MAY NOT COVER COLLISION DAMAGE OR MAY NOT PROVIDE FOR FULL REPLACEMENT COSTS FOR THE VEHICLE BEING PURCHASED. IF YOU DO NOT HAVE FULL COVERAGE, SUPPLEMENTAL COVERAGE FOR COLLISION DAMAGE MAY BE AVAILABLE TO YOU THROUGH YOUR INSURANCE AGENT OR THROUGH THE SELLING DEALER. HOWEVER, UNLESS OTHERWISE SPECIFIED, THE COVERAGE YOU OBTAIN THROUGH THE DEALER PROTECTS ONLY THE DEALER, USUALLY UP TO THE AMOUNT OF THE UNPAID BALANCE REMAINING AFTER THE VEHICLE HAS BEEN REPOSSESSED AND SOLD.

FOR ADVICE ON FULL COVERAGE THAT WILL PROTECT YOU IN THE EVENT OF LOSS OR DAMAGE TO YOUR VEHICLE, YOU SHOULD CONTACT YOUR INSURANCE AGENT.

THE BUYER SHALL SIGN TO ACKNOWLEDGE THAT HE/SHE UNDERSTANDS THESE PUBLIC LIABILITY TERMS AND CONDITIONS.
S/S _____.

Revision or correction of contract: If a contract of sale be revised or corrected after its original execution and at a time when the purchaser is not present at the premises of the dealer, the requirement of 10 Calif. Code of Regulations section 2114 with respect to the signing of the Statement of Insurance by the purchaser shall be deemed complied with if the dealer promptly mails to the purchaser at his or her last known address, two signed copies of said statement with a request to the purchaser that he or she execute and return one of them (10 Calif. Code of Regulations section 2114.3).

Physical Damage Insurance Disclosures

Every dealer who, in conjunction with the sale or lease of a vehicle, sells the transferee a physical damage insurance policy that does not also insure the transferee against damages resulting from ownership or operation of the vehicle arising by reason of personal injury or death of any person, or from

damage to property, must notify the transferee of that fact in a document other than the insurance policy. The notice must be printed in both English and Spanish, it must be signed by the transferee, and an exact copy must be furnished to the transferee at the time of signature. The document must contain the following notice in both English and Spanish in at least 10-point type:

"INSURANCE WARNING

The motor vehicle physical damage insurance policy you are buying does not allow you to legally drive on the streets of California. Generally, in order to legally drive on the streets of California, you must either purchase a type of insurance called "liability insurance" or deposit a bond with the Department of Motor Vehicles. If you drive this or any other motor vehicle without liability insurance or a bond, a police officer may request evidence of liability insurance or a bond at the time of a traffic stop. If you do not have evidence of liability insurance or a bond during a traffic stop, the fines can be from several hundreds of dollars to an amount that exceeds $1,000. If you get into an accident and do not have liability insurance or a bond, you will lose your driver's license for one year. If you cause the accident and do not have liability insurance or a bond, you may have to pay the injured person yourself and these costs may be substantial.

Liability insurance as well as the insurance needed to obtain a loan for your motor vehicle may be purchased through a licensed insurance agent or broker. The price for both types of insurance may be more or less than the price for the insurance you are being offered by the dealer. The State of California advises you to shop for insurance because prices may vary substantially.

I have read this notice and understand that I am about to buy a type of insurance that is available elsewhere and that does not allow me to drive the motor vehicle legally on the streets of California.

I also understand that if I drive on the streets of California without liability insurance or a bond, then I may be subject to severe financial penalties, including fines and personal payment for any damage to others that I may cause while driving.

Dated:_____

Signed:_____"

The DMV is required to make available a translation of the above notice in any of the languages used in the most recent statewide voter pamphlet. (Vehicle Code section 5604.5).

Prohibited Conduct and Problem Areas

Solicitation

The Federal Trade Commission has issued warnings to finance companies and automobile dealers against illegally coercing customers to purchase credit insurance from a particular source. A dealer may not represent directly or by implication that the purchase of such insurance must be made through a particular agent or broker as a prerequisite to the extension of credit. Civil penalties can be assessed for such an offense up to $10,000 (See also the section entitled "INSURANCE DISCLOSURE REQUIREMENTS" of the chapter on the Automobile Sales Finance Act in this Guide).

Insurance Assignment

It is a misdemeanor, in connection with the retail sale of a motor vehicle, for a dealer to accept assignment of an insurance policy, or rights thereunder, pertaining to any motor vehicle traded in by the purchaser, unless all amounts realized on such policy are credited by the dealer to the buyer on the next monthly payment due, or unless the same is refunded to the buyer (Business and Professions Code section 18450).

Penalty: In the event a dealer wrongfully accepts assignment of an insurance policy without the required credit or refund to the buyer, the buyer may recover from the dealer in a civil action three times the amount realized on the insurance policy (Business and Professions Code section 18451).

Dealer's Liability as Insurance Agent

Generally, the dealer, acting in the capacity of an agent of the insurance carrier in processing a policy, has no liability to the insured on account of claims arising from the failure of the carrier to perform its obligations under the policy, and in most cases the dealer would have the right to look to the carrier for indemnification from loss or damage arising from such claims. However, the dealer is subject to exposure to separate and direct liability to the insured (and in some cases the carrier as well) in the event that the insured has sustained damage attributable to the negligent or wrongful conduct of the dealer agent. Such exposure may arise from such things as the agent's misrepresentation of the cost or, nature and extent of coverage. Therefore, the dealer should exercise care in selecting well qualified insurance personnel and in maintaining strict operating procedures. As additional protection against exposure in this area, the dealer may obtain errors and omissions insurance coverage against claims arising from alleged negligence or inadvertence on the part of the dealership insurance personnel.

CAUTION

REGARDING ILLEGAL TRANSACTION OF INSURANCE BUSINESS: Dealers should carefully review all information available concerning aftermarket products which they intend to sell that include "warranties" that promise payment of benefits or specified sums of money in excess of the cost of replacing the defective product. The California Department of Insurance has taken a position that such "warranties" in fact cause the sale of the product to represent an insurance transaction because benefits are being conferred upon the consumer for consequential damages. If construed to be an insurance transaction, the sale of such a product must comply with numerous legal requirements including one that the consumer actually receives an insurance policy and that all insurance licensing requirements be met. Dealers should consult their own legal counsel regarding any questions concerning such aftermarket products and further realize that participation in the illegal transaction of insurance business can be prosecuted as a felony.

Collecting Insurance Proceeds for Repairs

Introduction

It is frequently the case in the dealer's operation of its service department and body shop that the cost of repair work on a particular vehicle is to borne by an insurance carrier rather than directly by the customer. The dealer's rights in connection with receiving payment from the insurance company may depend upon the type of coverage involved and the circumstances surrounding the insurance company's authorization of the repair work.

Duty of Insurance Company to Pay for Repairs

Type of Coverage

The duty of the insurance company to pay for repairs performed by the dealer on an insured vehicle will depend in part upon whether the coverage is for collision or liability.

Collision coverage (Insurance Code section 560): Every insurer issuing an automobile collision policy or policy for comprehensive coverage for a motor vehicle shall, in the event of damage to a covered automobile by collision or otherwise and the election by the insurer to have such automobile repaired by the repairer, make payment by check or draft payable to the repairer or to the named insured and the repairer, jointly, or, with the consent of the repairer, by an electronic funds transfer to the repairer, not later than ten days subsequent to the receipt of an itemized bill or invoice covering repairs authorized by the insurer which have been satisfactorily completed. The provisions of this code section include all cases where the insured has received actual notice that the repairer is doing work pursuant to a contract approved by the insurance company in which case the payment shall include the name of the repairer (Although not required by this code section, the customer's authorization must also be obtained under the provisions of the Automotive Repair Act in order to be able to hold the customer liable.).

CAUTION

REGARDING JOINT CHECKS: Remember that the legal duty to make the check or draft payable jointly arises only if; (1) the repaired vehicle is covered under the collision or comprehensive policy; (2) the repair work is authorized by the insurance company and is fully completed in a good and workman-like fashion; (3) an itemized bill is presented to the insurance company. The problem area is the authorization on the part of the insurer, as discussed below.

What if the insurance company makes the check or draft payable only to the customer?

The insurance company's obligation to pay for the repair work is not extinguished if its check or draft is made payable only to the named insured. The insurance company will remain liable to the dealer for the total cost of all repair work authorized by the insurance company.

Liability coverage: Oftentimes the insurance coverage comes not from the customer's collision policy, but rather from the liability policy of a third party who may have negligently caused the damage to the vehicle. In this situation, the law imposes no legal duty on the liability carrier to make the check or draft payable jointly to the customer and repairer.

If, however, the liability carrier expressly authorizes the repair work or in some way indicates its intention to pay the cost of repairs, and if the dealer performs the repair work in reliance on the liability carrier's promise or intention to pay, the liability carrier will be obligated under the law to pay the dealer the cost of the repair work.

NOTE

ON RIGHT AGAINST CUSTOMER: In connection with the dealer's rights and remedies against the

customer in this situation, refer to the chapter entitled "Liens on Vehicles and Lien Sales."

The Insurance Company's Authorization

Fundamental requirement: Whether the situation involves a collision policy or a liability policy, the insurance company, by authorized agent or representative, must authorize the repair work before it will be obligated to make payment to the dealer.

PRACTICAL TIP

Although oral authorization is recognized under the law, the better practice is to request written authorization from the insurance company. If the dealer relies on oral authorization, there should be noted on the repair order the time, date, and manner of authorization, and the name of the person giving the authorization. The dealer should also make certain that the authorization comes from an authorized representative of the insurance company. Many times independent adjusters are not employees of the insurance company and cannot authorize repairs on behalf of the insurance company. If only oral authorization is obtained, and thereafter a problem with coverage is discovered by the insurance company, the insurance company may attempt to avoid payment by denying that any authorization was given. The dealer will avoid disputes as to the existence of authorization if it is obtained in writing.

CAUTION

ESTIMATE MAY NOT BE AUTHORIZATION FOR REPAIR: Many insurance companies or insurance adjusters will undertake their own estimate of the cost of repairs, which will be recorded on their own repair estimate form. These written estimates do not constitute authorization for repair work. In fact, many such repair estimate forms expressly state that the written estimate is not an authorization for repair work. If repair work is commenced in reliance solely on such a written estimate, and no other authorization is given, the insurance company may not be obligated to pay the cost of the completed repair work. The customer, however, will still be liable for the cost of the repair work and the dealer will retain a mechanic's lien on the repaired vehicle provided the customer has authorized the work and the provisions of the Automotive Repair Act have been complied with (See chapter in this Management Guide entitled "Liens on Vehicles and Lien Sales.").

Financial Benefit to Insurance Adjuster

It is unlawful for an independent automobile damage appraiser or automobile insurance claims adjuster, appraiser, or representative, to receive any financial benefit from an automobile repair facility. Financial benefit is defined to include the receiving of any commission or gratuity, discount on repair costs, free repairs, employment by a repair facility, or possession of more than three percent direct ownership in an automobile repair facility located in the State of California (Insurance Code section 14038(i)). See also Insurance Code section 753.

Dealer's Liability Coverage

Introduction

This section will deal with legal questions and requirements concerning protection from exposure to liability in connection with the dealer's ownership and use of vehicles in the course of business. In addition to obtaining motor vehicle liability insurance coverage, dealers normally obtain insurance protecting against exposure to various types of liability claims which arise from the operation of the dealership business. Examples are errors and omissions, product defects, and comprehensive liability coverage. Any particular questions a dealer may have regarding the scope of his or her liability insurance coverage can and should be answered by the dealer's agent or carrier.

CAUTION

NO COVERAGE FOR PUNITIVE DAMAGES: Under California law, liability insurance coverage cannot include protection from exposure to punitive or exemplary damages (Insurance Code section 533).

Dealer's Liability as Owner: Permissive Use Law

Every **owner** of a motor vehicle is liable and responsible for death or injury to person or damage to property resulting from a negligent or wrongful act in the operation of the motor vehicle by any person using or operating the vehicle with the owner's express or implied permission. The motor vehicle dealer, as the owner of an inventory of motor vehicles and as vendor and lessor of these vehicles, is of course especially affected by this statutorily imposed responsibility (Vehicle Code section 17150).

The purpose of this law, known as the "permissive use law," is to protect innocent third parties from the careless use of motor vehicles, and to place on the vehicle owner the responsibility of ascertaining the character, ability and responsibility of the person to whom the vehicle is entrusted.

Owner Defined

A vehicle owner, for purposes of permissive use liability, is defined as a person having all the incidents of ownership, including the legal title of a vehicle, whether or not such person lends, rents or creates a security interest in the vehicle (Vehicle Code section 460). The definition of owner for this purpose does not include a bank or finance company which has financed the purchase of a motor vehicle and is listed as legal owner thereof. Some of the situations encompassed by this law are as follows:

a. The dealer furnishes a motor vehicle pursuant to a daily rental agreement;

b. A “loaner” vehicle is provided to a customer while the customer's vehicle is being repaired;

c. The dealer furnishes his or her employees with vehicles for their use in conducting dealership business or otherwise;

d. A prospective purchaser is allowed to test drive a vehicle;

e. The dealer sells a motor vehicle and does not comply with the transfer of title requirements of Vehicle Code sections 5600 et seq.

f. The dealer leases a motor vehicle to a customer pursuant to a written lease agreement which is not assigned to a finance company.

Limited Liability

Under this permissive use law, liability of a dealer as owner of a motor vehicle is limited to $15,000 for the death of or injury to one person, $30,000 for the death of or injury to more than one person in any one accident, and $5,000 for damage to property of others in any one accident (Vehicle Code section 17151).

CAUTION

REGARDING OUT OF STATE TRAVEL: This limited liability of a dealer as owner of a motor vehicle may not apply, however, to a situation where the permissive user, whether an employee driving a company car on vacation, or a lessee or renter of a vehicle from the dealer, drives the vehicle outside of the state and negligently operates the vehicle so as to cause injury or property damage to a third party in excess of the limitations. Where there is a possibility that a permissive user might drive the vehicle out of state, a dealer should consult his or her attorney and/or insurance broker regarding the need for additional coverage.

This limitation as to maximum amount of liability does not apply in cases where the injury or damage in question is caused by the negligent operation of a dealer owned vehicle by an employee of the dealer operating the vehicle in the course and scope of his or her employment. This would include accidents occurring while a salesperson is demonstrating a vehicle for a customer, a mechanic is test driving a vehicle, or a parts department employee is picking up or delivering parts.

Liability for Entrustment to Unlicensed or Unsafe Driver

The limited liability discussed in the previous section will not apply where a dealer knowingly employs, hires, permits or authorizes an unlicensed driver to drive a dealer-owned vehicle (Vehicle Code section 14606). Similarly, the limited liability will not apply where a dealer rents or entrusts a vehicle to a driver whom the dealer knows to be incompetent or incapacitated, such as a driver who is obviously intoxicated. In such situations, the dealer will be fully liable for a third party's injuries caused by the unlicensed or incapacitated driver's negligence. (See also the section entitled "Sales to Unlicensed, Risky, and Uninsured Drivers" in the chapter Other Important Topics.)

When the Dealer's Liability as Owner Terminates

Test Drive/Loaner Car: The liability of the dealer as owner of a motor vehicle generally terminates when the permission or consent for the use of the vehicle has terminated. In the case of a loaner car or a test driven car, this would usually be when the vehicle is returned to the dealership. Many cases have held that the permission or consent is also terminated when the user of the vehicle violates the terms of his or her consent, especially as to purpose, time and territorial limitations of use imposed by the dealership.

Lease/rental vehicle: The law generally holds that the owner's liability terminates when the terms of the permission or consent contained in the contract have been violated by the customer. For example, where a contract expressly limited the use of the vehicle to the state of Arizona, the owner of the vehicle was not liable for an accident which occurred across the border in California, as the express terms of the consent in the contract had been violated (Coulston v. Cooper (1966) 245 Cal.App.2d 866, 54 Cal. Rptr. 302). And where the contract specifically stated that no one other than

the customer was to drive the car, the owner was not liable for an accident subsequently caused by the customer's friend, since the express terms of consent contained in the contract had been violated (Marquez v. Enterprise Rent-A-Car (1997) 53 Cal.App.4th 319, 61 Cal.Rptr.2d 557). However, without such contractual limitations on consent, other courts have specifically held that the owner of the leased or rented vehicle would remain liable, as the owner of the vehicle, in similar instances on the theory that the owner had given implied permission to the customer absent contractual restrictions.

Sale of vehicle: If a motor vehicle is sold under a contract of conditional sale whereby the title to such vehicle remains in the dealer, neither the dealer nor the dealer's assignee shall be deemed to be an owner for purposes of liability (Vehicle Code section 17156).

However, the selling dealer shall not be completely relieved of responsibility until such time as he or she has delivered possession of the vehicle to the purchaser and has either: (a) made proper endorsement and delivery of the certificate of ownership, or (b) has delivered to the Department of Motor Vehicles or has placed in the U.S. Mail either the notice required by Vehicle Code sections 5900 and 5901 or the appropriate documents for registration of the vehicle pursuant to the sale or transfer. With respect to requirement (b), every dealer, upon transferring a vehicle by sale, lease or otherwise, whether new or used, shall not later than the end of the fifth calendar day thereafter, not counting the day of sale, give written notice of the transfer to the DMV at its Headquarters upon an appropriate form provided by the DMV (Vehicle Code section 5901(a)). In the event the dealer forwards written notice of the transfer beyond the five day deadline, some cases have held that the dealer will still be relieved of any liability for the purchaser's negligent use of the vehicle if the notice has been received by the DMV prior to the time of any accident.

Dealer's Insurance Policy Should Provide Coverage

In the event a third party makes a claim or files a lawsuit against a dealer in connection with the negligent use of one of the dealer's motor vehicles, the dealer should look to his or her liability policy for coverage. No policy of automobile liability insurance covering liability arising out of the ownership, maintenance, or use of any motor vehicle shall be issued or delivered in California unless it contains coverage for the permissive use situation, except that such coverage need not apply to any person, or to any agent or employee thereof, employed or otherwise engaged in the business of selling, repairing, servicing, delivering, testing, road-testing, parking, or storing automobiles with respect to any accident arising out of the maintenance or use of a motor vehicle in connection therewith (Insurance Code section 11580.1(b)).

CAUTION

EXCEPTION: Notwithstanding the legal requirement for coverage in the permissive use situation, the insurance company and the named insured, if the named insured is engaged in the business of leasing vehicles for a term of more than six months, or selling, repairing, servicing, testing or storing motor vehicles, may agree by the terms of the policy that the coverage shall not apply to any person other than the named insured or his or her agent or employee, except to the extent that the limits of liability of any other valid insurance available to such third persons are not equal to the minimum limits ($15,000 - $30,000 - $5,000) specified by law. In short, the dealer can have a policy specifically excluding coverage for permissive users, other than the dealer's employees or agents, except to the extent that the permissive user's insurance coverage does not meet the $15,000 - $30,000 - $5,000 minimum requirement (Insurance Code section 11580.1(d)).

Additional Requirement for Lease Contracts

If the policy is issued to a named insured engaged in the business of leasing vehicles, which business includes the lease of vehicles for a term in excess of six months, and the lessor includes in the lease automobile liability insurance, the terms and lists of which are not otherwise specified in the lease, the named insured must incorporate a provision in each vehicle lease contract advising the lessee of the provisions of Insurance Code section 11580.1(d) and the fact that the limitation contained therein is applicable except as otherwise provided for by statute or federal law (Insurance Code section 11580.1(d)).

Dealer's Auto Liability Policy - Primary and Excess Coverage

Introduction: Many cases have arisen involving an automobile liability loss covered by two or more automobile liability policies. For example, assume that a person driving a dealer-owned vehicle with the dealer's permission negligently causes an accident, and that both the dealer and the vehicle's operator have liability insurance which covers the liability loss. Many conflicts have arisen as to how the coverage should be apportioned between the policies, especially where one or both policies contains a clause excluding coverage if there is another policy covering the loss. It is the declared public policy of the State of California to avoid such conflicts and the resulting litigation problems.

Statutory presumptions: California law sets forth, under various circumstances, which policy of insurance shall be primary and which policy of insurance shall be excess only. In this context, primary means that the policy will provide coverage to its full limits and excess means the policy will provide coverage only to the extent the dollar amount of liability exceeds the limits of the primary policy. The law bases the determination of primary and excess coverage upon the nature of the insured's business (Insurance Code section 11580.9)

Dealer as Seller and Repairer of Motor Vehicles

Where two or more policies affording automobile liability insurance apply to the same motor vehicle in an occurrence out of which liability arises, and one of such policies affords coverage to a dealer engaged in the business of selling, repairing, servicing, delivering, testing or storing motor vehicles, then in the event the vehicle is being operated by the dealer's employee or agent, the insurance afforded by the policy issued to the dealer shall be primary, and the insurance afforded by any other policy shall be excess. In the event the vehicle is being operated by any other person other than the dealer's agent or employee, the insurance afforded by the policy issued to the dealer shall be excess only, and the insurance available to the vehicle operator as a named insured shall be primary. For example, if while test driving a customer's vehicle after repair work, a dealer's employee causes an accident out of which a liability loss arises, and if both the dealer's policy and the customer's policy cover the loss, the statute provides that the dealer's policy must provide primary coverage (Insurance Code section 11580.9(a)).

Dealership as Lessor of Motor Vehicle

Where two or more policies are applicable to the same liability loss, and one of such policies affords coverage to a dealer engaged in the business of renting or leasing commercial vehicles, or leasing any other motor vehicle for six months or longer, the insurance policy of the leasing dealer shall be excess only and the insurance available to the lessee as named insured shall be primary. Thus, for example, where a dealer has leased a vehicle on a 36 month open-end lease, and a liability loss arises as a consequence of the lessee's negligent operation of the subject vehicle, the lessee's automobile liability coverage will be primary and the dealer's coverage will be excess only (Insurance Code section 11580.9(b)).

Loading/Unloading of Vehicle

Where two or more policies are applicable to the same loss arising out of the loading or unloading of a motor vehicle, and one of the policies is issued to the owner, tenant or lessee of the premises on which the loading or unloading occurred, the insurance afforded by the policy covering the premises (i.e., the dealer) shall be primary and any insurance afforded by a policy covering the motor vehicle shall be excess (Insurance Code section 11580.9(c)).

All Other Situations

In any situation not otherwise provided for, where two or more policies affording valid and collectable liability insurance, apply to the same motor vehicle or vehicles in an occurrence out of which a liability loss arises, the insurance afforded by the policy in which such motor vehicle is described or rated as an owned motor vehicle shall be primary, and the insurance afforded by another policy or policies shall be excess (Insurance Code section 11580.9(d)).

Modification of Presumptions

The foregoing presumptions may be modified or amended only by an agreement signed by the insurer and the named insured (Insurance Code section 11580.9(f)).

Insurance Coverage in Non-Liability Situations

Introduction

Many times a dealer suffers a loss as a consequence of some act or acts on the part of a third party. Examples include theft from the dealership premises, embezzlement by an employee, conversion of a vehicle, and payment by a customer with a bad check.

Examples of Types of Coverage

The following represent a few examples of the types of losses typically covered in most dealer policies:

Trick and device: The dealer suffers a loss by voluntarily parting with evidence of title to or possession of a motor vehicle without receiving payment, or acquires a motor vehicle from a seller who did not have legal ownership; in either event, the dealer is induced to do so by criminal scheme, criminal trick, criminal device or criminal false pretense.

PRACTICAL TIP

There is a wide disparity in trick and device clauses contained in insurance policies. They

range from coverage for a loss sustained by a dealer by reason of trick and device with little in the way of limiting language, thus offering reasonably broad coverage to the dealer who sustains such a loss, to very narrowly drawn clauses with a number of limiting conditions. It is not uncommon for a dealer to sustain what he or she clearly considers to be a trick and device loss and discover that the coverage is too narrowly drawn to cover the loss. It is strongly recommended that a dealer review the trick and device policy with his or her agent and/or attorney to make sure coverage is not unduly limited by conditions imposed in the policy.

Employee dishonesty: A dealership employee, with the intent of deriving a financial benefit, embezzles or steals money, securities or other property from the dealership.

PRACTICAL TIP

There is likewise a wide disparity in employee dishonesty or fidelity policies and this is another frequent source of conflict. All too often the dealer will sustain a loss which the dealer later finds is not covered by insurance. A policy, for example, frequently may exclude coverage for defalcations committed by officers. Also, some policies appear to have wide coverage by purporting to indemnify the employer against any loss sustained by the dishonest act of an employee committed alone or in conjunction with others, but the same policy will so narrowly define the terms "loss" or "dishonest act" that there is extremely limited coverage. It is strongly urged that a dealer review the fidelity coverage with his or her agent and/or attorney to make sure that there are no conditions or definitions which unduly limit the coverage.

Burglary and theft: The dealership suffers a loss of money, securities or other property by reason of burglary or robbery.

To reiterate, whatever the nature or extent of the loss, or whether the loss is a liability or casualty loss, the dealer should immediately contact his or her insurance agent regarding the question of coverage under his or her policy. Legal questions should be directed to the dealer's local counsel.

Litigation Procedure

Introduction

In the event the dealer is served or is about to be served with a lawsuit, he or she should immediately tender the matter to its insurance agent or insurance carrier to see if the subject matter of the lawsuit is covered under the dealer's policy. The dealer should be aware that state law imposes a 30 day deadline on answering lawsuits (Code of Civil Procedure section 412.20(a)(3)). Therefore, it may become necessary for the dealer to contact an attorney for advice if there is any uncertainty as to the time within which to file a responsive pleading.

Tender to Insurance Carrier

It is important that the lawsuit or claim be referred as soon as possible to the insurance agent or carrier. Most liability policies impose a duty upon the insured to notify the insurance carrier - immediately (or within a reasonable time) upon learning of or discovering the existence of a potential claim or lawsuit. A typical policy also imposes a duty on the dealer to cooperate with and assist the insurance company in the investigation, settlement and defense of the lawsuit, including, if necessary, appearance at depositions and court hearings. The failure of the dealer to meet these duties could provide the insurance company with a basis for rejecting payment of a claim or defense of a lawsuit.

NOTE

ON TENDERING ALL CLAIMS: You should always submit any lawsuit filed against you to your insurance carrier. If the carrier denies coverage, your attorney should analyze your policy for any potential coverage. Insurance companies sometimes mistakenly deny coverage or make close calls in their favor. In an important case you might want to consult with attorneys who specialize in interpretation of insurance policies.

A number of court cases in California and throughout the country have construed "advertising injury" clauses in insurance policies very broadly. This means that lawsuits you may think are not covered by your insurance may in realty be covered. Under some court cases interpreting the "advertising injury" clause of your policy, you might be covered for allegations of intentional or negligent misrepresentation in the sale of vehicles. You might also be covered for any number of other claims against you such as unfair, unlawful, or fraudulent business practices, or for false statements made by employees.

Thirty Day Deadline

Once the dealer has been served with the Summons and Complaint, there are 30 days in which to file with the court and serve on the plaintiff a written response (Code of Civil Procedure section 412.20(a)(3)). The dealer should always be aware of this legal duty. Failure to file and serve a written response within the prescribed deadline will enable the plaintiff to obtain a judgment by default against

the dealer. In this event, the insurance company may refuse to pay any claim by reason of the dealer's failure to act in a timely manner to protect his or her interests.

Contact Legal Counsel

If the dealer has any legal questions regarding a lawsuit or claim, the dealer should contact his or her own attorney. In addition, since the insurance company oftentimes will not notify the dealer of its intention to accept or reject defense of the lawsuit until after the 30 day deadline, the dealer may want to contact an attorney to protect the dealer's interests until the insurance company responds, and, if necessary, obtain an extension of the 30 day deadline from the plaintiff's attorney.

Termination of Dealership Business Effect on Insurance Coverage

If the dealership business is terminated, the dealer should contact his or her insurance broker or agent to receive confirmation that there will be coverage for any claims that could be made after the termination of business. The dealer's coverage for pre-termination events should remain in effect so long as the dealer has any legal liability.

EXAMPLE

Illustrating this point is a case concerning a dealer who cancelled his insurance policy upon termination of the dealership business. A serious claim later arose from an accident caused by negligent repair work performed on a customer's vehicle while the dealer was still in business. The dealer's cancelled insurance policy was in effect at the time of the negligent repairs, but contained a "claims made" provision, covering only those claims made prior to cancellation of the policy. The dealer consequently had no coverage for this loss.

A dealer will have an additional need to maintain insurance during the period the corporation is winding up affairs, which may continue for some time after the dealership business has terminated. Therefore, it is recommended that the dealer always contact his or her agent or broker upon termination of business.

Financial Responsibility Law

Introduction

Every driver and owner of a motor vehicle must at all times maintain in force one of the forms of financial responsibility recognized by California law. This of course affects the dealer to the extent the dealer owns and uses motor vehicles in the operation of the dealership business (Vehicle Code section 16020). Such financial responsibility is established if the driver or owner is an insured or obligee under a form of insurance or bond which complies with the requirements of the Vehicle Code and which covers the driver for the vehicle involved in the accident; if the owner or driver deposits cash with the DMV; if the owner or driver is an obligee under a policy issued by a charitable risk pool which complies with the requirements of the Vehicle Code; or if the owner is a self-insurer (Vehicle Code section 16021).

The Financial Responsibility Laws starting at Vehicle Code section 16000 are extremely detailed and lengthy and should be consulted for more details. This chapter will merely cover how financial responsibility is established and when proof of financial responsibility must be furnished.

Establishing Financial Responsibility

Insurance Policy

Evidence of financial responsibility may be established by filing with the DMV satisfactory documentation that the owner had a motor vehicle liability policy or bond in effect at the time of the accident with respect to the driver or the motor vehicle involved in the accident, unless it is established that at the time of the accident the motor vehicle was being operated without the owner's permission, express or implied, or was parked by a driver who had been operating the vehicle without permission. (Vehicle Code section 16054(a)).

NOTE

ON MINIMUM COVERAGE REQUIREMENT: Such liability policy or bond must be issued by an insurance company or surety company admitted to do business in the State of California by the Insurance Commissioner, and must contain coverage for not less than $15,000 because of bodily injury to or death of one person, not less than $30,000 because of bodily injury or death

in any one accident, and not less than $5,000 because of injury to or destruction of property in any one accident (Vehicle Code section 16056(a)).

Cash Deposits

Evidence of financial responsibility may also be established by depositing cash with the DMV in the amounts specified in Vehicle Code section 16056(a), currently $35,000 (Vehicle Code section 16054.2). A certificate of deposit number will be furnished the depositor as proof of his or her financial responsibility. In the event proof of financial responsibility has been established in this manner, and a period of four years has elapsed following the effective date of the suspension, the cash deposit or any balance thereof remaining shall be refunded, if the director of the Department of Motor Vehicles is satisfied that there are no outstanding or pending claims against the deposit. If the refundable deposit remains unclaimed by the depositor for a period of six years from the effective date of the suspension, the deposit shall then be transferred to the motor vehicle account in the state transportation fund (Vehicle Code section 16027).

Self-Insurance

Who may qualify: Any person in whose name more than 25 motor vehicles are registered may qualify as a self-insurer by obtaining a certificate of self-insurance issued by the DMV(Vehicle Code section 16052).

Application for certificate of self-insurance: The DMV may in its discretion, upon application, issue a certificate of self-insurance when it is satisfied that the applicant in whose name more than 25 vehicles are registered is possessed of ability to pay judgments obtained against him or her in amounts at least equal to $15,000 for bodily injury or death to any one person, $30,000 for bodily injury or death in any one accident, and $5,000 for property damage. One who applies for issuance of a certificate of self-insurance must use a form furnished or approved by the DMV. The application form may be obtained from the financial responsibility department of the DMV in Sacramento (Vehicle Code section 16053(a)).

The application must be accompanied by an audited financial statement for the three year period immediately preceding the date of application, which statement shall include an opinion of the current financial condition of the applicant rendered by an independent certified public accountant. The audited financial statement must reflect a net worth of not less than $2,200,000 on the date of the application. The DMV will also require a statement of claims and losses during the preceding three year period, accident and civil judgment history, claim reserves, and a history of any insolvency proceedings. The foregoing information shall be only for the confidential use of the DMV in determining the applicant's eligibility for a certificate of self-insurance (13 California Code of Regulations sections 80.55 through 80.80).

Renewal requirements: Within twelve months after issuance of the certificate, and at twelve month intervals thereafter, the certificate holder must submit to the DMV a completed Financial Responsibility Self-Issuance Renewal Attachment (Form SR70) and an audited financial statement for the previous year. The financial statement must include an opinion of the net worth of the certificate holder, rendered by an independent certified public accountant, for the date and time when the financial statement is signed.

Cancellation: Upon five days notice and a hearing, the DMV may upon reasonable grounds cancel a certificate of self-insurance (Vehicle Code section 16053(b)). Reasonable grounds include failure to maintain any requirement for obtaining the certificate, failure to submit annual financial statements or submission of fraudulent or incomplete documents (13 Calif. Code of Regulations section 80.90) as well as failure to pay any judgment within 30 days after the judgment has become final (Vehicle Code section 16053(b)).

When Evidence of Financial Responsibility is Required

Every driver and every owner of a motor vehicle must at all times be able to establish financial responsibility, and must at all times carry in the vehicle evidence of the form of financial responsibility. See Vehicle Code sections 16020, 16021, and 16070.

Reporting and Insurance Responsibilities in the Event of an Accident

In the event of an accident resulting in property damage in excess of $750 or any bodily injury, the driver of the vehicle involved, or the employer of the driver at the time of the accident if the driver was driving a vehicle owned or leased by the employer with the employer's consent, must report the accident on a form approved by the DMV to the Sacramento office of the DMV. In the case of a driver reporting, the report must be filed within 10 days of the accident. Vehicle Code section 16000.

Whenever a driver involved in such an accident fails to provide evidence of financial responsibility (such as valid insurance coverage) to the DMV, his or her driver’s license will be suspended (see Vehi-

cle Code sections 16000, 16002, 16020, 16021, and 16070).

Where the driver is driving a vehicle owned or leased by his or her employer with the consent of the employer, the driver is required to report the accident to the employer within 5 days on a form approved by the employer, and the employer has 10 days from the receipt of the employee's report to report the accident to the DMV in Sacramento (see Vehicle Code section 16002). However, an employer-owner is not obligated to make such a report if at the time of the accident the employer has a valid certificate of self-insurance or has on file with the Department a certificate of an insurance company or surety company that there is in effect a policy or bond meeting the minimum requirements of the law covering the vehicle involved in the accident. Where the employer is required to file the report, it must contain evidence of liability insurance meeting the minimum requirements of the law covering the driver's operation of the vehicle (see Vehicle Code Sections 16002 and 16051-16056).

Registration Renewal

Additionally, all motor vehicle owners must furnish evidence of financial responsibility to the DMV when applying for renewal of vehicle registration. See Vehicle Code section 4000.37.

PRIVACY, SAFEGUARDS, IDENTITY THEFT AND RED FLAGS

Chapter 5

Contents

PRIVACY, SAFEGUARDS, IDENTITY THEFT AND RED FLAGS

OVERVIEW: Few topics have received as much attention from regulators at both the federal and state level as consumer privacy rights and identity theft. As a result, extensive statutes and regulations have been enacted which are designed to protect consumer privacy rights and prevent identity theft. This chapter focuses on the key aspects of federal and California laws and regulations which relate to privacy rights and identity theft and are applicable to dealership operations.

Privacy

Since 2001, dealers have been required to comply with a federal privacy law known as the Gramm-Leach-Bliley Act (the "GLB Act") (15 U.S.C. sections 6801 et seq.) and the supporting Federal Trade Commission regulations (the "FTC Rule") (16 C.F.R. part 313). This compliance is necessary because vehicle leasing and credit sales (also selling insurance) are financial activities which bring dealerships within the statutory definition of a "financial institution" under the GLB Act. Other dealer owned entities such as in-house leasing companies may also fit this definition and be subject to the requirements of the GLB Act. Basically, the GLB Act requires a financial institution to provide to customers a notice of its privacy policies and practices, including those relating to the confidentiality and security of certain consumer information designated as "nonpublic personal information" under the GLB Act (referred to as "consumer information" in this chapter). The GLB Act also prohibits a financial institution from disclosing consumer information to third parties unless: (i) the consumer is advised of the potential disclosure of that information, (ii) the consumer is given the opportunity to prohibit that disclosure (the "opt out right"), and (iii) the consumer does not exercise the opt out right.

Key California privacy laws discussed in this chapter include California Civil Code section 1798.85 relating to social security numbers; California Business and Professions Code section 22575 relating to privacy policies on commercial web sites; California Civil Code section 1798.81.5 relating to personal information security; California Civil Code section 1798.83 relating to a consumer's right to ask about information sharing practices; and California Civil Code section 1798.82 relating to computer system breaches that involve the unauthorized access to personal information. Dealers are urged to develop a comprehensive privacy policy covering all areas of dealership operations.

NOTE

REGARDING CALIFORNIA PRIVACY REQUIREMENTS FOR INSURANCE PRODUCTS: The GLB Act specifically empowers the insurance authority for each state to develop and enforce regulations protecting the privacy of insurance customers (15 U.S.C. sections 6801 and 6805(a)(6)). In California, the Insurance Commissioner has developed regulations (Sections 2689.1 through 2689.24 of Title 10 of the California Code of Regulations) which are designed to protect the privacy of nonpublic personal information of insurance customers. The general approach of these regulations in terms of privacy protections and notice requirements is similar to the approach followed by the FTC Rule. Dealerships engaged in transacting insurance business should be familiar with these regulations for compliance purposes.

Privacy Notice

Notice Delivery

In general, to comply with the GLB Act, a dealership must hand deliver an initial written notice of the dealership's privacy policies and practices (the "privacy notice") to each of its customers (it is a good practice for a dealership to give it to both the buyer and co-buyer and lessee and co-lessee) who are involved in consumer lease or credit sale transactions (i.e., for personal, family or household purposes). This privacy notice should be delivered prior to the time the customer relationship is established (for example, when a lease is signed) (16 C.F.R. section 313.4(a)(1)). The Federal Trade Commission ("FTC") has taken the position that a dealership establishes a customer relationship with an individual when he or she signs a credit application because the dealership then provides a type of

credit brokering service for that individual. For this and other reasons (mainly to keep a dealership's compliance policy simple), the privacy notice should be given when a credit application is signed. A privacy notice should be given earlier (i.e., before any disclosure of consumer information occurs) if a dealership collects information from an individual interested in leasing or purchasing a vehicle on credit who does not sign a credit application or contract and the dealership wishes to share that information with a third party to follow up on the lead (16 C.F.R. section 313.4(a)(2)). Although the regulations allow for a privacy notice to be communicated electronically, this is valid only if the consumer agrees to that type of notice delivery and the actual delivery of the notice can be confirmed (16 C.F.R. section 313.9(b)(1)(iii)).

Annual Notice

The GLB Act further requires that a financial institution give a privacy notice annually to each of its customers (16 C.F.R. section 313.5). However, if a dealership sells the lease or conditional sale contract to a bank or other financial institution as normally occurs, the consumer involved is no longer considered the dealership's "customer" for purposes of this annual notice requirement. If the dealership needs to give an annual privacy notice (for example, if it is stuck with a lease or conditional sale contract), the simplest approach is to mail it first class to the individual's last known address. A privacy notice must be given annually as long as the obligation under the contract held by the dealership is outstanding.

Notice Content

Essentially, a privacy notice must in a clear and conspicuous (i.e., understandable) manner, explain the type of consumer information the dealership collects and where it comes from; whether the dealership shares this consumer information and with whom; and the dealership's practices for protecting the confidentiality and security of consumer information. It should be noted that consumer information should not be considered simply what a person submits on a credit application, but may also include for example a consumer's name and address if that information is derived from the consumer's effort to obtain a financial service (i.e., to lease or purchase a vehicle on credit).

The specific content requirements for a privacy notice as stated in the FTC Rule (see the 16 C.F.R. section 313.6) include:

a. A general description of categories with examples (i.e., information from a consumer such as name, address, social security number, etc.) of consumer information collected by the dealership;

b. Categories of consumer information the dealership discloses;

c. Categories of affiliated parties (i.e., entities under common control or ownership with the dealership) and nonaffiliated third parties (i.e., entities not under common control or ownership with the dealership) with whom the dealership shares consumer information (about current and former customers), where the sharing is not covered by certain statutory exceptions discussed below;

d. A general description of categories of consumer information the dealership shares with nonaffiliated third parties (the general categories of these parties should also be disclosed) to secure services (for example, having an outside company send a customer a birthday card) or to engage in joint marketing efforts (see the 16 C.F.R. section 313.13 information sharing exception). Note that a dealership contracting for services with a nonaffiliated third party must have a written contract which includes a confidentiality provision requiring the service provider to keep the disclosed consumer information confidential and to use it only for the purposes requested by the dealership. Note also that if a dealership intends to share information with a service provider regarding consumers who are not yet customers of the dealership, the dealership must make sure that it gives its privacy notice to such consumers before any sharing of information under this exception takes place;

e. An explanation of the right of the consumer to opt out (i.e., prohibit the disclosure of consumer information) if that is applicable. Note that this opt out right only applies if a dealership is sharing consumer information to nonaffiliated third parties where the disclosure does not fit any of the statutory exceptions discussed later in this chapter. If a dealership's information sharing practices are appropriately limited, the dealership can avoid giving the opt out notice to consumers and avoid the compliance problems that can arise (i.e., implementing the necessary follow-up should a customer wish to opt out). Many dealerships do not share consumer information with nonaffiliated third parties, except for a manufacturer or distributor. In response to the GLB Act, many manufacturers and distributors have modified their retail delivery report ("RDR") practices to limit the disclosure of consumer information to them by their dealerships, which may allow those dealerships to complete the RDR process without having to give an opt out notice to their customers;

f. The disclosure of a dealership's practices regarding sharing an individual's credit information which is subject to the federal Fair Credit Reporting Act (15 U.S.C. section 1681a(d)(2)(A)(iii)). Specifically, the dealership needs to disclose whether it shares an individual's credit information with its

affiliates. If the dealership's practice is to share such information, the dealership must, before any information is shared, provide the person an opt-out right which would allow the person to prohibit the sharing of that information;

g. A dealership's policies and procedures regarding the protection of confidentiality and security of consumer information (i.e., the information is protected from unauthorized access and is available only to dealership employees who need access to perform their work). A dealership must actually take steps to implement protective measures regarding consumer information to comply with the FTC Safeguards Rule (see discussion of the Safeguards Rule later in this chapter); and

h. A statement that the dealership may disclose consumer information to nonaffiliated third parties in a manner covered by the information sharing exceptions allowed under the FTC Rule (see 16 C.F.R. sections 313.14 and 313.15). Under these exceptions, a dealership is allowed to share consumer information with nonaffiliated third parties without having to inform the consumer of the sharing before it occurs and also without having to give the consumer the right to opt out. Note, however, that a dealership is always required to give its privacy notice to a consumer when a customer relationship is established.

Information Sharing Exceptions

Consumer information sharing which qualifies for exceptions under the GLB Act and FTC Rule (see 16 C.F.R. sections 313.14 and 313.15) is basically described as follows:

a. When a dealership is disclosing the consumer information as is necessary to effect, administer or enforce the financial transaction which the consumer has requested (for example, submitting a consumer's credit application to a prospective lender);

b. When the consumer information is shared by a dealership with the consent of a consumer (for example, responding to a consumer's request to give consumer information to an outside insurance agent to secure insurance for a leased vehicle);

c. When consumer information is shared by a dealership for legal or regulatory purposes, such as responding to a subpoena; acting to prevent fraud; addressing consumer disputes; and communicating with: (1) consumer attorneys; (2) dealership attorneys, accountants and auditors; or (3) government agencies and regulators;

d. When consumer information is shared by a dealership in connection with the proposed or actual sale, merger, transfer or change of the business; and

e. When consumer information is shared by a dealership with consumer reporting agencies in accordance with the Fair Credit Reporting Act.

As mentioned previously, there is also an exception recognized by the FTC Rule which allows a dealership to share consumer information with nonaffiliated third parties involved in providing services to the dealership or with financial institutions with whom a joint marketing agreement is in place (see 16 C.F.R. section 313.13). This exception allows a dealership to share the information without giving the consumer an opt out right, but does require that the dealership give a copy of its privacy notice (which will include a statement that such sharing does occur) to the consumer before the sharing takes place. Again, this exception requires that a dealership have a written contract with the service provider which includes a provision committing the nonaffiliated third party to keep the consumer information confidential and to use it only for the purposes requested by the dealership.

Opt Out Notice

If a dealership makes disclosures of consumer information to nonaffiliated third parties and the disclosures are not covered by any of the exceptions discussed previously, the dealership must give an opt out notice to a consumer as part of its privacy notice (16 C.F.R. section 313.10(a)(1)). This opt out notice must identify the categories of consumer information that the dealership discloses (or reserves the right to disclose) and the categories of the nonaffiliated third parties to whom that information is disclosed. The notice should also state that the consumer can opt out of these disclosures and identify the financial product or services that the consumer obtains from the dealership which would be impacted by the opt out decision (16 C.F.R. section 313.7(a)).

The opt out notice must designate a reasonable means (see 16 C.F.R. section 313.7(a)) for a consumer to exercise the opt out right which may include any of the following:

a. Designate check-off boxes in prominent positions on the form;

b. Include a reply form that includes the address to which the form should be mailed;

c. Provide an electronic means to opt out such as a form that can be sent via email or processed at the

dealership's website (the consumer must agree to the electronic delivery of this information); or

d. Provide a toll-free telephone number that the consumer may call to opt out.

A dealership may not require a consumer to write his or her own letter to exercise the opt out right (16 C.F.R. section 313.7(a)(2)(iii)(A)). Note that the opt out notice should also cover the situation involving joint consumers (for example, a buyer and co-buyer or lessee and co-lessee) and state whether the exercise of the opt out right by one consumer applies to just that individual or to the other individual as well (16 C.F.R. section 313.7(d)). If the dealership gives an opt out notice, it must allow the consumer a reasonable period of time to exercise that right (basically 30 days from the date an opt out notice is delivered) (16 C.F.R. section 313.10(a)(3)(i)). If the dealership is notified that a consumer has opted out, it must act as soon as reasonably practicable after receiving that notice to make sure that no consumer information is shared (except as permitted by the exceptions discussed previously). If the opt out right is exercised, the dealership must abide by the consumer's election until it is revoked in writing (unless the consumer agrees to revoke electronically) (16 C.F.R. section 313.7(g)).

NOTE

MODEL PRIVACY NOTICE: Based upon the efforts of the FTC and a number of other government agencies, a model privacy notice form was developed for financial institutions (including dealerships) to use to comply with the privacy notice requirements of the GLB Act. This model form was designed to be easily understood by consumers and also allows for compliance with the Affiliate Marketing Rule discussed later in this chapter. Although use of the form is not mandatory, dealers should use it to take advantage of the protection it provides ("safe harbor") against legal challenges to the form of a dealership's privacy notice. Privacy notices based upon earlier FTC guidelines do not have this safe harbor protection. The model privacy notice form (which has several versions) can be viewed and actually completed at the Federal Reserve's free privacy notice online form builder website at www.federalreserve.gov/bankinforeg/privacy_notice_instructions.pdf.

CAUTION

Regarding Completing A Model Privacy Form: Dealers should be aware that while the format of the model privacy notice form is simplified, completing the form requires precisely following some complicated instructions. For assistance in this area, dealers should review the NADA Management Guide publication entitled, "A Dealer Guide to the FTC Privacy Rule and the Model Privacy Notice" available at www.Nada.org/nadauniversity /resourcetoolbox.

CAUTION

Regarding GLB Act Issues: Because of the extensive technical requirements of the GLB Act and FTC Rule, dealers should carefully review their practices and procedures involving the handling of consumer information to develop an adequate compliance strategy and consult legal counsel as needed. To assist dealerships in their efforts to comply with the GLB Act, the FTC has generated a publication entitled, "The FTC's Privacy Rule and Auto Dealers, Frequently Asked Questions," This publication is available at www.ftc.gov/bcp/edu/pubs /business/auto/bus64.pdf.

NOTE

REGARDING AUTOBROKERS: Dealers should be aware that the GLB Act and FTC Rule impact transactions involving autobrokers. An autobroker does fall within the statutory definition of a "financial institution" as a result of being engaged in activities relating to credit sales, finance brokering and leasing. As a result, an autobroker is required to give notice of the autobroker's privacy policy to consumer customers. A dealership entering into a consumer credit sale or lease transaction involving an autobroker should consider requiring the autobroker to give the dealership's privacy policy to that customer (a good practice is to also require that the autobroker obtain a signed acknowledgement from the consumer confirming receipt of the dealership's privacy policy). A reason for this approach is that the autobroker may be considered an agent of the dealership (for example, because of compensation being paid to the autobroker by the dealership). Another reason is that the notice will state how the dealership might handle consumer financial information received from the autobroker (for example, a dealership may disclose such financial information to a non-affiliated third party). Dealers doing business with autobrokers should carefully review their dealership procedures to ensure compliance with the requirements of the GLB Act and FTC Rule so as to avoid potentially serious legal consequences.

NOTE

AFFILIATE MARKETING RULE: Among several regulations developed by the FTC to implement the Fair and Accurate Credit Transaction Act of 2003 ("Fact Act") is the Affiliate Marketing Rule. Basically, this regulation prohibits a dealership from using certain customer information obtained from an affiliate for marketing purposes unless the consumer is provided with notice and a reasonable opportunity to opt out of future marketing solicitations. This notice (and opt out opportunity) is separate from the privacy notice that dealerships are required to provide to customers under the GLB Act, although the notices can be combined. Information covered by the Affiliate Marketing Rule includes that obtained from the customer's business or account relationship with an affiliate or the customer's credit application or report, as well as information received from third party sources. The rule contains several model forms to assist in compliance. Dealers having questions as to how to implement this particular rule, including how to coordinate it with already existing regulations relating to information sharing policies such as the FTC Rule under the GLB Act, are encouraged to consult with dealership counsel. The full text of the Affiliate Marketing Rule, including model forms, is available at the FTC website (www.ftc.gov) by searching "Affiliate Marketing Rule." The NADA Management Guide publication entitled "A Dealer Guide to the FTC Affiliate Marketing Rule" available at www.nada.org/nadauniversity/resourcetoolbox is an additional resource regarding this rule.

Standards for Safeguarding Consumer Information

In connection with the implementation of the GLB Act, the FTC has developed additional regulations which relate to maintaining the security and confidentiality of "customer information" (defined as nonpublic personal information about a customer) from misappropriation, alteration, tampering, and other misuse (16 C.F.R. part 314). These regulations, designated the "Safeguards Rule," require the development, implementation and maintenance of a comprehensive, written information security program ("Program"). Such a Program should outline a dealership's policies and procedures relating to the physical, administrative and technical safeguards that are in place to protect customer information. The following elements must be included in a Program:

a. **Program Coordinator**. An employee or employees must be designated to coordinate a dealership's Program. This person or persons should be responsible for coordinating the Program and be empowered with the ability and resources necessary to design, implement, maintain and enforce the safeguards.

b. **Risk Assessment**. Risk assessment should be undertaken with a focus on the "reasonably foreseeable" internal and external risks to the security, confidentiality and integrity of customer information which could result in the unauthorized disclosure, misuse, alteration, destruction or other compromise of such information. This risk assessment should cover "all relevant areas" of the dealership's operations for the purpose of evaluating the sufficiency of the safeguards in place. At a minimum, areas that should be covered include the following:

   (1) employee training and management;

   (2) information systems, including network and software design as well as information processing, storage, transmission and disposal; and

   (3) detection, prevention and responses to attacks and intrusions on a dealership's electronic and non-electronic information systems, or other system failures.

c. **Additional Safeguards**. Regular testing should be performed in order to ensure the effectiveness of all safeguards' key controls, systems and procedures. If existing safeguards are not adequate, additional safeguards should be designed and incorporated into the Program taking into account the following factors:

   (1) the size and complexity of the dealership and its operations;

   (2) the nature and scope of the dealership's finance and lease activities; and

   (3) the sensitivity of the customer information collected, stored and transmitted (for example, social security numbers should be afforded the highest degree of safeguard protection).

d. **Oversee Service Providers**. The Safeguards Rule requires dealers to ensure that their affiliates and service providers maintain appropriate safeguards for the consumer information that is shared with them. The Safeguards Rule defines a "service provider" as "any person or entity that receives, maintains, possesses, or otherwise is permitted access to customer information through its provision of services directly to a [dealer]." A dealer should therefore:

(1) take reasonable steps to select and retain service providers capable of maintaining appropriate safeguards for customer information; and

(2) require that all service providers *contractually agree* to implement and maintain such safeguards. This contractual requirement may be met by having a separate contract with the service provider or by revising the existing primary contract to include an information safeguards clause.

e. **Evaluate Program**. A dealership's Program should be continuously evaluated and adjusted in light of:

(1) the results of the dealership's testing and monitoring of the Program safeguards;

(2) any material changes to the dealership's operations or business arrangements;

(3) any changes in widely available technology; and

(4) any other circumstances that the dealer knows or has reason to know may have a material impact on the dealership's Program.

NOTE

REGARDING RECORDS DISPOSAL: Any information security program developed by a dealership to comply with the Safeguards Rule should provide for the appropriate disposal of customer information. The FTC rule (16 C.F.R. part 682), authorized by the Fact Act, provides guidelines on the proper disposal of consumer report information and records. California's "Shredding Law" (Civil Code section 1798.81) already addresses the record disposal issue as it requires records containing consumer information to be destroyed before being discarded. See discussion of this statute in the chapter in the Management Guide entitled, "Records Retention."

CAUTION

REGARDING COMPLIANCE WITH THE FTC AND SAFEGUARDS RULES: Dealers should be aware that compliance with the FTC and Safeguards Rules requires an ongoing effort. Legal counsel should be consulted as questions arise. The FTC has audited dealers regarding compliance with the Safeguards Rule and in instances of non-compliance may pursue a cease and desist order. Civil penalties may be imposed if the cease and desist order is violated. The FTC publication entitled "Protecting Personal Information, A Guide for Business" which is available at the FTC's website at www.business.ftc.gov/documents/bus69protecting-personal-information-guide-business, is a good source of ideas for evaluating a dealership's information security program.

NOTE

REGARDING 8300 CASH REPORTING RULE: The collection of personal information by a dealership may be required in transactions where the customer is paying cash for purposes of IRS/FinCEN Form 8300 (the cash transaction report). Some of the items that must be collected to complete the form include the customer's name, address, social security number, birth date, occupation, and name and number of an identification document, such as a driver's license. Basically, a Form 8300 must be filed if a dealership receives $10,000 or more in cash. For this purpose, "cash" means US and foreign currency in excess of $10,000. It also includes a cashier's check, money order, bank draft, or traveler's check having a face amount of $10,000 or less when two or more are presented or when it is combined with cash so that the total amount exceeds $10,000. The term "cash" does not include a personal check, a check drawn on the account of a business, certified personal and business checks, or amounts charged to a credit card. Dealership records pertaining to Form 8300 filings should be retained indefinitely (certainly at least 5 years) and kept in accordance with the dealership's information security program.

California Laws Relating to Privacy

As mentioned previously, a number of California statutes have been enacted to protect the privacy of consumer information. Certain key statutes are discussed below.

Social Security Number Privacy

Social security numbers (SSNs) are recognized as nonpublic personal information and are subject to the protections of all consumer privacy laws, including the GLB Act, the California law (Civil Code section 1798.81) which requires businesses disposing of records with personal identifiable information to destroy or otherwise make the records unreadable, and the California law (Civil Code section 1798.82) which requires businesses to make a disclosure to individuals whose personal information may have been accessed by unauthorized persons as the result of a security

breach of a computerized data system. However, California Civil Code section 1798.85 is specifically designed to safeguard the confidentiality of SSNs as it provides that SSNs may not be:

a. Publicly posted or displayed, or in any manner communicated or otherwise made available to the general public. This would include a post-it note left out in the open on a desk that contains a SSN;

b. Printed on any card required for the individual to access products or services, or , with limited exceptions, on any materials that are mailed to the individual, unless required by state or federal law and then only if the SSN is not visible until the envelope is opened. "Printing" includes any barcode, chip, magnetic strip, or other technology;

c. Requested or transmitted over the Internet, unless the connection is secure or the social security number is encrypted; or

d. Used as a user name to access an Internet Web site, unless a password or unique personal identification number or other device is also required.

Requirement to Post Online Privacy Policy

Dealerships operating websites which collect consumer information must comply with a collection of California statutes (Bus. Prof. Code sections 22575-22579) known as the Online Privacy Protection Act of 2003 ("Online Privacy Protection Act"). The basic requirement of the Online Privacy Protection Act is that an operator of a commercial website that collects personally identifiable information about consumers residing in California must conspicuously post a privacy policy. This privacy policy must do the following:

a. Identify the categories of personally identifiable information collected;

b. Identify the categories of persons or entities with whom that information may be shared;

c. Describe the process, if any, that a consumer can use to change the personal information collected by the website; and

d. Describe the process the website operator uses to notify consumers of changes in the privacy policy.

For purposes of the Online Privacy Protection Act, "personally identifiable information" includes the following: first and last name, a home or other physical address, email address, telephone number, social security number, and other information collected (such as information from "cookies") that is maintained in a form in combination with a name or other personally identifiable information.

The Online Privacy Protection Act authorizes several approaches to "conspicuously posting" a privacy policy on a website, including:

a. Posting the actual privacy policy on the web page if it is the home page or the first significant page after entering the website;

b. Using an icon that hyperlinks to a web page with the actual privacy policy posted, if the icon includes the word "privacy", has a contrasting color or other distinguishable appearance from the web page, and is located on the home page or first significant page after entering the website;

c. Using a textlink that hyperlinks to a web page with the actual privacy policy posted, if the textlink includes the word "privacy," or is written in capital letters equal to or greater in size than the surrounding text, or is written in type size that is larger than the surrounding text with contrasting type, font, color or other characteristics that set it off and is located on the home page or first significant page after entering the website; or

d. Using any other functional hyperlink that is displayed so that a reasonable person would notice it.

NOTE

REGARDING COMPLIANCE: The Online Privacy Protection Act does provide that a website operator is technically not in violation of the requirement to post the privacy policy unless the operator fails to post it within 30 days after being notified (arguably, this notice could be given by a consumer) of non-compliance.

CAUTION

REGARDING PRIVACY POLICY: Dealers should make sure that the privacy policy posted to comply with the Online Privacy Protection Act is consistent with the privacy policy provided by their dealerships to consumers to comply with the GLB Act.

Personal Information Security

Pursuant to California Civil Code section 1798.81.5, businesses that own or license personal information about California residents must implement and enforce reasonable security measures to protect the personal information from unauthorized access, destruction, use, modification or disclosure. If personal information about a California resident is to be shared with a nonaffiliated third party, the business must require the nonaffiliated third party to implement reasonable security measures as well.

For purposes of this statute, "personal information" includes an individual's first name or first initial and last name, and *one* of the following when either the name or data elements is not encrypted or redacted:

a. Social security number;

b. Driver's license number or California identification card number;

c. Account number, credit or debit card number, in combination with any security code, access code or password that would permit access to an individual's financial account; or

d. Medical information.

Personal information does not include publicly available information that is lawfully made available to the public through federal, state or local government records.

NOTE

REGARDING COMPLIANCE WITH CIVIL CODE SECTION 1798.81.5: As discussed in this chapter previously, since dealerships are considered "financial institutions" for purposes of the GLB Act, dealers should already have in place safeguard procedures which protect a consumer's personal information so as to be in compliance with the FTC's Safeguards Rule. As long as a dealership is complying with the Safeguards Rule, it would appear reasonable to conclude that the dealership is in compliance with the provisions of Civil Code section 1798.81.5 (See Civil Code section 1798.81.5(e)(5)).

REGARDING PROTECTION OF DEALER CUSTOMER DATA: California Vehicle Code sections 11713.3(v) and 11713.25 prohibit manufacturers and computer vendors from accessing, modifying or extracting information from a confidential dealer computer record (including personally identifiable consumer data) without the prior written consent of the dealer. See further discussion of this topic in the section entitled "Computer Access Issues" in the Other Important Topics chapter of this Management Guide. It is further noteworthy that pursuant to California Vehicle Code Section 11713.13(f)(1)(C), a manufacturer or distributor is required to indemnify a dealer from third party claims that result from the improper use or disclosure by a manufacturer or distributor of nonpublic personal information obtained from a dealer that relates to a consumer or employee of the dealer.

A Customer's Right to Ask About Information Sharing Practices

Dealers should be aware of California Civil Code section 1798.83 which requires businesses that share a customer's "personal information" with third parties to make certain disclosures to the customer, if the third parties use the information for their own "direct marketing purposes." This rather confusing statute gives a customer having an "established business relationship" with a business, the right to ask the business to disclose the categories of personal information shared with third parties and used for their direct marketing purposes.

To attempt to understand this statute, dealers need to comprehend certain key terms which are basically defined as follows:

a. "Customer" is a California resident providing personal information to a business at the creation of or throughout the duration of an established business relationship which is primarily for personal, family, or household purposes.

b. "Direct Marketing Purposes" is the use of personal information to solicit or induce a purchase, rental, lease or exchange of products, goods, property or services directly to individuals by means of mail, telephone, or electronic mail for personal, family, or household purposes.

c. "Established Business Relationship" is a relationship (which has not been expressly terminated by either party or if not ongoing is based upon a transaction occurring within 18 months) formed by a voluntary, two-way communication between a business and a customer, with or without an exchange of consideration, for the purpose of purchasing, renting, or leasing real or personal property or obtaining a product or service.

d. "Personal Information" is, among other things, name and address, email address, telephone number, kind of product or service purchased, social security number, occupation, credit card number, information pertaining to credit worthiness, assets, income or liabilities (see Civil Code section 1798.83(e)(7) for the complete list of "personal information").

e. "Third Party" is, among other things, a business that is a separate legal entity from the business that has an established business relationship with a customer.

Dealers need to evaluate the information sharing practices (with a focus on how the third parties use the information) of their dealerships to determine if they will need to comply with Civil Code section 1798.83. However, because dealerships do typically share customer information with third parties such as affiliates, manufacturers, and finance companies who may use such information for their direct marketing purposes, it is likely that compliance with this statute will be required.

PRACTICAL TIP

Dealership personnel should be trained so that when a customer makes a request about a dealership's information sharing practices as contemplated by Civil Code section 1798.83, the re-

quest is referred to upper management as soon as possible so that a proper response to the customer can be developed within the 30-day time limit as required by the statute.

If a dealership does determine that its information sharing practices require compliance with Civil Code section 1798.83, the following steps should be taken:

a. Establish and publicize a "contact point" for receiving customer requests under the statute as follows:

(1) The dealership needs to designate a mailing address, email address, telephone or fax number (toll-free) where a customer may submit his or her request; and

(2) The dealership needs to publicize the "contact point" in at least one of the following three ways:

(a) Train customer service employees to inform dealership customers of the contact point information;

(b) Modify the dealership's website to add a section to the privacy policy page or a link to a page with the heading: "Your Privacy Rights" (the heading needs to comply with certain specific style and size requirements designated to call attention to text set out in Civil Code section 1798.83(b)(1)(B)) with text describing a customer's rights pursuant to Civil Code section 1798.83 and providing the designated contact point information. If the dealership's privacy policy is modified in this manner, the dealership is only required to respond to customer requests made to the designated address or number; or

(c) Make the contact point information readily available upon request of a customer at every place of business in California where there is regular customer contact.

b. Comply with the statutory response requirements as follows:

(1) Disclose free of charge the following information to the customer in writing or by electronic mail:

(a) A list of the categories of personal information which have been disclosed to third parties for the third parties' direct marketing purposes during the immediate proceeding calendar year; and

(b) The names and addresses of the third parties receiving the personal information (if the name of a third party does not reveal the nature of its business, examples of the products or services marketed by the third party, if known by the dealership, sufficient to give an indication of the third party's business must be disclosed).

If a dealership receives a customer request pursuant to Civil Code section 1798.83 at the designated contact point address or number, this response must be made within 30 days. A customer request received at other dealership addresses or numbers must be responded to within a reasonable period of time, not to exceed 150 days.

(2) If a dealership has implemented, publicized and complied with a privacy policy that gives its customers a free method to opt-in or opt-out of information sharing, then the dealership may comply with any customer requests made pursuant to Civil Code section 1798.83 by simply notifying the customer of his or her right to use the opt-in or opt-out policy.

PRACTICAL TIP

If a dealership is not reasonably sure if a third party is using for its own direct marketing purposes the personal information shared by the dealership, the dealer should make an inquiry to the third party as to how the third party uses the information and obtain, if possible, a written response. Such a response could be important in determining the dealership's compliance strategy regarding Civil Code section 1798.83.

NOTE

REGARDING STANDARDIZED NOTICE: A dealership may develop a standardized response notice for purposes of complying with Civil Code section 1798.83 and potentially that notice could be the same privacy policy notice used to comply with the GLB Act. However, dealers must make sure that the GLB Act privacy notice does comply with all the requirements of Civil Code section 1798.83, including identifying the names and addresses of the third parties receiving the personal information.

Exemptions

Under certain "exemptions" recognized by Civil Code section 1798.83, a business is not required to comply with the statute even though personal information has been disclosed to third parties. However, many of these exemptions are unclear in their application (for example, the third party use of personal information covered does not appear to include a use for direct marketing purposes). Some of the exemptions which potentially could apply to dealership information sharing practices are summarized as follows:

a. If the personal information is shared pursuant to a written contact relating to a joint offering of a product or service and all of the following requirements are met:

(1) The product or service is provided by a party to the contract;

(2) The product or service is offered, endorsed and sponsored by and clearly and conspicuously identifies for the consumer the businesses that disclose and receive the disclosed personal information; and

(3) The contract provides that the third party receiving the personal information is required to maintain the confidentiality of the personal information and is prohibited from disclosing or using it other than to carry out the joint offering or servicing of the product or service that is the subject of the contract;

b. If disclosure of the personal information relates to payment history or other transaction experiences involving the customer and is to or from a consumer reporting agency as part of the process used to generate a consumer report covered by the federal Fair Credit Reporting Act.

c. If disclosure of the personal information is to a third party financial institution solely for the purpose of the dealership obtaining payment for the transaction in which the customer paid the dealership for goods and services with a check, credit card, charge card, or debit card;

d. If disclosure of the personal information is between a dealership and a financial institution relating to a program involving the purchase of retail installment contracts and the personal information disclosed is necessary for the financial institution to maintain or service accounts on behalf of the dealership relating to those retail installment contracts, or to complete, effectuate, administer, or enforce customer transactions or transactions between the financial institution and the dealership, and if the personal information is used solely to market product or services directly to customers with whom both the dealership and financial institution have established business relationships as a result of the retail installment contract program; or

e. If disclosure of the personal information is between affiliated third parties which share the same brand name, except that this exemption does not apply if the personal information relates to certain categories identified in Civil Code section 1798.83(f), including height, weight, telephone number, social security number, bank account number, credit card number, debit card number, and certain lists of customer names and addresses which allow the third party to extrapolate personal information of that type.

CAUTION

REGARDING CIVIL CODE SECTION 1798.83 EXEMPTIONS: The exemptions described in Civil Code section 1798.83 are not very clear in terms of their application. Under these circumstances, a dealership should consider carefully any decision to rely upon an exemption as a basis for not complying with that statute.

Legal Consequences of Non-Compliance

Any customer injured by a violation of Civil Code section 1798.83 may institute a lawsuit to recover damages (injunctive relief is also available). A customer prevailing in such a lawsuit may also recover reasonable attorney's fees and costs. Additionally, a civil penalty of $500 per violation may be assessed and if a violation is willful, intentional or reckless, the penalty may be up to $3,000 per violation.

It is noteworthy, however, that pursuant to Civil Code section 1798.84(d), any business alleged to have violated the statute in a manner which is not willful, intentional or reckless, may assert as a complete defense, the fact that within 90 days of being notified of a failure to comply with the statute, the business made the required disclosure.

Breach of Computerized Data Systems Notification Requirement

As dealerships typically utilize extensive computerized data systems in their operations, dealers should be aware of California Civil Code section 1798.82. This statute requires that any person or entity conducting business with a computerized data system must give written notice to a resident of California if there is a breach of that system which results in personal information (such as a social security number or driver's license number) being acquired by an unauthorized person.

NOTE

REGARDING CREDIT CARD NUMBERS: California law (Civil Code section 1747.09) specifically provides that any person or entity accepting credit cards for the transaction of business is prohibited from printing more than the last five digits of the credit card number or the expiration date upon any receipt electronically printed and provided to the cardholder. The FACT Act also has a similar provision imposing this prohibition.

Identity Theft and Red Flags

Both federal and California law place certain duties on persons or entities such as dealerships involved in credit transactions where the potential for identity theft exists. The FTC final rule under the

FACT Act defines "identity theft" as "a fraud committed or attempted using the identifying information of another person without authority" (16 C.F.R. section 603.2(a)). As discussed in the section entitled "Fraud Alerts/Personal Information Discrepancies" in the Credit Reports and Decisions Chapter of this Management Guide, steps must be taken by a dealership to verify the identity of a consumer when in response to a request for a consumer credit report, the dealership receives fraud alerts or is notified or becomes aware of discrepancies between personal information listed in the credit report and the credit application submitted by a consumer.

Additionally as a result of the issuance of a regulation known as the "Red Flags Rule" by a team of federal banking agencies and the FTC under the FACT Act, businesses that offer credit, including automobile dealerships, are required to establish policies to detect, prevent and mitigate identity theft. Specifically to comply with the Red Flags Rule, a dealership must develop a written "Identity Theft Prevention Program", consisting of reasonable policies and procedures to identify, detect and respond to "Red Flags" which are patterns, practices or specific activities that indicate the possible existence of identity theft. As part of the process of developing this Identity Theft Prevention Program, a dealership is required to do the following:

(1) Identify the scope of the program. This is done by cataloging all forms of transactions and in house accounts that the program should cover. While primarily designed to protect consumers engaging in purchases for personal, family or household use, some business transactions may also be covered, depending on the risk of identity theft.

(2) Identify relevant Red Flags and incorporate them into the program. The actual examples of Red Flags listed in the Red Flags Rule should be considered. Additional Red Flags not published in the Rule should be included based on the dealership's own experience and circumstances.

(3) Identify the ways the dealership will detect the Red Flags included in its program.

(4) Identify how the dealership will respond appropriately to detected Red Flag events to prevent identity theft or reduce any harm that might result if identity theft occurs.

(5) Provide means for the program to be updated periodically to reflect changes in identity theft risks to customers and the dealership.

A dealership's board of directors (or senior management if the dealership is a limited liability company) should approve the Identity Theft Prevention Program and designate a senior management person to oversee the implementation of that program. These oversight duties should include assigning specific responsibilities under the program, reviewing compliance reports prepared by dealership personnel, and coordinating approval of material changes to the program as new identity theft risks emerge.

CAUTION

REGARDING RED FLAGS RULE COMPLIANCE: Dealers should have a solid compliance strategy relating to the Red Flags Rule and consult legal counsel as appropriate. The NADA Management Guide publication entitled, "A Dealer Guide to the FTC Red Flags and Address Discrepancy Rules: Protecting Against Identity Theft", which is available at www.NADA.org/nadauniversity /resourcetoolbox is a good compliance resource regarding the Red Flags Rule. Also, at www.ftc.gov/redflagsrule, the FTC provides guidance for creditors subject to the Red Flags Rule.

Fingerprinting Customers

Many dealerships have instituted a policy of fingerprinting customers (typically a thumbprint) in connection with selling and leasing vehicles. The purpose of fingerprinting is to deter identity theft. Although some customers complain from time to time that being fingerprinted is an invasion of privacy or otherwise puts their security at risk, fingerprinting, as part of an effort to deter identity theft, is not prohibited by state or federal law. In fact, some law enforcement agencies encourage the practice.

Dealers should be aware, however, that because of the high profile nature of fingerprinting and the characterization of fingerprinting as biometric data, a policy requesting a fingerprint should be carefully implemented. For example, a dealership could be subjected to a claim of illegal discrimination if it appears that customers are being requested to provide fingerprints on the basis of their race or ethnic background. For that reason, a fingerprinting policy should be uniformly applied to all customers across the board. In addition, dealership personnel should be prepared to face the situation where a customer absolutely refuses to be fingerprinted. In that instance, dealership personnel should consider taking alternative steps to verify the customer's identity. Any fingerprints obtained from customers should be protected as confidential information.

Dealerships that fingerprint customers should consider developing a written statement to be delivered to customers setting forth the dealership's reasons for requesting fingerprints and confirming that the fingerprints will be treated as confidential information. Certainly any statements made to customers regarding a fingerprinting policy should be fully accurate in content. For example, statements

that law enforcement agencies endorse the fingerprinting policy should be made only if those statements are accurate. Also, there should be no statement that the fingerprints will be automatically released to law enforcement agencies.

Dealers should not hesitate to contact their legal counsel regarding fingerprinting policies, as new legal developments and questions relating to such policies are likely to continue.

Identity Theft Investigations

Because of the increasing instances of identity theft, dealerships are likely to receive inquiries from law enforcement authorities to examine deal jackets and other related dealership records as part of an identity theft investigation. Such inquiries pose a dilemma, however, as dealers typically wish to cooperate with law enforcement authorities, but also realize that a customer's non-public personal information is subject to certain legal protections. To protect against claims that non-public personal information was improperly released, a dealership should request law enforcement authorities to provide proof of their authorization to examine the records requested before the dealership releases them. This type of authorization may vary, but two forms are designed to particularly address identity theft situations. One form is a search warrant under California Penal Code section 1524 which law enforcement authorities may obtain to seize records or other evidence that shows a violation of California Penal Code section 530.5 (this statute makes it illegal for a person to use another individual's personal identifying information without consent). Law enforcement authorities may also be authorized to review records as a result of a written request submitted to the dealership by the alleged identity theft victim under provisions of state or federal statutes (see California Penal Code section 530.8 and 15 U.S.C. section 1681g (e)). In connection with such a request, the alleged victim is generally required to present to the dealership a copy of a filed police report relating to the identity theft.

While not a risk free approach, if a dealer is inclined to allow law enforcement authorities to review dealership records without authorization of the type discussed above, the dealership should at least obtain something in writing from those authorities confirming they are requesting the records as part of a criminal investigation. Such documentation is important as many of the laws and regulations protecting consumer privacy rights (for example, the GLB Act) recognize an exception to a consumer's privacy protection in those instances where a properly authorized criminal investigation is occurring. In all cases, a dealer should carefully consider a request by law enforcement authorities to review dealership records and consult legal counsel as necessary to review the authorization provided and develop the most appropriate response.

NOTE

REGARDING IMPACT OF IDENTITY THEFT ON DEBT COLLECTION: Dealership personnel involved in collecting consumer debts must be aware that such activity will be impacted if a claim of identity theft is raised by a debtor. Specifically, California Civil Code Section 1788.18 requires that a debt collector cease collection efforts regarding a consumer debt upon receipt from the debtor of a police report filed by the debtor alleging identity theft and a written statement from the debtor containing specified details concerning the debtor and the alleged identity theft. A debt collector, upon receipt of these materials, is required to review and investigate the debtor's claim of identity theft, and may resume debt collection efforts only after a determination is made in good faith that the information from the debtor does not establish that the debtor is not responsible for the debt. The debt collector is required to notify the debtor in writing of its determination before debt collection activities are resumed.

TELEMARKETING, FAX, AND EMAIL

Chapter 6

Contents

TELEMARKETING, FAX, AND EMAIL

OVERVIEW: A desire to reduce unwanted solicitation of consumers by telephone and other means was an impetus to many of today's privacy laws. However, privacy laws were soon followed by another set of laws that directly target telemarketing calls, commercial faxes, and email communications. This chapter summarizes and comments on these laws and their impact on automobile dealers.

Telemarketing Regulations

Introduction

The telemarketing rules are significantly complicated by the existence of three separate sources of regulation – Federal Trade Commission (FTC) regulations, Federal Communications Commission (FCC) regulations, and California law.

This discussion focuses on California Business and Professions Code Code sections 17590 et seq. ("Bus. Prof. Code"), and the FCC regulations (47 CFR sections 64.1200, 64.1601, and 68.318) because they both apply to in-state calls.

The FTC Telemarketing Sales Rule (16 C.F.R. part 310), which applies only if at least some interstate calling is undertaken, is not discussed in detail in this chapter because it is assumed that most California dealers generally have no occasion to make telemarketing calls outside California.

CAUTION

ON INTERSTATE CALLS: There are significant differences between the FCC and FTC regulations, not only as to do-not-call and related technical matters, but as to substantive requirements concerning the process of selling over the telephone, especially if any type of sales transaction is consummated over the telephone, without a face-to-face meeting at the dealership premises. Dealers who undertake any degree of interstate telemarketing should ensure themselves that their interstate calling is either insufficient to trigger the FTC regulations or that they are complying with those regulations. The number and type of interstate calls allowed before the FTC regulations would apply is unclear due to vague language declaring the FTC's regulations applicable to any telemarketing "plan, campaign, or program" that "involves more than one interstate call." For compliance assistance dealers may review the FTC publication entitled "Complying with the Telemarketing Sales Rule" available at http://business.ftc.gov/ documents /bus27-complying-telemarketing-sales-rule. For dealers not engaged in interstate business, it may be helpful to specifically state in the dealership's written telemarketing policy that none of the dealership's plans, campaigns, or programs for marketing by phone will be placed to out of state telephone numbers.

The FCC regulations were issued primarily under the authority of the federal Telephone Consumer Protection Act, 47 U.S.C. section 227, while the FTC regulations included in the Telemarketing Sales Rule were primarily authorized by the federal Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. sections 6101-6108.

In order to present an integrated picture of the requirements faced by California dealers, the information below draws simultaneously from both the FCC rules and California law.

NOTE

FEDERAL AND STATE LAW BOTH APPLY: Although the FCC regulations preempt state law provisions that are less restrictive than the FCC regulations themselves – thus serving as a "floor" beneath which state laws cannot authorize businesses to go – the federal regulations do not prohibit states from enacting more stringent telemarketing rules for intrastate calls. As a result, dealers are forced to examine both California and federal law on each element of telemarketing (especially the exceptions to the do-not-call rules) and to follow the more restrictive of the two laws in each case. In some cases, the federal and state approaches use different terminology, which complicates the analysis even more. Dealers should exercise care when receiving advice or seeking compliance solutions from national organizations, since there is a risk that the California component of the telemarketing rules will be overlooked or not properly integrated into the federal scheme.

Telemarketing Defined

The term "telemarketing" is defined and used differently in each set of regulations. In fact, the FCC regulations define "telemarketing" on the one hand and "telephone solicitation," on the other, slightly differently. To simplify matters for purposes of this discussion, a telemarketing call is any call that is subject to regulation under the telemarketing rules of either the FCC regulations or California law. Under this definition, telemarketing calls are not necessarily prohibited or illegal as such, but instead are the kinds of calls that could be restricted under the regulations. Any call meeting the following criteria would be a telemarketing call:

- The call is initiated by the dealership or on its behalf and does any of the following:
- • Encourages the rental, lease, exchange, or purchase of (or investment in) goods or services or offers to sell, lease, or otherwise provide goods or services;
  - *• Promotes any product or service;*
  - *• Offers any extension of consumer credit;*
  - *• Collects marketing information that may be used to make a solicitation at some future time;*
  - *• Offers any gift of goods or services; or*
  - *• Offers a prize or opportunity to receive a prize*

Examples of Calls Not Involving Telemarketing

Calls that do not meet the above criteria would not be telemarketing calls, and therefore are not restricted under any of the rules discussed in this chapter. For example, a call to advise a consumer that work on his or her vehicle is complete – and nothing more – would not be a telemarketing call.

Upselling not covered by California or FCC "Intrastate" Regulations, only by FTC "Interstate" Regulations

When a customer places a call to the dealer, the call cannot be a telemarketing call under the above criteria, regardless of what is said or done during the course of the call. But under the FTC regulations governing interstate calls, some calls made by the customer can be transformed into telemarketing calls if "upselling" is undertaken. Upselling refers to sales efforts that take place during a phone call that was started for some other purpose. For example, during a call to the service department by a customer checking on the status of his or her vehicle, a service advisor might suggest additional work. Under the FTC regulations, such upselling would transform the call into a telemarketing call. But unless a dealership makes calls into other states for telemarketing purposes, it should not be subject to the FTC regulations. Those dealers in communities near California's borders should consult the FTC publication referred to previously and their own advisors to ensure their compliance with requirements unique to the FTC regulations, including upselling.

Basic Requirements for Making Telemarketing Calls

No telemarketing calls should be made (even to numbers not on the national do-not-call list) unless all of the following conditions are met, each of which is discussed in greater detail later in this chapter:

1 Have a written telemarketing compliance policy and training program on internal do-not-call requests, and implement the means to record and honor those requests

2 Take advantage of safe-harbor protections through written policies and training on the national do-not-call list and other telemarketing rules and implement the means to comply with those rules, including the downloading and saving of numbers from the national list, the checking of numbers before they are dialed, and the creation and maintenance of documentation establishing that these steps were accomplished

3 Honor the national and company specific do-not-call rules

4 Ensure the Caller ID transmitted when calls are made is accurate and not blocked

5 Have calls made no earlier than 8:00 a.m. and no later than 9:00 p.m.

6 Let phones ring at least four rings or fifteen seconds before hanging up

7 Have employees/contractors give the proper identifying information and contact numbers when calling

Written Policy and Training

Basic Company-Specific Do-Not-Call Policy and Training

Unless the business decides to forego any and all telemarketing calls (even to numbers not appearing on any do-not-call list), the FCC rules require dealers and other businesses to establish and have in place a written telemarketing compliance policy, to be "available upon demand." The regulations do not state to whom the policy must be made available upon demand and it is unknown whether consumers have standing to demand a copy.

The policy must at a minimum specify that the dealership will do the following:

- Create and maintain a company-specific (internal) do-not-call list

- Record numbers and, if given, names from do-not-call requests on the internal list and maintain them for five years
- Ensure the do-not-call requests are honored for five years
- Train all employees or others having telemarketing duties in the use of the do-not-call list

The policy and training must in fact be implemented. Until the written policy is in place and employee training has been conducted, the only sales or marketing calls that can be made are those to non-residential, land-line numbers.

While these basic policy and training requirements should absolutely be followed before telemarketing of any kind is conducted, a more comprehensive telemarketing policy and training program can serve as a defense to accidental violations of the California telemarketing law and the national do-not-call provisions of the FCC regulations.

Safe Harbor Protection Against Liability Available If Additional Written Procedures and Training Maintained

The FCC regulations provide that businesses can be relieved from liability for accidental violations of the national do-not-call list rules if the following "safe harbor" requirements are met:

- Have written procedures to comply with national do-not-call list rules:
- Provide each employee and contractor engaged in any aspect of telemarketing with training on dealership telemarketing policies and procedures
- Maintain and record the company-specific (internal) do-not-call list
- Use a process to prevent calls to numbers on the national registry
- Use registry data downloaded no more than 31 days prior to the date of any call
- Use a process to ensure registry data is not sold, shared, etc.
- Purchase the registry data as required and avoid any cost sharing arrangements
- Maintain records documenting the above

Likewise, an "affirmative defense" can be asserted by a dealership to avoid liability for violations of the California telemarketing law if the violation resulted from an inadvertent accident that occurred even though the dealership had policies, procedures, training, and instruction in place to abide by the law. Dealers seeking to take advantage of the state and federal affirmative defense/safe harbor rules should develop and implement comprehensive written telemarketing policies and procedures and provide similarly comprehensive training, monitoring, and enforcement.

Do-Not-Call Rules

Two Do-Not-Call Lists

The most well known and publicized feature of the telemarketing regulations is the concept of do-not-call lists. The regulations, in fact, call for two such lists: the national list, and the company-specific list. Unless an exception clearly applies, no dealership employee or agent may place telemarketing calls to residential or wireless phone numbers listed on either do-not-call list.

National Do-Not-Call List

Sole responsibility for maintaining the national list (used both by the FTC and FCC) is vested in the FTC. California law acknowledges the FTC list as the source of numbers that the California telemarketing law prohibits a dealership from calling. A dealership can have access to the FTC list by paying the appropriate fees which are based upon the number of area codes involved in a telemarketing campaign. Evading the fees by sharing data is illegal. Affiliated dealerships may share the data unless both of the following are true: (a) they are operated by separate legal entities and (b) they do business under separate names.

CAUTION

ON SECURING ACCESS TO THE LIST: Until a business completes the process of registering as a national do-not-call list user, and pays any fees that might be required, all telemarketing must be suspended, except for calls to persons covered by the express written permission exception or the established business relationship exemption, discussed later in this chapter. However, until access to the national do-not-call list is obtained, it is highly recommended that no such calls be made because any mistaken conclusion that the exceptions apply could result in liability without benefit of the safe harbor rules, discussed previously.

PRACTICAL TIP

Presently, fees for accessing the national do-not-call registry are waived for the first five area codes. Registration and downloading information may be found at www.telemarketing.donotcall.gov. Each and every company that makes telemarketing calls or on whose behalf telemarketing calls are made must register on the Do-Not-Call website. Even if a dealership uses a third party to make the calls, the dealership must be registered and cause the fees to be paid for all of the area codes it needs.

CAUTION

ON UPDATING THE LIST: The FTC rules require dealerships to "scrub" their lists against the registry every 31 days.

NOTE

ON DOWNLOADING NUMBERS FROM THE REGISTRY: Downloads of numbers on the registry are available as a complete list, from a particular area code, or as a list only of those phone numbers that have been added or removed since an earlier download. A lookup feature is also available where the user inputs from one to several numbers into an FTC web page to see if the numbers are listed in the national do-not-call registry.

Company-Specific Do-Not-Call List

As to the company-specific or "internal" list, a dealership must keep records of all customer requests not to be called for a 5 year period, and must record any residential telephone subscriber's name, if given, and telephone number on the internal dealership do-not-call list. Every employee who makes a telemarketing call must be authorized and able to honor the request by causing the number and, if given, name to be included on the internal list – the customer cannot be forced to call back or to call another number. While the FCC regulations allow businesses up to 30 days, if necessary, to begin honoring the do-not-call request, California law does not directly recognize this leeway in every case, so it is important that a dealership implement do-not-call requests as quickly as possible.

CAUTION

INTERNAL DO-NOT-CALL LIST IS A SUPER-LIST: The importance and force of do-not-call requests made directly to a dealership and the dealership's internal do-not-call list cannot be overemphasized. A consumer's request not to be called again and to be placed on a dealership's do-not-call list trumps all exceptions that would otherwise allow calls to numbers on the national do-not-call list, even the formal written consent exception. Arguably, no telemarketing call of any kind can be placed after a dealership receives a do-not-call request, unless and until the consumer formally requests to be removed from the dealership's internal do-not-call list. Whether oral requests for removal from the list are valid is not totally clear. In any case, no request for removal should be considered effective unless it is received and recorded in a verifiable manner.

Exceptions and Exclusions to Do-Not-Call

The do-not-call rules do not apply, and calls may be made (subject to the certain requirements discussed later in this chapter) if certain exceptions or exclusions apply. The following list of exceptions and exclusions may be used as a checklist to determine whether a telemarketing call may be made:

Non-Telemarketing

If a call is not for telemarketing purposes, the telemarketing rules are not applicable and the call may be made even though the phone number being called is listed on the do-not-call list. Note that calls made, in whole or in part, for any of the following purposes should be considered telemarketing calls: to encourage a sale; to promote a product or service; to gather marketing information that may be used to make a solicitation; or to offer a prize or make a gift.

Calls to Non-Residential, Non-Wireless Numbers

Only wireless and residential numbers may be registered on the national do-not-call list, and the company-specific do-not-call procedures only apply to calls to such numbers. However, calls to businesses are still subject to certain technical rules concerning prerecorded messages and auto dialers, and to the fax rules discussed later in this chapter.

NOTE

REGARDING BUSINESS-TO-BUSINESS CALLS: Calls placed to the residential numbers of "telecommuters" or others who use their residential phone line for business purposes can lead to unintended consequences. The FCC regulations and California law regulate calls to residential numbers and cellular numbers, not business "land line" numbers. But these rules are open to the interpretation that they cover all telemarketing calls – even business-to-business ones – placed to residential or wireless numbers on the do-not-call list. Care should therefore be used in placing marketing calls to home-based businesses, including wholesalers.

Both Lists Checked – Number not Found

If both the national and dealership do-not-call lists are checked, and the number is not found, a call to the number may be made. The FTC reports that more than 217 million telephone numbers have been placed on the national list. The remaining exemptions below apply even if the number to be called is listed on the national list.

Express Written Consent and Agreement To Receive Calls

Calls, even telemarketing calls, may be made to those on the national do-not-call list (but not on the dealership's internal list) if the call is made with the express written consent and agreement of the person called. Since there is no time limit or automatic expiration of such written agreements, the regulations impose significant requirements before such written agreements can be considered effective. At a minimum, a document giving a business permission to contact a consumer for an unlimited period of time must meet the following requirements:

- Be a written agreement
- State the name of the party that can make the calls (e.g., dealership name)
- Clearly state that the consumer wishes to be contacted
- Specify the telephone number or numbers that may be called
- Be a clear and conspicuous statement of consent which is not buried in fine print where the consumer might not notice it
- Not be part of a "contract of adhesion" – that is, not be part of a standardized contract presented to customers on a take-it-or-leave-it basis
- Be signed by the party to be called and
- Shall not have been revoked – revocation becomes immediately effective upon any consumer request not to be called.

NOTE

REGARDING SOLICITATION BY MAIL TO OBTAIN CONSENT FOR TELEMARKETING CALLS: Under California law, a telephone solicitor may by mail request a recipient's consent to receive information via telephone. If the recipient's telephone number is not listed on the national do-not-call registry, the solicitation must clearly and conspicuously disclose the following information: (1) the name of the sender of the mailing and of the entity that is requesting permission to call; (2) the telephone number to which calls are to be placed; and (3) notice that the recipient may be contacted by a telephone solicitor (Bus. Prof. Code section 17514). California law also does not prohibit mail solicitations to obtain written permission to make telemarketing calls to recipients whose telephone numbers are on the national do-not-call registry. In that situation, the telephone solicitor must obtain written permission signed by the recipient which clearly and conspicuously discloses the following information: (1) the name of the sender of the mailing and of the entity that is requesting permission to call; (2) the telephone number to which the calls may be placed; and (3) notice that the recipient may be contacted by a telephone solicitor even if the subscriber's telephone number is listed on the do-not-call registry (Bus. Prof. Code sections 17592(f)(1) and (2)).

Established Business Relationship

Calls may be made to those on the national do-not-call list (but not on the dealership's internal list) if made to a consumer with whom the dealership has an established business relationship, which exists if the consumer has voluntarily made a purchase, rental, or lease of the dealership's goods or services or participated in a financial transaction with the dealership within the 18 month period preceding the telemarketing call.

Although a payment on an installment contract or lease would count as a separate "transaction," it appears that only the assignee-finance source (and not the dealership) can count on post-assignment payments to renew the relationship. Customer-pay service department work would appear to count as a purchase for purposes of renewing the relationship period.

CAUTION

ON EARLY TERMINATION OF ESTABLISHED BUSINESS RELATIONSHIP: An established business relationship terminates immediately upon the customer's request not to be called, even if the 18 month period has not expired, and even if the customer continues to do business with the dealership.

PRACTICAL TIP

To protect the ability to call a customer at the end of the contract or lease, a dealership should consider obtaining express written consent to call at the time contracts are signed for the sales or lease transaction. Otherwise, the 18 month established business relationship exception will most likely expire well before end of the contract or lease, unless the 18 month period is extended in the interim by repair or other dealership transactions with the customer.

Express Request / Consumer Inquiry

A call may be placed to a number on the national do-not-call registry (but not the dealership's internal do-not-call list) if the call is made in response to a consumer's "express request," which may be oral or written. In most cases, the telemarketing call must be placed no more than 30 business days after receipt of the express request. The 30 business days

rule and the requirement to receive an express request arise out of California law.

A similar exception for consumer "inquiries" exists under federal law, which allows calls to be made within 3 months of an inquiry. The FCC regulations treat this exception as a special version of the established business relationship exception. Since California dealers are required to compare the federal and state restrictions in each area and comply with the more restrictive of the two requirements, the federal 3 month inquiry exception should not be considered available in California.

NOTE

DEFINITION OF EXPRESS REQUEST: As discussed above, California law and federal law differ on the "inquiry" exception to the do-not-call rule. Under California law, the express request exception is generally limited to a period of 30 business days, as opposed to the 3 month FCC inquiry exception. Moreover, calls made pursuant to the California exception apply only if the business has received the consumer's "express request" (presumably, to be telephoned). California dealers should therefore take care to avoid relying on the more flexible federal exception that is triggered merely upon a consumer "inquiry." For example, looking up the phone number of and calling a customer to respond to his or her email request for more information might fit the federal exception, but may not fit California's exception. Dealers should also be aware that the FCC specifically stated in its rulemaking that calls made to national do-not-call numbers pursuant to an inquiry need not be limited to the line of business or subject matter of the inquiry. An argument could be made under California law that the call must be limited to responding to the subject matter of the express request.

CAUTION

FALLING SHORT OF THE EXPRESS REQUEST / INQUIRY REQUIREMENTS: Some customer inquiries and even requests to be called back may not be enough to qualify as an "express request" under California law, or even as an "inquiry" under the FCC regulations. The FCC noted that calls asking for the dealership's hours of operation, for example, would not satisfy the inquiry exception. Other routine informational calls, such as requests for directions, should also not be considered to invoke the exception.

PRACTICAL TIP

Dealership personnel should be trained to help establish that consumer inquiries fall squarely on the side of express requests to be called simply by skillfully requesting a phone number each time an inquiry is received. For example, a dealership employee consistently asking all consumers making an inquiry "at what number do you request we contact you?" could help prove that those leaving a number did expressly request a call back. Such an inquiry would also prompt any consumer not wishing to be contacted by phone to make his or her wishes known.

California's time limit of 30 business days for calling numbers on the national do-not-call list after receipt of an express request is measured from the date of the consumer's last inquiry. If the product or service is unavailable at the time the inquiry was made and the consumer requests a call when the product or service is available, the 30 business days limit commences from the date the product or service becomes available. Calls made outside these time limits are presumed not to have been made in response to the consumer's express request.

Although California allows this 30 business days time limit to be held in abeyance pending availability of products or services previously inquired about, the FCC regulations do not. Specifically, the FCC regulations prohibit calls to do-not-call list consumers more than 3 months after the date of the consumer's last inquiry, without regard to product availability. In circumstances where the response to an inquiry is not expected to be available within 30 business days, it may be prudent for a dealership to have the consumer sign an agreement giving the dealership express consent to make telephone contact.

CAUTION

ON EARLY TERMINATION OF EXPRESS REQUEST EXCEPTION: The express request exception terminates immediately upon the customer's request not to be called, even if the 30 business days period has not expired.

Impact on Dealership Affiliates and Third Party Telemarketers

Do-Not-Call Requests Binding on Affiliates?

Telemarketing calls made by a dealership may impact affiliated entities, such as a second dealership under common control, or an affiliated leasing

or daily rental company. If a dealership receives a do-not-call request in response to a telemarketing call, does the request apply only to that dealership entity, or to affiliates of that dealership? Under the FCC regulations, the request would only automatically cover affiliates if they would reasonably be expected by the consumer to be covered by the request. But the FCC regulations also appear to authorize the consumer to expressly name affiliates that the consumer wants included in the do-not-call request. California law provides that where the original company receiving the do-not-call request shares a "brand name" with affiliates, those affiliates are also burdened by the do-not-call request and may not thereafter make telemarketing calls to the consumer. Under California law, where no brand name is shared, the do-not-call request only impacts the entity actually receiving the request. A highly conservative response to these two sets of rules would be for a dealership to simply maintain a centralized internal do-not-call list that would be disseminated to and honored by all affiliated companies.

Affiliate Sharing of Established Business Relationship

If a dealership has an established business relationship with a consumer, can the affiliates of the dealership also rely on that relationship to fall within the exception allowing calls to numbers on the national do-not-call registry? The FCC regulations provide a somewhat vague answer to this question, stating that it depends on the reasonable expectations of the consumer, but cannot include joint marketing partners.

In this area, since California has the stricter standard, its provisions control. California law relies on the concept of the shared brand name. If the affiliates share a brand name, they may each rely on the same established business relationship. If no brand name is shared, the relationship may be asserted only by the entity that conducted business with the consumer. It is unknown whether dealerships that share a common name would be considered to have the same "brand name" under these rules where each dealership name also includes a vehicle line-make, for example, "Cronkite Mazda" and "Cronkite Ford." A conservative way of handling this issue would be for a dealership to simply assume that the established business relationship only applies to the entity with which the consumer actually did business.

Limited Delegation to Outside Telemarketing Vendors

Companies who hire telemarketing firms to make all calls on their behalf must nevertheless register for and pay the national do-not-call access fees. It is a violation of the FCC regulations to enter into any fee sharing or access sharing arrangement with a third party, even with a retained telemarketing company.

Even where telemarketing calls are performed by an outside vendor, the person making the call must advise the consumer of the name of the dealership on whose behalf the call is being made. In addition, the Caller ID information transmitted by a telemarketer may be edited to show the dealership's name and customer service number, rather than the telemarketing company's name and number.

Dealership Liability for Violations by Telemarketing Vendors

Some outside vendors offer technology that permits do-not-call requests received on the dealership's behalf to be collected and transmitted to a central list for that dealership, and permits those making calls for the dealership to access the central list, and the national do-not-call list (and lists of exceptions to the national list), before making a call. Some telemarketing companies promote themselves as capable of taking over all aspects of telemarketing, including compliance. The FCC regulations provide that a dealership will be liable for any failure to honor a company specific do-not-call request even if the dealership hired a vendor to record and/or maintain do-not-call requests. California law appears to only speak to the hiring of a telemarketing firm as such, stating that liability for the acts of outside telemarketing vendors will be imposed on a dealership if the dealership controls the business practices of the telemarketer, and does not speak to "outsourced" compliance vendors.

Since dealerships may face liability for the failures of vendors, the importance of selecting quality vendors (whether to conduct telemarketing and/or to secure compliance services) with the resources, commitment, and contractual obligation to fully comply with the applicable requirements is critical.

Regulations Applicable To Calls Permitted Under Do-Not-Call

Any call for telemarketing purposes to a residential or wireless line, even if it is not prohibited by a do-not-call list (either because the number is not on the list or because an exception applies), remains subject to the following limitations and requirements:

After 8 a.m./Before 9 p.m.

Calls to residential numbers cannot be made outside the period of 8 a.m. to 9 p.m. local time at the called party's location. This rule does not apply if any of the following exemptions apply: express

written agreement, express request, or established business relationship. However, unless the express written agreement or express request specifies that calls may be made outside of these hours, such calls are not recommended. In addition, California law generally limits any use of auto dialers to between the hours of 9:00 a.m. and 9:00 p.m.

Callers Must Identify Themselves

The person making the call must provide the called party with all of the following information: the name of the individual calling (e.g., the dealership employee's name), the name of the dealership, and a telephone number or address for the dealership, which address or telephone number must be capable of accepting a do-not-call request. Any telephone number provided must not be a 900-line or other pay-to-call line.

CAUTION

ON REQUIRED IDENTIFICATION: The requirement that a dealership employee immediately state his or her own name, the name of the dealership, and a contact number or address applies to every telemarketing call made, regardless of any exception, course of dealing, or other reason. Proof of compliance with this requirement may prove elusive, as a dispute may boil down to the caller's word against the called party's word. It is therefore necessary to insist on strict compliance with this requirement not only to stress its importance, but to also provide believable evidence that no dealership employee would likely overlook this requirement.

CAUTION

FORM OF DEALERSHIP NAME REQUIRED DURING IDENTIFICATION: Sections of the FCC regulations dealing with prerecorded messages and faxes require identification of the caller/sender using the official corporate/entity name, not a dba name. This requirement is not found in the sections regulating live telephone calls. However, the thrust of the regulations is to provide accountability. It is therefore suggested that the dealership be identified by its official corporate/entity name or, if the dealership's legal counsel agrees, under an officially recorded and published dba.

NOTE

REGARDING ROBOCALLS: The FTC's Telemarketing Sales Rule, which applies to interstate calls, prohibits pre-recorded commercial telemarketing calls (known as "robocalls") to consumers unless the telemarketer has obtained written permission from the consumers that they want to receive such calls. There is no prior business relationship exception to this prohibition. The FCC regulations, which apply to dealerships making only in state calls, have been amended to also prohibit robocalls unless the written consent of the consumers to be called is obtained. Because of the complexities involved, dealers considering a telemarketing campaign which utilizes robocalls should have it reviewed for legal compliance issues.

Callers Must Be Able to Accept Do-Not-Call Requests

The person making the call must be able to accept and register on the dealership's internal do-not-call list a request not to be called made by anyone being called.

Caller ID Accurate, Not Blocked.

Businesses must not block Caller ID information (including, where available, transmission of "subscriber name") and must take all steps necessary to have the telephone company transmit an accurate Caller ID number and name. To be deemed accurate, the number and name transmitted must be associated with the dealership (or truthfully report the telephone company data regarding any outside telemarketing firm actually placing the call), but the dealership has the choice of having the Caller ID reflect the actual number and name assigned to the line being used, or the dealership's main or customer service numbers and the dealership's name. However, the number chosen to be transmitted must be one that consumers may dial to make do-not-call requests during regular business hours.

Calls To Be Allowed to Ring Four Rings or Fifteen Seconds

To prevent the perceived problem of consumers answering ringing telephones only to find no one on the other end, one of the FCC regulations prohibits disconnecting an unanswered telemarketing call prior to at least 15 seconds or 4 rings.

Call Center/Technology Limitations

The FCC regulations and certain California laws impose technical requirements on call center technology. These include, subject to certain exceptions, the following:

No system may be used to call numbers to determine the nature of the line (e.g., fax, modem, voice, etc.) ("war dialing").

Auto dialers may not be used to call emergency telephone lines, hotel and hospital guest rooms, pagers, cell phones or wireless phones, or other

phones where the called party is charged for the call, or to simultaneously engage two or more telephone lines of a business. California law generally limits any use of auto dialers to between 9:00 a.m. and 9:00 p.m.

The FCC regulations provide that pre-recorded or other automated speech systems may not be used to deliver any advertising message or solicitation, unless a dealership has the consumer's express written consent to do so. Even when businesses are allowed to use these systems, pre-recorded messages must identify the caller's name and number. California's Consumer Legal Remedies Act, Civil Code section 1770(a)(22)(A) generally prohibits any pre-recorded calls absent a pre-existing relationship, and California Public Utilities Code sections 2871-2875.5 generally limit the use of such systems to between 9:00 a.m. and 9:00 p.m.

Technical "Call Abandonment" rules must be followed, and records kept to document compliance, when "predicative dialing" or other equipment is used whereby the call is automatically dialed and then connected to a live operator. In such cases, the system must ensure the prompt (2 second) connection to a live operator once the called party answers the phone, and provide for a backup recorded greeting and self-identification if the system occasionally (but not more than 3% of the time) fails to meet this requirement. Calls that reach voicemail or an answering machine will not be considered "answered" by the called party. Therefore, a call that is disconnected upon reaching an answering machine will not be considered an abandoned call

Additional Do-Not-Call Issues

Due to at least two separate layers of regulation – state and federal – some calls that might otherwise be exempt are not. The following points highlight special concerns that arise from the overlap of state and federal law. These points apply only in the context of calls to consumers whose numbers are listed in the national do-not-call registry.

No Personal Relationship Exception

While the FCC rules recognize a personal relationship exception, the California rules do not. Since the law requires dealerships to follow the more restrictive of the two regulatory schemes in each instance, the exemption should be considered unavailable.

No Gift/Prize Exception

Apparently in response to the telemarketing practice of first announcing that the consumer has won a prize or is to receive a gift, any call seeking to offer a prize or gift, even if no other sales or promotion efforts are made, is categorized as a telemarketing call under California law.

Phone Survey Exception Restricted

The FCC rule permits market research surveys by telephone to phone numbers on the do-not-call list, unless the survey is merely a pretext to engage in telemarketing. However, California law prohibits surveys if they seek "market information" that "will or may be used" for direct solicitation of the consumer. It appears this provision prohibits phone survey data gathered from do-not-call consumers from being used to sell or market to do-not-call consumers. For example, if a do-not-call consumer's address or age is determined by phone survey, that piece of information cannot later be used to send (or to target) direct mail to that consumer (unless, of course, the consumer expressly requested to be provided with information). On the other hand, a survey conducted solely for purposes of gathering general statistical data should not be deemed prohibited.

No Private-Party Classified Ad Exception

While California law appears to exclude calls a dealership may make in response to classified or other private-party advertisements placed by a consumer from the do-not-call restrictions, the FCC rule contains no such explicit exemption. As stated previously, the law requires dealerships to follow the more restrictive of the two regulatory schemes in each instance, so the exemption should be considered unavailable. However, calls to private party ads would probably not be considered "telemarketing" calls under the FCC definition if the caller carefully refrained from attempting to sell or promote the dealership's products or services and instead limited the discussion to the consumer's ad itself.

No Small Business Exemption.

While California law contains an exception for small businesses, the FCC expressly declined to adopt such an exception. Again, since the stricter of the two regulatory schemes must be followed in each instance, the exemption should be considered unavailable.

Text Messaging to Cell Phones or Pagers Limited

Under California law, a business may not send a text message advertisement to a cellular telephone or pager unless there is an existing relationship and opportunity to opt-out from receiving text messages from that business (Bus. Prof. Code section 17538.41). The applicable statute is not violated if the electronic mail message is forwarded, without

the knowledge of the sender, to a mobile telephone services handset, pager or two-way messaging device. It should, however, be noted that the FCC, in connection with the implementation of the CAN-SPAM Act, does publish a list of wireless domain names at www.transition.fcc.gov/cgb/policy/ DomainNameDownload.html. Arguably, the sender of an electronic mail message would be deemed to have knowledge that any email sent to any wireless domain name on that list would be forwarded to a wireless device.

Use of Downloaded Do-Not-Call Numbers Limited to Telemarketing Compliance

Under the FCC regulations, businesses are prohibited from disclosing or using downloaded do-not-call numbers for any purpose other than complying with the telemarketing requirements.

NOTE

REGARDING INTERNET LEAD GENERATION SERVICES: In an advisory opinion dated July 19, 2006, the FTC considered the situation of an internet based lead generator providing leads to lenders who wanted to contact those leads by telephone. The key issue addressed by the FTC was whether inquiries by consumers to a lead generator qualified as an "established business relationship" with the lenders involved that allowed them to call such consumers even when they were listed on the national do-not-call list. The FTC concluded that an "established business relationship" did not exist between these lenders and the consumers making inquiries to the lead generator, but recommend that enforcement activity should not be initiated against a lender in that situation if the lead generator clearly and conspicuously disclosed before the consumer divulges his or her telephone number that:

1. The consumer may receive telemarketing calls as a consequence of submitting his/her telephone number;

2. The maximum number of entities from which the consumer may receive the calls; and

3. The name of entities that may contact the consumer (if possible).

While this advisory opinion does not have the force of law, it would suggest that dealerships could call consumers identified by internet lead generators even if they are on the national do-not-call list, if the lead generators made disclosures of the type discussed above. Dealers considering such activity should consult with legal counsel to verify that necessary compliance procedures are in place to minimize the legal risks involved.

Penalties and Enforcement

Federal

Failure to comply with the FCC rules could result in, among other things, a fine up to $16,000 for each violation or each day of a continuing violation, except that the amount assessed for any continuing violation shall not exceed a total of $112,500 for any single act or failure to act (47 C.F.R. section 1.80(b)). Each call to a number on the do-not-call list is a separate violation. However, under the Communications Act, the FCC cannot impose liability on an entity that does not hold an FCC license without first issuing a citation to that entity. It is also possible that the FTC could bring an enforcement action under the Fair Trade Commission Act, and seek similar fines.

In addition to governmental enforcement, a consumer may file a civil lawsuit in state court for a violation of the FCC rules. A consumer may seek to recover actual monetary loss or $500 in damages for each violation, whichever is greater, and an injunction prohibiting further violations. The court may also award treble damages if the violator willfully or knowingly violated these rules (47 U.S.C. sections 227(b)(3) and (c)(5).) Plaintiffs' attorneys have filed class actions in state and federal courts on behalf of consumers for alleged violation of FCC regulations. Class actions brought in federal court have generally been dismissed because the statutes and regulations give state courts exclusive jurisdiction over private rights of action, and limit federal court jurisdiction to actions brought by state attorneys general or the FCC.

For certain violations, such as wrongfully using an autodialer, a consumer's cause of action arises as soon as the caller violates the rules. For other violations, including telephone solicitation violations, a consumer's cause of action does not arise until he or she has received more than one telephone call within any 12-month period by or on behalf of the same company.

The statute of limitations for a violation of the do-not-call registry rules and other federal telemarketing regulations and laws is 4 years.

California

The California Attorney General, a district attorney, or a city attorney may bring a civil action to enforce the California telemarketing laws and to obtain an order to enjoin the violation and/or a civil penalty of up to the penalty amount that the FTC

may seek for violation of its regulations, as discussed above.

In addition, a consumer may file a civil lawsuit for a violation of the California telemarketing laws. Generally, such actions may be brought in small claims court and seek an injunction or order to prevent further violations. If a person obtains an injunction or order and service of the injunction or order is properly effected, a person who thereafter receives further solicitations in violation of the injunction or order within 30 days after service of the initial injunction or order may file a subsequent action in small claims court seeking enforcement of the injunction or order and a civil penalty to be awarded to the person in an amount up to $1,000.

Documenting Telemarketing Compliance – Record Keeping

It is essential for a dealership to keep records documenting compliance with the telemarketing rules. Since both the national and company-specific do-not-call lists are to be maintained and honored for a period of 5 years, and since the statute of limitations for enforcement actions is generally 4 years, it is conceivable a dealership would need records going back 9 years to establish compliance. For example, a consumer would have until 2017 to file an action wherein he claims he received a telemarketing call in 2013 in violation of a company-specific do-not-call request made in 2008. To defend the case, the dealer would need records from 2008 – some 9 years prior to the claim. The following discussion identifies some of the documents and records that should be maintained. Many of these items may be maintained electronically.

Proof of Written Policy, Training and Employee Compliance

Proof of attendance at training and a willingness and ability to comply with the telemarketing rules should be maintained by a dealership for each employee who might make telephone calls to consumers, or who supervises those that do. Evidence of supervision of the telemarketing policy is also important. For example, dealerships could spot-check telephone numbers dialed using the SMDR feature of their telephone system against the national and company specific do-not-call lists, and, if any matches are found, spot check for evidence of applicable exceptions. Of course, the written telemarketing compliance policy discussed previously must be maintained perpetually.

Company-Specific Do-Not-Call List

A dealership must maintain a company specific do-not-call list. It must list the numbers and, if supplied, names of those making do-not-call requests. The list should also provide the date the request was received and the date it was actually added to the master do-not-call list, if different. It would be helpful if the list also showed the name of the employee or agent receiving the request. Space could also be reserved on the list to reflect any formal written request that a name or number be removed from the list. Numbers cannot be deleted from the list until at least 5 years after the date of the do-not-call request, but prior to any such deletions, an archive of the list should be made and stored for at least an additional 4 years.

List of Numbers Downloaded from the National Registry

The phone numbers downloaded from the national do-not-call registry must be maintained by or on behalf of a dealership. The list should include the numbers exactly as received from the FTC list and the date of the download. The list must be updated or replaced every 30 days. If replaced with a complete download, each list should be stored for 9 years. If updated by means of a changed-numbers-only download, each download should be archived for 9 years, and data fields should be added to the master list to reflect for each number, the date of the most recent downloaded, adding or otherwise affecting that number.

Verification of Checking of Lists, Scrubbing of Numbers

Evidence should be maintained by a dealership that potential telemarketing calls are screened in a timely manner against the national and company-specific do-not-call lists, and, if an exception is being relied upon for placing a call against a number on the national list, that the exception is available and has not expired. Such evidence could take a variety of forms. Sophisticated systems are available, for example, whereby every phone call is automatically screened at the time it is placed, with a record being created of each screening. Other systems rely on "scrubbing" telephone lists in advance of allowing sales people or BDC employees to have access to the lists. A dealership should take steps to ensure the scrubbing is done at a time close to the actual placing of calls.

Evidence of Compliance with Express Request Exception

When a dealership calls a number on the national do-not-list based on the express request exception, proof of the existence and timeliness of the request is essential. One method of proof is a centralized log of all express requests which, contemporaneously with the request, logs the phone number and date, time, and manner of receiving the request. The

master log should be edited to drop-off any request more than 30 business days old, but an archive of the log should first be made and stored for at least 4 years. Another approach is to require that copies of all message pads, notes, or other documents that contemporaneously record an express request be stored in a central location.

Evidence of Compliance with Established Business Relationship Exception

Evidence should also be maintained by a dealership of the existence and timeliness of an established business relationship exception when it is being used to call a number on the national do-not-list. This could take the form of a specialized customer list that includes only the names and numbers of customers who have had a transaction with the dealership within the past 18 months, preferably including the name, number, date of transaction, and type of transaction. Records should be maintained of all additions and deletions to this list.

Records Establishing Call Abandonment Rate When Using Predictive Dialers

The FCC regulations require that records be kept demonstrating the abandonment rate and other compliance with the rules governing predictive dialers or other technology whereby a phone number is dialed automatically, and then connected to an operator after the call is answered.

Voice Logging and Taping and Recording Of Calls

Many dealership BDC operations or other call centers utilize recording or taping systems to monitor call quality and customer service. It is important to ensure that such recordings comply with the requirements of both state and federal law. The FCC requires that notice of any recording of a telephone conversation must be given to the other parties to the conversation (47 C.F.R. section 64.501). This notice may be conveyed by consent of all parties, verbal notice of recording at the beginning of the call, or use of a periodic beep tone. California Penal Code sections 631 et seq., for example, prohibit recording of telephone communications without the "consent" of all parties to the call. Violations are punishable by a fine of up to $2,500, imprisonment for not more than 1 year, or both. A civil plaintiff may recover the greater of $5,000 or 3 times the amount of any actual damages sustained. California Public Utilities Commission (CPUC) General Order 107-B provides that telephone calls cannot be recorded without a beep-tone notification approximately every 15 seconds. Additional concerns arise where employee personal calls might be recorded, as doing so raises significant privacy concerns. Additionally, dealerships which log customer calls may be required to disclose that practice in the privacy notices they give to consumers, and to safeguard the recorded data as they would other non-public personal information. Dealers are urged to have any program designed to record telephone communications reviewed and approved by legal counsel.

Fax Advertising Regulations

Fax transmissions are subject to both federal law (the Junk Fax Prevention Act of 2005; 47 U.S.C. section 227) and California law (Bus. Prof. Code section 17538.43). The applicable legal requirements are discussed in more detail below.

Fax Identification Required for All Faxes

Under both federal and California law, no fax may be sent for any purpose or to any telephone number unless the fax is marked at the top or bottom of each transmitted page, or on the first page, with the date and time it is sent, an identification of the business sending the message, and the telephone number of the sending machine or of the business.

No Faxing of Unsolicited Advertising

Both the federal and California statutes basically define the term "unsolicited advertisement" as "any material advertising the commercial availability or quality of any property, goods, or services that is transmitted to any person without that person's prior express permission." California law specifically prohibits the transmission of faxes containing unsolicited advertising. Although federal law contains a similar prohibition, it does recognize an exception where the business sending the fax has an established business relationship with the fax recipient. This inconsistency between California and federal law has been somewhat addressed by a federal court in the case of *Chamber of Commerce of the United States v. Bill Lockyer*, 2006 U.S. Dist. Lexis 8324 (E.D. Cal. February 27, 2006) which rendered a decision indicating that California law should be controlling regarding intrastate faxes (i.e. faxes sent within California) and that federal law should be controlling regarding interstate faxes (i.e. faxes sent from one state to another). Because of the more restrictive California law, dealerships should not fax advertising materials to anyone, including

existing customers, without first obtaining the express permission of the recipient.

Applicable to Residence and Business Faxes

The prohibition against transmission of faxes containing unsolicited advertising applies to faxes to residential, business, or other types of fax lines.

Not Applicable If Fax Entirely Free of Advertising

Unless faxes are entirely free of advertising, they are subject to the rule of prohibiting them from being sent unless the recipient has given permission.

To be considered free of advertising, a fax should contain nothing that purports to feature the "availability or quality" of any goods or services. This definition is very broad and would appear to permit the argument that a faxed service department reminder would be considered faxed advertising if it suggests that the customer should or could have the scheduled service performed at the dealership.

CAUTION

ON MIXED FAXES AND FAX COVER SHEETS: Faxes that are primarily for purposes of exchanging non-advertising information could be snared by the rules as an unsolicited faxed advertisement, if somewhere within the fax, a statement concerning the availability or quality of goods and services are included. For example, a faxed cover sheet with an advertising slogan such as "Home of Great Deals" could turn an otherwise non-advertising fax to the dealership's accountant into an unsolicited advertisement.

Not Applicable if Sent With Prior Express Written Invitation or Permission.

Under both California and federal law, faxes containing an advertising message may be sent with the prior express permission of the recipient. Both California law and federal law also do not require that the recipient's permission be in writing, although such permission is best documented by a written agreement signed by the intended recipient which specifies the telephone number to which faxes may be sent, and clearly states that the person wishes to receive faxes from the dealership. As recognized by California law, this permission may be for a specific or unlimited number of advertisements and may be obtained for a specific or unlimited period of time.

CAUTION

REGARDING OPT OUT NOTICE: FCC regulations issued to implement the Junk Fax Prevention Act of 2005 provide that fax advertisements sent with the recipient's prior expressed permission must include an opt out notice that allows the recipient to opt out of receiving future faxes from the sender. As a result of these regulations, a dealership faxing an advertisement to a recipient with the recipient's permission should include on the first page of the fax a clear and conspicuous notice (meaning the notice is at the top or bottom of the fax and separate and distinguishable from the advertising text) which provides the recipient with a toll free method of opting out from receiving future faxed advertisements and instructions for doing so. The toll free method may be in the form of a website address, email address, or a toll free telephone or fax number, but must permit the recipient to make an opt out request 24 hours a day, 7 days a week. To be effective, an opt out request by a fax recipient should identify the fax number to which it relates and should be sent to the toll free method stated in the dealership's faxed advertisement. An opt out request must be honored by a dealership within the shortest reasonable time, which may not exceed 30 days, after which time, the dealership may no longer send unsolicited advertisements to that number, unless the recipient subsequently provides prior expressed permission to the dealership.

CAUTION

REQUESTS FOR CONSENT CANNOT BE FAXED: While it is permissible to mail or email a request that permission to fax be given, faxing such a request, even if in the form of a consent form, is prohibited.

Penalties and Enforcement

California law applicable to faxes provides for a variety of enforcement remedies, including injunctive relief and/or actual or statutory damages of $500 per violation, whichever amount is greater. The FCC rules, which could also apply, provide for significant fines for each violation or each day of a continuing violation.

E-mail Regulations

The Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 ("CAN-SPAM Act") (19 U.S.C. sections 7701-7713) preempts all state email/anti-spam laws, including California anti-spam laws. It does not preempt state laws of a general nature that also happen to impact

what can be said in an email message, such as fraud, contract, etc.

Individual Email Requirements of The CAN-SPAM Act

Among others, the CAN-SPAM Act contains the following general requirements of interest to dealers (**as discussed below, not all of these requirements apply to all types of email)**:

- **Accurate Headers**. Have accurate, non-misleading sender, header, origination, and transmission information
- **No Spoofing.** Do nothing to disguise the computer used to initiate the message
- **Truthful Subject Line.** Do not permit subject lines that would be false or misleading as to the content of the message
- **Contain Postal Address.** Include the sender's valid physical postal address
- **Opt-Out Notice.** Include a notice that the recipient may opt out of receiving further unsolicited commercial email
- **Opt-Out Address.** Include a functioning return email address or another Internet-based mechanism valid for at least 30 days through which the recipient can "opt out." Requests must be processed within 10 days of receipt. A menu of choices to only opt-out of certain types of email is permitted, as long as one choice is to opt-out of receiving all commercial email messages and
- **Advertising Notice**. Include a "clear and conspicuous" notice that the message is an advertisement or solicitation. It is not necessary that this notice appear in the subject line. It can be in the message body instead.

Classification of Email Under CAN-SPAM

The CAN-SPAM Act divides email into three categories, and applies the above requirements to the email selectively. Two of the categories are types of "commercial email."

Commercial email under CAN-SPAM is any electronic mail message the ***primary purpose*** of which is the commercial advertisement or promotion of a commercial product or service and which does not fall within the definition of transactional or relationship email under the Act. With this definition in mind, the three categories of email are:

- Unsolicited commercial email – must satisfy all of requirements listed above;
- Commercial email with affirmative consent – must satisfy all of the above requirements, except the advertising notice;
- Transactional or relationship email – need only comply with the accurate headers and no-spoofing requirements

Each category of email is discussed in the following sections.

Unsolicited Commercial Email

Unsolicited commercial email is commercial email sent without the recipient's "affirmative consent." Unsolicited commercial email must satisfy all of the requirements noted above. While all requirements must be met, the law does not prohibit it from being transmitted to anyone who has not yet provided the sender with an opt-out request.

Commercial Email Sent With Affirmative Consent

If sent with "affirmative consent," the sender of commercial email is relieved from complying with the advertising notice requirement noted above.

When determining whether affirmative consent has been received, the recipient must have expressly consented to receive commercial email messages. Consent can either be given to the dealership on the recipient's own initiative, or given in response to a request that it be given, or implied if the recipient, at his or her own initiative, contacts the company to receive a commercial email message. Consent can also be obtained indirectly by a vendor acting on the company's behalf, if the vendor has disclosed in a "clear and conspicuous" fashion that the company (sender) may send commercial email messages.

Transactional And Relationship Email

Only the accurate header and no-spoofing requirements apply to transactional and relationship email. Under the Act, this type of email falls into one or more of the following categories: (1) emails that facilitate or confirm a commercial transaction the recipient has already entered into with the sender; (2) transactional messages that provide product safety or warranty information for a product or service that the recipient has used or purchased; (3) messages pertaining to a subscription, membership, account, loan, or other kind of ongoing business relationship; (4) emails providing information about an employment relationship or benefit plan; and (5) messages that deliver products or services (such as a downloadable file), including product updates or upgrades. The CAN-SPAM Act grants the FTC rulemaking authority to change the definition as necessary to accommodate new technology or practices. Including an advertisement in a transactional or relationship message does not necessarily make that email a "commercial electronic mail message" for purposes of the CAN-SPAM Act, so long as the advertisement does not become the pri-

mary purpose of the email. Links included in transactional or relationship email to web sites, even advertising web sites, also do not change the character of the email.

In certain instances, an email message may have commercial advertising content combined with other content of a transactional or relationship nature. The FTC issued a final rule which sets out the criteria for determining the "primary purpose" of an email, which is the key to knowing which CAN-SPAM Act requirements apply. These criteria generally focus on the email recipient's likely and reasonable interpretation of the subject line of the email or the body of the message (considering such factors as the placement of the commercial content in the message; the proportion of the message dedicated to commercial content; and how colors, graphics, typestyle, and style are used to highlight the commercial content) (16 C.F.R. Part 316). It also should be noted that the FTC has stated its opinion that dealership emails notifying a customer of scheduled maintenance are "transactional or relationship" messages, if the dealership can establish that the scheduled maintenance is "designed to ensure the safe operation" of the vehicle.

NOTE

REGARDING AFFIRMATIVE CONSENT: The FTC has taken the position that if a consumer opts out of receiving future commercial emails from a business, but then subsequently requests information from that business, the consumer may again be sent emails by the business because the subsequent request constitutes "affirmative consent" as required by the CAN-SPAM Act.

Additional CAN-SPAM Requirements

The CAN-SPAM Act also prohibits the following

- Harvesting of email addresses from Web sites
- Dictionary attacks and other automated means to randomly generate email addresses
- Disclosing the email address of a person who opted-out to any other entity seeking to send that party email
- Sending bulk email from a computer without authorization or through open relays
- Registering for five or more email accounts and using them to send bulk email

The Act also regulates sexually oriented material. It requires that such material be readily identified in the subject line. When "initially viewed," the message body should include only instructions on how to access the sexually oriented material, as well as the sender's postal address, a notice the message is an advertisement or a solicitation, and a working unsubscribe mechanism.

Finally, there are many technical prohibitions in the Act against malicious or abusive email practices, such as using email to interfere with the operation of computers or computer networks.

Enforcement and Penalties

Fines as high as $2,000,000 can be levied, and a 3 year prison sentence may be assessed for predatory and abusive commercial practices. The FTC is the primary body authorized to enforce the CAN-SPAM Act. States' attorneys general, state officials, or other relevant state agencies may bring cases under the Act, although those actions are limited if a federal action by the FTC has been initiated or is pending. A person who identifies a violation can collect a bounty of 20% of the civil penalty collected. When a state sues, a court can award injunctive relief and actual damages. A court can also, in lieu of actual damages, award statutory damages up to $250 per violation ("with each separately addressed unlawful message received by or addressed to such recipients treated as a separate violation") up to the maximum of $2,000,000. Internet service providers are also allowed to sue for damages, but these are calculated differently. The statutory damage amounts can be increased by up to 3 times by a court in appropriate cases such as when there is an "aggravated violation" or other form of willful violation and courts can also award attorney's fees and costs in appropriate circumstances. In appropriate circumstances, damages can be reduced as well.

NOTE

REGARDING CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 17529.5: This California statute, which prohibits sending "spam" with misleading or falsified headers, appears not to be preempted by federal law. Under this statute, consumers and internet service providers are authorized to file private rights of action against persons who send email advertisements containing a third party's name (without the permission of the third party) or including misleading or falsified header or subject line information. The California Attorney General, an email service provider or the email recipient are authorized to recover liquidated damages of $1,000 per unsolicited commercial email advertisement transmitted in violation of the statute, up to $1,000,000 per incident (these liquidated damage amounts are subject to reduction by the court).

AUTOBROKERS

Chapter 7

Contents

AUTOBROKERS

OVERVIEW: Although never previously defined or specifically regulated under provisions of the California Vehicle Code, car dealers had "brokered" the sale of vehicles in this state for many years in one of two ways: by purchasing vehicles for resale on the open market with the use of the "hold-for-resale" procedure; or, by receiving a "bird dog fee" for arranging a vehicle sale transaction between a selling dealer and a buyer.

In 1994, the California Legislature enacted Chapter 1253 of the Statutes of 1994. This law, which became effective January 1, 1995, fundamentally altered the manner in which motor vehicle brokering is conducted in California. The law contains two basic components. First, it severely restricts the "hold-for-resale" procedure by making it unlawful for anyone to advertise for sale, sell, or purchase for resale a new vehicle unless that person is licensed and franchised to do so. And second, it defines "brokering" as an arrangement under which a licensed dealer may charge a fee to act as a third party agent for the purpose of facilitating a vehicle sale transaction between a selling dealer and a retail purchaser.

Chapter 1253 contains the following legislative intent which confirmed the Legislature's intent to protect the benefits and integrity of the new motor vehicle franchise system:

The Legislature finds and declares all of the following:

(a) The distribution, sale, and service of new motor vehicles in the State of California vitally affects the general economy of the state and the public welfare.

(b) The new motor vehicle franchise system, that operates within a strictly defined and highly regulated statutory scheme, assures the consuming public of a well organized distribution system for the availability and sale of new motor vehicles throughout the state; a network of quality warranty and repair facilities to maintain those vehicles; and a cost-effective method for the state to police those systems through the licensing of private sector franchisors and franchisees.

(c) It is the intent of the Legislature in enacting this act to protect the integrity and benefits of the new motor vehicle franchise system, while also affording consumers the choice and flexibility of utilizing the services of an autobroker to arrange or negotiate new car purchases within a framework that ensures a high level of consumer protection and accountability. This act is intended to legitimize the activity of motor vehicle brokering by defining that activity and permitting any holder of a motor vehicle dealer license to register with the Department of Motor Vehicles as an autobroker and thereafter engage in brokering activities pursuant to the provisions of this act.

Restriction on Hold-for-Resale

The "hold-for-resale" is a registration exemption procedure originally adopted by the DMV to facilitate the wholesale transfer by franchised new vehicle dealers of new vehicles and chassis that were converted to commercial coaches, mobilehomes, and recreational vehicles, and then resold as "new" by other dealers not franchised by the manufacturer of the original vehicle or chassis. Over the years, used car dealers (many of which called themselves "autobrokers") began utilizing the "hold-for-resale" procedure to purchase new passenger vehicles and light duty trucks for resale and were permitted to resell those vehicles at retail as "new," even though they met none of the franchise requirements to be licensed as a new motor vehicle dealer. As a result of legislation enacted in 1988, the Vehicle Code definition of a "new vehicle" was amended in such a manner so as to classify new vehicles acquired by nonfranchised dealers as "used" as a matter of law. Moreover, under the 1988 legislation, nonfranchised dealers were specifically permitted to purchase new vehicles for resale, provided the vehicles were resold as "used."

Chapter 1253 repealed that portion of the 1988 legislation which permits a used car dealer to advertise its ability to purchase for resale, as used, new vehicles available from franchised dealers and amends the definition of a "new vehicle" in such a manner that a car remains "new" until such time as it has first been sold at retail or registered and hard plated. Most importantly, Vehicle Code section 11713.1(f) specifically makes it unlawful for a dealer to: "Advertise for sale, sell, or purchase for resale any new vehicle of a line-make for which the dealer does not hold a franchise." The following, however, are exceptions to this general rule: (A) A mobilehome. (B) A recreational vehicle as defined in section 18010 of the Health and Safety Code. (C)

A commercial coach, as defined in section 18001.8 of the Health and Safety Code. (D) An off-highway motor vehicle subject to identification as defined in section 38012 of the Vehicle Code. (E) A manufactured home. (F) A new vehicle that will be substantially altered or modified by a converter prior to resale. (Note later in this chapter the new definition of a converter in Vehicle Code section 267). (G) A commercial vehicle with a gross vehicle weight rating of more than 10,000 pounds. (H) A vehicle purchased for export and exported outside the territorial limits of the United States without being registered with the department. (I) A vehicle acquired in the ordinary course of business as a new vehicle by a dealer franchised to sell that vehicle, if all of the following apply:

(i) The manufacturer or distributor of the vehicle files a bankruptcy petition.

(ii) The franchise agreement of the dealer is terminated, canceled, or rejected by the manufacturer or distributor as part of the bankruptcy proceedings and the termination, cancellation, or rejection is not a result of the revocation by the department of the dealer's license or the dealer's conviction of a crime.

(iii) The vehicle is held in the inventory of the dealer on the date the bankruptcy petition is filed.

(iv) The vehicle is sold by the dealer within six months of the date the bankruptcy petition is filed.

Note, however that the limited exception for dealers terminated pursuant to a manufacturer's or distributor's bankruptcy proceeding does not entitle a dealer whose franchise agreement has been terminated, canceled, or rejected to continue to perform warranty service repairs or continue to be eligible to offer or receive consumer or dealer incentives offered by the manufacturer or distributor. Together, these and other changes make it unlawful for a non-franchised dealer to acquire a new vehicle using the "hold-for-resale" procedure and resell that new vehicle to a retail purchaser. However, as discussed below, Chapter 1253 authorizes a dealer to engage in brokering activities, as defined, by charging a fee to facilitate the retail sale of a new car between a franchised new car dealer and a retail purchaser.

CAUTION

REGARDING ACCEPTING RESALE CERTIFICATES: As discussed in the Sales and Use Tax Chapter in this Guide, resale certificates should not be accepted by dealers when a dealer is purchasing a new motor vehicle for resale in a line-make for which that dealer does not hold a franchise, unless the transaction falls within one of the exceptions stated above. A resale certificate may be accepted in good faith from a leasing company that is purchasing a new vehicle to lease.

Requirements of a Dealer Who Brokers

Although the term "autobroker" was not previously defined in the Vehicle Code, those transacting business as an autobroker have always been required to hold a dealer license because the Vehicle Code makes it unlawful to negotiate or attempt to negotiate the sale or exchange of a vehicle for a commission or brokerage fee unless licensed as a dealer. (A vehicle salesperson may also engage in such activity buy may only receive payment from the dealer for whom he or she is licensed to work.) Chapter 1253 did nothing to change current law in that respect, but requires that in addition to qualifying for and holding a valid dealer license, any dealer who chooses to broker a transaction must first obtain from the DMV an autobroker's endorsement to the dealer's license and pay a $100 registration fee to obtain the endorsement (there is also a $75 annual renewal fee that must be paid).

Chapter 1253 defines the terms "autobroker," "auto buying service," and, "brokering," by adding the following definitions to the Vehicle Code:

Vehicle Code section 166: *An "autobroker" or "auto buying service" is a dealer, as defined in section 285, who engages in the business of brokering, as defined in section 232.5.*

Vehicle Code section 232.5: *"Brokering" is an arrangement under which a dealer, for a fee or other consideration, regardless of the form or time of payment, provides or offers to provide the service of arranging, negotiating, assisting, or effectuating the purchase of a new or used motor vehicle, not owned by the dealer, for another or others.*

Simply put, Chapter 1253 defines and restricts the activities of an autobroker to the classical definition of a broker, i.e., a third party intermediary or agent who facilitates a sale transaction on behalf of a buyer and/or seller and collects a fee for that service. However, regardless of whether a dealer uses a dealer license to act as an agent/broker to facilitate a sale transaction on behalf of another or others, or as a principal for the purpose of directly buying or selling a vehicle, that dealer is subject to all of the licensing, advertising, and other regulatory requirements and prohibitions applicable to all motor vehicle dealers.

In addition to the requirement of obtaining an autobroker's endorsement to a dealer's license, any dealer who engages in brokering activities must also adhere to the following requirements:

Autobroker Log

Upon application and payment of the fee the department will issue the dealer an autobroker's endorsement on the dealer license and an autobroker log. Similar to a report-of-sale book, the autobroker log remains the property of the DMV and may be inspected by the DMV at any time. It is unlawful for a brokering dealer to fail to record, for each brokered transaction, the following information in the log: (1) VIN of the brokered vehicle; (2) date of the broker agreement; (3) selling dealer's name, address, and dealer number; (4) name of the consumer; and, (5) brokering dealer's name and dealer number. See Vehicle Code section 11735.

Written Brokering Agreement

Each brokered sale transaction requires not only a written purchase contract between the selling dealer and the retail customer, but also a written brokering agreement between the brokering dealer (autobroker) and the retail customer.

The brokering agreement must be printed in at least 10-point type and is required to contain specified terms, conditions and disclosures. See Vehicle Code section 11738. The law also requires that a completed and executed copy of the brokering agreement must be provided to both: (1) the consumer entering into the brokering agreement (the completed copy must be provided prior to the time that the consumer signs an agreement for the purchase of the vehicle described in the brokering agreement or, prior to accepting one hundred dollars ($100) or more from that consumer, whichever occurs first); and, (2) the selling dealer (the completed copy must be provided prior to the time that the selling dealer enters into a purchase contract with the consumer). See Vehicle Code section 11736.

Disclosure of Whether Fee Is Payable

Vehicle Code section 11736(f) imposes on a dealer who brokers a retail sale transaction an affirmative duty to disclose to the consumer and selling dealer, as soon as practicable, both of the following:

1. The dollar amount of any brokerage fee the consumer is obligated to pay the brokering dealer. This arrangement must also be confirmed in the written brokering agreement.

AND

2. Whether the brokering dealer will, or will not, receive a fee or other compensation from the selling dealer. This arrangement is required to be confirmed in the written brokering agreement by printing, in at least 10-point bold type, one of the following two notices: **"We do not receive a fee from the selling dealer."** or **"We receive a fee from the selling dealer."** See Vehicle Code section 11738(d).

Fiduciary Duty

When brokering a retail sale as an agent of the consumer, selling dealer, or both, the brokering dealer owes a fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with his or her principal or principals. See Vehicle Code section 11735(e).

Limit on Deposits

When brokering a sale transaction, the brokering dealer may not accept a purchase deposit from any consumer that exceeds 2.5% of the selling price of the vehicle described in the customer's written brokering agreement. See Vehicle Code section 11736(b).

Trust Account

In circumstances when a purchase deposit or any purchase money is received by a brokering dealer, Vehicle Code section 11737 requires the brokering dealer to deposit such funds in a trust account and specifies how the trust can be encumbered, who must serve as trustee of the account, where the trust account must be maintained, and impresses a trust on all money received by a brokering dealer for the benefit of consumers who have paid any money to a brokering dealer.

Refund Requirements

A brokering dealer must unconditionally refund any deposit or purchase money it receives from a consumer upon demand at any time prior to a consumer's signing of a vehicle purchase agreement with a selling dealer and taking delivery of the vehicle described in the brokering agreement. See Vehicle Code section 11736(c). (The refund of brokerage fees is discussed below.)

Canceling a Brokering Agreement for Non-Performance

Vehicle Code section 11736(d) requires that a brokering dealer must cancel a brokering agreement and refund, upon consumer demand, any money paid by a consumer, including a brokerage fee paid in advance, under any of the following circumstances:

1. When the final price of the brokered vehicle exceeds the purchase price listed in the brokering agreement.

2. When the vehicle delivered is not as described in the brokering agreement.

3. When the brokering agreement expires prior to the customer being presented with a purchase agreement from a selling dealer arranged through the brokering dealer that contains a purchase price at or below the price listed in the brokering agreement.

Vehicle Code section 11736(i) also provides that it is unlawful for a brokering dealer to fail to advise a consumer, prior to accepting any money, that a full refund will be given if the motor vehicle ordered through the autobroker is not obtained for the consumer or if the service orally contracted for is not provided.

Advertising

Vehicle Code section 11713(b)(1)(A) makes it unlawful for any dealer to advertise or offer for sale or exchange in any manner, any vehicle not actually for sale at the premises of the advertising dealer or available to the dealer directly from the manufacturer or distributor of the vehicle at the time of the advertisement or offer. Moreover, Vehicle Code section 11713.1(f) specifically makes it unlawful for a dealer to advertise for sale, sell, or purchase for resale a new vehicle of a line-make for which the dealer does not hold a franchise, subject to the exceptions mentioned above.

However, a dealer having an endorsement on the dealer's license from the department as an autobroker may advertise its brokering services, i.e., the ability to arrange or negotiate vehicle sale transactions as an autobroker. Advertisements for autobrokering services are permitted to make reference to the fact that a brokering dealer can arrange or negotiate a consumer's purchase of a new car from a franchised new car dealer and even specify new vehicle line-makes and models that can be brokered. But advertisements for brokering services may not advertise the price or payment terms of any vehicle or otherwise offer vehicles for sale. In addition, all autobroker ads must clearly and conspicuously disclose: (1) that the advertiser is an "autobroker" or "auto buying service" **and**, (2) the following statement: **"All new cars arranged for sale are subject to price and availability from the selling franchised new car dealer."** See Vehicle Code section 11713(b).

As to any printed advertisement, the above disclosure statement must be printed in not less than 10-point bold type size and be textually segregated from other portions of the printed advertisements. However, the disclosure statement is not mandated in two limited circumstances: (1) classified advertisements for autobrokering services that measure two column inches or less; and, (2) radio advertisements of a duration of less than eleven seconds that do not reference specific line-makes or models of vehicles. However, even small classified ads and ten second radio ads must comply with the requirement of disclosing that the advertiser is an autobroker or auto buying service and all of the other requirements, restrictions, and prohibitions. See Vehicle Code section 11713(b).

Cannot Act as Seller and Broker in The Same Transaction

A dealer may not act as a seller and provide brokering services, both in the same transaction. It is an inherent conflict of interest for a dealer to act as both an agent and principal in the same transaction. See Vehicle Code section 11736(e).

Record Retention

Any dealer who brokers a retail sale transaction must maintain for a minimum of three years a copy of the executed brokering agreement and other notices and documents related to each brokered transaction. See Vehicle Code section 11736(h).

Selling Dealer's Obligations in a Brokered Transaction

Only franchised new car dealers can actually sell new cars to retail purchasers. A retail purchaser can either purchase a new car directly from a franchised new car dealer without the assistance of a third party broker, or retain the services of an autobroker to facilitate the sale. Either way, it is the franchised new car dealer who actually sells the new car to the retail purchaser and it is the franchised new car dealer's name that must appear on the sale contract as the seller.

Register and Title Vehicle

In a brokered sale transaction, it is the sole duty and responsibility of the selling franchised new car dealer (not the autobroker) to: complete and process a new car report-of-sale form; apply for title and registration in the name of the purchaser and any appropriate lienholder; calculate and post registration, license, and appropriate DMV fees; collect and pay sales tax to the Board of Equalization; secure the manufacturer's new car warranty in the name of the purchaser; and, make all applications for any manufacturer's rebates and incentives which may be due the purchaser. In other words, a franchised new car dealer has the same duties and responsibilities in a brokered sale transaction as he or she would if no third party autobroker were involved in the transaction. See Vehicle Code section 11739.

Collecting the Sales Tax

If a new car dealer sells a new car to another dealer not franchised to sell the type of vehicle purchased and is presented with a resale certificate from the purchaser, is the selling dealer relieved from the liability of collecting sales tax? Revenue and Taxation Code section 6091 presumes that all gross receipts are subject to sales tax until the contrary is established and the burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he or she takes from the purchaser a certificate to the effect that the property is purchased for resale. Moreover, Revenue and Taxation Code section 6092 provides that a resale certificate relieves a seller from liability for sales tax only if taken in good faith.

The autobroker law specifically makes it illegal for a dealer to purchase a new vehicle for resale unless the vehicle qualifies for one of the limited exceptions discussed above. Therefore, unless a new car dealer can document that a new car sales qualifies for one of the limited "hold-for-resale" exemptions, he or she cannot in good faith accept a resale certificate indicating that the vehicle is purchased for resale and will face tax liability for the failure to remit sales tax.

Must Disclose Whether Fee Is Paid to Autobroker

It is unlawful for a selling dealer to fail to disclose, in a clear and conspicuous manner in at least 10-point bold-face type on the face of any contract for the retail sale of a new motor vehicle, whether the transaction is, or is not, subject to a fee received by an autobroker from the selling new motor vehicle dealer and the name of the autobroker, if applicable. See Vehicle Code section 11713.1(x). Standard vehicle sale contract forms contain a notice something like:

> ***Payment of Brokerage Fee***
>
> If the box is checked, the selling dealer has paid or will pay a fee to the following autobroker in connection with this sale:_____

No Consignment of New Vehicles

It is unlawful and grounds for license suspension or termination for a franchised new car dealer to consign for sale to another dealer (whether or not that dealer is registered as an autobroker) a new vehicle. See Vehicle Code section 11713(q).

No Display of New Vehicles at Autobroker's Business Premises

Vehicle Code section 11713(r) makes it unlawful for a franchised new car dealer to display a new motor vehicle at the business premises of another dealer who has an autobroker's endorsement to the dealer's license.

Autobroker Cannot Use Your License, Supplies, or Books

It is unlawful for any dealer to permit the use of the dealer's license, supplies, or books by any other person for the purpose of permitting that person to engage in the purchase or sale of vehicles, or permit the use of the dealer's license, supplies, or books to operate a branch location. It also is unlawful for a new car dealer to operate a branch location which is not authorized by its franchisor and licensed by the DMV as a branch location. Likewise, it is unlawful for a new car dealer to loan another dealer (whether or not the dealer has an autobroker's endorsement) its report-of-sale forms, special plates, or other supplies. However, Vehicle Code section 11735(d) does specify that an autobroker may obtain a consumer's signature on a selling dealer's motor vehicle purchase agreement, provided the contract has already been executed by the selling dealer; and, the autobroker may later deliver, with the selling dealer's written approval, the sold vehicle.

Manufacturer Prohibition

Vehicle Code section 11713.3(s) makes it unlawful for a manufacturer or distributor to dishonor a warranty, rebate, or other incentive offered to the public or a dealer in connection with the retail sale of a new motor vehicle, based solely upon the fact that an autobroker (as defined) arranged or negotiated the sale. However, the factory can disallow the rebate or incentive if the purchaser or dealer is ineligible to receive the rebate or incentive pursuant to any other term or condition of a rebate or incentive program.

Motor Clubs

Motor Clubs Are Not Dealers or Autobrokers

Vehicle Code section 286 specifically exempts a motor club (such as AAA) licensed by the Department of Insurance, from the Vehicle Code definition of a "dealer" provided it "does not arrange or negotiate individual motor vehicle purchase transactions on behalf of its members but refers members to a new motor vehicle dealer for the purchase of a

new motor vehicle and does not receive a fee from the dealer contingent upon the sale of the vehicle."

Therefore, if a motor club runs a "Vehicle Purchasing Service" whereby it receives an advertising fee from one or more dealers in order for the dealer to be listed in the motor club's "list of participating dealers" and the motor club: (1) does not involve itself in arranging or negotiating individual sale transactions; and, (2) does not receive a fee from the selling dealer contingent upon the sale of a vehicle to one of its members--then, the motor club is not required to maintain a dealer license (or an autobroker endorsement to the license) and none of the brokering requirements discussed above would apply.

Motor Club Advertising Requirement

If a motor club offers a service that refers members to a new motor vehicle dealer for the purchase of a new motor vehicle, and the dealer pays the motor club any compensation, including, but not limited to, an advertising, promotional, or marketing fee, any advertisement of that service shall clearly and conspicuously disclose that the dealer has paid the fee and shall have the following statement: **"All new cars arranged for sale are subject to availability and a price prearranged with the selling franchised new car dealer."** See Insurance Code section 12150.

Q & A

Is an autobroker required to have a dealer license?

Yes. Motor vehicle brokering is an activity that can only be performed by a licensed dealer.

Can any holder of a dealer license become an autobroker?

Yes. Any holder of a dealer license can pay the $100 fee and obtain an autobroker's endorsement to his or her dealer license.

Is an autobroker required to have a dealer bond?

Yes. An autobroker is licensed as a dealer and must comply with all dealer licensing requirements, including a $10,000 dealer bond.

Does an autobroker have to maintain an established place of business?

Yes. All dealers are required to maintain an established place of business at which the dealer's books and records are maintained; appropriate signage is posted; and the dealer's license and the licenses of salespersons working at that location are displayed. In addition, the dealer must comply with the above requirements and obtain a branch license for other sites or locations operated and maintained by the dealer. However, a dealer with an autobroker's endorsement who does not also sell or buy new or used vehicles at retail is exempt from the requirement of maintaining a display area at his or her established place of business.

Can an autobroker maintain an office at a credit union location?

Yes, provided the dealer maintains a clear physical division between the dealer's operations and any other type of business conducted at the same location and the dealer qualifies for and obtains a branch license from the DMV to operate at that location.

Does an employee of an autobroker who negotiates or arranges a brokered sale transaction have to have a salesperson's license?

Yes, such activity is included in the Vehicle Code definition of a "Vehicle Salesperson".

Can an autobroker act as an agent for both the buyer and the selling dealer?

Yes. An autobroker can accept a fee from either the buyer or seller, or both (but must disclose that fact to both parties) and may act as an agent for either the buyer, the seller, or both.

Can an autobroker take a new car on consignment from a franchised new car dealer?

No. It is unlawful for a new motor vehicle dealer to consign for sale to another dealer a new vehicle.

Can a new car be displayed at the business premises of an autobroker?

No Such activity is specifically prohibited.

Can an autobroker advertise new cars for sale?

No. However, a dealer registered as an autobroker can advertise its brokering services, including its ability to broker the purchase of a new car -- provided that such an advertisement clearly and conspicuously discloses that the advertiser is an autobroker or auto buying service and contains the following statement: **"All new cars arranged for sale are subject to price and availability from the selling franchised new car dealer."**

Can an autobroker take any money from a consumer prior to signing a brokering agreement with the customer?

Yes, provided that it is under $100. The law requires that when brokering a sale transaction, the brokering dealer (autobroker) must execute a written brokering agreement with the consumer and provide the consumer with an executed copy of the agreement prior to the consumer signing a contract

to purchase the brokered vehicle or, prior to accepting $100 or more from the consumer, whichever occurs first.

Can autobrokers deliver brokered cars?

Yes, provided that the brokered vehicle has already been sold pursuant to a duly executed purchase agreement with the selling dealer and the selling dealer gives the broker written approval for the delivery. However, there are a number of reasons why the selling dealer may wish to withhold such approval or take appropriate precautions prior to granting such approval. See No. 9 of the Do's and Don'ts below for a further discussion of this issue.

Will a Toyota dealer still be able to buy a new Ford from a Ford dealer utilizing the "hold-for-resale" registration exemption procedure and resell that new vehicle to his or her next door neighbor?

No. Under the provisions of Chapter 1253 it is unlawful for a dealer to sell any new vehicle of a line-make for which the dealer does not hold a franchise. However, the Toyota dealer could broker the sale transaction between his or her neighbor and the Ford dealer if the Toyota dealer has an autobroker's endorsement, enters into a written brokering agreement with his or her neighbor, and abides by all of the other statutory brokering requirements.

Does Chapter 1253 affect leasing?

No. The provisions of Chapter 1253 only apply to retail sale transactions. A lessor may purchase a new vehicle from a franchised dealer and lease that vehicle to a retail lessee. However it would be unlawful for a leasing company to purchase a new vehicle and resell that new vehicle to a retail customer, if the leasing company is not franchised to sell the make of the vehicle sold.

Can a selling dealer "loan" the dealer's new car report of sale forms to an autobroker?

No. It is unlawful for a dealer to permit the use of the dealer's license, supplies, or special plates by any other person for the purpose of permitting that person to engage in the purchase or sale of vehicles.

What is the liability of the selling dealer should an autobroker abscond with a consumer's purchase deposit or purchase proceeds?

It depends. Although the failure of an autobroker to deposit such funds in a trust account and to keep those funds unencumbered is grounds for dealer license revocation, such action may be of little comfort to a selling dealer when the autobroker who absconds with purchase proceeds is acting as the agent of the selling dealer. In such a situation, the actions of the agent will most likely be imputed to the seller who will have an uphill battle with the retail purchaser. On the other hand, if the autobroker is working as the exclusive agent of the purchaser and has not accepted any compensation from the selling dealer, any potential loss should fall on the shoulders of the purchaser.

In order to avoid such a dilemma, it is highly recommended that when selling a vehicle in a brokered transaction, the selling dealer should instruct the purchaser or the purchaser's lender to pay the selling dealer directly. There is no legitimate reason why an autobroker should handle purchase proceeds.

A new car dealer learned an expensive lesson when selling a new car through an autobroker. The franchised dealer was contacted by an autobroker who was looking for a $50,000 high-line new vehicle that the autobroker's client, a Silicon Valley executive, was desirous of purchasing. The franchised new car dealer agreed to sell the new vehicle to the executive who signed a one-pay conditional sale contract with the new car dealer and took delivery of the vehicle with the assistance of the autobroker. The executive tendered a check for the full purchase price to the autobroker who deposited the check in his bank account. However, before the autobroker could pay the new car dealer, the IRS froze the autobroker's bank account and attached the funds for payment of back taxes.

After failing in its efforts to collect the purchase proceeds from the autobroker, the new car dealer declared the purchaser in default of the one-pay contract, caused the dealership to be listed as a lienholder on the ownership certificate, and demanded that the purchaser tender a second check directly to the new car dealer. In response to the new car dealer's demand, the purchaser filed a complaint with DMV claiming that the autobroker was acting as an agent of the new car dealer and that because the purchaser had already paid the new car dealer's agent, he was entitled to the vehicle's ownership certificate free and clear of the new car dealer's purported lien. The DMV sided with the purchaser because the new car dealer had no written agreement with the purchaser that specified what the agency relationship (or lack thereof) was between the dealer and the autobroker; and, the dealer had given no specific instructions to the purchaser concerning payment of the purchase price. After DMV threatened to file a license accusation against the new car dealer, the dealer released its lien on the vehicle and was left with an unsecured claim against the autobroker.

As noted above, allowing a third party to handle your purchase proceeds can be risky. The risk can be avoided altogether by prohibiting the autobroker from handling purchase proceeds and instructing the purchaser or the purchaser's lender to pay the selling dealer directly. However, if you permit an autobroker to handle purchase proceeds, make sure

you have a written acknowledgment from the purchaser that specifies whose agent the autobroker is and which party will bear the risk of loss in the event that the purchase proceeds are not properly forwarded by the autobroker to the selling dealer.

Is a selling dealer liable for any false representations made by an autobroker?

It depends. For example, let's say that an autobroker knows that the purchaser is looking for a vehicle that will tow her 3000 lb. boat and the broker advises the purchaser that the vehicle being brokered will handle the job. What happens when the transmission burns out because the vehicle only had a towing capacity of 2000 lbs.? If the autobroker is working as an agent of the selling dealer, any representation made by the autobroker will be imputed to the principal -- in this case, an implied warranty of fitness for a particular purpose. On the other hand, if the autobroker is working as the exclusive agent of the purchaser, the selling dealer cannot be bound by the broker's representations.

Can the factory charge-back a rebate or dealer incentive to a franchised new car dealer because an autobroker arranged or negotiated the dealer's sale of a new car?

No. Manufacturers and distributors are specifically prohibited from dishonoring rebates and incentives in such a situation. However, the prohibition only applies to "brokering" as defined in the Vehicle Code and would not apply in situations where a new vehicle is actually sold to a middleman such as a leasing company or exporter.

Do's and Don'ts in Dealing with Autobrokers

1. Make sure that any autobroker you do business with has a valid DMV dealer license and has an endorsement from the DMV as an autobroker. Ask the autobroker for a photocopy of the autobroker's dealer license and proof of its autobroker endorsement or call the DMV Occupational Licensing Unit to inquire of the status. The autobroker's good standing with the DMV should be reviewed periodically.

2. Do not pay a fee or commission to a salesperson employed by another dealer or an unlicensed individual or entity. It is unlawful for a dealer to pay a fee or commission in connection with the sale or transfer of a vehicle to anyone other than: (1) a licensed salesperson employed by the selling dealer; or, (2) another dealer falling within the definition of an autobroker in Vehicle Code section 232.5 and complying with all the autobroker requirements required by law. The payment of any brokerage fee or commission to an autobroker should be made payable to the business entity (corporation, partnership, or sole proprietorship) whose name appears on the autobroker's dealer license. See further discussion below "No Fees To Be Paid to Parties without Compliance with the Broker Law."

3. In each brokered transaction, make sure the autobroker provides you with a completed and fully executed copy of the brokering agreement with the buyer **before** you enter into a contract with the buyer to sell a vehicle. The law requires this procedure and if the vehicle (including all options) and the purchase price described in the brokering agreement do not comport with the description and price in your sale contract, the buyer is permitted by law to cancel the brokering agreement.

4. In reviewing the terms and conditions of the brokering agreement, determine whether or not the autobroker is holding a deposit paid by the buyer. If the autobroker is holding a buyer's purchase deposit, you may want to insist that the autobroker turn the deposit over to you prior to your delivery of the brokered vehicle. (Purchase deposits held by autobrokers are limited by law to no more than 2.5% of the vehicle purchase price and are returnable upon demand by the consumer at any time prior to the consumer entering into a purchase agreement with the selling dealer and the customer taking delivery of the vehicle.)

5. Because you contract directly with the buyer to sell a new car, the buyer, not the autobroker, will be contractually obligated to pay you the purchase price. Make sure you thoroughly review the legitimacy and creditworthiness of the buyer--just as you would if an autobroker were not involved in the transaction.

6. At the time you enter into a sale contract with the buyer and deliver the vehicle, you may wish to instruct the buyer, both verbally and in writing, that all purchase proceeds (including deposits, down payments, pick-up payments, and pay-off checks) should be made payable directly to and delivered to you, not the autobroker. Likewise, if a buyer's third party lender is involved, you may wish to advise the lender to forward any purchase money directly to you. Although the law permits an autobroker to place deposits and purchase proceeds in an autobroker trust account, why take the risk that an unscrupulous broker may abscond with the proceeds or that your proceeds could become enmeshed in an insolvent autobroker's bankruptcy proceedings? If you knowingly permit an autobroker to hold purchase money and the autobroker fails to turn over to you those proceeds, you may lose your claim against the customer for payment of the purchase price. The buyer owes purchase proceeds to you,

not the autobroker. Make sure the buyer is aware of that fact.

7. If you have or will pay the autobroker any type of compensation for arranging a sale, regardless of the form or time of payment, that fact and the autobroker's name must be disclosed on the face of your sale contract.

8. If an autobroker is acting as your agent, make sure that he or she has not made any representations or commitments to the buyer that you do not know of or want to be obligated to perform. Generally speaking, an agent is someone you have specifically authorized to represent you in dealings with a third party. However, an agency relationship will be found to exist in circumstances when a principal intentionally, or by lack of ordinary care, causes a third party to believe another to be his or her agent even though that person is not really employed by him or her.

9. Although the law does not prohibit an autobroker from delivering, with the selling dealer's written approval, a vehicle that has already been sold pursuant to a duly executed purchase agreement entered into between the buyer and the selling dealer, this type of an arrangement may expose the selling dealer to unnecessary financial and/or liability risks. By allowing an autobroker to deliver a brokered vehicle, the selling dealer's identity in the transaction is not only diminished--the selling dealer loses control over the collateral--which could later become a problem should the purchaser fail to honor the terms of the sale contract or should the autobroker abscond with or damage the vehicle. If an autobroker is acting as an agent of the selling dealer, the selling dealer can be held liable for the wrongful or negligent acts of the dealer's agent should the vehicle be involved in an accident resulting in bodily injury and/or property loss. In addition, the selling dealer's franchise or operating agreement with the factory may require the selling dealer to personally explain, at the time of delivery, the vehicle's operating and safety features, the duration and terms of warranty, lemon law remedies, or other information. The safest practice is to insist that the buyer sign all of the paperwork and take physical delivery of the vehicle at your dealership premises. Also see the discussion later in this chapter, Offsite Sales and Delivery.

10. Never allow another dealer (whether the dealer has an endorsement from the DMV as an autobroker or not) to take possession of, fill out, or sign your report-of-sale forms. Such activity remains unlawful. Report-of-sale forms issued by the DMV to a dealer should never leave the issued dealer's business premises. The same prohibition applies to dealer plates and other DMV issued supplies.

11. It is unlawful for a new car dealer to conduct business from an unauthorized location. Moreover, such activity is contractually prohibited in virtually all franchise agreements. Therefore, you should not permit your employees to conduct new car sale transactions at the business premises of an autobroker. New car dealers who can prove that another new car dealer of the same line-make is engaged in such activities within their relevant market area may lodge a complaint with the DMV and/or initiate proceedings before the New Motor Vehicle Board to stop such an unauthorized encroachment.

12. Do not display a new vehicle at the business premises of an autobroker. Such activity is unlawful, even if the new car is posted with a sign stating that no sales are permitted.

13. As the seller of a vehicle in a brokered transaction, you must abide by all seller related duties and responsibilities under the law, including: Truth In Lending requirements; warranty and other Commercial Code laws; Revenue and Taxation Code obligations; and registration and licensing requirements. It is the responsibility of the selling dealer, not the autobroker, to: fill out a new car report-of-sale and notice of transfer; collect and remit to the DMV registration and license fees; collect and remit to the Board of Equalization sales tax on the gross receipts; make application for any applicable incentives or rebates; and, register the warranty with the factory (see the discussion above regarding collecting sales tax).

CAUTION

REGARDING RED FLAGS IDENTITY THEFT PREVENTION PLAN: Below is part of a discussion from the CNCDA 2008 bulletin about an autobroker theft ring and the importance of identity theft prevention.

The DMV has capped a 13-month investigation by busting a massive identity theft ring based in the Fresno area. The ring involved a Southern California auto broker and was assisted by a northern California new car dealer. Nine suspects were arrested on 113 felony counts of identity theft, grand theft, auto theft, and perjury. DMV reports that at least 20 new car dealers throughout the state fell victim to the scam with over two million dollars in damages suffered, but this number could easily increase as new victims continue to be identified. The theft ring used the identities of deceased persons and persons who recently moved out of the country to purchase dozens of high-end vehicles from unsuspecting dealers.

The breakup of the ring, as well as the general increase in identity theft involved with new vehicle purchases should highlight the danger of permitting

autobrokers to vet the identity and creditworthiness of consumers. We recommend increased vigilance when selling vehicles to or through used car dealers—even those with whom you have a long-standing relationship. Note that many of the agreements you hold with finance companies require that your dealership confirm the identity of customers. Should a customer in a brokered transaction end up being an identity thief, the finance company may very well force you to buy back the contract or indemnify the finance company for the loss – much like they are now doing to many dealers that were fleeced in the present case. Given this concern and the rash of various scandals involving autobrokers, we encourage you to carefully evaluate the financial stability of autobrokers you do business with and their capability to properly safeguard the non-public personal and financial information of your customers. Moreover, make sure that your Red Flags Rule Identity Theft Prevention Plan contains adequate measures to address the risks of selling vehicles through autobrokers. Some common-sense steps include requiring that the end customer pick up the vehicle at your dealership, and that you examine his or her driver's license for authenticity independent of the brokering dealer. You should also note that autobrokers should qualify as "service providers" for purposes of the Red Flags Rule. Accordingly, you must ensure that the activity of the service provider is conducted in accordance with policies and procedures designed to detect, prevent, and mitigate the risk of identity theft—such as contractually requiring the autobroker to implement its own identity theft prevention policy to detect and appropriately handle any red flags that may arise. See the discussion of the Red Flags Rule in the Credit Reports and Decisions chapter of this Guide. See also the discussion immediately below, "Broker Involvement Putting Auto Dealers at Risk" elaborating on the importance of compliance with the Red Flags Rule and the proper handling of credit applications in a brokered transaction.

Broker Involvement Putting Auto Dealers at Risk

For decades, dealers selling vehicles through autobrokers have fallen victim to fraud schemes and faced liability for autobroker non-compliance. Despite such risks, many new car dealers have continued working with brokers to extend their effective range of product distribution. Although an autobroker's role in a transaction has traditionally been limited to arranging and negotiating for a customer's purchase of a new vehicle at a franchised new car dealership, some broker activities push the envelope of this model by preventing the customer from having any direct contact with the selling dealer–with the broker handling legally sensitive duties such as identity verification and credit applications. Dealers should be aware that the greater the role that an autobroker plays in a transaction (beyond mere negotiation of the purchase price of a specific vehicle), the greater risk the selling dealer bears for everything from disclosure non-compliance to identity theft and involvement in straw purchases.

Identity Verification:

Dealers should be very concerned with the role of an autobroker in verifying the identity of their customers and complying with the Red Flags Rule. CNCDA was informed of a Southern California dealer who had to buy back a brokered sales contract when it turned out that the broker and purchaser were involved in a straw purchase ring together. Dealers can prevent falling victim to similar circumstances by ensuring that the customer visits the dealership to provide positive identity verification and to execute the transaction.

While broker involvement in straw purchase rings may not be commonplace, broker handling of identity verification is problematic under any circumstance. The broker may or may not have any identity verification procedures in place thereby increasing the risk of identity theft. A dealer's Identity Theft Prevention Plan (required under the Red Flags Rule) may have some guidance about handling off-site transactions or any other transactions where the consumer is not verified by dealership personnel. Dealers should be sure to adhere to their Identity Theft Prevention Plan without exception. And dealers who rely on a broker to perform any aspect of identity verification and/or completion of customer documents or other steps necessary to complete the transaction are required by the Red Flags Rule to effectively oversee and supervise the identity theft protection procedures and practices used by the broker—a daunting task at best.

Credit Application:

Another problem in autobrokering is when the broker insists on involvement in the credit application process. Having the broker handle any part of the credit application/review process is dangerous. In addition to state law concerns, the selling dealer puts itself at risk of violating the federal Equal Credit Opportunity Act (ECOA), Fair Credit Reporting Act (FCRA), Fair and Accurate Credit Transactions Act (FACTA), and Gramm Leach Bliley Act (Privacy Rule and Safeguards Requirements). It is strongly recommended that dealers require all consumers to visit your dealership to handle the credit application and contracting process.

CNCDA has been made aware of two dangerous broker credit application processes: Under the first scenario, the broker receives an electronic credit application from a consumer, which is then forwarded to the selling dealer to pull a credit report. This provides serious legal compliance issues, including whether the selling dealer and finance companies are authorized to access a credit report, whether discussing creditworthiness with the broker may render the dealer a Credit Reporting Agency, whether the dealer will be seen as in conspiracy with the broker in misrepresenting the true identity of the creditor to whom the credit application is being made (the dealer), whether the dealer has a duty to issue an adverse action notice if the broker's original offer for credit terms is rejected, and violations of the federal Privacy and Safeguards Rules.

Under a second scenario brought to CNCDA's attention, a broker asks the dealer to send a blank copy of the dealer's credit application for the customer to complete with the broker (the broker would act as the go-between for the credit application process). This is arguably even more problematic than pulling a credit report based upon the consumer's credit application with the broker. In addition to serious identity theft, privacy, and information safeguard concerns, having the broker handle the customer's credit application on behalf of the dealership could be construed as rendering the broker as an unlicensed salesperson of the selling dealer.

Dealers should exercise caution when brokers perform activities outside price negotiation for the vehicle. The dealer can be liable for the broker's legal noncompliance and some brokers may not pay close attention to the various legal requirements involved in the purchase of a vehicle through an autobroker. Under no circumstances, however, should a dealership allow a broker to become involved at any stage in the credit application process. The broker should not be involved in this process. By limiting broker involvement to traditional price negotiation, a dealership will have better control over potential legal liability.

Bird Dog and Referral Fees

Dealers frequently ask about whether they can pay cash or offer other incentives (commonly known as bird dog or referral fees) to the local barber, high school, customers, or other dealers in return for referrals to new customers who visit, purchase, or lease a vehicle from the dealership. While doing so seems innocuous (and is allowed in many other states), California law specifically forbids such payments by various statutes that prohibit the activity.

Vehicle Code section 675 defines a "vehicle salesperson" in part as a person who "[i]nduces or attempts to induce any person to buy or exchange an interest in a vehicle required to be registered, and who receives or expects to receive a commission, money, brokerage fees, profit, or any other thing of value, from either the seller or purchaser of the vehicle." There are some exceptions to the salesperson definition for insurance companies, private party sellers, and automakers, but no exception exists for members of the general public, or other licensed dealers, who refer a customer to a dealer in return for payment. See the full definition of a Vehicle Salesperson below in the "Text of Autobroker and Related Laws" section. In essence, California law considers that dealers who provide payment in the form of cash, future discounts, or even oil changes to a person who refers a customer are effectively employing a salesperson, and must follow the usual licensing requirements (sending notice of hiring/firing and posting their license at the dealership).

Vehicle Code section 11713(h) bans dealers from employing "any person as a salesperson who has not been licensed . . . ." Because of the broad definition of "salesperson," paying bird dog or referral fees can be considered as employing an unlicensed salesperson. This has been confirmed by senior DMV officials. The Vehicle Code designates this violation as a criminal misdemeanor, which can lead to fines and administrative action up to and including revocation of a dealer's license.

In addition to the potential dealership violation, the person making a referral can also face serious legal action. While prosecution of the "bird dog" is unlikely, Vehicle Code 11800 provides that it is "unlawful for any person to act as a vehicle salesperson without having first procured a license or temporary permit issued by the department . . . ." As is the case for the dealer violation, the violation is considered a criminal misdemeanor.

Civil Code section 2982.1 also prohibits dealers from offering a discount or other benefit if the benefit depends upon the purchaser either selling or giving information or assistance for the purpose of leading to the sale of a vehicle to another person under a contract governed by the Automobile Sales Finance Act. Be sure to avoid providing a special price, accessory, or other benefit to customers based on an obligation to send you more business.

Vehicle Code section 232.5 provides as follows: " 'Brokering' is an arrangement under which a dealer, for a fee or other consideration, regardless of the form or time of payment, provides or offers to provide the service of arranging, negotiating, assisting, or effectuating the purchase of a new or used motor vehicle, not owned by the dealer, for another or others." If anyone falls within this definition, including licensed dealers, all of California's autobroker rules apply.

Offsite Sales and Delivery

Offsite vehicle delivery can be a confusing subject given the relative lack of clear legal standards governing the practice. However, several legal issues have a bearing on offsite delivery, including laws concerning door-to-door solicitation, dealer licensing, dealer established place of business, and the definition of a vehicle "sale." How these laws impact offsite delivery depends on whether the offsite delivery can be considered an offsite sale.

One law having a possible impact on offsite deliveries is the Door-To-Door Solicitation Rule (the "Rule") of the Federal Trade Commission (FTC) (16 CFR § 429.0 et seq.). Once the Rule is triggered, a buyer must be given a three-day right to rescind his or her purchase, and must be given written notice of that right. However, the Rule only applies where the customer is solicited by representatives of the seller in person at the customer's home or other offsite location, and the agreement to purchase is made offsite. It does not apply to sales pursuant to prior negotiations during a visit by the buyer to the dealership, nor to sales conducted and consummated entirely by mail or telephone (and presumably Internet) and without face-to-face contact between the buyer and the seller or its representative prior to delivery. The Rule is subject to several other exceptions and limitations.

However, the Rule does not specifically address the scenario of a dealership employee being sent off premises to deliver a vehicle and obtain the customer's signature on a purchase contract. In response to specific questions concerning this example, the FTC issued a non-binding FTC staff opinion letter in 2001. According to the letter, the Rule does not apply "where the delivery driver's only function is to obtain the buyer's signature on a fully completed contract that contains terms that have been negotiated before the delivery occurred." The letter explains that merely obtaining the buyer's signature at an offsite location would not constitute an act of "solicitation" that would trigger the Rule. To stay clear of the Rule, dealers should ensure that representatives sent offsite to obtain contract signatures avoid any selling or negotiating. Note that the Rule applies to both purchases and leases.

Although California has its own home solicitation law (see Civil Code §§ 1689.5 – 1689.7), it does not apply to sales of motor vehicles (Civil Code § 1689.5(c). However, Vehicle Code section 11714(b) effectively provides that a dealer shall not "sell" a vehicle from a location other than its posted established place of business or authorized branch location(s). Specifically, the statute states that "a dealer shall not sell any vehicle at retail at a location that is not posted pursuant to Vehicle Code section 11709. Section 11709 requires the licenses of the dealer and salespeople and basic dealership signage to be posted at the dealership.

But what actual offsite activities does section 11714(b) prohibit? Does "sell" as used in this law refer simply to persuasion to encourage a sale, or does it include all activities leading up to "consummation" of the sale including contract signing and delivery? Is this analysis affected by Vehicle Code section 5901(d)'s statement that a vehicle sale is deemed completed and consummated when the purchaser has signed a purchase contract and has taken physical possession or delivery of the vehicle? Unfortunately, no published court decision has addressed how broadly "sell" should be defined in this context. However, a DMV memo dated March 8, 2000 provides guidance. Association counsel confirmed in 2005 that the memo continues to reflect DMV's position on the subject.

According to the DMV memo, the applicable Vehicle Code sections require every vehicle sale to be made at the dealer's established place of business. However, the memo goes on to identify permissible offsite delivery activities. First, if the customer signs the purchase contract and all applicable documents at the dealership, the dealer would not be prohibited from thereafter delivering the vehicle to the customer. Second, the memo points out that a dealer could transmit a dealer-signed and fully completed purchase contract to the customer's home or other offsite location, have the customer sign and send the signed paperwork back to the dealership, and then allow the customer to take delivery offsite. According to the memo, this arrangement results in a sale at the dealership because the contract would be received at the dealership. Despite one reference in the memo to this chain of events taking place by mail, the memo neither endorses nor specifically condemns sending a dealership employee to deliver the paperwork in lieu of using the mail. However, the memo clearly prohibits any sales activity offsite. As such, selling, promotion, and negotiation should not be conducted during any offsite vehicle delivery.

The DMV memo discusses the "No-Cooling Off" signs required to be posted at the dealership and their obvious absence in a transaction where the contract is not signed at the dealership. The DMV gives the suggestion in the memo that the No-Cooling Off warning be included with the contract in at least 12-point type. However, Civil Code section 2982(r) requires conditional sale contracts to include the No-Cooling Off notice in 12-point bold type in any event. Consequently, most contract

forms, such as the LAW 553, already include the No-Cooling Off warning suggested by the DMV.

Brokers are sometimes involved in offsite deliveries. Vehicle Code section 11735(d) authorizes an autobroker to obtain a consumer's signature on a selling dealer's motor vehicle purchase agreement that has already been executed by the selling dealer and, with the selling dealer's written approval, to deliver a vehicle sold pursuant to a fully signed motor vehicle purchase agreement. However, the law requires the selling dealer to complete and process all title and registration documents, and registrations with the factory for purposes of warranties, rebates, recalls and the like. See Vehicle Code § 11739. The selling dealer is also specifically prohibited by Vehicle Code section 11713(m) from allowing an autobroker or any other dealer to use the dealer's license, report of sale forms, or other books and records. Dealers should also be aware of a number of other potential risks associated with autobroker delivery of vehicles, as discussed in the "Do's and Don'ts" and “Broker Involvement Putting Auto Dealers at Risk” discussions above.

In summary, a pure courtesy delivery after the customer has signed the contract and other purchase paperwork at the dealership should pose no legal problem, unless prohibited by factory-imposed vehicle delivery procedures. Beyond this scenario, however, the applicable legal requirements become subject to interpretation. In light of the views of the FTC and DMV discussed above, at a minimum, dealers should ensure that all contract terms are negotiated to the customer's full and complete agreement (in person, by telephone, or over the Internet) before offsite delivery is made. In addition, the customer should be provided with a dealer-signed copy of the contract before delivery is made. Moreover, when making an offsite delivery, dealership personnel should limit their activities to delivering the vehicle and, if not already in hand, obtaining the necessary paperwork signed by the customer, with no negotiating, selling, or other persuading being permitted.

Finally, multiple or repeated offsite deliveries at the same location could be considered inconsistent with the requirement that each place of business of the dealer be licensed as an established place of business or branch location (see Vehicle Code §§ 320; 1671). These rules could impact "partner programs" that involve offsite delivery, such as having a fleet manager visit a credit union on a regular basis to deliver vehicles to credit union customers working on loan paperwork and/or to obtain the signatures of those customers on vehicle contracts or leases.

Text of Autobroker and Related Laws

The following is the text of the statutes relating to autobrokers:

Definition of Autobroker

Vehicle Code section 166 defines an autobroker as follows: *An "autobroker" or "auto buying service" is a dealer, as defined in section 285, who engages in the business of brokering, as defined in section 232.5.*

Definition of Brokering

Vehicle Code section 232.5 defines "brokering" as follows: *"Brokering" is an arrangement under which a dealer, for a fee or other consideration, regardless of the form or time of payment, provides or offers to provide the service of arranging, negotiating, assisting, or effectuating the purchase of a new or used motor vehicle not owned by the dealer for another or others.*

Definition of Converter

Vehicle Code section 267 defines "converter" as follows: *A "converter" is a person, other than a vehicle manufacturer, who, prior to the retail sale of a new vehicle , does any of the following to the vehicle:*

(a) Assembles, installs, or affixes a body, cab, or special equipment to the vehicle chassis.

(b) Substantially adds to, subtracts from, or modifies the vehicle, if it is a previously assembled or manufactured new vehicle.

Definition of Vehicle Salesperson

Vehicle Code section defines a Vehicle Salesperson as follows:

(a) “Vehicle salesperson” is a person not otherwise expressly excluded by this section, who does one or a combination of the following:

(1) Is employed as a salesperson by a dealer, as defined in Section 285, or who, under any form of contract, agreement, or arrangement with a dealer for commission, money, profit, or other things of value, sells, exchanges, buys, or offers for sale, negotiates, or attempts to negotiate, a sale, or exchange of an interest in a vehicle required to be registered under this code.

(2) Induces or attempts to induce any person to buy or exchange an interest in a vehicle required to be registered, and who receives or expects to receive a commission, money, brokerage fees, profit,

or any other thing of value, from either the seller or purchaser of the vehicle.

(3) Exercises managerial control over the business of a licensed vehicle dealer or who supervises vehicle salespersons employed by a licensed dealer, whether compensated by salary or commission, including, but not limited to, any person who is employed by the dealer as a general manager, assistant general manager, or sales manager, or any employee of a licensed vehicle dealer who negotiates with or induces a customer to enter into a security agreement or purchase agreement or purchase order for the sale of a vehicle on behalf of the licensed vehicle dealer.

(b) The term "vehicle salesperson" does not include any of the following:

(1) Representatives of insurance companies, finance companies, or public officials, who in the regular course of business, are required to dispose of or sell vehicles under a contractual right or obligation of the employer, or in the performance of an official duty, or under the authority of any court of law, if the sale is for the purpose of saving the seller from any loss or pursuant to the authority of a court of competent jurisdiction.

(2) Persons who are licensed as a manufacturer, remanufacturer, transporter, distributor, or representative.

(3) Persons exclusively employed in a bona fide business of exporting vehicles, or of soliciting orders for the sale and delivery of vehicles outside the territorial limits of the United States.

(4) Persons not engaged in the purchase or sale of vehicles as a business, disposing of vehicles acquired for their own use, or for use in their business when the vehicles have been so acquired and used in good faith, and not for the purpose of avoiding the provisions of this code.

(5) Persons regularly employed as salespersons by persons who are engaged in a business involving the purchase, sale, or exchange of boat trailers.

(6) Persons regularly employed as salespersons by persons who are engaged in a business activity which does not involve the purchase, sale, or exchange of vehicles, except incidentally in connection with the purchase, sale, or exchange of vehicles of a type not subject to registration under this code, boat trailers, or midget autos or racers advertised as being built exclusively for use by children.

(7) Persons licensed as a vehicle dealer under this code doing business as a sole ownership or member of a partnership or a stockholder and director of a corporation or a member and manager of a limited liability company licensed as a vehicle dealer under this code. However, those persons shall engage in the activities of a salesperson, as defined in this section, exclusively on behalf of the sole ownership or partnership or corporation or limited liability company in which they own an interest or stock, and those persons owning stock shall be directors of the corporation; otherwise, they are vehicle salespersons and subject to Article 2 (commencing with Section 11800 of Chapter 4 of Division 5).

(8) Persons regularly employed as salespersons by a vehicle dealer authorized to do business in California under Section 11700.1 of the Vehicle Code.

Definition of Dealer

Vehicle Code section 285 defines a dealer as:

"Dealer" is a person not otherwise expressly excluded by section 286 who:

*(a) For commission, money, or other thing of value, sells, exchanges, buys, or offers for sale, negotiates or attempts to negotiate, a sale or exchange of an interest in, a vehicle subject to registration, a motorcycle, snowmobile, or all-terrain vehicle subject to identification under this code, or a trailer subject to identification pursuant to Section 5014.1, or induces or attempts to induce any person to buy or exchange an interest in a vehicle and, who receives or expects to receive a commission, money, **brokerage fees**, profit, or any other thing of value, from either the seller or purchaser of said vehicle, or*

(b) Is engaged wholly or in part in the business of selling vehicles or buying or taking in trade, vehicles for the purpose of resale, selling, or offering for sale, or consigned to be sold, or otherwise dealing in vehicles, whether or not such vehicles are owned by such person.

Definition of New Vehicle

Vehicle Code section 430 defines a new vehicle as: *A "new vehicle" is a vehicle constructed entirely from new parts that has never been **the subject of a retail sale,** or registered with the department, or registered with the appropriate agency or authority of any other state, District of Columbia, territory or possession of the United States, or foreign state, province, or country.*

Definition of Retail Sale

The definition of a retail sale is contained in Vehicle Code section 520: *A "retail sale" is a sale of goods to a person for the purpose of consumption and use, and not for resale to others, including, but not limited to, an arrangement where a motor vehicle is consigned to a dealer for sale.*

Requirement of Established Place of Business

Vehicle Code section 1671 in part provides: *A dealer who does not offer new or used vehicles for sale at retail, a dealer who has been issued an autobroker's endorsement to his or her dealer's license and who does not also sell motor vehicles at retail, or a dealer who is a wholesaler involved for profit only in the sale of vehicles between licensed dealers, shall have an office, but a display area is not required.*

Autobroker Registration Fee

Vehicle Code section 9262(d) provides: *The fee for an autobroker's endorsement to a dealer's license is as follows:*

(1) For the original endorsement, a nonrefundable fee of one hundred dollars ($100).

(2) For the annual renewal of the endorsement, a fee of seventy-five dollars ($75)

Brokers Subject to All Dealer Laws

Vehicle Code section 11700.2 provides: *A dealer who obtains an autobroker's endorsement to his or her dealer's license is subject to all of the licensing, advertising, and other statutory and regulatory requirements and prohibitions applicable to a dealer, regardless of whether that dealer acts as the buyer of a vehicle, the seller of a vehicle, or provides brokering services on behalf of another or others for the purpose of arranging, negotiating, assisting, or effectuating the sale of a vehicle not owned by that dealer.*

Allowable Autobroker Advertising

Vehicle Code section 11713(b)(1)(A) states that it is a violation for the holder of any license to:

Advertise or offer for sale or exchange in any manner, any vehicle not actually for sale at the premises of the dealer or available to the dealer directly from the manufacturer or distributor of the vehicle at the time of the advertisement or offer. However, a dealer who has been issued an autobroker's endorsement to his or her dealer's license may advertise his or her service of arranging or negotiating the purchase of a new motor vehicle from a franchised new motor vehicle dealer and specify the line-makes and models of those new vehicles. Autobrokering service advertisements may not advertise the price or payment terms of any vehicle and shall disclose that the advertiser is an autobroker or auto buying service, and shall clearly and conspicuously state the following: "All new cars arranged for sale are subject to price and availability from the selling franchised new car dealer."

(B) As to printed advertisements, the disclosure statement required by subparagraph (A) shall be printed in not less than 10-point bold type size and shall be textually segregated from the other portions of the printed advertisement.

(2) Notwithstanding subparagraph (A), classified advertisements for autobrokering services that measure two column inches or less are exempt from the disclosure statement in subparagraph (A) pertaining to price and availability.

(3) Radio advertisements of a duration of less than 11 seconds that do not reference specific line-makes or models of motor vehicles are exempt from the disclosure statement required in subparagraph (A).

Deposits

Vehicle Code section 11713(p) states that it is a violation for the holder of any dealer's license to: *Accept a purchase deposit relative to the sale of a vehicle, unless the vehicle is present at the premises of the dealer or available to the dealer directly from the manufacturer or distributor of the vehicle at the time the dealer accepts the deposit. Purchase deposits accepted by an autobroker when brokering a retail sale shall be governed by Sections 11736 and 11737.*

These code sections are set forth below.

Display of Vehicles

Vehicle Code section 11713(r) provides that is unlawful for a licensed dealer to: *Display a vehicle for sale at a location other than an established place of business authorized by the department for that dealer or display a new motor vehicle at the business premises of another dealer registered as an autobroker. This subdivision does not apply to the display of a vehicle pursuant to subdivision (b) of section 11709 or the demonstration of the qualities of a motor vehicle by way of a test drive.*

It Is Unlawful for Anyone other than a New Motor Vehicle Dealer To Sell a New Vehicle

Vehicle Code section 11713.1(f) makes it unlawful for a licensed dealer to:

(1) Advertise for sale, sell, or purchase for resale, any new vehicle of a line-make for which the dealer does not hold a franchise.

(2) This subdivision does not apply to any transaction involving any of the following:

(A) A mobilehome.

(B) A recreational vehicle as defined in section 18010 of the Health and Safety Code.

(C) A commercial coach, as defined in section 18001.8 of the Health and Safety Code.

(D) An off-highway motor vehicle subject to identification as defined in section 38012.

(E) A manufactured home.

(F) A new vehicle that will be substantially altered or modified by a converter prior to resale.

(G) A commercial vehicle with a gross vehicle weight rating or more than 10,000 pounds.

(H) A vehicle purchased for export and exported outside the territorial limits of the United States without being registered with the department.

(I) A vehicle acquired in the ordinary course of business as a new vehicle by a dealer franchised to sell that vehicle, is not justified if all of the following apply:

(i) The manufacturer or distributor of the vehicle files a bankruptcy petition.

(ii) The franchise agreement of the dealer is terminated, canceled, or rejected by the manufacturer or distributor as part of the bankruptcy proceedings and the termination, cancellation, or rejection is not a result of the revocation by the department of the dealer's license or the dealer's conviction of a crime.

(iii) The vehicle is held in the inventory of the dealer on the date the bankruptcy petition is filed.

(iv) The vehicle is sold by the dealer within six months of the date the bankruptcy petition is filed.

(3) Subparagraph (I) of paragraph (2) does not entitle a dealer whose franchise agreement has been terminated, canceled, or rejected to continue to perform warranty service repairs or continue to be eligible to offer or receive consumer or dealer incentives offered by the manufacturer or distributor.

Required Disclosures on Sales Contracts

Vehicle Code section 11713.1(x) makes it unlawful for a licensed dealer to: *Fail to disclose, in a clear and conspicuous manner in at least 10-point bold-face type on the face of any contract for the retail sale of a new motor vehicle that this transaction is, or is not, subject to a fee received by an autobroker from the selling new motor vehicle dealer, and the name of the autobroker, if applicable.*

Unlawful for Manufacturers to Dishonor Warranties, Rebates, or Other Incentives in Broker Transactions

Vehicle Code section 11713.3(s) makes it unlawful for a manufacturer or distributor: *To dishonor a warranty, rebate, or other incentive offered to the public or a dealer in connection with the retail sale of a new motor vehicle, based solely upon the fact that an autobroker arranged or negotiated the sale. This subdivision shall not prohibit the disallowance of that rebate or incentive if the purchaser or dealer is ineligible to receive the rebate or incentive pursuant to any other term or condition of a rebate or incentive program.*

Further Autobroker Requirements - Registration, Autobroker Log, and Fiduciary Duties

Vehicle Code section 11735 provides:

(a) No dealer shall engage in brokering a retail sales transaction without first registering with the department as an autobroker and paying the fee required by subdivision (d) of section 9262 and obtaining from the department an autobroker's endorsement to the dealer's license. An autobroker's endorsement shall be automatically cancelled upon the cancellation, suspension, revocation, surrender, or expiration of a dealer's license.

(b) Upon the issuance of an autobroker's endorsement to a dealer's license, the department shall furnish the dealer with an autobroker's log. The autobroker's log shall remain the property of the department and may be taken up at any time for inspection.

(c) The autobroker's log shall contain spaces sufficient for the dealer to record the following information with respect to each retail sale brokered by that dealer:

(1) Vehicle identification number of brokered vehicle.

(2) Date of brokering agreement.

(3) Selling dealer's name, address, and dealer number.

(4) Name of consumer.

(5) Brokering dealer's name and dealer number.

(d) Nothing in this code prohibits a dealer who has been issued an autobroker's endorsement to his or her dealer's license from delivering, with the selling dealer's written approval, motor vehicles that have been sold pursuant to a duly executed motor vehicle purchase agreement or obtaining a consumer's signature on a selling dealer's motor vehicle purchase agreement that has already been executed by the selling dealer.

(e) When brokering a retail sale as an agent of the consumer, selling dealer, or both, the brokering dealer owes a fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with its principal or principals.

(f) For purposes of this section and Sections 11736, 11737, and 11738, "consumer" means any

person who retains a dealer to perform brokering services in connection with a retail sale.

Acts Which Are Unlawful in Autobrokering

Vehicle Code section 11736 provides for various unlawful acts in the brokering of a retail sale:

It is unlawful for any dealer licensed under this article to do any of the following when brokering a retail sale:

(a) Fail to execute a written brokering agreement, as described in section 11738, and provide a completed copy to both of the following:

(1) Any consumer entering into the brokering agreement. The completed copy shall be provided prior to the consumer's signing of an agreement for the purchase of the vehicle described in the brokering agreement or, prior to accepting one hundred dollars ($100) or more from that consumer, whichever occurs first.

(2) The selling dealer. The completed copy shall be provided prior to the selling dealer's entering into a purchase agreement with the consumer.

(b) Accept a purchase deposit from any consumer that exceeds 2.5 percent of the selling price of the vehicle described in the brokering agreement.

(c) Fail to refund any purchase money, including purchase deposits, upon demand by a consumer at any time prior to the consumer's signing of a vehicle purchase agreement with a selling dealer and taking delivery of the vehicle described in the brokering agreement.

(d) Fail to cancel a brokering agreement and refund, upon demand, any money paid by a consumer, including any brokerage fee, under any of the following circumstances:

(1) When the final price of the brokered vehicle exceeds the purchase price listed in the brokering agreement.

(2) When the vehicle delivered is not as described in the brokering agreement.

(3) When the brokering agreement expires prior to the customer being presented with a purchase agreement from a selling dealer arranged through the brokering dealer that contains a purchase price at or below the price listed in the brokering agreement.

(e) Act as a seller and provide brokering services, both in the same transaction.

(f) Fail to disclose to the consumer and selling dealer, as soon as practicable, whether the autobroker receives or does not receive a fee or other compensation, regardless of the form or time of payment, from the selling dealer and the dollar amount of any fee that the consumer is obligated to pay to the autobroker. This arrangement shall be confirmed in a brokering agreement.

(g) Fail to record in the dealer's autobroker log, for each brokered sale, all of the information specified in subdivision (c) of section 11735.

(h) Fail to maintain for a minimum of three years a copy of the executed brokering agreement and other notices and documents related to each brokered transaction.

(i) Fail to advise the consumer, prior to accepting any money, that a full refund will be given if the motor vehicle ordered through the autobroker is not obtained for the consumer or if the service orally contracted for is not provided.

Deposits when Brokering a Retail Sale

Vehicle Code section 11737 provides:

(a) A dealer who brokers a motor vehicle sale shall deposit directly into a trust account any purchase money, including purchase deposits, it receives from a consumer or a consumer's lender. This subdivision does not require a separate trust account for each brokered transaction.

(b) The brokering dealer shall not in any manner encumber the corpus of the trust account except as follows:

(1) In partial payment to a selling dealer for a vehicle purchased by the brokering dealer's consumer.

(2) To make refunds.

(c) Subdivision (b) shall not prevent payment of the interest earned on the trust account to the brokering dealer.

(d) The brokering dealer shall serve as trustee of the trust account required by this section. If the brokering dealer is a partnership or a corporation, the managing partner of the partnership or the chief executive officer of the corporation shall be the trustee. The trustee may designate in writing that an officer or employee may manage the trust account if that officer or employee is under the trustee's supervision and control, and the original of the writing is on file with the department.

(e) All trust accounts required by this section shall be maintained at a branch of a bank, savings and loan association, or credit union regulated by the state or the government of the United States.

(f) The brokering dealer has a fiduciary responsibility with respect to all purchase money received from a consumer or consumer's lender relative to a brokered sale transaction.

(g) The following are deemed to be held in trust for consumers who have paid purchase money to a brokering dealer:

(1) All sums received by the brokering dealer whether or not required to be deposited in an actual trust account and regardless of whether any of these sums were required to be deposited or actually were deposited in a trust account.

(2) All property with which any of the sums described in paragraph (1) has been commingled if any of these sums cannot be identified because of the commingling.

(h) Upon any judicially ordered distribution of any money or property required to be held in trust and after all expenses of distribution approved by the court have been paid, every consumer of a brokering dealer has a claim on the trust for purchase money payments made to the brokering dealer. Unless a consumer can identify his or her funds in the trust within the time established by the court, each consumer shall receive a proportional share based on the amount paid.

Contents of Brokering Agreement

Vehicle Code section 11738 provides for the contents of the brokering agreement:

The brokering agreement required by section 11736 shall be printed in no smaller than 10-point type and shall contain not less than the following terms, conditions, requirements, and disclosures:

(a) The name, address, license number, and telephone number of the autobroker.

(b) A complete description, including line-make, model, year model, and color, of the vehicle and the desired options.

(c) The following statement:

"The following information shall be completed prior to the signing of this brokering agreement:

Dollar Purchase Price of Vehicle: _____.

Date this agreement will expire if a purchase agreement from a selling dealer is not presented for your signature: _____.

Fee that you will be obligated to pay us, if any: _____."

(d) One of the following notices, as appropriate, printed in at least 10-point bold type and placed immediately below the statement required by subdivision (c):

(1) "We do not receive a fee from the selling dealer."

(2) "We receive a fee from the selling dealer."

(e) The following notice on the face of the brokering agreement with a heading in at least 14-point bold type and the text in at least 10-point bold type, circumscribed by a line, that reads as follows:

NOTICE

This is an agreement to provide services; it is not an agreement for the purchase of a vehicle. California law gives you the following rights and protection:

Once you have signed this agreement, you have the right to cancel it and receive a full refund of any money paid, including any brokerage fee you may have paid, under any of the following circumstances:

(1) The final price of the vehicle exceeds the purchase price listed above.

(2) The vehicle is not as described above upon delivery.

(3) This agreement expires prior to your being presented with a selling dealer's purchase agreement.

If you have paid a purchase deposit, you have the right to receive a refund of that deposit at any time prior to your signing a vehicle purchase agreement with a selling dealer. Purchase deposits are limited by law to no more than 2.5 percent of the purchase price of a vehicle and must be deposited by an autobroker or auto buying service in a federally insured trust account. If you are unable to resolve a dispute with your autobroker or auto buying service, please contact an investigator of the Department of Motor Vehicles.

(f) The date the agreement is executed.

(g) The signature of the autobroker and consumer.

Selling Dealer's Duties regarding Title Registration, Warranties, Rebates, and Incentives

Vehicle Code section 11739 states:

For purposes of title registration, warranties, rebates, and incentives, in a brokered retail new motor vehicle sale, the selling, franchised new car dealer, and not the autobroker, is responsible to apply for title in the name of the purchaser, to secure vehicle registration and the license plates for the purchaser, to secure the manufacturer's warranty in the name of the purchaser, and to make all applications for any manufacturer's rebates and incentives due the purchaser. If there is a manufacturer's recall, the consumer shall be notified directly by the manufacturer.

Motor Clubs

Insurance Code section 12150 provides:

(a) Buying and selling service is an arrangement by a motor club whereby the holder of a service contract with a motor club is aided in any way in the purchase of sale of an automobile.

(b)(1) If a motor club offers a service that refers members to a new motor vehicle dealer for the purchase of a new motor vehicle, and the dealer pays the motor club any compensation, including, but not limited to, an advertising, promotional, or marketing fee, any advertisement of that service shall clearly and conspicuously disclose that the dealer has paid the fee and shall have the following statement: "All new cars arranged for sale are subject to availability and a price prearranged with the selling franchised new car dealer."

(2) In a printed advertisement, the disclosures required by paragraph (1) shall be in not less than 10-point bold type and shall be textually segregated from the other portions of the advertisement.

(3) The disclosures required by paragraph (1) do not apply to general advertisements of a motor club that merely list an auto buying service as one of several services offered by the motor club and that do not provide any details of the auto buying service.

Vehicle Code section 286 which defines the term "dealer" excludes motor clubs in section (p):

Any motor club, as defined in section 12142 of the Insurance Code, that does not arrange or negotiate individual motor vehicle purchase transactions on behalf of its members but refers members to a new motor vehicle dealer for the purchase of a new motor vehicle and does not receive a fee from the dealer contingent upon the sale of the vehicle.

NEW AND USED CAR WARRANTIES

Chapter 8

Contents

NEW AND USED CAR WARRANTIES

OVERVIEW: This chapter explains the various laws governing vehicle warranties and offers methods to limit your liability by having the manufacturer assume the burden of customer claims under these laws where applicable. This chapter also includes an analysis of the Federal Trade Commission (FTC) Used Car Rule.

Scope and Purpose Of Major Warranty Statutes

There are three sources of warranty law – the California Commercial Code, the Song-Beverly Consumer Warranty Act and the federal Magnuson Moss Act.

Definition of Warranty

In its most basic sense a warranty is a representation with backbone: the seller will have to make the buyer whole if the representation turns out to be false, regardless of how careful the seller was in making sure the representation was true. For many years, even before warranties were delivered with consumer products, legal rules took shape concerning what turns a representation into a warranty. Questions were raised and answered as to whether simply offering a product for sale carried with it certain implied warranties, whether advertising statements could be considered express warranties, whether a manufacturer could be held liable under one or more warranty claims even though it never had a contract with the ultimate consumer, and many other matters.

In the sale of vehicles, and other consumer products, the emergence of manufacturers' warranties skewed the meaning of the word warranty toward more of a promise to repair certain problems, excepting only those caused by certain unexpected events, such as an accident. Likewise, additional laws were passed which dealt with consumer warranties, covering such things as the format and presale availability of the warranty document, what can be included in the document for the warrantor's benefit, and permissible warrantor conduct in performing its warranty obligations, with penalties for failing to abide by the rules.

For the auto dealer, the layering of these developments over the years has resulted in a patchwork of laws and regulations which is very difficult to sort out.

Generally, warranty law flows from three sources: the California Uniform Commercial Code, ("UCC" or "Commercial Code"), the Song-Beverly Consumer Warranty Act contained in the California Civil Code ("Song-Beverly") and the federal Magnuson-Moss Warranty Act ("Magnuson-Moss").

California Commercial Code Warranties

The UCC covers the sale of all goods, both at wholesale and retail. It contains technical rules regarding warranties, but they are very broad in their scope. Song-Beverly and Magnuson-Moss are consumer based warranty laws, but often borrow from the UCC, and impose rules limiting the "waiveability," of warranties which might pertain to the transaction, including UCC warranties.

The UCC defines the meaning of express warranty and defines two types of implied warranties - the implied warranty of merchantability and the implied warranty of fitness for a particular purpose.

Unlike Song-Beverly and Magnuson-Moss which deal only with retail consumer sales, the **UCC warranties apply to all sales, even commercial sales and dealer trades.**

How oral statements and advertising materials may come to be regarded as express warranties is governed by the UCC, whereas the provisions of Song-Beverly and Magnuson-Moss apply only to written warranties where a direct promise is made to cause the vehicle to perform, or conform to a standard.

UCC Implied Warranty Of Merchantability

The implied warranty of merchantability is codified in Commercial Code section 2314 and insofar as an automobile dealer is concerned **the implied warranty of merchantability simply means that there shall be implied in every contract for the sale of an automobile that the vehicle being sold is of merchantable quality (i.e. that at the time of sale it is fit for the ordinary purposes for which a vehicle is used).**

The implied warranty of merchantability arises in every contract of sale so it applies to both new car and used car sales.

What is meant by "merchantable" varies with the type of product sold and is to a large extent, except as modified by statute, controlled by the base minimum level of function that satisfies the public's reasonable expectations in connection with an automobile purchase. A new car to be merchantable should be in a condition at the time of sale where it can be expected to be free from significant defects for the duration of the factory warranty, if not longer; whereas a used car depending on the mileage will be held to a lesser standard. The higher the mileage, the lesser the reasonable expectations, and the lower the standard by which the vehicle can be judged; provided, of course, that the vehicle is actually useable for transportation at the time of sale.

UCC Implied Warranty of Fitness For A Particular Purpose

Commercial Code section 2315 defines the implied warranty of fitness for a particular purpose, also called "fitness for use." If the seller knows or should know at the time of the sale that the buyer has a particular or special purpose for which the vehicle is required, and knows or should know that the buyer is and will be reasonably relying on the seller's skill or judgment to select a suitable vehicle, an implied warranty that the vehicle is fit for such purpose will be deemed to exist. For example, if a purchaser advises a dealer that he or she is interested in a vehicle which can tow a boat or trailer to the mountains and relies upon the advice of the salesperson to pick the vehicle suitable for that purpose, an implied warranty arises in favor of the customer that the vehicle will be suitable for that purpose.

Thus, the implied warranty of fitness is based on communications taking place between the dealer and customer. Those same communications can also form the basis of an express warranty. **Under many circumstances, an express warranty survives attempted disclaimers contained in the contract. It is therefore very important that your sales personnel refrain from making any exaggerated assertion of fact about the quality of the product being sold, and where the sale does involve special reliance on the expertise of the seller, your contract should spell out in writing the precise special representations that were being made.**

UCC Express Oral and Written Warranties

Commercial Code section 2313 provides that an express warranty is created whenever any affirmation of fact or promise relating to the goods being sold becomes part of the basis of the bargain. Under such a warranty, the goods must conform to the affirmation or promise. To be part of the basis of the bargain means that the affirmation of fact or promise is made part of the terms of the purchase and sale agreement. Contrast this to "puffing statements" by the salesperson that do not constitute a warranty.

CAUTION

ORAL REPRESENTATIONS: While certain oral representations made by salespersons will not constitute an express warranty under Commercial Code section 2313, such representations may, if untrue, result in a violation of the Consumer Legal Remedies Act (Civil Code section 1770) as well as Business and Professions Code section 17200. See Chapter 9, "Consumer Legal Remedies Act" in the California Auto Dealer Advertising Law Manual This is especially problematic in connection with mileage claims for electric vehicles. Ensure that your staff conveys only what has been clearly communicated by the manufacturer in writing regarding mileage estimates.

Waiving And Disclaiming Warranty Rights Under the UCC

Subject to the limitations discussed below, the implied warranties under the UCC may be disclaimed, and remedies for breach of both implied and express warranties may be limited. Examples of proper limitations include disclaiming all warranties, written or oral, best accomplished by an unmistakable "as-is" statement separately signed on the front of the contract, or, where a warranty is given, limiting the buyer's remedy to having the vehicle repaired only, thus eliminating any other potential claim for damages. As explained below, Song-Beverly Magnuson Moss, and (as to certified used vehicles), the Car Buyers Bill of Rights, drastically curtail the rights of the seller to disclaim or limit the buyer's warranty rights and remedies. Where these statutes do not apply, however, the method of disclaimer is the same with respect to both new and used cars and will be discussed in more detail in connection with used car sales where the disclaimer has the most significance to a dealer.

California Song-Beverly Consumer Warranty Act

Unlike the UCC, the Song-Beverly Consumer Warranty Act (Civil Code sections 1792 et seq.) only applies to the sale of consumer goods (including vehicles with gross vehicle weight ratings of under 10,000 pounds) bought for use primarily for personal, family, household, or for business purposes (so long as the business has no more than five vehicles registered to it). Song-Beverly deals not only with motor vehicles, but also other consumer goods, including parts and accessories.

Generally speaking, Song-Beverly does the following:

- extends the implied warranty of merchantability
- makes it more difficult to disclaim the implied warranty of merchantability;
- makes more definite the duration of the implied warranties;
- provides for the extension of warranties while a vehicle is being repaired;
- provides for a right of indemnity in favor of the dealer against the manufacturer;
- provides for various notices to the buyer regarding the buyer's rights under warranties; and
- strengthens the buyer's remedies in case of a breach of warranty to include in addition to all of the UCC remedies a right to treble damages for a willful breach.

Federal Magnuson-Moss Warranty Act

Like the Song-Beverly Act, the Magnuson-Moss Warranty Act (15 U.S.C. section 2301) does not mandate that a manufacturer or dealer provide or offer any warranty. Magnuson-Moss states that if you issue a written warranty with a vehicle you sell, or if you enter into as an obligor a service contract concerning the vehicle, then certain requirements pertain to the transaction (15 U.S.C. section 2308).

Magnuson-Moss mandates certain disclosures be contained in any written warranty, and prohibits those who issue express warranties or who, as the obligor, enter into service contracts from disclaiming implied warranties, although in those circumstances implied warranties may be limited by agreement to the duration of the written warranty. These requirements apply only to the party who "actually makes" the warranty or enters into a service contract as an obligor (although some plaintiffs' attorneys have attempted to argue that a dealer might be deemed an obligor under a service contract even if not shown as such on the contract itself depending on the role the dealer plays in furnishing the necessary parts and labor and bearing the risk of loss of claims). The FTC agrees that if the manufacturer actually makes the warranty, and the dealer "does no more than distribute or sell a consumer product covered by a written warranty offered by [the manufacturer] and which identifies [the manufacturer] as the warrantor," the dealer has legally made no warranty under Magnuson-Moss. 16 C.F.R. section 700.4; 15 U.S.C. section 2310(f).

Magnuson-Moss requires that written warranties meet stringent standards regarding their content, and that they be labeled and referred to either as either a "full warranty" or "limited warranty."15 U.S.C. sections 2303 and 2304. All manufacturer's warranties are limited warranties and any written warranty you would be giving (generally, dealers do not issue their own warranties) should be a limited warranty. You are therefore obligated to use that terminology in referring to any such warranties in sales, advertising, or other communication with customers. **Therefore, never use the term "full warranty."**

Magnuson-Moss also contains pre-sale availability rules requiring any warranty that accompanies the vehicle to be available for review by potential buyers. Dealers shall make the entire text of written warranties available to consumers, by prominently displayed signs advising of availability or by placing the warranty's terms in close proximity to the vehicle. 52 Fed. Reg. 7,569; 16 C.F.R. 702.3(a)(1) and (2).

Magnuson-Moss applies to written warranties on products which are normally used for personal, family or household purposes. 15 U.S.C. section 2301(1). **The term "normally used" is interpreted by the FTC merely to mean that a personal, family or household use of the product being sold is not uncommon. Under this interpretation, most every passenger car and light–duty pick-up truck would be covered by the Act.** Any consumer may enforce the provisions of the Act, and the FTC also interprets the term consumer very broadly to include both businesses and individuals. Only a small class of purchasers would not come under the Act, such as persons purchasing solely for resale.

New Car Warranty Issues

Implied Warranties

Since a dealer rarely, if ever, makes an express written warranty in connection with a new car sale, your primary concern is when and how are you liable for the implied warranty of merchantability if, for some reason, you cannot or do not disclaim it (e.g., where you are the obligor under a service contract entered into with the buyer within 90 days of purchase).

Under The Commercial Code

You, the dealer, are deemed by law to make an implied warranty of merchantability to the customer under the UCC on every new car sale unless you have disclaimed it.

You can disclaim this implied warranty by a conspicuous writing (it can even be on the back side of the contract) which states that there is no implied warranty of merchantability accompanying the sale.

Conspicuous is defined by the Code as "so written that a reasonable person against whom it is to operate ought to have noticed it...." Commercial Code section 1201(10).

Language in the body of a form is "conspicuous" if it is in larger or contrasting type or color. Most conditional sale contract forms contain a disclaimer on the back side in larger type than the other printing and some use a contrasting color, but you should be absolutely certain that the contract form you use has a conspicuous disclaimer. You can also disclaim by the use of the words "as is" or "with all faults" and although the Code does not specifically say that these words must be conspicuous, there can be little doubt that the courts would read in such a requirement.

Under Song-Beverly

Song-Beverly (Civil Code section 1792) provides that every sale of a new motor vehicle (or other new consumer goods) is deemed to be accompanied **by the implied warranty of merchantability of the manufacturer and the retail seller**. Civil Code section 1792 goes on to say, "**the retail seller shall have a right of indemnity against the manufacturer in the amount of any liability under this section."**

Thus on every new car sale that you make for personal, family, household, or small business purposes as discussed under the heading "Under the Lemon Law," you will be held responsible jointly with the manufacturer for the implied warranty of merchantability with a right of indemnity against the manufacturer.

In consumer sales under Song-Beverly, you cannot disclaim the implied warranty of merchantability if an express warranty "is given" – presumably by either you or by the manufacturer, nor can you disclaim an implied warranty on a new vehicle without strictly following Song-Beverly's stringent "as-is" documentation requirement – a requirement that mandates stating that absolutely no warranty of any kind (and from any source) covers the goods. In practical terms, therefore, you cannot disclaim implied warranties in consumer sales of new vehicles when sold, as most are, with manufacturer warranties.

Song-Beverly provides that the duration of its implied warranty of merchantability on a new car shall be coextensive in duration with any express warranty which accompanies the sale, but in no event shall the duration be less than 60 days nor more than one year. Civil Code section 1791.1(c).

Under The Lemon Law

One component of Song-Beverly, the Tanner Consumer Protection Act found in Civil Code section 1793.22, known by most as the "lemon law," applies only to new motor vehicles. "New Motor Vehicle" means a new motor vehicle that is bought or used primarily for personal, family, or household purposes. "New Motor Vehicle" also means a new motor vehicle with a gross vehicle weight under 10,000 pounds that is bought or used primarily for business purposes by a person, including a partnership, limited liability company, corporation, association, or any other legal entity to which not more than five motor vehicles are registered in this state. "New motor vehicle" includes the chassis, chassis cab, and that portion of a motor home devoted to its propulsion, but does not include any portion designed, used or maintained primarily for human habitation. Also included are dealer-owned vehicles, demonstrators or other motor vehicles sold with a manufacturer's new car warranty, but not motorcycles or unregistered motor vehicles to be used exclusively off the highways. Civil Code section 1793.22(e)(2).

Except for a member of the Armed Forces, the lemon law has also been limited to vehicles sold in California. Under the California Supreme Court's ruling in *Cummins, Inc., vs. Superior Court*, 36 Cal. 4th 478, a California resident who buys a car in another state and has it repaired repeatedly in California is not entitled to refunds or damages under California's lemon law. The Court emphasized that the warranty law only covers "goods sold in California." In the case of a member of the Armed Forces, the Lemon Law applies to vehicles purchased by a member of the Armed Forces regardless of which state his or her motor vehicle is purchased or registered if the member of the Armed Forces purchased a vehicle covered under the Lemon Law and the member was stationed in or a resident of California at the time he or she purchased the motor vehicle or at the time he or she filed an action pursuant to the Lemon Law. Civil Code § 1795.8.

The lemon law affirmatively requires the manufacturer to either replace the vehicle or refund the customer's money, at the customer's option, when a material problem with the vehicle cannot be remedied after a reasonable number of repair attempts. To be material, the problem must substantially impair the use, safety, or value of the vehicle. Civil Code section 1793.22(e) (1).

Reasonable Number of Attempts Presumption

Under the lemon law, the customer, including both buyers and lessees, enjoy a presumption that a reasonable number of attempts have been made to conform a new motor vehicle to the applicable express written warranties, triggering the duty of the dealer to replace or buy-back the vehicle, if, within eighteen (18) months from delivery to the buyer or 18,000 miles on the odometer of the vehicle

(whichever occurs first), one or more of the following occurs: (1) the same nonconformity results in a condition that is likely to cause serious bodily injury if the vehicle is driven, the nonconformity has been subject to repair at least twice by the manufacturer or its agents, and the buyer or lessee has at least once directly notified the manufacturer of the need for repair of the nonconformity; (2) the same nonconformity has been subject to repair four or more times by the manufacturer or its agents, and the buyer has at least once directly notified the manufacturer of the need for repair of the nonconformity; or (3) the vehicle has been out of service for a cumulative total of more than thirty (30) calendar days since its delivery to the buyer. Civil Code section 1793.22(b). Even though this presumption can be overcome by other evidence, if the manufacturer fails to meet its burden of overcoming the presumption, it might be held to have willfully violated the lemon law, thus subjecting itself to lemon law penalties.

The presumption, however, may not be asserted if a qualified third party dispute resolution process exists, until after the customer has resorted to the third party process. The manufacturer must be bound by the decision of the third party process, but if the customer is dissatisfied with the decision, the findings and decision of the third party process shall without further foundation be admissible in any legal action brought by the customer. The act sets forth the qualification requirements for a third party dispute process, one of which is that it be certified by the Department of Consumer Affairs. Civil Code section 1793.22(c) and (d).

Where the manufacturer or its representative has been unable to repair the vehicle to conform to the applicable warranties after a reasonable number of attempts as defined in the act, it must replace the vehicle or refund the purchase price. There is no requirement that the buyer seek to "rescind" the purchase. In either instance, the buyer is also entitled to all incidental expenses, including, but not limited to, reasonable repair, towing, and rental costs incurred, reasonable attorney's fees where suit was required to enforce the provisions of the lemon law, and under certain conditions, civil penalties equal to twice the amount of any damages. If the customer elects to take a replacement vehicle, the manufacturer is entitled to deduction for such use. In either instance, the amount attributable to sue by the buyer is determined by multiplying the actual price of the new motor vehicle paid or payable by the buyer by a fraction of having as its denominator 120,000 and having as its numerator the number of miles traveled by the new motor vehicle prior to the time the buyer first delivered the vehicle to the manufacturer or distributor or its authorized service and repair facility, for correction of the problem that gave rise to the nonconformity. Civil Code section 1793.2(d)(2).

Lemon Law Penalties

In addition to a refund or replacement, the customer may claim a civil penalty not to exceed two times the actual damages, which is added on top of the actual damages (thus possibly allowing a verdict equal to three times the actual damages.) Two triggers in the law determine whether a penalty is available. The first, under Civil Code section 1794(c), applies if the manufacturer's failure to repair or replace was "willful." This section will not apply to a claim based solely on a breach of an implied warranty.

Willfulness will not exist where the factory has a good faith and reasonable belief that the customer's case is not supported by the facts. *Kwan v. Mercedes-Benz Of North America, Inc.* (1994) 28 Cal.Rptr.2d 371.

The second trigger to lemon law penalties is authorized by section 1794(e). It requires no willfulness and applies if after the occurrence of any of the events giving rise to the presumption established under the lemon law, Civil Code section 1793.22(b), the manufacturer has no qualified third party dispute resolution process (as most do not), and the manufacturer receives a customer demand for repair or replacement but does not comply with it within 30 days.

Lemon Law Damages

In addition to vehicle replacement or full refund, a customer may recover incidental damages for lemon law violations. Those damages are limited to monetary losses actually incurred, and do not include emotional distress damages, even if the violation was willful. *Kwan v. Mercedes-Benz Of North America, Inc.* (1994) 28 Cal.Rptr.2d 371. In determining the amount of monetary losses actually incurred by a customer electing the refund remedy under Song-Beverly, the court has held that a buyer may recover all paid finance charges from the manufacturer since the statute provides for payment of "the actual price paid or payable by the buyer." *Mitchell v. Blue Bird Body Company* (2000) 95 Cal. Rptr. 2d 81.

Lemon Law Reacquisition Agreements

Civil Code section 1793.26 prohibits gag clauses regarding the problems experienced with the vehicle in lemon law settlement agreements. Specifically, the law states that any automobile manufacturer, importer, or distributor who takes back a vehicle, or assists a dealer or lienholder in taking back a vehicle, is prohibited from requiring that a buyer

or lessee agree not to disclose the problems with the vehicle or the non-financial terms of the reacquisition. The law further prohibits including a gag clause, confidentiality clause or similar clause in any release or other agreement, whether prepared by the manufacturer, importer, distributor, dealer or lienholder, which would prohibit the buyer or lessee from disclosing information to anyone about the problem with the vehicle or the non-financial terms of the reacquisition. Civil Code section 1793.26(a)(1) and (2). Any such gag or confidentiality clause in violation of the statute will be deemed to be null and void as against the public policy of California. Civil Code section 1793.26(b). The statute is not intended to prevent any confidentiality clause, gag clause, or similar clause regarding the financial terms of the reacquisition of the vehicle. Civil Code section 1793.26(c).

The Lemon Law's Definition of New Vehicle

The lemon law's definition of new vehicle, however, is not entirely clear. One California court has read the definition to cover all demonstrators and any other motor vehicle, even a used car, sold with a manufacturer's new car warranty. *Jensen v. BMW of North America, Inc.* (1995) 41 Cal.Rptr.2d 295. Another court, albeit in a decision ordered decertified for publication, saw the mere existence of some unexpired warranty coverage as not dispositive of the issue. Court battles on the lemon law definition of new vehicle are likely to continue for years to come.

Lemon Law and Recreational Vehicles

It had been widely assumed that the lemon law does not apply to the coach portion of a motorhome, nor to non-motor vehicle recreational vehicles, like travel trailers. This was because Song-Beverly's vehicle lemon law provisions excluded, by name, the coach portion of motorhomes from the definition of "new vehicle." However, Song-Beverly contains a "lemon law" that applies to non-vehicle consumer goods as well, Civil Code section 1793.2(d)(1). This lemon-law applies to the coach portion of recreational vehicles, while the vehicle lemon law applies to the chassis. *National R.V., Inc. v. Foreman* (1995) 40 Cal.Rptr.2d 672.

Dealer Indemnity Rights – Song-Beverly

Some manufacturers have strenuously opposed breach of warranty claims. In suits where both the dealer and manufacturer are named defendants, the manufacturer has often been recalcitrant about settling and all too frequently has tried to put pressure on the dealer to contribute to a settlement.

But not only does Song-Beverly specifically provide for indemnity in favor of the dealer against the manufacturer, it goes further and prescribes the conditions under which **the manufacturer must (without any dealer contribution or duty)** replace the customer's car or refund the full purchase price to the customer, less an offset for customer use. Civil Code section 1793.2(d)(2).

With the legislature specifically providing that a manufacturer (and not the dealer) has the duty to replace the vehicle or refund the customer's purchase price at the option of the buyer when the vehicle cannot be repaired after a reasonable number of attempts, it is incumbent on the manufacturer to more actively participate in solving customer complaints. Furthermore, with its added vulnerability at the trail level, the manufacturer should be required to more actively purse settlement of the really troublesome cases without any reasonable expectation of a dealer contribution.

Dealer Indemnity Rights – Vehicle Code

In addition, Vehicle Code section 11713.13(f)(1) now mandates that manufacturers indemnify their dealers for liability and reasonable costs (including attorney fees) arising out of customer or other third party claims against the dealer based the condition or design of the vehicle or parts or on any service systems or procedures required or recommended to the dealer by the manufacturer.

Under Magnuson-Moss

Magnuson-Moss does not impose or mandate its own implied warranties. If your new car sale is covered by Song-Beverly, that is, the vehicle is sold for personal, family or household purposes, or is covered as a small business, Magnuson-Moss for all practical purposes does not change what has been said under the preceding section covering the implied warranty of merchantability under Song-Beverly. If Song-Beverly does not apply (for example, in a sale for business purposes excluding small business), then Magnuson-Moss prevents you from disclaiming the UCC warranty of merchantability if you enter into a service contract within 90 days of the sale, or, whether directly or through "adoption," you issue your own written warranty. (15 U.S.C. section 2308).

The Act defines a service contract as a "contract in writing to perform services relating to the maintenance or repair (or both) of a consumer product." One court has held that the selling of a service contract between a buyer and a third party does not create a contractual obligation between the dealership and the buyer and does not prohibit the dealership from disclaiming implied warranties.

In *Priebe v. Autobarn, Limited* (2001) 240 F.3d 584, the plaintiff knew he was purchasing the used motor vehicle at issue "as is" from the dealership

and the dealership's paperwork properly disclaimed all express and implied warranties, including the implied warranties of merchantability and fitness for a particular purpose. Yet several months later when the plaintiff discovered that the vehicle had suffered previous damage, he sued the dealership alleging, among numerous other claims, that the dealership breached the implied warranty of merchantability under Illinois law. The plaintiff claimed that the dealership was prohibited from disclaiming the implied warranties because he purchased a service contract when he originally bought the vehicle. The U.S. Court of Appeals for the Seventh District disagreed. The Court held that the service contract could not be construed as creating a warranty of merchantability because the service contract bound the service administrator, not the dealership, to repair the vehicle. Selling a service contract between a consumer and a third party does not create a contractual obligation between the dealership and the consumer and it does not prohibit the dealership from disclaiming implied warranties in Illinois.

The Federal Trade Commission has issued the following opinion regarding disclaimer of warranties: Where a dealer merely acts as a sales agent in selling a third party's service contract or extended warranty, the dealer may in fact disclaim implied warranties under the Magnuson-Moss Warranty Act. Although the FTC's informal opinion is not binding in court, it provides further assurance that when a dealer sells a service contract as the agent of a third-party service provider, without the dealership itself incurring any obligations to perform or pay for repairs, the dealer can disclaim implied warranties. For more information regarding FTC informal opinion, please visit www.ftc.gov or for "A Businessperson's Guide to Federal Warranty Law" go to http://www.ftc.gov/bcp/conline/pubs/buspubs/warranty.shtm.

Express Warranties

Neither Song-Beverly nor Magnuson-Moss impose any duty on a dealer to make any express written warranty on a new car sale. We therefore defer discussion of the requirements under these two acts for the contents of a written warranty to the section entitled "Warranties As They Relate To Used Car Sales."

Magnuson-Moss and Song-Beverly also regulate the content of service contracts. Service contracts must conspicuously disclose in simple and readily understood language the terms, conditions, and exclusions of the contract. Moreover, under Magnuson-Moss, various "legends" (that is exact statements required by law) may be required in the service contract, and certain types of provisions, such as clauses making the dealer's decision final, are prohibited. Since these requirements are extensive and extremely technical, they will not be dealt with here. See the chapter in this Guide entitled Service Contracts. Unless you are dealing with a reputable service contract administrator who has had the form service contracts to be used by you carefully drafted, reviewed, and updated by legal counsel, your attorney should be consulted before any service contract, or written warranty made by you, is issued to any customer.

As to unwritten express warranties, formal or informal, you may be bound by any affirmation of fact or promise made by your salespersons relating to the quality, performance, or value of the vehicle sold.

While Magnuson-Moss and Song-Beverly do not apply to unwritten warranties, under the UCC, you may be held liable for an unwritten warranty if your salesperson makes an affirmation of fact or promise relating to the quality or performance of the vehicle sold. The type of oral affirmations that may be considered express warranties usually center around claims that a salesperson represented a much higher mileage range for a particular electric vehicle or made representations regarding the hauling capacity of a truck or the towing capacity of a vehicle. Such oral representations often take priority over any disclaimers contained on the back of the contract and salespersons should be cautioned in this regard.

The Adoption Problem

Although Magnuson-Moss and Song-Beverly apply in most respects only against the party making a written warranty, (for example, the manufacturer), sometimes arguments are made that the dealer, by passing on the warranty of the manufacturer, has "adopted" the factory warranty as its own. If the adoption theory is accepted, the dealer can be sued for failing to live up to the terms of the warranty, or for warranty law violations that, absent adoption, could only be asserted against the factory. Some plaintiff attorneys have made the argument that a third party obligor service contract was in fact "adopted" or otherwise structured such that the dealer should be considered the true obligor and therefore prohibited by Magnuson Moss from disclaiming implied warranties.

The adoption principle does not take away any rights the dealer would have against the factory to be indemnified against such claims, but a finding of adoption would give a disgruntled customer the ability to bypass any action against the manufacturer and proceed directly against the dealer.

Although no reported California court cases directly address the issue of adoption of new car warranties, several out-of-state cases have. Adoption has been found to result from language on the re-

verse side of a sale contract that assured the buyer that the dealer would promptly perform warranty repairs; from the dealer's issuance of a pre-delivery checklist; from poorly drafted language in a warranty booklet that seemed to obligate the dealer; and from the dealer's stamping of its dealership name on the factory warranty booklet.

As discussed in the following section, California's Song-Beverly Act specifically recognizes that manufacturers must reimburse dealers for claims and damage caused by violations of the factory's warranty duties. While this fact may help reduce the chance of an adoption finding in California, dealers must guard against statements or action which would lead buyers to believe the dealer stands as co-warrantor with the factory under the factory warranty.

Pre-Sale Availability Of Warranties

Although Magnuson-Moss does not require that a dealer give any written warranty, it does require that you make the terms of the manufacturer's written warranty available to potential buyers prior to sale (15 U.S.C. section 2302(b) ; 16 C.F.R. section 702.3). With respect to new car warranties, Magnuson-Moss requires that the manufacturer giving the warranty provide the dealer with the warranty materials necessary for the dealer to comply with the requirements.

A dealer is required to comply with "pre-sale availability" rules mandating that the text of any written warranties offered with the vehicle be readily available to shoppers. The dealer must either conspicuously display the text of the written warranty in close proximity to the product, or post signs in conspicuous places advising that the warranties are available for inspection. The FTC enforces this requirement through "test shoppers" that it employs to catch violations of such technical requirements.

Since Magnuson-Moss covers all written warranties, whether for new or used cars, **the dealer also has a similar obligation to make available to prospective customers for used cars the terms of any written warranty provided in connection with used car sales**. Thus, if you offer a 90 day 50-50 used car warranty, or some such similar warranty in connection with your used car sales, it should be posted in a conspicuous place to attract the attention of your used car purchasers or a notice that such a warranty is available should be posted.

Likewise, it is possible for the FTC to argue that the text of any unexpired manufacturer's warranty on a used car also be available for inspection prior to the sale.

Shifting Warranty Law Responsibility to the Factory

It is important to realize that the law is on the side of the dealer when it comes to who is ultimately responsible for the loss occasioned by a breach of warranty of a new vehicle. The manufacturer made the vehicle and should be responsible for its quality. Although both the dealer and manufacturer are liable to the customer for breach of an implied warranty of merchantability, the law specifically provides that the dealer is entitled to indemnity against the manufacturer for any resulting liability (Civil Code section 1792). In addition, the manufacturer is also liable on its express warranty and many other duties imposed by Song-Beverly.

Furthermore, the "lemon law" specifically provides that if the vehicle under warranty cannot be repaired to conform to the applicable warranties after a reasonable number of attempts, the manufacturer must at the option of the buyer, and provided the buyer has followed the law's procedures, either replace the goods or reimburse the buyer in an amount equal to the purchase price paid by the buyer, less that amount directly attributable to the use by the buyer.

As soon as a warranty dispute develops you may consider doing the following:

a. Get the manufacturer involved. When the matter is still in the talking or letter writing stage do not hesitate to advise the customer of both his or her and your rights against the manufacturer.

b. If the customer has an attorney, have your attorney contact the customer's attorney before any suit is filed to see if he or she can head off your being named in the lawsuit, or to at least make sure the customer's attorney names the manufacturer as a defendant in the lawsuit, and that he or she is familiar with the manufacturer's liability under the "lemon law" provisions if they are applicable to the particular dispute.

c. If the suit has been filed naming both you and the manufacturer as defendants, first tender the defense of the action in your behalf to the manufacturer or have your attorney tender the defense. The willingness of a manufacturer to take over the defense is greatly influenced by whether any allegations are made of dealer misconduct, such as fraud by the dealer, negligent get-ready or repair, or after-market accessory failure. Absent such allegations, you generally are entitled to defense and indemnification with no duty on your part to contribute. If you encounter resistance, you or your

attorney might consider threatening a cross-complaint against the manufacturer for indemnity, since under Civil Code section 1792 you are entitled to full indemnity from the manufacturer, and under Vehicle Code section 11713.13(f)(1) you are entitled to indemnity from the manufacturer based the condition or design of the vehicle or parts or on any service systems or procedures required or recommended to the dealer by the manufacturer.

d. If the manufacturer is not willing to take over the defense, then you have the option of filing a cross-complaint for indemnity or you can wait for the outcome of the action and if a judgment is rendered against you, you can then file a complaint for indemnity in a separate action if the manufacturer does not agree to pay the entire judgment.

e. If you do not file a cross-complaint, consider, with the assistance of your attorney, the "vouching in" provisions of California Uniform Commercial Code section 2607(5)(A). Under this statute, you are allowed to place the factory on notice that a lawsuit is pending and thereby bind the factory to any determination made in that suit as to the condition of the vehicle, even if the factory is not a party to the case. This means that you do not have to re-litigate the condition of the vehicle in any subsequent suit against the factory for indemnification.

f. If the manufacturer is not named in the lawsuit and the customer's complaint is directed solely at you, which unfortunately happens quite often, you have several alternatives. You should first check your dealership sales and service agreement with the manufacturer to see if there is an indemnity clause for breach of warranty claims against you. If so, follow the provisions of the dealership sales and service agreement for remitting the lawsuit to the manufacturer. If there is no such indemnity agreement, or you believe the manufacturer has wrongfully rejected your claim that the manufacturer should defend, then you should consider consulting with your attorney about other ways to involve the manufacturer in the litigation. One of these considerations will be the "vouching in" provisions of Uniform Commercial Code section 2607 discussed above. Another will be review and possible resort to the indemnification provisions of Vehicle Code section 11713.13(f)

g. Finally, if the customer's complaint in any way seeks damages for emotional distress or personal injuries, you should also tender your defense to your liability insurance carrier.

Used Car Warranty Issues

Implied Warranty of Merchantability

Under The UCC

Just as with new car sales, the UCC imposes an implied warranty that the used vehicle is merchantable unless disclaimed in the manner prescribed by the UCC. UCC section 2314. To be merchantable, under most circumstances, the used vehicle would be required to meet the safety requirements of the Vehicle Code with respect to lights, windshield wipers, brakes and tires. In addition, it should be fully operational with all accessories such as radio, heat and air conditioning in working order. At least at the time of sale it should have no known mechanical problems other than those inherent in the vehicle based upon its age and mileage. In this regard, custom in the industry has a significant bearing on what is expected in the way of performance of a used motor vehicle.

If a used vehicle does not meet minimum requirements such as these, it would be risky to sell such vehicle at retail without a disclaimer of the implied warranty of merchantability. However, so long as you neither issue your own used vehicle warranty or enter into a service contract as the obligor with the buyer at the time of sale or within 90 days, you are permitted to disclaim the all implied warranties.

Duration of Implied Warranty Of Merchantability

Although the UCC implied warranty of merchantability has no "duration" as it were - it relates only to the condition of the vehicle at the time of sale - the period of time it takes for a problem to develop is evidence of the vehicle's condition at the time of sale. A major problem that develops quickly can prove that the vehicle was in poor condition when delivered, while a sufficiently long period would establish little or no problem at the time of the sale. For convenience, this period can be referred to as the "length" of the implied warranty. The length will vary based upon the sales price, age and mileage of the vehicle. The newer and more expensive the model, the longer the duration.

We do get some hint as to what the legislature considered to be a reasonable period within which problems must manifest themselves by looking to the Song-Beverly Act, which specifies that its im-

plied warranty of merchantability for used vehicles shall extend for not less than 30 days nor more than 3 months. Civil Code section 1795.5(c). **These numbers certainly can be cited and urged as reasonable guidelines in the event a claim is asserted under the UCC implied warranty regarding a problem which arises after the 90 day period**. If any customer or customer's attorney asserts such a claim, and if you deny the claim, you can point to the maximum period of 3 months set forth in Song-Beverly.

However, this approach may be challenging in view of the decision of the Court of Appeal in *Mexia v. Rinker Boat Company, Inc.* That case holds that even though the Song-Beverly implied warranty of merchantability is of limited duration, as long as the four year statute of limitations is not violated, a buyer can still sue for breach of the warranty even if the defect were discovered months or years after the warranty expired – so long as the jury is convinced that the defect did exist within the duration of the warranty.

In effect, the court in *Mexia* took the notion of a "condition" warranty from the UCC (where a buyer can sue if a very serious defect existed at the time of sale even if not discovered for years thereafter) and applied it to Song-Beverly, contrary to the general view that the Song Beverly implied warranty is a warranty to keep the vehicle merchantable for the duration of the warranty.

Under Song-Beverly

Song-Beverly (Section 1795.5) provides that the obligation of a retail seller of used consumer goods who sells such used goods with a written warranty shall be the same as that imposed on manufacturers giving express written warranties under the Act. As pointed out before, when a warranty is given, or service contract entered into, there can be no waiver of implied warranties. **Accordingly on any used car sale in which you issue a written warranty, you will also be held responsible for an implied warranty of merchantability**. Fortunately, Song-Beverly further provides that you may limit the duration of implied warranties to the duration of the express warranty, and automatically makes its implied warranty of merchantability coextensive in duration with the written warranty given by you, but in no event shall such implied warranty have a duration of less than 30 days nor more than 3 months following the sale of the used vehicle with any warranty. It is unclear as to whether implied warranties imposed under the UCC and other laws are subject to this automatic limitation, so any used car warranty should specifically limit them accordingly.

Once again, these provisions relate only to sales for a personal, family, household, or small business purpose.

Under Magnuson-Moss

On sales of consumer products covered by Magnuson-Moss, the dealer cannot disclaim the implied warranty of merchantability if the dealer gives its own written warranty, or enters into a service contract as the obligor with the buyer at the time of sale or within 90 days thereafter. 15 U.S.C. section 2308. In these cases, the implied warranty may be limited in duration to the duration of a written warranty of reasonable duration provided the limitation is set forth clearly and prominently on the face (which means first page) of the warranty. If no written warranty is given, but a service contract is entered into, then the duration of the implied warranty of merchantability, according to the FTC, may not be limited.

Disclaiming Implied Warranties

Except where you issue a written warranty or enter into a service contract as an obligor, the implied warranty of merchantability can be disclaimed on used car sales. The stringent disclaimer requirements contained in Civil Code section 1792.4 for selling new vehicles "as-is" are not applicable to used vehicles.

The disclaimer is accomplished in the simple manner prescribed by the UCC, and in addition, the "AS IS-NO WARRANTY" box must be checked on the Buyer's Guide required to be attached to the used vehicle by the FTC Used Car Rule. The UCC method of disclaimer is set forth in answer to the question in the section of this chapter entitled "WARRANTIES AS THEY RELATE TO NEW CAR SALES" regarding how to disclaim this implied warranty. The disclaimer contained on the back of most conditional sale contract forms can be sufficient, but in connection with the disclaimer of the implied warranty of merchantability on a used car sale you may consider having the words "as is" stamped or written in a conspicuous manner on the front side of the contract obtain the customer's initials in proximity to where you have placed the words "as is." This procedure will support additional evidence of an as-is sale, including checking the "AS IS - NO WARRANTY" box on the Buyer's Guide required by the FTC Used Car Rule to be attached to the used vehicle.

Disclaimer language in used car sale contracts is very important. Unlike the case of the new car, where the manufacturer has issued a warranty, and the dealer is thus prohibited from disclaiming any implied warranties and the manufacturer is required to deliver a relatively "lemon free" vehicle, in the

used car setting, there is generally no warranty, and no manufacturer to fall back on in the event of a problem.

Certified Used Vehicles

The Car Buyers Bill of Rights, Vehicle Code section 11713.18 prohibits the sale of a certified used vehicle "as is." The law also specifically prohibits disclaimer of the implied warranty of merchantability as to certified used vehicles. Most factory sponsored certified preowned (CPO) programs feature a factory extended warranty or service contract. However, the law applies even if there is no factory CPO program involved – the law is triggered solely on the basis of the words used to advertise and describe the vehicle.

PRACTICAL TIP

Check all documents used to transact used vehicle sales to ensure that "as is" references and waivers or disclaimers of the implied warranty of merchantability have been deleted or have been made inapplicable to certified used vehicles.

Dealer Express Warranties on Used Car Sales

This section discusses the implications of Magnuson-Moss and Song-Beverly on express warranties for used cars. Since other laws may also apply, you should consult with your attorney prior to implementing a used car warranty program.

Written Warranties Under Magnuson-Moss

If you issue your own used vehicle warranty, you can control your own exposure by the terms you choose to provide to your customers.

Any written used car warranty that you give must conform to the requirements of Magnuson-Moss. Since as a practical matter you will never be giving a full warranty as that term is used in Magnuson-Moss, you must under the law clearly and conspicuously label any warranty that you give as a **"limited warranty"** (15 U.S.C. section 2303(a)(2)). Generally speaking, you are obligated to fully disclose in simple and readily understood language the terms and conditions of the warranty.

The warranty must contain the following information: (a) the name of the party to whom extended, (b) a description of the vehicle, (c) what parts are covered, (d) a statement of what the dealer will do and will not do in the event of a problem, (e) a detailed explanation of the steps the purchaser should follow to obtain warranty service, as well as information on available informal dispute settlement mechanisms, (f) any limitations on implied warranties or remedies such as consequential damages, and (g) a statement that state law may render the above limitations void and may give the buyer additional rights (16 C.F.R. section 701.3). Items (f) and (g) must be on the first ("face") page of the warranty (16 C.F.R. section 701.1(i)).

Magnuson-Moss prohibits certain provisions in warranties and service contracts that might appear reasonable and expected:

- No warranty or service contract may give the warrantor the final decision on any question of fact. Thus, it is illegal to say "dealer's decision regarding the nature and extent of any defect is final."
- Nor may the final decision may be given by any third party, except for a court (16 C.F.R. section 700.8). This requirement was illustrated by the U.S. District Court holding in *Wilson v. Waverlee Homes, Inc.* (1997) 954 F.Supp. 1530, in which the court held that a binding arbitration clause in an installment sales contract relating to an alleged breach of warranty was unenforceable and in violation of Magnuson-Moss. The court noted that although Magnuson-Moss allows a warrantor to establish informal dispute settlement mechanisms or procedures, a consumer cannot be bound by the informal dispute settlement procedures and such procedures are a prerequisite, not a bar, to suit in court.
- No warranty or service contract may "tie-in" coverage under the warranty to use of any supplier's goods or services, unless those goods or services are provided at no charge. Thus, unless you offer free service to your warranty or service contract holders, it is illegal to say "this warranty will be void unless routine service is performed by us" or "by an authorized General Motors dealer" (15 U.S.C. section 2302(c); 16 C.F.R. section 700.10).

It is recommended that any limited warranty that you provide your customers contain a limitation on the duration of all implied warranties, with specific reference to those of merchantability and fitness, to a period of time no less than your written warranty, or such shorter period as allowed by law.

It is also strongly recommended that you specifically exclude any right of the buyer to recover consequential damages resulting from a breach of both the express warranty and any implied warranties of merchantability or fitness for a particular purpose.

The warranty should also limit your liability for a breach of the express warranty and the above two implied warranties to repair of the vehicle or replacement of defective parts and it should clearly set forth any percentage of labor or materials that

the customer will be required to pay. The above limitation on the duration of the implied warranties together with these limitations on damages must appear on the face of the warranty in clear unmistakable language and they must be prominently displayed.

Additionally, Magnuson-Moss contains many technical requirements, including the requirement that, for some of the above limitations to be effective, certain legends must be set forth which would appear to apply only to interstate manufacturers, but which are nevertheless required, including "Some States do not allow limitations on how long an implied warranty lasts, so the above limitation may not apply to you" (16 C.F.R. section 701.3(a)(7)) and "Some States do not allow the exclusion or limitation of incidental or consequential damages, so the above limitation or exclusion may not apply to you." (16 C.F.R. section 701.3(a)(8) It is therefore strongly recommended that any written warranty you give be reviewed by counsel prior to its use.

The Magnuson-Moss required "limited warranty" description and warranty content requirements only apply to warranties as they are defined under Magnuson-Moss. A term such as "free trial exchange privilege" or a promised right to return within a designated number of days are not warranties under Magnuson-Moss and need not be labeled as such, although these programs could very well run into single document rule issues. See the section entitled The Single Document Rule in the chapter in this guide entitled Automobile Sales Finance Act.

Written Warranties Under Song-Beverly

Song-Beverly also covers dealer express warranties on used car sales by providing that the obligation of a retail seller of used consumer goods who sells such goods with a written warranty shall be the same as that imposed on manufacturers giving express written warranties on new goods under the Act (Civil Code section 1795.5). The Act obligates the dealer to maintain sufficient repair and service facilities to carry out the terms of such express warranties (Civil Code section 1795 (a)).

The scope of what constitutes a "written warranty" under this section of Song-Beverly was narrowed by the California Supreme Court decision of *Gavaldon v. DaimlerChrylser* (2004) 13 Cal.Rptr.3d 793 wherein*.,* the court held that a written service contract, under which the dealer undertakes to preserve or maintain the utility or performance of the vehicle, is NOT an express written warranty under Civil Code section 1793.2(d)(2). As a result of *Gavaldon*, service contracts will not be considered express warranties so long as the service contracts do not make any reference to "warranty" or "guarantee" and are not called an "extended warranty." Consequently, dealers wishing to preserve the distinction between service contracts and warranties under the lemon law should carefully review the names, labels and content of all their service contract programs. Additionally, one unpublished court of appeal decision decided after *Gavaldon* left open the possibility that oral representations made to a buyer that a service contract is a warranty or guarantee may be sufficient to bring a service contract within the scope of Song Beverly and thus dealers should also be very careful that such representations are not made in connection with the sale of a service contract.

Oral Express Warranties – Commercial Code

Any oral affirmation of fact or promise made by a salesperson to the customer which relates to the goods being sold and which is made during the "dickering" over the terms of sale will constitute an express warranty under Commercial Code section 2313.

You must keep a very careful watch and control over sales personnel particularly with respect to representations relating to the condition of the used vehicle. **Expressions such as "this car has been completely overhauled," and/or "this car has been fully reconditioned," are extremely dangerous**. What you might consider "fully reconditioned" to mean and what a customer construes these words to mean are probably going to be entirely different and unfortunately the courts will construe such language in most instances in favor of the customer. Salespersons should be strongly cautioned not to use such language. If you have a set procedure for reconditioning used cars that you retail, you should prominently display that procedure so that it will set the limit. The customer will then have a more difficult time convincing any court that he or she was told anything beyond these limits.

Disclaiming Oral Warranties

Clauses appearing in contracts which purport to eliminate oral statements by sales personnel are often ignored by courts. For example, one case found such a clause insufficient to overcome a claim of oral warranty and held that the following elements are necessary before an express oral warranty may be effectively disclaimed: the disclaimer must be specifically negotiated between the buyer and seller; the disclaimer must set forth the particular qualities and characteristics of performance that are not being warranted; the disclaimer must be made a part of the bargain between the parties; and the disclaimer must be agreed upon before the sale was completed. *Western Recreational Vehicles, Inc. v. Swift Adhesives, Inc.* (9th Cir. 1994) 23 F.3d 1547;

see also Commercial Code section 2316. Furthermore, disclaimers are often ignored based on the court's interpretation of some consumer protection statutes, such as the Consumer Legal Remedies Act. Nevertheless, disclaimers can be effective in at least limiting the range of claims you may be required to defend.

The FTC Used Car Rule

Magnuson-Moss authorized the FTC to commence rulemaking procedures on used vehicle sales and to adopt a disclosure rule on warranties and warranty practices. The final result of this authorization is the FTC Used Car Rule ("Rule"), (16 C.F.R. Part 455). The purpose of the Rule is to give meaningful disclosures relating to warranties to a used car purchaser, and this is primarily accomplished by displaying a "Buyers Guide" for each used car being offered for sale.

Sales Governed By The Rule

By reason of the broad definitions contained in the Rule, all used car sales by a dealer to a consumer including the sale of demonstrators, company cars and light duty trucks are governed by the Rule.

A "vehicle" as defined in the Rule means "any motorized vehicle, other than a motorcycle, with a gross vehicle weight rating (GVWR) of less than 8,500 lbs., a curb weight of less than 6,000 lbs., and a frontal area of less than 46 sq. ft." This definition is designed to include within the Rule's coverage the sale of light duty trucks and exclude larger trucks and recreational vehicles. A "used vehicle" is defined as "any vehicle driven more than the limited use necessary in moving or road testing a new vehicle prior to delivery to a customer." **It should be noted that since this definition clearly encompasses demonstrators and company cars, there will be instances where the Buyers Guide label required by the Rule must be affixed to vehicles which also bear a Monroney Act sticker.**

Since the Rule defines a consumer as any person who is not a used vehicle dealer, **sales of used vehicles to persons and entities for a business purpose are covered by the Rule**. Dealer trades, wholesale sales, and sales between dealers are excluded as are lessor-lessee sales.

Unfair and Deceptive Practices

The Rule declares that it is a deceptive act or practice for any used vehicle dealer, when that dealer sells or offers for sale a used vehicle: (1) to misrepresent the mechanical condition of a used vehicle; (2) to misrepresent the terms of any warranty offered in connection with the sale of a used vehicle; (3) to represent that a used vehicle is sold with a warranty when the vehicle is sold without any warranty; (4) to fail to disclose, prior to sale, that a used vehicle is sold without any warranty; and (5) to fail to make available, prior to sale, the terms of any written warranty offered in connection with the sale of a used vehicle (16 C.F.R. section 455.1 (a) and (b)). **The Rule specifically provides, however, that if a dealer complies with the five basic requirements set forth below, the dealer does not violate these prohibitions of the Rule. Do not confuse item (5) above with the requirement that a written warranty document be delivered at the time of sale if a vehicle is offered with a used car warranty. That document, separate and apart from the Buyers Guide, must still be given to the customer.**

Requirements

There are five basic requirements which must be met in connection with a used car sale to a consumer to comply with the Rule. These are as follows:

a. **The dealer must complete and display a "Buyers Guide" on all used vehicles offered for sale to a consumer**. The exact wording and form of the "Buyers Guide" has been prescribed by the FTC, and forms prepared in accordance with the specifications of the Rule may be ordered from The Reynolds and Reynolds Company. The Buyers Guide must be displayed prominently and conspicuously in any location on the vehicle in such a fashion that both sides are readily readable. It is permissible to remove a form temporarily from its display location during a test drive, but you must return it as soon as the test drive is over. A copy of the guide is available at http://www.ftc.gov/bcp/guides/usedcar-compy.shtm.

b. **The dealer must deliver either the original or a true copy of the Buyers Guide to the buyer at the conclusion of the sale**. If during the negotiations for the sale changes have been agreed upon with respect to warranties or the lack thereof which differ from those disclosed on the Buyer's Guide, the Buyers Guide should be corrected to comply with the changes before delivering it or a copy of it to the customer. Although the Rule does not require the dealer to retain the original or a copy of the Buyers Guide, it is recommended that this be done, and it is further recommended that the dealer obtain the customer's signature or initials on both the original and copy, particularly where there have been changes or where the vehicle is being sold without a warranty.

c. **The sales contract itself must incorporate the information included on the Buyers Guide**. The contract must set forth in a conspicuous

manner the following language: "The information you see on the window form for this vehicle is part of this contract. Information on the window form overrides any contrary provisions in the contract of sale." It is incumbent that each dealer examine the contract forms being used by the dealership, both English and Spanish, to make sure that this required disclosure is included.

d. **If the used car sale is conducted in Spanish, both the Buyers Guide and the contractual disclosure statement must be in Spanish**. Before any sales efforts are conducted in Spanish, a Spanish version of the Buyers Guide must be posted on the vehicle. As a practical matter, both English and Spanish versions of the Buyers Guide should be displayed where Spanish language sales are not uncommon.

   In a 2012 notice of proposed rulemaking, the FTC proposed adding a sentence in Spanish on the face of the English language Buyers Guide, alerting Spanish-speaking consumers who cannot read the Buyers Guide in English to ask for a copy in Spanish.

e. **The dealer may not make any statements, oral or written, or take other actions which alter or contradict the disclosures contained on the Buyers Guide, or use the Guide to make disclosures about other matters.**

Form And Content Of The Buyers Guide

As long as a dealer uses an approved Buyers Guide form, the necessary disclosures are included in the form, and there are only a few blanks required to be filled out by the dealer. Dealers should not make any other changes to the Buyers Guide other than filling in these blanks. Even changes which do not modify the content of the form, such as providing a Spanish translation directly on the English form, do not satisfy the Rule's requirement that the Guide be prepared and printed exactly as instructed in the Rule.

The basic disclosures which will be found on any approved form are a notice that spoken promises are difficult to enforce and that the dealer should be asked to put all promises in writing; a pre-purchase inspection notice suggesting that the customer should ask the dealer if he or she may have the vehicle inspected by a mechanic either on or off the lot; a notice that the information on the form is part of any contract to buy the vehicle and removal of the form before sale (except for test driving) is a violation of federal law; and a list of some of the major defects that may occur in used motor vehicles.

The dealer is required to complete the Buyers Guide by filling in the following information at the places indicated on the form:

a. The make, model, model year, and VIN number of the used vehicle offered for sale should be set forth on the form.

b. If the vehicle is being sold without any warranty express or implied, the "as is - no warranty" box on the form should be checked. If a service contract is available, the smaller-print "service contract" box must be checked. The "as is - no warranty" box may be checked even though the dealer also checks the service contract box.

c. If a warranty is given, the dealer must check the "warranty" box and must also check the box indicating whether the warranty is a "full" or "limited warranty." Because as a practical matter a dealer will never be giving a "full" warranty as that term is used in Magnuson-Moss, in any used car sale where a warranty is given, the "limited warranty" box should always be checked. The percentage of labor and percentage of parts the dealer agrees to pay should be filled in at the appropriate spaces as well as the systems covered and the duration of the warranty. The specific systems covered by the warranty, for example, "engine, transmission, differential," are to be listed. You cannot use short hand, such as "drive train" or "power train" for covered systems. You can make use of the list of defects provided by the FTC on the reverse side of the Buyers Guide to describe covered systems. That list contains under each system a series of possible problems that could arise concerning each system. Although you do not have to list on the Buyers Guide each and every exclusion provided in your warranty, if your warranty excludes any of these potential problems from any covered system, this fact should be set forth on the face of the Buyers Guide. Exclusions should also be stated whenever they are necessary for "clarification." An example would be to set forth "electrical system – battery excluded." One other available alternative is to list under the "systems covered" section the statement "all systems shown on the reverse side of this Buyers Guide are covered except for the following:" at which point you would list all noncovered systems (53 Fed. Reg. 17,666).

d. If a service contract is available, the "service contract" box on the form should be checked. A service contract under the Rule means a contract in writing for any period of time or any specific mileage to refund, repair, replace, or maintain a used vehicle which is provided at an extra charge beyond the price of the used vehicle, provided that such contract is not regulated as insurance under state law.

e. The name and address of the dealership should be placed at the space indicated.

f. In the space provided, the dealer must put the name and telephone number of the person who should be contacted if any complaints arise after sale. This is a requirement which the FTC takes more seriously than one might expect.

Certified Pre-Owned Vehicles and the Buyers Guide

The AB 68 prohibition against selling a certified used vehicle "as is" is easy to understand in theory, but can lead to confusion when it comes time to fill out the Used Car Buyers Guide. The as-is prohibition is one of many AB 68 requirements covering certified used vehicle sales found in Vehicle Code section 11713.18, which also prohibits disclaiming the implied warranty of merchantability on certified used vehicles. However, dealers are not required to offer warranties or service contracts on certified used vehicles.

The Buyers Guide form familiar to most California dealers offers two main choices to be selected by check box: either "as Is" or "warranty." When faced with AB 68's prohibition of as-is CPO sales, dealers obviously cannot check the Guide's "as is" box. However, simply checking the "warranty" box may leave the impression (and have the legal effect) that the dealership itself is issuing a warranty, over and above the factory CPO warranty. Fortunately, there is an alternative to simply checking the warranty box.

Where a factory extended warranty is provided, based on informal guidance obtained from the FTC, the dealer should check the large box next to "Warranty", leave both the "limited" and "full" boxes blank, and insert the following statement in the "Systems Covered" section: "MANUFACTURER'S WARRANTY APPLIES. A manufacturer's warranty comes with the vehicle. Consult the manufacturer's warranty booklet for details as to warranty coverage, service location, etc." Then, skipping a line for clarification, add the following language: "The dealership itself assumes no responsibility for any repairs, regardless of any oral statements about the vehicle. All warranty coverage comes from the manufacturer's warranty."

Certified used vehicle programs do exist that are not operated by the factory. However, if a certified used vehicle is to be sold without a factory warranty, the above language should not be used. Instead, if the vehicle is sold with a warranty made by the dealer, mark the "warranty" box on the Buyers Guide accordingly and fill all of the associated blanks completely and correctly (see the New and Used Car Warranties chapter of the Dealer Management Guide for detailed instructions). If no warranty is being offered (whether or not a service contract is available) obtain the "Implied Warranties Only" version of the Buyers Guide and mark the Implied Warranties Only box. (The Implied Warranties Only version has been in use for many years in states where as is sales are prohibited.) Under no circumstances may a used vehicle be sold as "certified" with the Buyers Guide marked "as is."

Proposed Buyers Guide Revisions

In December 2012, the FTC issued a notice of proposed rulemaking that requested public comment on a number of changes to the Buyers Guide proposed by the FTC. Since the proposed changes resulted from a lengthy period of review by the FTC, it is anticipated that the changes proposed will become effective sometime in 2013. The comment period ended in March 2013. The proposed changes include —

- placing boxes on the back of the Buyers Guide where dealers will have the option to tell people whether (a) the manufacturer's warranty still applies; (b) the manufacturer's used vehicle warranty — like a manufacturers certified used car warranty — applies; or (c) some other (non-dealer) used vehicle warranty applies;
- adding a statement to the Buyers Guide encouraging prospective buyers to get vehicle history information and directing them to an FTC website for more about vehicle histories;
- adding catalytic converters and airbags to the list of systems on the back of the Buyers Guide; and
- adding a statement in Spanish to the English-language version of the Buyers Guide letting consumers know they can ask for a copy in Spanish.

Of these changes, the first item listed if the most significant, in that it would completely change the way dealers disclose unexpired factory warranty coverage on the Buyers Guide, and would provide for the first time a specific means of disclosing non-dealer used vehicle warranties, such as certified pre-owned warranties. As proposed, the boxes for disclosing these warranties are on the back of the Buyers Guide, leaving the front exclusively for disclosing whether or not the dealer is providing the dealer's own warranty.

NOTE

FEBRUARY 2013 BUYERS GUIDE CHANGES. When the FTC announced the above proposed revisions to the Buyers Guide, it also ordered a minor change to the Spanish version of Guide to correct an error be implemented, effective February 11, 2013. Dealers will be permitted to use up all remaining stock of the earlier version of

the form, but must only purchase properly revised Spanish versions after February 11, 2013.

Used Car Warranty Questions and Answers

Must the dealer disclose whether the used vehicle is still covered by the manufacturer's warranty?

Although not required by Magnuson-Moss or Song-Beverly, if the dealer has knowledge that the vehicle is covered by an unexpired manufacturer's warranty, it is a good idea to disclose that the vehicle may be covered by manufacturer's warranty because otherwise the customer may later claim he or she needlessly paid for repairs that were covered under warranty. However, this issue raises the next two questions.

Do warranty booklets need to be available for all used cars with unexpired factory warranties?

No, according to an FTC attorney who advised the Association that the rules requiring pre-sale availability of manufacturer warranty terms will not be imposed in full measure on used car sales since the sales are considered "for resale," and thus exempt from the pre-sale rule. Under the proposed revisions to the Guide, a statement will be included directing the consumer to ask the dealer for warranty materials on unexpired factory warranties, but the FTC made clear in its comments on the proposed changes that the dealer is not required to have the materials available.

Can implied warranties be disclaimed on used cars with unexpired factory warranties?

In some cases, but not all. Song Beverly's implied warranty waiver prohibition operates when written warranties "arising out of a sale" (Civil Code section 1791.2(a)(1)) are given. Civil Code section 1793. The more positive and unequivocal the dealer's statements concerning unexpired warranty coverage, the more likely will be application of the waiver prohibition. If the dealer merely advises the buyer of possible unexpired warranty coverage, there is a strong argument that no warranty was "given" in that sale. This becomes quite important given the length of emissions and rust-through factory warranties.

How does the dealer disclose the unexpired manufacturer's warranty?

Until the Guide is revised, as expected, to include appropriate check-boxes to make this disclosure, the dealer may add the following statement below the "Full/Limited Warranty" disclosure: "Manufacturer's warranty still may apply. The time and mileage limits of the manufacturer's original warranty have not expired on the vehicle. Consult the manufacturer's warranty booklet for details as to warranty coverage, service location, etc." If the remainder of the manufacturer's warranty IS THE ONLY WARRANTY BEING FURNISHED, the dealer should check the large box next to "Warranty," not fill in either the "limited" or "full" boxes, insert the above statement, and then, skipping a line for clarification, add the following language: "The dealership itself assumes no responsibility for any repairs, regardless of any oral statements about the vehicle. All warranty coverage comes from the unexpired manufacturer's warranty."

If the status of unexpired warranties is not entirely known to the dealer, the above language should be modified to read "Portions of the manufacturer's warranty may remain unexpired on this vehicle; contact the manufacturer to verify any coverage and for information concerning these non-dealer warranty terms and transfer procedures." Unlike the more positive statement of unexpired coverage mentioned previously, do not treat this statement alone as a basis for checking the warranty box; in other words, check the boxes exactly as you would have if this statement were not included.

What must the dealer disclose when a "certified" used vehicle is covered by a manufacturer's warranty?

As discussed above, Vehicle Code section 11713.18 prohibits selling a certified used vehicle "as-is" or with a disclaimer of the implied warranty of merchantability. Generally, a factory certified preowned program warranty or service contract is provided to buyers of such vehicles. If so, follow the procedures discussed above under the heading "Certified Pre-Owned Vehicles and the Buyers Guide."

What if warranty terms are negotiated and agreed to that differ from those shown on the Buyers Guide?

If the "As Is-No Warranty" box on the Buyers Guide has originally been checked, and during the negotiations the dealer agrees to furnish a warranty, or vice versa, you must make the appropriate changes on the form before the sales contract is signed.

What are some examples of acceptable and unacceptable locations for displaying the Guide?

The FTC provided these examples of proper display locations: hanging from the rear view mirror; resting under the windshield wipers; or hanging from an exterior side view mirror. Examples given of improper locations were inside glove boxes; on the floor; or in the trunk. The requirement that both sides of the Guide be readable can be read, according to informal contact with the FTC, as authorizing the display of the Guide in a manner likely to give notice that two sides exist, and in a manner in which

the customer can obtain access to both sides. For example, a Guide hanging from a side view mirror that comes to rest against the body of the vehicle would satisfy the Rule, even though the customer must turn the Guide over to read the back side.

Can I modify the Guide to serve as a disclosure tool for other purposes?

Technically, no. The Rule provides that the Guide it to satisfy and exact, line-by-line layout, which does not permit modification (except for filling-in blanks).

Some dealers who always give a used car warranty black out the "As-Is" language for marketing or sales staff control purposes. Is this practice okay?

No. The FTC views the Guide as an educational tool as well as a disclosure. Blacking out unused sections of the Guide meets the disclosure goal, but defeats the educational goal, and directly violates the rule against modifying the Guide in any way.

Warranty Issues Common to New and Used Car Sales

Notice of Extension of Warranty During Repair

One of the most significant provisions of Song-Beverly is its extension of the warranty period under any written warranty during the period the vehicle is in for repairs and providing for a notice of the buyer's rights in this regard on all warranty repair orders.

Every work order or repair invoice **for warranty repairs or service** shall clearly and conspicuously incorporate in 10-point bold face type the following statement either on the face of such work order or repair invoice, or on the reverse side thereof, or on the attachment to the work order or repair invoice:

- *A buyer of this product in California has the right to have this product serviced or repaired during the warranty period. The warranty period will be extended for the number of whole days that the product has been out of the buyer's hands for warranty repairs. If a defect exists within the warranty period, the warranty will not expire until the defect has been fixed. The warranty period will also be extended if the warranty repairs have not been performed due to delays caused by circumstances beyond the control of the buyer, or if the warranty repairs did not remedy the defect and the buyer notifies the manufacturer or seller of the failure of the repairs within 60 days after they were completed. If, after a reasonable number of attempts, the defect has not been fixed, the buyer may return this product for a replacement or a refund subject, in either case, to deduction of a reasonable charge for usage. This time extension does not affect the protections or remedies the buyer has under other laws.*

If the required notice is placed on the reverse side of the work order or repair invoice, the face of the work order or repair invoice shall include a notice in 10-point bold face type: “Notice to Consumer: Please read important information on back.” A copy of the work order or repair invoice and any attachment thereto shall be presented to the buyer at the time warranty service or repairs are made. Civil Code section 1793.1(a)(2).

This provision raises a number of questions for dealers and the following points cover the answers to the questions most frequently asked:

a. The warranty period is extended only for the number of whole days that the product has been out of the buyer's hands for repair. Thus, if repairs are effected and the vehicle returned or made available to the buyer on the same day there would be no warranty extension.

b. The warranty extension provisions apply both to the manufacturer's factory warranty and any dealer warranty on used cars.

c. A dealer may not in our opinion obtain a waiver of the warranty extension from the customer when the dealer is too busy to get to the particular customer's job. Such a waiver would contravene public policy.

d. The notice requirement applies only to warranty repairs and does not extend to service where the customer pays the bill.

e. The buyer must be provided with a work order or receipt with the date of return and the date the buyer was notified the goods were repaired or serviced.

f. There is no requirement that the dealer maintain any particular record-keeping system whereby it can be ascertained how long any particular warranty has been extended. It is up to the customer to prove by testimony and by repair orders the length of time the customer contends his or her warranty has been extended.

Factory Warranty Adjustment Programs

Song-Beverly requires disclosure of all factory programs to pay for or contribute to the repair of problems not covered by the new car warranty. Civil Code sections 1795.90 to 1795.93. The law

now calls such programs warranty adjustment programs and requires dealers to do two things.

Service Bulletin Availability

Under Civil Code section 1795.91, dealers must give notice to all prospective new car buyers or lessees of the availability of factory service bulletins. Dealers can comply by posting the related sign set forth in the chapter entitled "Public Signs at Dealerships" in this Management Guide.

Disclosure of Warranty Adjustment Program

Civil Code section 1795.92(c)requires factories to give dealers written notice of adjustment programs within 30 days of creating the program. If a dealer has received notice of such a program, the dealer must disclose the principal terms and conditions of the program to all consumers seeking repairs for a condition covered by the program.

Statutory Requirements for New Car Warranties Based on Mileage

If a manufacturer or dealer of a new car makes any express warranty to the buyer which is based on the amount of miles that the car is driven, only those miles which the car has been driven on and after the date the car is first sold as new to the buyer shall be considered for purposes of the warranty. The mileage indicated upon the odometer on the date the new car is sold to the buyer shall be the mileage upon which the warranty shall commence. Vehicle Code section 28052.

Statute of Limitations For Breach Of Warranty

Unfortunately, the statute of limitations for breach of warranty is lengthy, and determining when it starts to run is complicated.

For breach of the UCC implied warranty of merchantability, the statute of limitations is 4 years from the date of sale (Commercial Code section 2725). Thus, a customer has 4 years from the date of sale to sue you under the UCC. Certain notice requirements are imposed on the customer, however, under the UCC, but these may not be applicable under the parallel Song-Beverly implied warranties.

The statute of limitations for breach of express warranties, and for violations of the Song-Beverly Act and "lemon law," is 4 years from the date the breach is or should have been discovered. Thus, if the vehicle is expressly warranted for one year and the defect occurs and is discovered 11 months after the date of sale, the statute of limitations extends 4 years from that date. A lemon law lawsuit may be filed four years after discovery of the existence of the inability to satisfactorily repair the problem, even if the problem was known immediately after sale. *Krieger v. Nick Alexander Imports, Inc.* (1991) 285 Cal. Rptr. 717.

In any event, under express warranties or the Song-Beverly implied warranties, a request for repair (or other relief if the customer claims repair would be insufficient) generally must be brought within the warranty period; otherwise, there would have been no breach of warranty. However, in *Mexia v. Rinker Boat Company, Inc.*, the court determined that the Song-Beverly implied warranties define a period of time in which they may be breached, and that the breach can be established by proof that a defect existed anytime within that warranty period, even if no claim were made within the warranty period (such as where the nonconformity is discovered after the warranty period expires). Although *Mexia* remains on the books, it has been called into question by several subsequent cases as inconsistent with the fundamental purpose of establishing a duration for warranty.

Remedies for Breach of Warranty

The UCC contains basic remedies for breach of its warranty provisions (see Commercial Code sections 2711 et seq.). For a material breach of warranty, provided that timely notice of the breach is given, a customer is entitled to rescind the contract and obtain a return of the purchase price. The seller in this instance is entitled to an offset based upon the depreciation occasioned by the buyer's use. The buyer may also elect to retain the vehicle and sue for damages and the measure of damages for any breach of warranty is the difference between the value of the vehicle at the time of sale, and the value that the vehicle would have had if it had been as warranted, unless special circumstances show that damages should legally be for a different amount. Also, unless excluded by the terms of the warranty, a customer may recover incidental and consequential damages.

You are entitled to include limitations on the customer's right of recovery, under the warranty, but these limitations must be prominently displayed on the face of the warranty and even then can be disallowed if they are unconscionable, or deemed to "modify" an implied warranty when an express warranty is given.

Incidental and consequential damages can include such items as transportation costs while the customer was without the vehicle, car rental fees, cost of lodging in the event of a breakdown while on a trip, lost wages while dealing with problems necessitated by the defect, and in the event of a rescission, recovery of finance charges, sales tax and registration fees. These are only examples of what

courts have ordered in other cases decided under the various versions of the Uniform Commercial Code around the country and decisions vary from jurisdiction to jurisdiction. Thus, this does not mean that they should necessarily be awarded in every case. If damages to be awarded under a Song-Beverly claim are liquidated – that is, easily calculated – then prejudgment interest may be awarded under Civil Code section 3287.

In addition to the above remedies, Song-Beverly provides that for any willful or intentional violation of its sections, including failure to observe any express or implied warranty on a consumer product, the consumer buyer may be awarded three-times ("treble") damages as well as reasonable costs, expenses and attorney's fees. Civil Code section 1794. The California Supreme Court has held that dealers and factories may recover litigation costs from buyers who sue unsuccessfully under the Song-Beverly Act (*Murillo v. Fleetwood Enterprises, Inc.* (1998) 73 Cal.Rptr.2d 682.) The Supreme Court in Murillo also held that prevailing auto sellers may recover expert witness fees when the plaintiff rejects an out-of-court settlement proposal made prior to the litigation proceeding pursuant to Code of Civil Procedure section 998.

Magnuson-Moss provides that any person who violates the Act commits a violation of section 5 of the FTC Act (15 U.S.C. section 41) and is subject to the sanctions of the FTC. Magnuson-Moss also provides for injunctive relief to enjoin violations on the part of a manufacturer or dealer giving express written warranties (15 U.S.C. section 2310 (c)). Except for Used Car Rule violations, Magnuson-Moss enforcement activity at the dealer level is relatively rare, but this should not operate as an excuse for not adhering to its requirements. FTC sanctions may run as high as $10,000 per violation.

CAUTION

REGARDING SERVICE CONTRACTS: It is not recommended that a dealer include the giving of a service contract as part of the price of the vehicle. If the price of the vehicle is increased to cover the giving of a service contract, the selling dealer could be accused of violating the Automobile Sales Finance Act because service contracts are to be separately itemized on the contract. Further, a dealer may not offer a "free" or "at no extra charge" service contract in advance of the negotiating process. See Vehicle Code section 11713.1(h) and Chapter 22, "Free Goods and Servicers " in the California Auto Dealer Advertising Law Manual.

Factory Bankruptcy and Dealer Warranty Duties

Song-Beverly imposes an affirmative duty on the manufacturer to provide service and repair facilities within this state that are reasonably convenient for performing warranty service. If a manufacturer became bankrupt and went out of business such that it no longer provided those repair facilities, Civil Code section 1793.3 permits consumers to exercise remedies directly against the retailer who sold them their particular vehicle. If the facilities test is not failed (for example, because some dealers or other facilities continue to offer warranty repair within a reasonable distance), consumers must continue to follow the factory's designated system for warranty service.

If the manufacturer is no longer providing authorized facilities of any kind, subdivision (a) of section 1793.2 provides that the seller of that particular vehicle "shall" either repair or replace the vehicle; refund the purchase price; or send the buyer to an independent repairer willing to do the repair without charge to the consumer.

For the cost of doing these things, the seller has a claim for reimbursement against the manufacturer under section 1793.5, but nothing in the law appears to authorize the seller to refuse to perform on the basis of non-payment, or expected non-payment, of those claims. Also, because the seller is identified as "the retail seller of those goods" (devoid of any reference to any continuing relationship with the factory), this obligation does not appear to be premised on the seller holding itself out as a retailer of the brand in question – that is, terminating the linemake from the brands the dealer represents may not make a difference in the dealer's obligation.

The consumer does not have these same rights against other retailers of the goods of the manufacturer. Subdivision (b) of section 1793.2 provides that other retailers of that manufacturer "may" undertake the same steps that are required of the retail seller (and thereby create for themselves a claim for reimbursement), but there is no obligation for them to do so.

Thus, when a warranty claim is made to a dealer who no longer considers himself or herself obligated under the dealer agreement to perform warranty work, the dealer needs to ask two questions:

"First……, did I in fact sell this vehicle? If not, I am not required to repair it under Song-Beverly even if I am or at one time was a dealer for that brand;

"Second……., if I am the seller, has the factory now failed the authorized facilities test? If there is simply no nearby dealer or factory facility still performing warranty work at the factory's direction, I

must repair the vehicle even if I never expect to be reimbursed."

Special Rules for Aids to the Physically Disabled

Song-Beverly provides special rules concerning devices and equipment to assist a physically disabled person. "assistive device" is defined in Song-Beverly as any instrument, apparatus, or contrivance, including any component or part thereof or accessory thereto, used or intended to be used to assist an individual with a disability. Civil Code section 1791(p). This is of interest to dealers who may on occasion be called upon to sell or lease a vehicle which has been modified to accommodate a person with a physical disability.

Any sale of such an assistive device, whether new or used, is not only subject to Song-Beverly's implied warranty of fitness for that user's particular purpose, notwithstanding what discussions were had between buyer and seller concerning the use, but also must be accompanied by a written warranty that the seller must prepare and deliver to the buyer containing exact language required by the statute to the effect that if the device does not specifically fit the needs of the ultimate user (even if someone other than buyer), it may be returned to the seller within 30 days of the date of actual receipt of the item, or completion of installation and fitting by the seller, whichever occurs later. During that 30 day period, if the item is returned, it must be either adjusted or replaced to the satisfaction of the user, or the total purchase price, without any deduction for loss of use, must be refunded. All contracts and security agreements executed in connection with the sale must also be promptly cancelled without penalty. Moreover, the law provides that these warranties covering assistive devices may not be waived or limited, regardless of the language used in the contract. Civil Code section 1793.02.

The law is silent as to whether an entire motor vehicle would be subject to these substantial warranty obligations simply because it contains special driving controls or a hydraulic lift for the physically disabled. It can be argued under the definition of the term assistive device, which includes reference to "components" and "accessories" that only such components and accessories are covered, while the whole vehicle is not. However, if possible, it would be recommended that arrangements be made for the motor vehicle to be sold without assistive devices, and then for the assistive devices to be sold and installed separately, preferably by a third party who specializes in such matters.

Lemon Law Disclosure and Title Branding

Civil Code sections 1793.23 and 1793.24 specify what circumstances trigger a dealer's duty to disclose to a consumer the fact that a vehicle has previously been reacquired by the manufacturer to resolve an express warranty dispute.

The law imposes on the manufacturer the burden of determining whether a vehicle repurchased with money from the manufacturer is a "lemon" or a "goodwill" buyback and requires the manufacturer to complete the required Disclosure Form prior to offering such a vehicle for sale. In particular, the law sets forth the following requirements for manufacturers and dealers:

Manufacturer Requirements

1. Any manufacturer who reacquires or assists a dealer or lienholder to reacquire a motor vehicle in response to a request by the buyer or lessee that the vehicle be replaced or accepted for restitution (regardless of whether it meets the legal standard of a "lemon") must, prior to any subsequent sale, lease, or other transfer, prepare, execute, and deliver to the subsequent transferee (which will usually be a dealer), a statutory Disclosure Form. A copy of the Disclosure Form is reprinted at the end of this article.

2. When filling out the Disclosure Form, the manufacturer must list the following information:

(A) Year, make, model, and VIN of the repurchased vehicle;

(B) Whether: (i) the vehicle was simply repurchased after the last retail owner requested its repurchase due to specified problems, or (ii) the vehicle was repurchased because it had a defect, and title to the vehicle has been branded with the inscription "Lemon Law Buyback" (this election is made by the manufacturer checking one of two boxes on the disclosure form);

(C) The nature of each problem reported by the original owner; and,

(D) Repairs, if any, made to correct each reported problem.

3. If the manufacturer makes a determination that the vehicle qualifies as a "Lemon Law Buyback," the second box on the Disclosure Form must be checked and the manufacturer must, prior to transferring the vehicle to any other entity:

(A) Cause the vehicle to be retitled in the manufacturer's name and title branded with the inscription "Lemon Law Buyback;" **and**,

(B) Affix a decal to the left front doorframe of the vehicle which specifies that title to the vehicle has been branded (dealers should instruct their used car managers and vehicle buyers to be on the lookout for such a decal, and the bill makes it unlawful for anyone to knowingly remove or alter such a decal).

Dealer Requirements

Dealers need to know when and how to observe two principal disclosure requirements, one using a Disclosure Form, and one using a Disclosure Statement.

Completion and Delivery of Disclosure Form

Any person, including any dealer, who acquires a motor vehicle for resale and knows or should have known that the vehicle was reacquired by the vehicle's manufacturer in response to a request by the last retail owner or lessee of the vehicle that it be replaced or accepted for restitution because the vehicle did not conform to express warranties must, prior to sale, lease, or other transfer of the vehicle, execute and deliver to the subsequent transferee the statutory Disclosure Form entitled "Warranty Buyback Notice" that is reprinted at the end of this article.

Simply put, any time the factory repurchases a vehicle or assists a dealer to repurchase a vehicle because of an alleged warranty nonconformity, the factory must fill out the Disclosure Form, execute the Form, obtain the signature (on the Form) of the dealer to whom the vehicle is being transferred, and provide that dealer with an executed copy of the disclosure form. Each time thereafter the vehicle is wholesaled prior to its transfer to the first retail customer, each wholesale transferor must execute and deliver a copy of the disclosure form to his or her wholesale transferee.

Preparation and Delivery of Disclosure Statement

Any dealer who purchases for resale a motor vehicle when the vehicle's ownership certificate is inscribed with the notation "Lemon Law Buyback" must, prior to the sale, lease, or ownership transfer of the vehicle provide the transferee with a Disclosure Statement signed by the transferee that states:

DISCLOSURE STATEMENT

"THIS VEHICLE WAS REPURCHASED BY ITS MANUFACTURER DUE TO A DEFECT IN THE VEHICLE PURSUANT TO CONSUMER WARRANTY LAWS. THE TITLE TO THIS VEHICLE HAS BEEN PERMANENTLY BRANDED WITH THE NOTATION 'LEMON LAW BUYBACK.'"

Dealers should note that the above Disclosure Statement language is identical to the language contained in the Disclosure Form (reprinted at the end of this chapter) after the second check box. However, a distinction should be drawn between the Disclosure Form and the above Disclosure Statement. The Disclosure Form is only required to be given between transferees during the time frame commencing when a vehicle is repurchased by the manufacturer from the last retail owner or lessee of a vehicle until such time as it is sold or leased to another retail owner or lessee, which retail owner or lessee will be provided with and acknowledge in writing the Disclosure Form. Once a vehicle that has been repurchased by the factory is ultimately sold or transferred to another retail buyer or lessee, any duty to utilize the statutory Disclosure Form ends.

However, should a dealer procure a trade-in vehicle or otherwise acquire a vehicle which has previously had its title branded with the inscription "Lemon Law Buyback," the dealer has a separate duty to provide his or her transferee with the Disclosure Statement shown above, and obtain the transferee's signature on that statement, regardless of whether the dealer's transferor has provided him or her with any type of disclosure.

Example

On February 1, 2007, a vehicle is repurchased by its manufacturer from a retail owner and the factory determines that the vehicle is a "lemon." Thereafter, the factory: causes the title to be branded with the inscription "Lemon Law Buyback;" affixes to the vehicle the required doorframe decal; and, prepares and executes the statutory disclosure form.

On March 1, 2007, the factory sells the vehicle at auction to Dealer A; obtains Dealer A's signature on the disclosure form; and, provides a fully executed copy of the disclosure form to Dealer A.

On March 15, 2007, Dealer A retails the vehicle to Mr. Smith; obtains Mr. Smith's signature on a copy of the statutory disclosure form provided to Dealer A by the factory; and, provides Mr. Smith with a fully executed copy of the disclosure form prior to consummation of the sale.

On January 1, 2008, Mr. Smith trades-in the vehicle to Dealer B. What duty does Dealer B have to a subsequent transferee?

Because title to the vehicle has been branded with the inscription "Lemon Law Buyback" (and hopefully Dealer B is aware of this fact because the dealer has either reviewed the title or noticed the doorframe decal - or both), Dealer B must, prior to a subsequent transfer, provide the transferee with and have him or her sign a Disclosure Statement (shown above).

However, Dealer B is not required to fill out or provide the transferee with a copy of the more detailed Disclosure Form reprinted herein because any obligation to utilize that disclosure form ceased after Dealer A sold the vehicle to Mr. Smith.

Warranty Buyback Notice - The Disclosure Form

Reprinted on the next page is the Disclosure Form, officially entitled "Warranty Buyback Notice."

WARRANTY BUYBACK NOTICE

(Check One)

This vehicle was repurchased by the vehicle's manufacturer after the last retail owner or lessee requested its repurchase due to the problem(s) listed below.

THIS VEHICLE WAS REPURCHASED BY THE VEHICLE'S MANUFACTURER DUE TO A DEFECT IN THE VEHICLE PURSUANT TO CONSUMER WARRANTY LAWS. THE TITLE TO THIS VEHICLE HAS BEEN PERMANENTLY BRANDED WITH THE NOTATION "LEMON LAW BUYBACK." Under California law, the manufacturer must warrant to you, for a one year period, that the vehicle is free of the problems(s) listed below.

VIN	Year	Make	Model

Problem(s) Reported by Original Owner	Repairs Made, if any, to Correct Reported Problems

Signature of Manufacturer _____ Date _____

Signature of Dealer(s) Date

_____ _____

_____ _____

_____ _____

Signature of Retail Buyer or Lessee Date

_____ _____

_____ _____

Warranties for Anti-Theft Devices

Under California law, automobile insurance is defined to include any warranty or guaranty that promises service, maintenance, parts replacement, repair, money, or other indemnity in the event of loss or damage to a motor vehicle from any cause. This broad definition created uncertainty as to whether anti-theft products, including window etching accompanied by an anti-theft warranty, were deemed to be insurance – thus requiring compliance with state insurance laws, including insurance licensing requirements.

The matter has now been clarified by Insurance Code section 116.6. Under that code section, warranties issued in connection with the sale of anti-theft devices, including window etch products, will not constitute automobile insurance if the provider of the anti-theft device and accompanying warranty (called the "warrantor") complies with all of the following requirements:

1. The warrantor maintains an insurance policy with an admitted insurer, providing coverage for 100% of the warrantor's obligations under the anti-theft warranty. The warrantor must file a copy of this insurance policy with the Insurance Commissioner. The insurance policy must contain a provision for giving the Insurance Commissioner not less than 30 days notice prior to the effective date of any cancellation, or, in the event that the cancellation is due to fraud, material misrepresentation or defalcation by the warrantor, not less than 10 days prior notice to the Insurance Commissioner.

2. The warrantor does not use the words insurance, casualty, surety, mutual or any other words descriptive of the casualty, insurance or surety business or deceptively similar to the name or description of any insurance company, in the product name, in the warranty, or in any advertising.

3. The warranty has been issued to a customer who is already insured under a comprehensive vehicle insurance policy for the vehicle.

4. The benefit is payable upon the theft of the vehicle, as defined in the warranty, and subject to the satisfaction of the procedural proof of claim requirements of the warranty.

5. The warranty is in writing and provides all of the following:

(A) The benefits are limited to the difference between the actual cash value of the stolen vehicle and the vehicle's replacement cost, temporary vehicle rental expenses, reimbursement for insurance policy deductible, and registration fees and taxes on a replacement vehicle or a fixed amount for those benefits.

(B) A statement that the warranty holder shall be entitled to make a direct claim against the insurer covering the obligations of the warranty upon the failure of the warrantor to pay any covered claim within 60 days after a complete proof-of-loss has been filed with the party designated in the warranty.

(C) A disclosure stating clearly the name, address, and telephone number of the insurer covering the obligations of the warrantor.

(D) A toll-free telephone number established and operated by the warrantor for the warranty holder to call for questions about the warranty or the procedures to file a claim.

(E) A statement that clearly indicates the terms of the warranty, whether new or used cars are eligible for the vehicle protection product, the method for calculating the benefits paid and provided to the warranty holder, and the procedure for filing a claim under the warranty.

(F) A disclosure in 10-point type or larger that reads as follows: "This agreement is a product warranty and is not insurance. It is not subject to state insurance laws but is subject to state law concerning warranties."

(G) A disclosure in 10-point type or larger that reads as follows: "To be eligible for this warranty, the warranty holder must have comprehensive insurance coverage on the vehicle that is protected by the antitheft device."

If all of the foregoing requirements are met, then the anti-theft warranty will not be deemed automobile insurance, but instead will be deemed an express warranty governed by state warranty laws.

This law does not apply to any warranty which only provides for the repair or replacement of the vehicle protection product subsequent to a mechanical or electrical breakdown of the vehicle protection product.

SERVICE CONTRACTS

Chapter 9

Contents

SERVICE CONTRACTS

OVERVIEW: This chapter discusses the requirements of the California regulatory scheme applicable to vehicle service contracts.

Insurance Code sections 12800 to 12860, cover the definitions of a "vehicle service contract" and provide that a vehicle service contract does not constitute insurance if certain requirements relating to licensing, form content, notices, cancellation rights and insurance policy backing for service contract obligations are met. This regulatory scheme basically incorporates Civil Code sections 1794.4 and 1794.41 which also regulate service contracts.

CAUTION

REGARDING CONFIRMING VSC PROGRAM COMPLIANCE. Before selling any VSC, a dealer should confirm that the VSC program involved is in compliance with the applicable requirements. A failure to confirm this legal compliance may expose a dealer to significant legal consequences. Dealers should also be aware that as part of the regulatory scheme, the California Insurance Commissioner is authorized by Civil Code section 12855 to adopt regulations relating to VSCs and dealers will need to monitor the development of any such regulations.

Definition of Vehicle Service Contract

Under Insurance Code Section 12800(c), a "vehicle service contract" ("VSC") is defined as a contract or agreement (for a separately stated consideration and a specific duration of time) covering the repair, replacement or maintenance of a motor vehicle (or watercraft) resulting from an operational or structural failure due to a defect in materials or workmanship, or due to normal wear and tear. A VSC may also provide for incidental payment under limited circumstances for towing, substitute transportation, emergency road service, rental car reimbursement, deductible amounts under a manufacturer's warranty, and reimbursement for travel, lodging or meals.

A VSC may also include any of the following:

(a) an agreement for a term of at least one year, for separately stated consideration, that promises routine maintenance.

(b) an agreement that promises the repair or replacement of a tire or wheel necessitated by wear and tear, defect, or damage caused by a road hazard. Note that an agreement by a tire manufacturer to repair or replace a tire because of wear and tear, defect or damage caused by road hazard is exempt from the requirements applicable to a VSC. Such an exemption also applies to a warranty provided by a tire or wheel distributor or retailer where the warranty only covers defects in the material or workmanship of the tire or wheel.

(c) an agreement that promises the repair or replacement of glass on a vehicle necessitated by wear and tear, defect or damage caused by a road hazard. Note that a warranty provided by a vehicle glass or glass sealant manufacturer is exempt from the requirements that are applicable to a VSC. Such an exemption also applies to a warranty provided by a vehicle glass distributor or retailer where the warranty covers only defects in the material or workmanship of the vehicle glass.

(d) an agreement that promises the removal of a dent, ding or crease without affecting the existing paint finish using paintless dent repair techniques, and which expressly excludes the replacement of vehicle body panels, sanding, bonding or painting.

CAUTION

REGARDING OTHER INDEMNIFICATION BENEFITS: Dealers should be aware, however, that indemnification benefits included in a VSC providing for losses relating to theft, collision, fire or other such perils are considered automobile insurance. Locksmith services (unless part of an emergency road service benefit) are also considered automobile insurance (Insurance Code section 12820(c)).

NOTE

REGARDING DEFINITIONS OF MOTOR VEHICLES AND WATERCRAFT: Under Insurance Code section 12800(a), a "motor vehicle" is defined as a self-propelled device operated solely or primarily upon land and may include both self-propelled motor homes or recreational vehicles, non-self-propelled camping and recreational trailers, off-road vehicles, and trailers designed to transport off-road vehicles. The term "motor vehicle" does not include self-propelled vehicles with any of the following characteristics: (i) a gross

vehicle weight rating of 30,000 pounds or more which is not a recreational vehicle; (ii) it is designed to transport more than 15 passengers, including the driver; or (iii) it is used in the transportation of hazardous materials. Under Insurance Code section 12800(b), the term "watercraft" means a vessel (as defined by section 21 of the California Harbor and Navigation Code) and may include any non-self-propelled trailer used to transport such watercraft upon land.

REGARDING VSC COVERAGE: Pursuant to Civil Code section 1794.41, it continues to be a requirement that a VSC cover items, costs or time periods not covered by an express warranty (an overlap with an express warranty is permitted) (see further discussion of Civil Code section 1794.41 later in this chapter).

WHO CAN SELL A VSC: Pursuant to Insurance Code section 12810, a VSC may only be sold by a dealer or lessor retailer licensed in one of those capacities by the DMV who sells VSCs "incidental to his or her business of selling or leasing motor vehicles". Dealers should be aware that the phrase "incidental to his or her business of selling or leasing motor vehicles" does not prohibit a dealer from selling a VSC which covers a vehicle not sold or leased by the dealer.

REGARDING THE DESCRIPTION OF SERVICE CONTRACTS: Based upon the California Supreme Court decision of* Gavaldon v. Daimler Chrysler *(2004) 32 Cal. 4th 1246, if a service contract is described as an "extended warranty," a buyer may claim rights and remedies afforded a new car buyer against a manufacturer under the Song-Beverly Consumer Warranty Act (Lemon Law). Such a claim may also be supported if a service contract includes language referring to itself as a "warranty." See further discussion of this topic in the section entitled "Written Warranties Under Song-Beverly" in the New and Used Car Warranties chapter of this Management Guide.

Types of VSCs

Insurance Code section 12805 identifies various types of VSCs which do not constitute insurance, including three types discussed below in detail which are differentiated based upon whether the party obligated to perform under the VSC is a third party ("Third Party Obligor"), dealer ("Dealer Obligor") or manufacturer ("Manufacturer Obligor") (covering only vehicles manufactured or distributed by that manufacturer).

NOTE

REGARDING OTHER TYPES OF AGREEMENTS: Other types of agreements not discussed in detail in this chapter which, pursuant to Insurance Code section 12805, do not constitute insurance are: (1) agreements obligating a motor vehicle (or watercraft) parts distributor, manufacturer, or retailer to only repair or replace the part manufactured, distributed or retailed by that party and to possibly provide for consequential and incident damages resulting from failure of that part; (2) agreements relating to repair work previously performed by a repair facility which provide that the repair facility is obligated to repair or replace the part previously repaired and possibly for consequential and incident damages resulting from failure of that part; (3) agreements promising only routine maintenance that do not constitute a VSC.

Third Party Obligor VSC Program Requirements

With respect to a Third Party Obligor VSC program (where a third party other than the vehicle manufacturer is the obligated party under the VSC) the following requirements must be met so that the VSC involved will not be considered automobile insurance:

License Requirement

- The Third Party Obligor must be the holder of a "vehicle service contract provider license." For disciplinary purposes, this license is considered a property broker-agent and casualty broker-agent license with exceptions that allow an applicant to avoid satisfying certain pre-licensing and continuing education requirements and passing a qualifying exam (Insurance Code section 12815(a)).

Insurance Commissioner Filing Requirements

- The Third Party Obligor must file the VSC agreement (form contract) to be used with the Insurance Commissioner (Insurance Code section 12820(a)); and
- The Third Party Obligor must file with the Insurance Commissioner (legal division) a copy of an insurance policy covering 100% of the VSC obligations which must be approved pursuant to In-

surance Code section 12830(a) (see discussion of requirements applicable to the insurance policy later in this chapter).

VSC Form Disclosures Requirements

- The VSC agreement (form contract) to be used must contain the following disclosures required by Insurance Code section 12820(b):
  (a) a notice that states "Performance to you under this contract is guaranteed by a California approved insurance company. You may file a claim with this insurance company if any promise made in the contract has been denied or has not been honored within 60 days after your request. The name and address of the insurance company is: (insert name and address). If you are not satisfied with the insurance company's response, you may contact the California Department of Insurance at 1-800-927-4357";
  (b) if the third party obligor has satisfied the California Insurance Commissioner that it or its parent company has a net worth of $100,000,000, in lieu of obtaining the required insurance policy, a notice that states "If any promise made in the contract has been denied or has not been honored within 60 days after your request, you may contact the California Department of Insurance at 1-800-927-4357".
  (c) a conspicuous printing (in boldface type and no smaller than surrounding type) of contract language which excludes coverage or imposes duties upon the purchaser (Note that contract language excluding coverage for preexisting conditions must be in 12-point type);
  (d) the Third Party Obligor's full corporate name or fictitious name approved by the Insurance Commissioner, mailing address, telephone number and vehicle service contract provider license number;
  (e) a place to disclose the name of the purchaser and the name of the dealership (as the seller);
  (f) a conspicuous disclosure of the VSC's purchase price;
  (g) the disclosures required by Civil Code section 1794.4, including a clear and conspicuous statement of the Third Party Obligor's obligations under the VSC, any restrictions on the purchaser transferring or assigning the VSC, and a step by step explanation of the claims procedures (see further discussion of these disclosures later in this chapter);
  (h) the purchaser's cancellation and refund rights as required by Civil Code section 1794.41(see further discussion of these rights later in this chapter); and
  (i) the name of the service contract administrator, if any, and the administrator's license number.

NOTE

REGARDING "SERVICE CONTRACT ADMINISTRATOR": Dealers who are involved in service contract programs which utilize a "service contract administrator" (defined by Insurance Code section 12800(d) to mean any person, other than a person obligated on the VSC, who performs or arranges, directly or indirectly, the collection, maintenance, or disbursement of monies to compensate any party for claims or repairs pursuant to a VSC and who is involved in providing service contract forms and adjustments of claims) should confirm that the service contract administrator is licensed as a property broker-agent and casualty broker-agent (Insurance Code section 128.5(b)).

Record Requirements

The Third Party Obligor or its service contract administrator must maintain accurate accounts, books and records of all transactions as required by Insurance Code section 12840.

NOTE

REGARDING REQUIRED RECORDS: The accounts, books and records required by Insurance Code section 12840 must be made available to the Insurance Commissioner upon reasonable request. Any computerized record-keeping system must be capable of producing legible hard copies of a complete set of accounting records, including but not limited to a general ledger, cash receipts and disbursements journals, accounts receivable and accounts payable registers, copies of each type of VSC sold, the name and address of each VSC purchaser, a list of locations where the VSCs are marketed, sold or offered for sale, and written claims files which contain the dates and descriptions of the claims related to the VSCs. These records must be maintained for at least three (3) years after the expiration of a VSC and also must be accessible to an insurance company that has issued the policy backing the VSC obligations. A failure to maintain these records is grounds for suspension or revocation of the obligor's vehicle ser-

vice contract provider license and also is grounds for a cease and desist order.

Dealer Obligor VSC Program Requirements

Regarding Dealer Obligor VSC Programs (where the dealer is the party obligated under the VSC), the Dealer Obligor must comply with all of the requirements applicable to a Third Party Obligor VSC program, as discussed previously in this chapter, except that the Dealer Obligor is not required to obtain a vehicle service contract provider license (Insurance Code section 12805(a)(2)).

Manufacturer Obligor VSC Program Requirements

If a dealer intends to sell VSCs under a Manufacturer Obligor VSC program (where a motor vehicle manufacturer is the obligated party under the VSC which covers only vehicles manufactured (or distributed) by that manufacturer), the dealer should confirm the program is in compliance with all of the requirements applicable to a Third Party Obligor VSC program, as discussed previously in this chapter. It should be noted however, that the Manufacturer Obligor is not required to obtain a vehicle service contract provider license or file an insurance policy with the Insurance Commissioner (Insurance Code section 12805(c)).

Insurance Policy Requirements for Third Party and Dealer Obligor VSC Programs

The insurance policy that is required to back a Third Party Obligor (other than a manufacturer) VSC program or a Dealer Obligor VSC program is subject to the following requirements under Insurance Code section 12830:

(a) the policy must be issued by an insurance carrier admitted in the State of California and authorized to issue such insurance or a risk retention group ("RRG") qualified under federal law and in good standing and registered with the Insurance Commissioner;

(b) the insurance company or RRG involved must have and continue to have at all times an A.M. Best rating of B++ or better and surplus as to policyholders and paid-in capital of at least $15,000,000 (this limit can be $10,000,000 if the insurance company or RRG maintains a ratio of direct written premiums to surplus as to policyholders and paid-in capital of not more than 3-to-1; and

(c) the insurance company or RRG involved must annually file audited financial statements.

NOTE

REGARDING CANCELLATION OF INSURANCE POLICY BACKING VSC PROGRAM: A party obligated under a VSC may only have one active insurance policy at a time on file with the Insurance Commissioner (Insurance Code section 12830(d)). If the insurer cancels that policy, the obligor named in the policy must either obtain a new policy before the termination of the prior policy or discontinue any sale of VSCs until a new policy is effective and has been accepted by the Insurance Commissioner (Insurance Code section 12835).

REGARDING NET WORTH REQUIREMENT IN LIEU OF INSURANCE POLICY: A Third Party Obligor or a Dealer Obligor may establish to the Insurance Commissioner's satisfaction that it or its parent company has a net worth of $100,000,000, in lieu of providing the insurance policy required by Insurance Code Section 12830 (Insurance Code section 12836). To satisfy this net worth requirement, financial statements and affidavits attesting to the net worth of the obligor or the obligor's parent company must be submitted to the Insurance Commissioner. If the parent company is the entity satisfying the net worth requirement, it will be required to guarantee, in writing, the obligations of obligor relating to the VSCs issued by the obligor in California.

Criminal Penalties

Pursuant to Insurance Code section 12845, any VSC obligor or administrator failing to comply with the licensing and insurance policy requirements is guilty of a criminal offense punishable by imprisonment in a county jail or by a fine not exceeding $500,000, or both. This statute is not applicable to a dealer who is the obligated party under a VSC.

CAUTION

REGARDING DEALER COMPENSATION BASED ON ADJUSTMENT OF CLAIMS: A dealer who sells VSCs and participates in or influences, directly or indirectly, the process, administration, or adjustment of claims is prohibited from entering into any agreement which makes the amount of the dealer's commission or compensation contingent upon savings affected by the adjustment, settlement or payment of losses covered by the VSC (Insurance Code section 12850(b)).

NOTE

REGARDING BURDEN OF PROOF ON CLAIMS: It is the burden of the obligated party under a VSC to prove that a claim is not covered by a VSC and that any claim settlement amount is a proper amount (Insurance Code section 12850(a)).

Civil Code Section 1794.4 VSC Disclosures

Civil Code section 1794.4 requires VSCs to fully and conspicuously disclose in simple and readily understood language the terms, conditions and exclusions of the contract, and to contain certain information. Specifically, VSCs must include the following information:

(a) A clear description and identification of the motor vehicle.

(b) The VSC's start date and period of coverage measured by elapsed time or mileage.

(c) A description of any limits on the transfer or assignment of the VSC.

(d) A statement of the general obligation regarding services and parts to be provided without additional charge for the proper operation of the motor vehicle by the party obligated under the VSC with clear and conspicuous statements of the following:

(i) any services, parts, characteristics, components, properties, defects, malfunctions, causes, conditions, repairs or remedies that are excluded from the scope of the VSC.

(ii) any limit on the services and parts (necessary to maintain the normal operation of the motor vehicle) to be provided without additional charge.

(iii) any additional services that will be provided.

(iv) whether preventative maintenance will be provided, and, if so, the nature and frequency of that preventative maintenance.

(v) whether the VSC purchaser has an obligation to provide preventative maintenance or perform any other obligations, and, if so, the nature and frequency of those obligations, and the consequences of any noncompliance.

(vi) a step-by-step explanation of the claims procedure under the VSC, including the following information:

- the full legal and business name of the party obligated under the VSC;
- the mailing address of the party obligated under the VSC;
- the persons or class of persons authorized to perform service under the VSC;
- the name or title and address of anyone responsible for the performance of any obligations under the VSC;
- the method the VSC purchaser must use to give notice to the party obligated under the VSC of the need for service;
- if the motor vehicle must be transported for service or repair, whether the VSC will cover that transportation cost and either the place where the motor vehicle should be delivered or a toll-free number where the VSC purchaser may obtain that information;
- all other steps that the VSC purchaser must take to obtain service; and
- all fees, charges and other costs that the VSC purchaser must pay to obtain service.

(vii) an explanation of the steps that will be taken by the party obligated under the VSC to provide the benefits of the VSC.

(viii) a description of any right to cancel the VSC if the motor vehicle is returned, sold, lost, stolen or destroyed or if such a right does not exist or is limited, a statement of the fact.

(ix) information regarding the availability of any informal dispute settlement process.

Civil Code Section 1794.41 VSC Requirements and Cancellation Rights

VSCs are also required to comply with the applicable requirements of Civil Code section 1794.41 which include the following:

(a) The VSC must make the disclosures required by Civil Code section 1794.4 (see prior discussion of Civil Code section 1794.4 disclosures in this chapter);

(b) The VSC must be available for inspection by the VSC purchaser prior to purchase and either the contract or a brochure specifically describing the terms, conditions, and exclusions of the VSC, and the provisions of Civil Code section 1794.41 relating to contract delivery, cancellation and refund must be delivered to the VSC purchaser at or before the time of the VSC purchase. Within 60 days after the date of purchase, the VSC itself must be delivered to the VSC purchaser.

(c) The VSC must be applicable only to items, costs and time periods not covered by the express warranty (there may be an overlap with the express warranty, if the VSC covers items or costs not covered or provides relief not provided for by the express warranty).

(d) The VSC must be cancelable by the VSC purchaser under the following conditions:

With respect to a new motor vehicle, within the first 60 days of the receipt of the VSC (within 30 days for a used motor vehicle), and if the VSC purchaser provides written notice of cancellation and no claims have been made, the VSC purchaser is entitled to a full refund. If a claim has been made within the first 60 days (within 30 days for a used motor vehicle), the refund is calculated pro rata based on either elapsed time or mileage at the obligated party's option. Any cancellation that occurs after the first 60 days (30 days regarding a used motor vehicle) results in a refund to the VSC purchaser calculated pro rata based on either elapsed time or mileage (again at the obligated party's option). Also, if the cancellation occurs after the period during which a full refund is available, a cancellation or administrative fee may be assessed to the VSC purchaser which does not exceed 10% of the VSC price or $25, whichever is less. If the VSC was financed, the refund may be payable to the VSC purchaser or the lender of record or both.

Obligor's Right to Cancel VSC

Pursuant to Insurance Code section 12825, any party obligated under a VSC may include a provision that reserves the right for that party to cancel the VSC if the following requirements are met:

(a) the notice of cancellation is mailed to the VSC purchaser postmarked before the 61st day after the date the VSC was sold.

(b) the obligated party provides the VSC purchaser with a refund equal to the full purchase price stated on the VSC within 30 days from the date of cancellation. If a claim has been paid or will be paid, the refund may be provided on a pro rata basis less the amount of any claims paid prior to cancellation.

(c) the VSC ceases to be valid no less than 5 days from the postmark of the cancellation notice.

(d) the notice states the specific grounds for cancellation.

If the cancellation of the VSC by the obligated party is based on a failure of the VSC purchaser to pay or material misrepresentation or fraud by the VSC purchaser, the requirements stated above basically apply, except that the notice of cancellation may be given at any time. Specific grounds for the cancellation should be stated in the notice and if the reason for cancellation is material misrepresentation or fraud by the VSC purchaser, the refund may be made on a pro rata basis and should be paid within 30 days of cancellation.

CAUTION

REGARDING CLAIMS MADE PRIOR TO CANCELLATION: Any party obligated under a VSC who cancels a VSC is liable for claims covered by the VSC which are reported prior to the effective date of cancellation. A claim is considered reported if the VSC purchaser has completed the first step required under the VSC for reporting the claim (Insurance Code section 12825(d)).

VSC Refund Agreements

Insurance Code section 12865 regulates promises to refund some or all of the purchase price of a VSC under conditions where no claims are made, there is a limited number of claims made, or the dollar amount paid on claims does not exceed a set amount or percentage. Under this statute, such

promises are not considered insurance if the following requirements are met:

(a) The promise is offered without separate consideration;

(b) The promisor is one of the following and satisfies the applicable requirements:

(i) The promisor is obligated under the VSC, the refund promise is part of the VSC, and the promisor has complied with the statutory requirements applicable to the type of VSC program involved as discussed previously in this chapter.

(ii) The promisor is a dealer and the refund agreement provides no benefits other than a refund of some or all of the VSC purchase price and the dealer uses a "refund agreement administrator" (defined by Insurance Code section 12865(b) as a person other than the dealer who performs or arranges the collection, maintenance or disbursement of monies under a refund agreement and provides dealers with refund agreement forms and participates in the adjustments of refund agreement claims). To be a refund agreement administrator, a person must be licensed as a property broker-agent and casualty broker-agent and comply with other requirements which are basically equivalent to those applicable to a Third Party Obligor VSC program as discussed previously in this chapter. Those requirements include filing a copy of the refund agreement with the Insurance Commissioner; having the refund agreement include certain notices and disclosures; filing an approved insurance policy with the Insurance Commissioner covering 100% of the refund agreement obligations; and maintaining records relating to refund agreement transactions.

(iii) If the promisor under the refund agreement is neither a dealer nor a party obligated under the VSC, the person is labeled by the statute as a "refund agreement obligor." A "refund agreement obligor" must be licensed as a property broker-agent and casualty broker-agent and comply with other requirements which are basically equivalent to those applicable to a Third Party Obligor VSC program as discussed previously in this chapter. Those requirements include filing a copy of the refund agreement with the Insurance Commissioner; having the refund agreement include certain notices and disclosures; filing an approved insurance policy with the Insurance Commissioner covering 100% of the refund agreement obligations; and maintaining records relating to refund agreement transactions.

CAUTION

REGARDING BENEFITS OF REFUND AGREEMENT: A refund agreement obligor may not promise any benefit other than a refund of all or some of the VSC purchase price (Insurance Code section 12865(c)(3)). A promise in a refund agreement of additional benefits by a dealer or other party obligated under the VSC should be avoided because such a promise would likely constitute insurance which would trigger significant compliance issues.

NOTE

REGARDING WHO CAN OFFER REFUND AGREEMENTS: No person other than a dealer is authorized to provide or offer to provide a refund agreement to a VSC purchaser (Insurance Code section 12865(c)(4)).

NOTE

BE FAMILIAR WITH CONTRACT TERMS: There have been occasions where California dealers found themselves responsible for liability under thousands of Vehicle service contract refund agreements when the insurance company backing the agreements was forced into liquidation. Dealers should be aware that they may be responsible for such agreements–even when an administrator and insurance company agree to back the claims–when deciding whether to provide them to service contract customers.

VEHICLE REPAIR AND MODIFICATION

Chapter 10

Contents

VEHICLE REPAIR AND MODIFICATION

OVERVIEW: Repairing and modifying motor vehicles are activities that occur as part of the operation of an automobile dealership. Not surprisingly, these activities are subject to extensive government regulation. This chapter focuses on statutes contained in California Business and Professions Code sections 9980 through 9889.53 (sometimes hereinafter referred to as "Bus. Prof. Code") known as the Automotive Repair Act (hereinafter the "Act") and supporting regulations contained in sections 3301 through 3395.4 of Title 16 of the California Code of Regulations (hereinafter C.C.R.) which relate to vehicle repairs. The chapter also covers a combination of key California and federal laws which apply to any alteration of a vehicle prior to its sale or lease, including the federal Motor Vehicle Safety Standards (see 49 U.S.C. sections 30101, et seq., and 49 C.F.R. parts 567 and 571), California Health and Safety Code sections 43000, et seq., and Division 12 of the California Vehicle Code.

Automotive Repair Act

The collection of statutes that make up the Act are designed to regulate those areas of automotive repair deemed crucial to the safe operation of motor vehicles and susceptible to fraudulent and deceptive practices by repair dealers. As part of its overall design, the Act authorizes the creation of the Bureau of Automotive Repair (hereinafter the "Bureau") which has responsibility for registering and regulating repair dealers; accepting and mediating consumer complaints; and investigating violations of the Act. The highest priority of the Bureau in exercising its licensing, regulatory, and disciplinary functions is the protection of the public (Bus. Prof. Code section 9880.3). The Bureau is also responsible for the mandatory vehicle emission inspection and testing program. This subject however, is not covered in this chapter.

Bureau of Automotive Repair and Registration Requirements

Application of the Act

Repair of Motor Vehicles

The purpose of the Act is to regulate the activities of automotive repair dealers defined to be any "person who, for compensation, engages in the business of repairing or diagnosing malfunctions of motor vehicles" (Bus. Prof. Code section 9880.1(a)). The term "person" in this context includes entities such as partnerships, corporations, and limited liability companies. The phrase "repair of motor vehicles" is defined to be "all maintenance of and repairs to motor vehicles performed by an automotive repair dealer including automotive body repair work, but excluding those repairs made pursuant to a commercial business agreement and also excluding repairing tires, changing tires, lubricating vehicles, installing light bulbs, batteries, windshield wiper blades, and other minor accessories, cleaning, adjusting, and replacing spark plugs, replacing fan belts, oil, and air filters, and other minor services, which the director [refers to the Director of Consumer Affairs], by regulation, determines are customarily performed by gasoline service stations" (Bus. Prof. Code section 9880.1(e)). The provisions of the Act will also apply if it is determined that a repair service being performed "requires mechanical expertise, has given rise to a high incidence of fraud or deceptive practices, or involves a part of the vehicle essential to its safe operation" (Bus. Prof. Code section 9880.1(e)).

A commercial business agreement for the purposes of the Act means "an agreement, whether in writing or oral, entered into between a business or commercial enterprise and an automobile repair dealer, prior to the repair which is requested being made, which agreement contemplates a continuing business arrangement under which the automobile repair dealer is to repair any vehicle covered by the agreement, but does not mean any warranty or extended service agreement normally given by an automobile repair facility to its customers" (Bus. Prof. Code section 9880.1(i)).

Meaning of Compensation: "Compensation" as used in the Act refers to "any form of remuneration received for repairing or diagnosing malfunctions of motor vehicles. Where repair or diagnostic work is performed pursuant to a warranty, compensation is presumed to have been paid, whether the warranty has been obtained in connection with the purchase of a motor vehicle or otherwise" (16 C.C.R. section 3303(g)).

Focus on Passenger Vehicles

The Act applies only to the repair of motor vehicles defined as passenger vehicles which are required to be registered with the California Department of Motor Vehicles and all motorcycles, whether or not they are required to be registered (Bus. Prof. Code section 9880.1(d)).

Administration of the Act

Bureau of Automotive Repair

The Bureau of Automotive Repair, which is headed by a Bureau Chief, is part of the California Department of Consumer Affairs and is given the responsibility of administering and enforcing the Act (Bus. Prof. Code section 9882). As part of this responsibility, the Bureau is authorized to adopt those rules and regulations deemed necessary to implement the purposes of the Act. The Bureau Chief is an appointee of the Governor (Bus. Prof. Code section 9882.2).

Bureau Branches

As presently organized, the Bureau has 12 offices located throughout the State of California which cover enforcement, smog check operations and consumer assistance.

Registration of Automotive Repair Dealers

Registration Requirement

Any entity or individual who desires to conduct business as an automotive repair dealer is required by the Act to register with the Department of Consumer Affairs (Bus. Prof. Code section 9884.6). The registration process includes paying a fee and submitting the appropriate application which discloses information under penalty of perjury regarding the identity and location of the applicant, a statement that the location is properly permitted under local zoning ordinances and the applicant's retail seller permit number (Bus. Prof. Code section 9884 and 16 C.C.R. section 3351). Corporate applicants conducting business at more than one facility must identify individual officers and directors and designate the specific individual who will be in charge of each facility (Bus. Prof. Code section 9884.1).

For the purposes of the Act, the term "automotive repair dealer" also includes a person who, for compensation, adjusts, installs or tests retrofit systems on direct import used vehicles and so such individuals or entities are therefore required to be registered with the Department of Consumer Affairs (Bus. Prof. Code section 9884.6). The Air Resources Board is responsible for adopting regulations setting up a certification program for used direct import vehicles, defined as any 1975 or later model-year direct import vehicle not required to be certified as a new direct import vehicle (Health and Safety Code sections 44200 and 44201).

If an automotive repair dealer is also conducting business as an auto body repair shop (which is defined to be "a place of business operated by an automotive repair dealer where automotive collision repair or reconstruction of automobile or truck bodies is performed"), an application must also be made which includes a written statement signed under penalty of perjury that the applicant has all of the following items: (1) a city or county business license; (2) a State Board of Equalization identification or resale permit number; (3) an Environmental Protection Agency hazardous waste permit number; and (4) an Air Quality Management District spray booth permit number (Bus. Prof. Code sections 9889.51 and 9889.52).

NOTE

MORE ON AUTO BODY REPAIR SHOP DEFINITION: According to the applicable regulation, the phrase "auto body repair shop" means "an automotive repair dealer who performs repairs or reconstruction of automobile or truck bodies, structures, or frames." An auto body repair shop does not include an automotive repair dealer licensed by the Department of Motor Vehicles as a motor vehicle dealer and engaged in either the activity of up-fitting or down-fitting the dealer's vehicle inventory, or performing certain limited painting and structural repairs (16 C.C.R. section 3303(l)).

It is unlawful for any person or entity to conduct business as an automotive repair dealer without complying with the registration procedures set forth in the Act. Additionally, without a valid registration, an automotive repair dealer is precluded from benefiting from "any lien for labor or materials or the right to sue on a contract for motor vehicle repairs done by him" (Bus. Prof. Code section 9884.16).

Normally, upon receipt of an application, the Bureau will issue the registration and forward proof of

issuance to the applying repair dealer (Bus. Prof. Code section 9884.2). The Bureau is required to notify in writing a first time applicant of the decision reached as to the application within 45 days after the filing of a completed application with the necessary fee (16 C.C.R. section 3303.2(e)).

NOTE

ON EXEMPTION FROM REGISTRATION: Persons exempt from this registration requirement are: The employees of a repair dealer who only repair motor vehicles as employees; persons who are solely engaged in repairing vehicles "of one or more commercial, industrial or governmental establishments;" or persons who are registered pursuant to the Electronic and Appliance Repair Dealer Registration Law and whose work is "limited to the installation or replacement of a motor vehicle radio, antenna, audio recorder, audio playback equipment, ignition interlock device, or burglar alarm"; and certain persons not engaged in repairing or diagnosing malfunctions of motor vehicles, but whose primary business is the wholesale supply of remachined new or rebuilt automotive parts without compensation for warranty adjustments to those parts (Bus. Prof. Code section 9880.2).

Updating application information: Application information should be updated if changes occur, since the registration of a repair dealer can be treated as invalid if the Bureau determines that the outdated information is material (Bus. Prof. Code section 9884.4).

Registration Fee

The annual fee required for registration is per facility and renewal fees are payable each year thereafter for each facility to maintain its registered status. (Bus. Prof. Code section 9886.3 and 16 C.C.R. section 3351.1). The fees generated by this registration process pay the salaries, expenses and costs connected with the administration and enforcement of the Act by the Bureau (Bus. Prof. Code section 9886.4).

Registration Problems

Grounds for Invalidating a Registration

The Bureau is not required to automatically renew a repair dealer's registration. In fact, a dealer's registration may be denied, suspended, revoked or placed on probation in a situation where that dealer or any "automotive technician, employee, partner, officer, or member of the automotive repair dealer" has been involved in certain acts or omissions, not the result of a bona fide error, which are "related to the conduct of the business of the automotive repair dealer." These acts and omissions include the following:

(1) Making or authorizing in any manner or by any means whatever any statement written or oral which is untrue or misleading, and which is known, or which by the exercise of reasonable care, should be known, to be untrue or misleading.

(2) Causing or allowing a customer to sign any work order which does not state the repairs requested by the customer or the automobile's odometer reading at the time of repair.

(3) Failing or refusing to give to a customer a copy of any document requiring his or her signature, as soon as the customer signs the document.

(4) Any other conduct that constitutes fraud.

(5) Conduct constituting gross negligence.

(6) Failure in any material respect to comply with the provisions of this chapter or regulations adopted pursuant to it.

(7) Any willful departure from or disregard of accepted trade standards for good and workmanlike repair in any material respect, which is prejudicial to another without consent of the owner or his or her duly authorized representative.

(8) Making false promises of a character likely to influence, persuade, or induce a customer to authorize the repair, service or maintenance of automobiles.

(9) Having repair work done by someone other than the dealer or his or her employees without the knowledge or consent of the customer unless the dealer can demonstrate that the customer could not reasonably have been notified.

(10) Conviction of a violation of section 551 of the Penal Code" (Bus. Prof. Code section 9884.7 (a)).

A crime or act on the part of a repair dealer will be considered "substantially related to the qualifications, functions, or duties of a registrant if to a substantial degree it shows that the registrant is presently or potentially unfit to perform the functions authorized by the registration in a manner consistent with the public health, safety, or welfare" (16 C.C.R. section 3395.2).

Notice and Hearing Requirements

If a repair dealer's registration is denied, the Bureau is required to give written notice by personal service or mail to the applicant. Furthermore, upon receipt of such notification, the repair dealer is entitled to a hearing if a written request is filed with the Bureau within 30 days of the notification (Bus.

Prof. Code section 9884.7(a)). (See chapter entitled "DMV Investigations and Accusations" in this Management Guide for a complete discussion of administrative adjudication).

If a repair dealer operates multiple places of business, one of which engages in conduct of the type described in items (1) through (10) above, the Bureau is authorized to only suspend, revoke or place on probation the registration of the location where the violations occurred (Bus. Prof. Code section 9884.7(b)). However, if a finding is made that repeated and willful violations of the Act have occurred, the Bureau may suspend, revoke, or place on probation the registration of a repair dealer for all repair facility locations (Bus. Prof. Code section 9884.7(c)).

16 C.C.R. sections 3395 and 3395.1 set forth guidelines for the Bureau to consider in evaluating the rehabilitation of an applicant for a repair facility license or registration who has committed an act or been convicted of a crime which would be a basis for denying the application under Bus. Prof. Code sections 480 and 9884.7.

It should be noted that the expiration of a repair dealer's registration does not prevent the Bureau from proceeding with any investigation or disciplinary action. Also nothing in the Act prevents any individual from bringing a civil action against an automotive repair dealer (See further discussion of related matters in the section entitled "Consumer Complaints/Disciplinary Procedures" in this chapter).

Requirements regarding Repair Work

Not surprisingly, the practices of repair dealers concerning the authorization of actual repair work to be done for a consumer and estimating its cost are heavily regulated by the Act. Compliance with the statutory requirements covering these practices may be difficult, but a repair dealer must comply to avoid problems with the Bureau and to insure the dealer's ability to be entitled to compensation for repair work performed.

Written Repair Estimates

Prior to performing any repair work for a customer, a repair dealer is required to provide that customer with a "written estimated price for labor and parts necessary for a specific job" (Bus. Prof. Code section 9884.9(a) and 16 C.C.R. section 3353). This written estimate must include a statement identifying any repair work to be done by an individual other than the repair dealer or the dealer's employees (Bus. Prof. Code section 9884.9(b)). The odometer reading of the vehicle involved should also always be noted on the written estimate/work order (Bus. Prof. Code section 9884.7(a)(2)).

NOTE

REGARDING AUTOBODY OR COLLISION REPAIRS: If such repairs are involved, a repair dealer must provide in the itemized written estimate a separate description of the labor and parts and identify each part as either new, used, rebuilt or reconditioned. Each "crash part" shall be identified as such and further identified as an original equipment manufacturer crash part or a nonoriginal equipment manufacturer aftermarket crash part. (Bus. Prof. Code section 9884.9(c)). An "original equipment manufacturer (OEM) crash part" is defined as "a crash part made for or by the original vehicle manufacturer who manufactured, fabricated or supplied a vehicle or a component part." (16 C.C.R. section 3303(9)). A "non-original equipment manufacturer (non-OEM) aftermarket crash part" is defined as an aftermarket crash part not made for or by the manufacturer of the motor vehicle. (16 C.C.R. section 3303 (r)). A "crash part" is defined as a "replacement for any of the non-mechanical sheet metal or plastic parts which generally constitute the exterior of a motor vehicle, including inner and outer panels" (16 C.C.R. section 3303(p)).

No estimate needed if no agreement by dealer: A repair dealer is not required to give a written estimated price if the dealer "does not agree to perform the requested repair" (Bus. Prof. Code section 9884.9(a)).

The requirement of providing a written estimate for every repair job is a frequently violated section of the Act.

Teardown Estimates

In the instance where it is necessary for a repair dealer to "teardown" a vehicle component in order to prepare a written estimated price, the dealer is first required to give the customer a written estimated price for the teardown (defined as "the act of disassembly"). The dealer's estimated price for a teardown should cover the cost of reassembling the component involved and include the cost of parts and labor necessary to replace such items as "gaskets, seals and O-rings that are normally destroyed by teardown of the component" (16 C.C.R. section 3353(d)).

Additionally, a repair also is required to notify the customer orally and conspicuously in writing on the teardown estimate, the maximum time that the repair dealer will need to reassemble the vehicle or the vehicle component in the event the customer

does not elect to proceed with any repairs. The commencement of this time period is from the date of the authorization of the teardown and a repair dealer is required to reassemble the vehicle within that time period if the customer does elect not to proceed further with repairs or maintenance (16 C.C.R. section 3353(d)).

Once a repair dealer has performed a teardown, a written estimate of the repair work considered necessary must be prepared. The repair dealer is then required to obtain the customer's authorization of either the additional repairs or an election to have the vehicle reassembled before beginning any additional work (16 C.C.R. section 3353(d)).

When a repair dealer is aware that the teardown of a vehicle or its component may prevent a restoration of a component to its former condition, that information must be disclosed in writing on the teardown estimate before it is signed by the customer (16 C.C.R. section 3353(d)).

Sublet work: A repair dealer who has someone else perform repair services is responsible for those services in the same manner as if the repair dealer or the repair dealer's employees had performed them (Bus. Prof. Code section 9884.9(b)).

Special Requirements Regarding Transmissions

In addition to satisfying the requirements of 16 C.C.R. section 3353(d) regarding teardown estimates, a repair dealer who is involved in removing and disassembling a transmission must, if applicable, inform the customer that a diagnostic check of an electronic control module cannot be completed due to the condition of the transmission and make a written notation of that fact on the estimate (16 C.C.R. section 3361.1(a)).

Invoices

A basic requirement of the Act is that "all work done by an automotive repair dealer, including all warranty work, shall be recorded on an invoice and shall describe all service work done and parts supplied" (Bus. Prof. Code section 9884.8). The content of the invoice form used by an automobile repair dealer must separately list, describe and identify all of the following:

1. "All service and repair work performed, including all diagnostic and warranty work, and the price for each described service and repair.
2. Each part supplied, in such a manner that the customer can understand what was purchased, and the price for each described part. The description of each part shall state whether the part was new, used, reconditioned, rebuilt, or an OEM crash part, or a non-OEM aftermarket crash part.
3. The subtotal price for all service and repair work performed.
4. The subtotal price for all parts supplied, not including sales tax.
5. The applicable sales tax, if any."

A copy of the invoice must be given to the customer and retained by the dealer at the time the work is completed. In the instance where a component system has both new and used, rebuilt or reconditioned parts, the invoice must clearly disclose that information (Bus. Prof. Code section 9884.8 and 16 C.C.R. section 3356) (See also California Vehicle Code section 12001(b)).

NOTE

INVOICE EXAMPLE: The invoice format shown below is considered in compliance according to the Bureau:

Parts	**Cost**
New Ajax semi-metallic brake pad kit, part #ABPK-14	$50.00
4 quarts Ajax 10w40 motor oil	$ 5.00
New Ajax oil filter, part #AOF-10	$ 5.00
Labor	
Front Brake Service: Remove and replace front brake pads and resurface front rotors	$150.00
Engine Oil and Filter Change: Replace engine oil and oil filter	$30.00
Subtotals: Labor	$180.00
Parts	$60.00
Tax (@ 9.00%)	$ 5.40
	$245.40

Note

REGARDING GIVING DOCUMENTS TO CUSTOMERS: The failure of a repair dealer to give a customer a copy of any document required to be signed by the customer at the time it is signed is a basis for disciplinary action (Bus. Prof. Code section 9884.7(1)(c)).

Further Identifying Parts Information on Invoice

California Vehicle Code section 12001(a) requires that repair dealers selling and installing new parts in passenger cars must identify on the invoice "by brand name, or other comparable designation, the part or parts installed." Although a "comparable designation" is not defined, a designation such as OEM (when applicable) would seem to suffice.

Identifying Dealer Information on Invoice

Any invoice form used by a repair dealer is required to show the dealer's registration number and the corresponding business name and address. If a telephone number is listed, it should be the number listed for that dealer in the local telephone directory (16 C.C.R. section 3356).

NOTE

Regarding Towing Fees And Access Notice: Repair dealers that are involved in charging for towing and/or towing related storage, even in the context of passing through a sublet tow charge for services ordered by the vehicle owner or insurer, must comply with the requirements of California Vehicle Code section 22651.07. These requirements include conspicuously posting a "Towing Fees and Access Notice" sign; providing a copy of the notice to customers upon request; and providing a customer with an itemized invoice containing detailed information related to the towing services involved. The Bureau has taken the position that dealers may incorporate the required towing invoice disclosures in a repair invoice (if it is made clear the disclosures relate to towing services performed by another party) or may use a separate towing invoice. Dealers who insist that customers or insurers arrange and pay for their own tow charges directly are not subject to the requirements of this statute. See the chapter in this Management Guide entitled "Public Signs at Dealerships" for a further discussion of the Towing Fees and Access Notice sign.

NOTE

Regarding Safety Checks On Off-Lease Vehicles: Dealers are exempt from Vehicle Code equipment requirements relative to the sale of a leased vehicle registered in California to a lessee who has been in possession of the vehicle immediately prior to the time of sale (see California Vehicle Code section 11713(i)). Because of this exemption, dealers should be careful if they perform an off-lease safety inspection and charge the lessee a fee. No fee should be charged unless the lease contract requires an inspection and specifies a fee or the lessee requests or voluntarily agrees to an inspection and the fee at the time of purchase. The voluntary agreement of a lessee to pay an inspection fee should be documented in writing.

CAUTION

Regarding Filling Out Paperwork: In filling out an estimate, invoice or work order, a repair dealer may not "withhold therefrom or insert therein any statement or information which will cause any such document to be false or misleading, or where the tendency or effect thereby would be to mislead or deceive customers, prospective customers, or the public" (16 C.C.R. section 3373).

NOTE

Regarding Defective Parts: A repair dealer's violation of Vehicle Code section 12002 which prohibits the manufacture, sale or installation of vehicle parts known to have been determined to be defective and subject to customer notification or recall is grounds for the Bureau to take disciplinary actions against that dealer. (16 C.C.R. section 3395.3).

Miscellaneous Shop Supplies

16 C.C.R. section 3356(c) provides that "separate billing in an invoice for items generically noted as shop supplies, miscellaneous parts, or the like, is prohibited." That regulation also requires that if a customer is to be charged for a part, that part must be specifically listed as an item in the invoice. If any such item is not listed, then the item is not regarded as a part, and there should not be a separate charge made for it.

Because of this regulation, repair dealers should:

1. Make no notation or charge on an invoice for "miscellaneous shop supplies or parts";
2. Only charge for parts, materials, or supplies separately itemized and used in the repair;
3. Charge for materials or supplies such as welding rods, lubricants, specialty greases, etc., only if they are actually utilized during the repair process and are separately itemized in measurable units on the invoice;
4. Be ready to bear the burden of proving that any itemized parts, materials, or supplies were actually installed or utilized during the repair; and
5. Never charge a percentage of parts or labor for miscellaneous parts or supplies.

NOTE

REGARDING SALES TAX ON SUPPLIES USED FOR REPAIRS: The California Board of Equalization takes the position that the taxability of supplies which do not attach to the vehicle being repaired, such as sandpaper, cleaning solvent, paint thinner and masking tape, depends upon whether the dealer charges the consumer for the supplies. Because 16. C.C.R. 3356 prohibits charges for miscellaneous shop supplies not separately itemized, the rule of thumb should be that dealers may collect sales tax from the customer on separately itemized shop supplies–otherwise sales tax should have been paid when purchasing the supplies from a supplier. To the extent a dealer were to charge a consumer for specific supply items in connection with repairs involving taxable parts and non-taxable labor charges, the Board would consider sales tax to be due on those items on a prorated basis (see California State Board of Equalization Publication No. 25 entitled "Auto Repair Garages and Service Stations" (January 2013) at page 2).

NOTE

REGARDING SALES TAX ON WARRANTY REPAIRS: The California Board of Equalization considers a number of factors in determining whether sales tax applies to charges associated with warranty repairs. The key factors are whether the warranty is considered "mandatory" or "optional" and whether the customer must pay a deductible for repairs. The Board defines a "mandatory" warranty to be one given to a customer ,without an additional charge, at the time the vehicle is purchased (generally a manufacturer's warranty). The Board defines an "optional" warranty to be a warranty that a customer has an option to purchase for an additional, separately stated charge (generally a service contract). It is the Board's position that sales tax does not apply to charges for parts used in repairs performed under a mandatory warranty where a customer does not pay a deductible because sales tax for the warranty parts is considered paid as part of sales tax on the vehicle. For repairs performed under an optional warranty, the Board generally takes the position that the party obligated to provide the repairs is the consumer of the parts used during the repair. The obligated party is thus required to pay sales tax (or use tax if the repair dealer is the obligated party) on the cost of the parts. If a deductible amount is paid by a customer to a repair dealer in connection with repair work performed under either a mandatory or an optional warranty, the Board generally takes the position that sales tax is due on a prorated portion of the deductible amount paid by the customer which is determined by using the ratio of the billed price of parts used in the repairs to the total price of the repairs performed. (see California State Board of Equalization Publication No. 25 entitled "Auto Repair Garages and Service Stations" (January 2013) at pages 16-19; see also a discussion of this topic in the Sales and Use Tax Chapter of this Management Guide.)

Hazardous Waste Disposal Fee

The regulation adopted by the Bureau which relates to charges for toxic waste disposal provides that "an automotive repair dealer may charge a customer for costs associated with the handling, management and disposal of toxic waste or hazardous substances under California or federal law which directly relate to the servicing or repair of the customer's vehicle. Such a charge must be disclosed to the customer by being separately itemized on the estimate prepared pursuant to section 9884.9(a) of the Business and Professions Code and on the invoice prepared pursuant to section 9884.8 of the Business and Professions Code. In order to assess this charge, the automotive repair dealer must note on the estimate and invoice the station's Environmental Protection Agency identification number required by section 262.12 of Title 40 of the Code of Federal Regulations"(16 C.C.R. section 3356.1).

The Bureau's Statement of Reasons for this regulation indicates that the Bureau "recognizes that waste disposal requirements have increased for automotive repair dealers over the years, and that without a regulation allowing dealers to pass on associated costs to customers, such costs related to waste disposal may not be separately charged for by an automotive repair dealer. The proposed regulation would allow an automotive repair dealer to charge a customer for costs associated with the handling and disposal of toxic waste which directly relate to the servicing and repair of the customer's vehicle."

If a repair dealer wishes to assess such a charge, the following should occur:

1. Separately disclose and itemize the charge on **both** the repair estimate and the invoice;
2. The charge must be reasonably related to the costs associated with the handling, management and disposal of toxic waste or hazardous substances considered as such under either California or federal law (the regulation does not permit any charge which would result in profit on the handling or disposal of such wastes or substances; in determining the cost of a particular charge, a repair dealer should be prepared to demonstrate a reasonable relationship between the charge and the actual cost of handling, man-

agement, and disposal of the wastes or substances);

3. Note the automotive repair dealer's Environmental Protection Agency identification number on **both** the repair estimate and repair order (repair dealers may wish to have new repair estimate and invoice forms printed to include their EPA number);
4. Only assess a disposal charge in situations where toxic wastes or hazardous substances are actually removed from a repaired vehicle and disposed of (repair dealers bear the burden of proof); and
5. Beware of advertisements which may leave a repair dealer open to charges of false or misleading advertising and/or business practices (for example, a $15.99 advertisement for an oil change and filter that does not disclose the fact that a toxic waste disposal fee will also be charged).

CAUTION

Regarding Hazardous Waste Disposal Fee: Dealers should periodically analyze (at least on an annual basis) the amount charged to dealership service customers to cover the handling, management and disposal of hazardous substances to make sure that it reasonably equates to the actual costs incurred by the dealership. This analysis of costs should take into account any compensation (for example, vendor payments for used oil) received by the dealership for such substances.

NOTE

On Sales Tax On Toxic Waste Disposal Fees: The California Board of Equalization takes the position that whether the toxic waste disposal fee is taxable depends upon whether the repair itself is taxable. The Board gives the example of hazardous waste fees imposed on an oil change to reimburse the dealer for the costs of proper storage and disposal of the used oil. In such circumstances the Board concludes that the charge "is not taxable because it is related to nontaxable repair labor." The Board, however, considers a hazardous waste disposal charge to be subject to sales tax if it is solely related to the sale of parts (see California State Board of Equalization Publication No. 25 entitled "Auto Repair Garages and Service Stations" (January 2013) at page 2).

Need to Retain Records

A repair dealer is required to maintain legible copies of repair invoices (as well as all work orders and written estimates) for a period of not less than 3 years. Furthermore, these records are to be available for reasonable inspection and/or reproduction by the Bureau and/or other law enforcement officials during normal business hours (Bus. Prof. Code section 9884.11 and 16 C.C.R. section 3358). Because of the 4 year statute of limitations which applies to legal actions based on written agreements, a dealer should consider retaining such records for at least 5 years.

Customer Authorization

A basic concept underlying the statutes and regulations making up the Act is that no work is to be done by a repair dealer without the authorization of the customer. The importance of this concept is shown by the harshness of the applicable penalty when proper authorization is not obtained. As provided in Business and Professions Code section 9884.9, no charges accrue for any repair work actually performed unless an "authorization to proceed is obtained from the customer," and noncompliance with this statute has been consistently found by California courts to bar any recovery for repairs (including the cost of parts supplied) performed by a dealer (*Bennett v. Hayes* (1975) 53 Cal.App.3d 700). Additionally, pursuant to that statute, no charge can be made for work performed or repair parts supplied which exceed the estimate price previously consented to by a customer, unless there is an additional authorization obtained from that customer after it is determined that the additional work or repair parts are needed.

Restoration work not exempt: A repair dealer who does "restoration" work on a vehicle is not exempt from complying with the requirements of the Act (*Schreiber v. Kelsey* (1976) 62 Cal.App.3d Supp. 45).

CAUTION

Regarding "customer" definition.: Pursuant to Bus. Prof. Code section 9880.1(j), "customer" is defined to mean "the person presenting the motor vehicle for repair and authorizing the repairs to that motor vehicle." The statute specifically excludes an automotive repair dealer providing the repair services or an insurer involved in a claim that includes the motor vehicle being repaired, or an employee or an agent or a person acting on behalf of the dealer or insurer from being a "customer". Dealers should therefore make sure that any repair work is authorized by a "customer" before proceeding.

NOTE

On Insurance Company Authorization: It is also a basic principle that insurance companies are not obligated to pay for repairs unless they have

actually authorized them. See the chapter entitled "Insurance" in this Management Guide for further discussion of this subject.

CAUTION

REGARDING AUTOMOTIVE REPAIR REFERRALS: California's Penal Code section 551(a) makes it unlawful for any automobile repair dealer or its agents or employees to offer any insurance agent, broker or adjuster any fee, commission or other consideration for referring an insured to that automobile repair dealer for repairs covered under any policyholder's automobile physical damage or collision coverage.

California Penal Code section 551(b) also makes it unlawful for any repair dealer or its agents or employees to "knowingly offer or give any discount intended to offset a deductible required by a policy of insurance covering repairs to or replacement of a motor vehicle." A violation of Penal Code section 551 and a resulting conviction can have severe consequences including a fine of up to $10,000 and imprisonment in a county jail for up to three years.

Additionally, California Insurance Code section 754 prohibits any person from soliciting, receiving, offering or paying any referral fee based upon the referral of an individual for vehicle repair services when it is known or should be known that the services will be wholly or partially reimbursed by an insurance company. A referral fee includes kickbacks, bribes, or rebates, but does not include discounts or similar price reductions. A violation of this statute is a misdemeanor punishable by a fine not to exceed $1,000 for each violation.

CAUTION

REGARDING TOWING REFERRALS: 16 C.C.R. section 3368 makes it unlawful for a repair dealer to pay any kind of consideration to a towing service for the delivery of a vehicle (not owned by the dealer) for purposes of storage or repair. Additionally, this regulation prohibits a repair dealer from accepting anything of value from a towing company for arranging the services of a tow truck. A violation of this regulation is grounds for the Bureau to take disciplinary action against the repair dealer.

Oral, Fax or E-mail Consent to Additional Work

Pursuant to 16 C.C.R. section 3353(c), a repair dealer is required to obtain a customer's authorization for any additional repairs, parts or labor in excess of the original written estimated price. This authorization may be obtained in written, oral or electronic form (defined as a facsimile transmission (fax) or electronic mail (e-mail)) that includes a description of the additional repairs, parts, labor and the total additional cost.

If a customer orally consents to the additional repairs, the repair dealer is required to make a written notation on the work order of the "date, time, name of person authorizing the additional repairs and the telephone number called, if any, together with the specification of the additional repairs, parts, and labor and the total additional cost", and must either: (a) make a notation on the invoice of the same facts set forth in the notation on the work order; or (b) upon completion of repairs, obtain the customer's signature or initials to an acknowledgement of notice and consent, which states:

> " I acknowledge notice and oral approval of an increase in the original estimated price.
>
> _____
>
> (Signature or Initials) "

(Bus. Prof. Code section 9884.9(a) and also see 16 C.C.R. section 3353(c)(4)).

If a customer's authorization for additional work is obtained by a fax, the repair dealer is required to "attach to the work order and the invoice, a faxed document that is signed and dated by the customer and shows the date and time of transmission and describes the additional repairs, parts, labor and the total additional cost" (16 C.C.R. section 3353(c)(2)). The repair dealer should also have a statement that the additional repairs were authorized by fax recorded on the final invoice (16 C.C.R. section 3353(c)(4)).

If a customer's authorization for additional work is obtained by e-mail, the repair dealer is required to "print and attach to the work order and invoice, the e-mail authorization which shows the date and time of transmission and describes the additional repairs, parts, labor and the total additional cost" (16 C.C.R. section 3353(c)(3)). The repair dealer should also have a statement that the additional repairs were authorized by e-mail recorded on the final invoice (16 C.C.R. section 3353(c)(4)).

Authorizing sublet work: A repair dealer may have repair services performed by someone else only upon the consent of the customer, "unless the customer cannot reasonably be notified" (Bus. Prof. Code section 9884.9(b)). As a practical matter, a repair dealer should always obtain the customer's consent before using non-employees to perform repair work. To contend that a customer "cannot rea-

sonably be notified" is too subjective a determination in most instances to justify the risk.

Authorization from person designated by customer: Pursuant to Bus. Prof. Code section 9884.9(d), a "customer may designate another person to authorize work or parts supplied in excess of the estimated price, if the designation is made in writing at the time the initial authorization to proceed is signed by the customer." Consistent with the definition of a "customer" for purposes of authorizing repairs, a designee should not be the automotive repair dealer providing the repair services or an insurer involved in a claim that includes the motor vehicle being repaired, or an employee or an agent or person acting on behalf of such a dealer or insurer. A repair dealer should not provide additional work or parts based upon the request of the designee unless the authorization of the designee has been obtained from the customer and recorded in compliance with the following procedures stated in 16 C.C.R. section 3353(f):

1. The customer has designated by a separate form or by a designation incorporated into the dealer's work order form another person to authorize work not estimated or parts not included in the written estimated price given to the customer.
2. If a separate form is used, its form and content should be as follows:

"DESIGNATION OF PERSON TO AUTHORIZE ADDITIONAL WORK OR PARTS

I hereby designate the individual named below to authorize any additional work not specified or parts not included in the original written estimated price for parts and labor:

Name of Designee: _____

Phone Number: _____

Fax Number: _____

E-Mail Address: _____

Name of Customer: _____

Work Order No.: _____

Date: _____ _____

(Customer's Signature)"

3. If the customer's designation of another person is incorporated into a repair dealer's work order form, it should include the designation language required for a separate form as stated in item 2. above, with the name, phone number, facsimile number and e-mail address of the designee, and the customer's signature and date of signing.
4. If the designation form is separate from the work order, it should be completed in duplicate and a copy of the signed form should be given to the customer (with the customer's copy of the work order). The original of the signed designation form should be attached to the repair dealer's copy of the work order and retained for at least 3 years.

CAUTION

REGARDING AUTHORIZING CHANGES: When a customer has authorized repair work pursuant to a work order which includes itemized parts and labor, the repair dealer is not permitted to "change the method of repair or parts supplied without the written, oral, or electronic authorization of the customer" (16 C.C.R. section 3353(e)).

Authorization under Unusual Circumstances: The regulation covering the subject of customer authorization of repair work also provides a procedure to be followed in what are considered "unusual circumstances." Specifically, this procedure applies when a customer is not present to sign a work order, such as in some tow situations or when a customer wishes a dealer to take possession of a vehicle for purposes of repairing or estimating the cost of repair involved, but cannot deliver the vehicle to the dealer during regular business hours. Under those circumstances a repair dealer may not "undertake the diagnosing or repairing of any malfunction of the motor vehicle for compensation," unless the dealer has done all of the following:

(1) Prepared a work order providing a written estimated price for labor and parts necessary to repair the vehicle;

(2) Given the customer all of the information on the work order by telephone, fax or email and the customer has approved the work order; and

(3) Obtained the customer's oral, written or electronic authorization for the dealer to make the repairs with the dealer documenting the authorization as required by the statute.

(16 C.C.R. section 3353(g)).

Additional authorizations: In the event that the authorization procedures applicable under "unusual circumstances" are followed, but additional parts or labor become needed in excess of those included in the original written estimated price, a repair dealer must obtain a separate authorization (which can be obtained by following the procedures discussed previously under "Oral, Fax, E-Mail Consent to Additional Work" section of this chapter) from the customer regarding those items (16 C.C.R. section 3353(f)(3)).

CAUTION

REGARDING POSSIBLE PUNITIVE DAMAGES: A conscious disregard of the procedures involved in obtaining proper authorization from a customer has been found by a California appellate court to be a basis for awarding punitive damages against a repair dealer (*Zhadan v. Downtown Los Angeles Motor Distributors, Inc. *(1979) 100 Cal.App.3d 821).

PRACTICAL TIP

ON PROVISIONS IN REPAIR ORDERS: Note that if a dealer uses a repair order/invoice form which contains language authorizing attorney's fees when a collection lawsuit becomes necessary, a customer who is the prevailing party in a lawsuit concerning the repairs will be entitled to recover attorney's fees against the dealer. Note also that if a repair order form is used that has a provision allowing the repair dealer compensation for storage if the vehicle is not picked up and paid for within a reasonable period of time after the repairs have been completed, a good argument can be made to support a claim for storage expenses despite California Civil Code section 2892. This statute has been interpreted to mean that a repair dealer cannot claim storage expenses if the dealer retains the vehicle in exercise of lien rights arising out of the repairs. Finally, including a properly drafted consensual lien provision in a repair order form may authorize a repair dealer to retain possession of the vehicle, so the dealer can obtain a judgment against the customer for the amount of repairs and storage, and then execute on the vehicle through legal process. Such a consensual lien could provide authorization for the dealer to retain possession of the vehicle even though the dealer may have lost the statutory lien provided by Civil Code section 3067 et. seq. See the chapter entitled "Liens on Vehicles and Lien Sales" in this Management Guide for a discussion of the rules concerning statutory liens.

Return of Replaced Parts

A repair dealer is required to return replaced parts to a customer if that customer has made such a request at the time the work order is prepared. This requirement does not pertain to parts which must be returned to the manufacturer or distributor under a warranty arrangement (Bus. Prof. Code section 9884.10). However, when such an arrangement exists, the repair dealer is required to make an offer to the customer (at the time the work order is being prepared) to show the replaced parts.

Exceptions to return of parts requirement: In the event the customer is not being charged for the replacement part, a repair dealer is not required to show to the customer the replaced part (Bus. Prof. Code section 9884.10). Additionally, "parts and components that are replaced and that are sold on an exchange basis" do not have to be returned to the customer. However, this exception is based upon the customer being informed both orally and by written record on the work order and invoice that the particular parts involved are not returnable. In this situation, a dealer also has an obligation to provide the customer with a reasonable opportunity to inspect the replaced part if such a request is made by the customer prior to the work being commenced (16 C.C.R. section 3355).

Official sign: The Bureau requires registered repair dealers to display a sign which states that a customer is entitled to the return of replaced parts if a request is made when the work order is taken (Bus. Prof. Code section 9884.17). The sign must also inform customers to direct questions regarding estimates, invoices and return of parts to the manager of the repair facility and to direct unresolved questions regarding service work to the Bureau, whose toll-free telephone number and internet website address must be displayed on the sign (see 16 C.C.R. section 3351.4 and also the chapter entitled "Public Signs at Dealerships" in this Management Guide for the exact specifications of the sign).

NOTE

REGARDING REQUIREMENT TO PROVIDE COPY OF AUTOMOTIVE REPAIR DEALER'S SIGN: Whenever a repair dealer conducts business at a place other than that shown on the repair dealer's registration, the repair dealer must give to every customer, in addition to a copy of the work order, a copy of an official automotive repair dealer's sign that meets the following specifications:

1. ***Be reproduced on a white sheet of paper or other similar material no less than 8 ½ inches by 11 inches in size;***

2. ***Be proportionately reduced in size to fill the page in portrait format with no more than 1 inch margins outside the right, left, and bottom inset border lines;***

3. ***Include the current business name, address of record, business telephone number and registration number of the repair dealer, as shown by the Bureau's records, above the top inset border of the sign in print no smaller than the smallest print of the reduced sign; and***

4. ***Include no other information, printing, decoration, border or design (16 C.C.R. section 3351.3).***

CAUTION

REGARDING OBLIGATION TO RETURN REPLACED PARTS: A repair dealer should treat very seriously the obligation to return replaced parts to a customer making such a request. A failure to comply with this obligation is a clear violation of the Act which may result in disciplinary action being taken against the licensee.

NOTE

ON REPAIRS COVERED BY A MANUFACTURER'S ADJUSTMENT PROGRAM: A repair dealer is required under California Civil Code section 1795.91(b) to "disclose to a consumer seeking repairs for a particular condition at its repair shop, the principal terms and conditions of the manufacturer's adjustment program covering the condition if the dealer has received a service bulletin concerning the adjustment program." An "adjustment program" is defined to mean "any program or policy that expands or extends the consumer's warranty beyond its stated limit or under which a manufacturer offers to pay for all or any part of the cost of repairing, or to reimburse consumers for all or any part of the cost of repairing, any condition that may substantially affect vehicle durability, reliability, or performance, other than service provided under a safety or emission-related recall campaign" (California Civil Code section 1795.90(d)).

NOTE

Regarding Tire Inflation Regulation: A regulation Issued by the California Air Resources Board effective September 1, 2010 requires dealers, as automotive service providers, to check and inflate each operating tire on a service customer's vehicle to the recommended tire pressure rating. For a detailed summary of this regulation and compliance advice, dealers should review a comprehensive guide prepared by the California New Car Dealers Association entitled "A Dealer Guide to CARB's Tire Inflation Regulation." This guide is available at www.cncda.org.

Special Licenses for Brake and Lamp Services

Because of their impact on the public's safety and welfare, lamp and brake adjusting repair services are subject to special licensing requirements established in the Act. Unless these licensing requirements for an official lamp or brake adjusting station are met, a repair dealer is prohibited from performing the services involved (Bus. Prof. Code section 9888.3). An individual may perform these repair services only if he or she has the applicable license for a lamp or brake adjuster issued by the Bureau (Bus. Prof. Code section 9887.1).

License Requirements

Because of the highly specialized nature of these licensing requirements, this chapter does not discuss them in detail. The requirements for these particular licenses, including applications, fees, and qualifications, are generally contained in sections 9887.1 through 9887.3 and sections 9888.1 through 9888.4 of the California Business and Professions Code, as well as sections 3305 through 3310 and sections 3315, 3316, 3320 and 3321 of Title 16 of the California Code of Regulations.

Disciplinary/Penalty Provisions

General provisions concerning the denial, suspension and revocation of these special licenses are contained in California Business and Professions Code sections 9889.1 through 9889.10. Generally, violations of the regulations pertaining to these special licenses are considered infractions under California Business and Professions Code section 9889.21.

NOTE

ON OBTAINING INFORMATION FROM THE BUREAU: The Bureau is required to distribute copies of its regulations (including those pertaining to specialty licenses) to repair dealers (Bus. Prof. Code section 9884.19). Additionally, the Bureau puts out handbooks covering these specialty areas which can be purchased at a minimal cost.

Trade Standards

As part of its efforts to upgrade the automotive repair industry to the benefit of consumers, the Bureau has adopted regulations to establish acceptable standards for the performance of certain types of automotive repair in a good and workmanlike manner.

Ball Joints

One type of repair subject to these trade standards is the inspection, sale and installation of "ball joints," which are defined as "ball-and-socket assemblies designed to carry the vertical and horizontal stresses in the front suspension system of a mo-

tor vehicle while permitting steering and suspension movement" (16 C.C.R. section 3360.1). The sale and installation of ball joints are regulated by sections 3360.2 and 3360.3 of Title 16 of the California Code of Regulations. Repair dealers engaged in this kind of repair work should be thoroughly familiar with these regulations.

Automatic Transmissions

The Bureau has also adopted trade standards applicable to the repair, sale, and installation of automatic transmissions. These standards prohibit the use of terms such as a "rebuilt" or "exchanged," which are associated with transmission repairs unless certain minimum requirements for the repair and inspection of transmissions and torque converters (considered part of the transmission) are met. Again, repair dealers involved in this type of repair work should be thoroughly familiar with the requirements stated in Section 3361.1 of Title 16 of the California Code of Regulations.

CAUTION

REGARDING REBUILDING TRANSMISSIONS: A repair dealer should not represent to a customer that trade standards require the rebuilding of an automatic transmission. Such a representation is a basis for the Bureau to impose disciplinary sanctions (16 C.C.R. section 3361.1).

NOTE

ON EQUIPMENT REQUIREMENTS: Repair dealers performing automotive painting or engaged in the servicing or repairing of vehicle air conditioning systems must comply with regulations enacted by the Bureau that establish minimum equipment requirements (16 C.C.R. sections 3351.5 and 3351.6).

Advertising Regulations

The General Guideline

Another subject of Bureau regulations is advertising. Specifically, the Act allows the Bureau to adopt regulations necessary for the "protection of the public from fraudulent or misleading advertising by an automotive repair dealer..." (Bus. Prof. Code section 9884.19). These regulations are in addition to statutes already applicable (see for instance, Bus. and Prof. Code section 17500).

The basic premise of these regulations which applies not only to advertising, but to **any statement made by a repair dealer**, is that:

- *"No dealer shall publish, utter, or make or cause to be published, uttered, or made any false or misleading statement or advertisement which is known to be false or misleading, or which by the exercise of reasonable care should be known to be false or misleading" (16 C.C.R. section 3371).*

The standard for determining whether any advertisement, statement, or representation made by a repair dealer is false or misleading is whether it "tends to deceive the public or impose upon credulous or ignorant persons." In applying this standard, an advertisement, statement or representation is to be considered "in its entirety as it would be read or heard by persons to whom it is designed to appeal" (16 C.C.R. section 3372).

Specific Restrictions

Practices clearly prohibited by the Bureau's regulations include:

a. Advertising automotive service at a price which is misleading. Advertising is considered misleading if: it is intended to entice the customer into a more costly transaction; it has the capacity to mislead the public as to the extent that anticipated parts, labor or other services are included in the advertised price; it has the capacity to mislead the public as to the need for additional related parts, labor or other services; or the dealer knows the advertised service cannot usually be performed in a "good and workmanlike manner without additional parts, services or labor" (16 C.C.R. section 3372.1);

b. Inserting or withholding statements or information in estimates, invoices, or work orders which cause such a document "to be false or misleading, or where the tendency or effect thereby would be to mislead or deceive customers, prospective customers, or the public" (16 C.C.R. section 3373);

c. Advertising, representing or implying in any manner that a "used, rebuilt or reconditioned part or component is new unless such part and all of the parts of any component are in fact new" (16 C.C.R. section 3374);

d. Including in any advertising false or misleading representations concerning the "nature, extent, duration, terms or cost of a guarantee [or warranty] of a motor vehicle part or component or repair service subject to the provisions of the Act" (16 C.C.R. section 3375).

NOTE

REGARDING AN ADVERTISEMENT WHICH DISCLOSES ADDITIONAL LABOR, PARTS OR SERVICES ARE NEEDED: Pursuant to 16 C.C.R. section 3372.1(d), a repair dealer's "advertisement which clearly and conspicuously discloses that additional labor, parts or services are often needed will, to

that extent, not be regarded as misleading." However, this regulation requires that such a disclosure indicate "that many instances of performance of the service involve extra cost and, if the automotive dealer reasonably expects that the extra cost will be more than 25% of the advertised cost, that the extra cost may be substantial." The regulation further requires that the "type size of the disclosure statement shall be at least 1/2 the type size used in the advertised price, and the statement shall either be shown near the price or shall be prominently footnoted through use of an asterisk or similar reference."

Advertising displays: With respect to advertisements and advertising signs, a repair dealer is required to clearly show the dealer's name and address as shown on the registration certificate issued by the Bureau. Additionally, if a telephone number appears in the advertisement or on the advertising sign, the number is required to be the same number as is listed for that repair dealer in the local telephone directory (16 C.C.R. section 3371).

CAUTION

REGARDING ADVERTISING AUTOMOTIVE AIR CONDITIONING WORK: A repair dealer who advertises or performs (directly or through a sublet contractor) automotive air conditioning work and uses words such as "service, inspection, diagnosis, top off, performance check" or other words of similar meaning in any form of advertising or on a written estimate or invoice must comply with 16 C.C.R. section 3366. This regulation requires the repair dealer to perform sixteen listed procedures as part of the service work (for example, one procedure is that all exposed hoses, tubing and connections are examined for damage or leaks).

CAUTION

REGARDING AIRBAGS: A repair dealer should not install, distribute or sell any airbag which "is known, or which by the exercise of reasonable care should be known, to have been previously deployed, and which is part of an inflatable restraint system" (16 C.C.R. section 3367(a)). Violation of this regulation is a basis for the Bureau to impose disciplinary sanctions against a repair dealer (16 C.C.R. section 3367(b)).

Posting of Labor Rates

Except as stated below, there is no California law that requires the posting of retail labor rates for repair dealers.

Why This Issue Is Important. A Bay Area dealer paid a $25,000 fine to settle a lawsuit filed by the California Attorney General and the local district attorney which alleged that the dealership engaged in deceptive business practices by posting an hourly labor rate and charging customers based on a flat rate without any disclaimer or explanation for the flat rate billing system. Another Northern California dealer settled a class action suit in which the lead plaintiff claimed that she should have been charged for actual time instead of flat rate time allowances for a tune-up and brake inspection. That dealership also had an hourly labor rate posted and charged the hourly rate based on flat time instead of actual time. Although the settlement terms of this case were confidential, the attorney's fees and settlement costs involved were exorbitant. Other California new car dealers have faced similar cases.

Recommendation. California law does not require that hourly labor rates be posted by automotive repair dealers. Unless a dealer has a policy of charging for actual time, it is recommended that dealers avoid the posting of hourly labor rates or recording such rates on repair orders or estimates. This may require the removal or repainting of signs, or reprogramming computers to delete any reference to an hourly rate on repair orders and invoices. **The message to a customer should be that the written estimate he or she approves is the dealer's price for the job, and that the dealer will contact him or her for advance approval if more work is required.**

Posting of Prices. Lamp and brake adjusters, smog stations, and muffler stations all have "price posting" requirements for specific repairs and services. See the chapter on "Public Signs at Dealerships" in this Management Guide for complete details. The posting requirements, which can be satisfied without posting an hourly labor rate, generally are as follows:

Lamp and Brake Adjusters. Section 3307(d) of Title 16 of the California Code of Regulations requires a lamp and brake station (except fleet owner stations) to post conspicuously a list of prices for the specific activities for which it is licensed. Prices may be stated as a fixed fee.

Smog Check Stations. Section 3340.15(d) of Title 16 of the California Code of Regulations requires a smog check station to post conspicuously "in an area frequented by customers a list of price ranges for the specific activities for which it is licensed. The posted prices shall include the price charged by the station for inspections, and, if a separate price is charged for reinspections, the reinspection price. The station shall also post the inspection prices for vans and/or heavy-duty vehicles if those prices differ from the passenger car inspection price. If the station imposes an hourly labor charge for repairs, the hourly labor rate shall be posted. The price of issuance of a certificate of

compliance or noncompliance charged by the bureau shall be posted separately from the price of inspection and of the reinspection, if any."

Muffler Certification Stations. Section 604(c) of Title 13 of the California Code of Regulations requires each muffler certification station (except fleet owner stations) to post conspicuously in the customer area the prices for issuing exhaust certifications and for clearing enforcement documents.

Beware of Preprinted Signs. Part of the posting problem that dealers have encountered is caused by the fact that many preprinted signs containing Bureau required disclosures have a space for an hourly labor rate, which may mislead dealers (and Bureau employees) into thinking that the spaces must be filled in. Despite the way some signs have been printed, the law does not require the posting of hourly labor rates.

Manufacturers' Policies. Although many manufacturers formerly required the posting of retail labor rates, most have now dropped this requirement. If in doubt, a dealer should carefully review the dealer's warranty and reimbursement manual and check with the dealer's factory representatives. If a dealer's manufacturer requires background information on this subject, the CNCDA Sacramento office should be contacted.

Keeping Track of Mechanics' Time. Some dealerships record flat rate time and/or the actual time spent repairing a vehicle on the customer's repair order or invoice for the purpose of calculating the mechanic's compensation. It is recommended that such time records be recorded and maintained on internal dealership documents separate from documentation that is provided to the customer. Such a procedure will insure that a customer will not be misled into believing that he or she is being billed on time intervals rather than the estimated charge approved in advance of the repair being performed.

Exception: Dealers Who Only Charge for Actual Time. If a dealership has a policy of charging for actual time (rather than an amount based on "flat time" or "menu pricing"), the actual time spent on a repair should be documented and that fact noted on the repair order for the customer.

Disclosure Requirements for Warranties

As part of its effort to regulate representations made by repair dealers, the Bureau has also adopted regulations covering repair warranties. In applying these regulations, the term "guarantee" is considered to have the same meaning as the term "warranty" (16 C.C.R. section 3375). The Act requires that all warranties "shall be in writing and a legible copy thereof shall be delivered to the customer with the invoice itemizing the parts, components, and labor represented to be covered by such guarantee" (16 C.C.R. section 3376). Further requirements which must be met to avoid the warranty being considered false and misleading are a conspicuous and clear written disclosure of the following:

"(a) The nature and extent of the guarantee including a description of all parts, characteristics or properties covered by or excluded from the guarantee, the duration of the guarantee and what must be done by a claimant before the guarantor will fulfill his obligation (such as returning the product and paying service or labor charges).

(b) The manner in which the guarantor will perform. The guarantor shall state all conditions and limitations and exactly what the guarantor will do under the guarantee, such as repair, replacement or refund. If the guarantor or recipient of the guarantee has an option as to what may satisfy the guarantee, this must be clearly stated.

(c) The guarantor's identity and address shall be clearly revealed in any documents evidencing the guarantee" (16 C.C.R. section 3376).

If a warranty provides for adjustment on a pro-rata basis, it must clearly and conspicuously disclose this fact as well as "the basis on which the guarantee will be pro-rated, e.g., the time or mileage the part, component or item repaired has been used and in what manner the guarantor will perform" in order to avoid being considered false and misleading (16 C.C.R. section 3377). If a repair dealer uses a warranty with adjustments and those adjustments "are based on a price other than that paid by the customer, clear disclosure must be made of the amount. However, a fictitious price must not be used even where the sum is adequately disclosed" (16 C.C.R. section 3377).

Although the Bureau's regulations use the term "guarantee," written warranties covering the sale of parts and accessories (unless costing less than $10) are subject to the provisions of the federal Magnuson-Moss Warranty Act. The requirements of the Magnuson-Moss Warranty Act for the content of a written warranty and for the making of such terms available to the customer prior to the sale may be found under the headings entitled "Dealer Express Warranties on Used Car Sales" and "Federal Magnuson-Moss Warranty Act" respectively in the chapter entitled "New and Used Car Warranties" in this Management Guide. One of the more significant Magnuson-Moss Warranty Act requirements is that a written guarantee must be conspicuously labeled as a "limited warranty" (Note that as a practical matter "full warranties" are not given because they require compliance with complex requirements set forth in the Magnuson-Moss Warranty Act).

It should also be pointed out that the California Song-Beverly Act, which is also discussed in detail in the New and Used Car Warranties chapter, is applicable to the sale of new parts in connection with a consumer repair transaction, and that such a sale includes the implied warranty of merchantability.

Consumer Complaints/Disciplinary Procedures

Consumer complaints against repair dealers are actively investigated by the Bureau to enforce the Act (Bus. Prof. Code section 9882.5). These complaints direct the Bureau's attention to alleged violations of the Act by any employee, partner, officer or member of a repair dealer and furthermore provide information to the Bureau which is considered for purposes of future regulation of the automotive repair industry. Consumers are able to make complaints to the Bureau by either mailing or submitting online a written complaint form.

According to the most recent statistics maintained by the Bureau, the number of consumer complaints received is approximately 18,000 a year. The approach taken by the Bureau on handling a complaint depends upon the nature of complaint. Many complaints primarily concern the competency of mechanics and/or service writers and the inconvenience involved in obtaining the repair services being performed. In handling this type of complaint which usually does not involve a violation of the Act, the Bureau normally attempts to mediate between the repair dealer and consumer for the purpose of accomplishing a mutually acceptable settlement.

The Bureau will advise complaining consumers to contact other state agencies if it appears that such an approach would provide a better chance for them to favorably resolve their complaint. Often this means that a consumer will be referred to Small Claims Court (see discussion of this forum and procedures to be followed by a defendant dealer in the chapter entitled "Small Claims Court and Collection of Judgments" in this Management Guide).

Informal Actions

With respect to complaints received by the Bureau which do involve an alleged violation of the Act, the Bureau may pursue several forms of action depending on the circumstances involved. Circumstances considered by the Bureau include the seriousness of the violation (meaning to the extent it involves fraud, dishonesty or deceit); the likelihood that the conduct will be repeated; and the extent to which the penalty imposed will deter the conduct generally.

Informal actions that the Bureau may take include sending reprimand/violation/education letters and holding office conferences. During the fiscal year 2011-2012, the Bureau held 828 office conferences. The Bureau is also involved in conducting inspections and does issue warning/cease and desist letters which are directed to delinquent or unregistered repair businesses.

NOTE

REGARDING OFFICE CONFERENCES: To the extent that the Bureau becomes aware of several violations of the Act by a repair dealer over the course of one or more years, the Bureau may request, by a letter of notice to the dealer, an office conference to discuss the alleged violations. In some cases, the Bureau representative offers constructive criticism of the dealer's operating procedures and makes suggestions for improvement, including the offer of a consultation at the dealership between a Bureau representative and dealership personnel. Such consultation with dealership personnel may or may not be in the best interests of the dealer as it allows the Bureau representative the opportunity to discover further evidence which could later be used against the dealer. Typically, a written record of such a conference is prepared by the Bureau representative summarizing the discussions held.

NOTE

REGARDING BUREAU INVESTIGATION AREAS: According to the Bureau, a primary enforcement concern is the fraudulent sale of unnecessary maintenance services by repair dealers, including franchised new car dealers. An example of this type of activity is the unnecessary sale of various types of fluid flushes. It is the Bureau's position that factory recommended maintenance services and service intervals should be the primary source of required maintenance, and that a repair dealer must be prepared to justify any recommendations made by that service facility that vary from the manufacturer recommendations. Possible justifications that a dealer may present include the following: (1) dealership experience that shows manufacturer recommendations to generally be insufficient (for example, a manufacturer's maintenance recommendation may fail to provide for brake fluid replacement which is something the repair dealer knows should occur every 30,000 miles); (2) truly severe customer driving conditions; (3) the personal preference of a customer (for example, a customer who specifically requests oil changes every 3,500 miles despite understanding factory recommendations); and (4) individual diagnostics (for example, finding moisture in a customer's brake lines). As the Bureau con-

tinues to develop an enforcement policy relating to maintenance issues, repair dealers should take into account the following guidelines: (1) ensure that justification based upon experience exists for recommending maintenance services outside of the factory standards; (2) never recommend services that are specifically contrary to the manufacturer's recommendations (for example, do not recommend an engine flush if the manufacturer specifically prohibits engine flushes); and (3) never mislead a consumer into believing that dealer recommended maintenance services are recommended by the manufacturer when that is untrue. The Bureau also continues to have concerns relative to dealer compliance with invoice requirements in light of the increased computerization of repair documentation which allows less flexibility. The Bureau recommends dealers review the Bureau's publication entitled "Write It Right" for guidance as to these issues or consider scheduling a seminar where a Bureau staff member comes to a dealership and provides compliance training.

NOTE

REGARDING SETTLEMENT AGREEMENTS: In those situations where a dispute develops between a customer and a repair dealer, it is quite common for the parties to enter into a written settlement agreement as part of the resolution of the matter. Dealers should be aware that it is illegal for a settlement agreement to include a provision that prohibits the customer from filing a complaint with the Bureau or requires an existing complaint filed with that agency to be withdrawn. Such a provision is deemed void as against public and including it in a settlement agreement is grounds for disciplinary action against a dealer (Bus. Prof. Code section 143.5).

CAUTION

REGARDING STATEMENTS WITHOUT LEGAL ADVICE: Notwithstanding the informal and sometimes friendly tone of Bureau office conferences concerning consumer complaints, statements made by a dealer during such conferences either voluntarily or in answer to a Bureau representative's questions concerning alleged violations may be used in connection with the subsequent prosecution of either civil or criminal action against the dealer. Also the dealer at the conclusion of the conference may be asked to sign a statement confirming attendance at the conference and discussions of the alleged violations. Such statements may contain an acknowledgment by the dealer of violations which could be deemed an admission of wrongdoing, and they have been used by the Bureau in suits for injunctive relief and civil penalties. Therefore, it is strongly recommended that a dealer obtain legal advice from an attorney prior to appearing at such a noticed conference.

Citation hearings: Although rarely used, the Bureau may also pursue less serious complaints by contacting a local prosecutor (for example, city attorney or district attorney) to set up a citation hearing. The prosecutor conducts the hearing pursuant to a notice to the dealer for the purpose of reviewing the alleged violations. This procedure is seen by the Bureau as an alternative to filing a formal civil or criminal complaint and as in the informal office conference procedure, it is advisable for a dealer to obtain the guidance of an attorney prior to appearing at a local prosecutor's hearing.

Restitution: If a repair dealer complies with the measures suggested by the Bureau to compensate customers for damages suffered as a result of alleged violations of the Act, this fact is to be given "due consideration" at any subsequent disciplinary proceeding (Bus. Prof. Code section 9882.5). In general, it has been the practice of the Bureau to not bring a disciplinary action against a dealer solely on the basis of a violation of the written estimate requirement unless the dealer has failed to make restitution to the customer and the Bureau has been unable to obtain voluntary compliance by the dealer after repeated attempts.

Administrative Proceedings

With regard to more serious complaints involving alleged conduct which is deemed fraudulent by the Bureau or involves a repeat offender, the Bureau may initiate administrative proceedings (conducted by the California Attorney General's Office) to deny, suspend, or revoke the dealer's registration and/or special license(s). Such a proceeding is subject to the provisions of the California Government Code commencing with section 11500 which cover administrative adjudication (Bus. Prof. Code section 9884.12). These provisions are discussed in more detail in the section entitled "Hearing Procedure" in the chapter entitled "DMV Investigations and Accusations" in this Management Guide. If a repair dealer becomes involved in an administrative proceeding with the Bureau, the dealer should consult legal counsel.

NOTE

REGARDING DEADLINE FOR FILING ACCUSATIONS AGAINST REPAIR DEALERS: Any accusation seeking disciplinary action against a repair dealer must be filed within 3 years of when the act or omission alleged to be wrongful occurred, except that if fraud or misrepresentation is in-

volved, the accusation may be filed within 2 years after the discovery of the alleged facts by the Bureau (Bus. Prof. Code section 9884.20).

Penalties: The Bureau maintains certain penalty guidelines which set forth the minimum/maximum penalties for violations of the various requirements of the Act and the applicable sections of the California Code of Regulations. These guidelines, which are incorporated as part of the California Code of Regulations (16 C.C.R. section 3395.4), also set forth factors to be considered in either decreasing or increasing a penalty and the terms for any probationary time. For instance, a dealer who has allegedly failed to satisfy the written estimate requirement is subject to a minimum penalty of 90 days suspension of the repair dealer's license with 80 days stayed and a 2 year probationary period and a maximum penalty of revocation of the repair dealer's license. Regarding this and other violations, the Bureau's position on the penalty to be pursued is influenced by a repair dealer's history of prior violations and whether a dealer has provided restitution to the consumer involved and voluntarily accepted the Bureau's recommendations.

Court Proceedings

Generally, the Bureau has considered any act by a repair dealer involving intentional misrepresentation as fraudulent in nature. Examples of fraudulent conduct include "bait and switch" type escalation techniques, charging for parts not installed or labor not performed, and overselling. Overselling is established when there is a pattern of transactions involving questionable replacement of parts, particularly in those situations where customers have little choice but to proceed with the extra repairs.

Repair dealers may be pursued by the Bureau in court proceedings. The Bureau is authorized to apply for injunctive relief against a repair dealer in any superior court in the county where the dealer is conducting business or to file charges with local district or city attorney offices (Bus. and Prof. Code sections 9884.14 and 9884.15). The California Attorney General's Office may also be involved in pursuing enforcement activity against repair dealers, including seeking injunctive relief, civil penalties and restitution pursuant to Business and Professions Code section 17200 for practices constituting unfair competition (Bus. and Prof. Code sections 17203 and 17204). Civil penalties for unfair competition are authorized up to $2,500 per violation, with an additional $2,500 penalty available for each violation involving unfair competition perpetrated against senior citizens or disabled persons (Bus. and Prof. Code sections 17206 and 17206.1).

CAUTION

REGARDING CRIMINAL PENALTIES: Pursuant to Business and Professions Code section 9889.20, with limited exceptions, any person failing to comply with the Act is guilty of a misdemeanor. The possible punishment involved includes a fine not exceeding $1,000, or imprisonment not exceeding six months, or both the fine and imprisonment.

CAUTION

REGARDING CIVIL/ADMINISTRATIVE PROCEEDINGS: Settling a court action brought by a district attorney asserting violations of the Act by a repair dealer does not preclude the Bureau from initiating a separate administrative proceeding based upon the same allegations of wrongful conduct. Likewise, a court action may be filed after the settlement of an administrative proceeding even though the same alleged violations of the Act are involved. (Setliff Bros. Service v. Bureau of Automotive Repair (1997) 53 Cal.App.4th 1491)

Disclosure of Complaint Disciplinary License Status Information

In addition to providing information as to a repair dealer's license status, the Bureau also discloses information regarding consumer complaints and disciplinary actions involving that repair dealer (16 C.C.R. section 3303.1).

Specifically, in response to a request made by a member of the public by telephone, in person, or in writing (including fax or e-mail), the Bureau will provide the following information in writing concerning a repair dealer within ten days of a request:

a. The actual name and address of the licensee listed with the Bureau, including all fictitious business names; the license number; the date of the original license; the current status of the license; and the expiration or other termination date of the license; and

b. The number of administrative actions, if any, taken against the licensee; a brief summary of the violations alleged in the administrative actions; the current status of any pending administrative action, including appropriate disclaimer language to the effect that matters are alleged and no final determination has been made; the final disposition of any administrative actions, including any discipline or penalty imposed; and that citations have been satisfactorily resolved if that is the status.

The Bureau will also disclose complaint information about a licensee, if there is a determination made by the Bureau Chief (or the Chief's designee)

that any of the following conditions exist: (i) such information has a direct and immediate relationship to the health and safety of another person; (ii) the complaint involves a dangerous act or condition caused by the subject of the complaint that has or could result in death, bodily injury or severe consequences and disclosure may protect the consumer and/or prevent additional harm to the public; (iii) a series of complaints against the licensee has been received by the Bureau alleging a pattern of unlawful activity and it is determined that disclosure may help to protect the consumer and/or prevent additional harm to the public; (iv) the complaint has resulted in the issuance of a citation by the Bureau; (v) the allegations in the complaint are part of an administrative action that has been referred to the Attorney General for filing of an Accusation or Statement of Issues; or (vi) the complaint has been referred to a law enforcement agency for prosecution.

The Bureau will not provide copies of actual complaints and no personal information will be disclosed. Furthermore, information about a complaint will not be disclosed if the Bureau Chief (or the Chief's designee) determines that such a disclosure is (i) prohibited by statute or regulation; (ii) might compromise any investigation or prosecution; or (iii) endanger or injure the complainant or a third party.

If any of the required conditions exist as determined by the Bureau Chief and none of the reasons are present which prohibit disclosure of information, the Bureau will disclose the following information regarding complaints received against a licensee:

a. The total number of complaints that meet the conditions for disclosure;

b. The date of receipt and the nature of each disclosable complaint;

c. The disposition of each disclosable complaint, indicating whether the matter has been (i) referred for administrative action (meaning the filing of an Accusation or Statement of Issues filed by the Bureau, or the issuance of a citation by the Bureau); (ii) disposed of through any other action, formal or informal; or (iii) resolved by other disposition;

d. Information that is statutorily mandated to be disclosed; and

e. A description of the type of public information not included (i.e. civil judgments, criminal convictions and unsubstantiated complaints).

All disclosures of complaint information will include disclaimers indicating that the disclosure does not constitute endorsement or non-endorsement of a licensee, and that not all available information may be included.

NOTE

ON REQUESTS FOR INFORMATION: In responding to a request for information, the Bureau does send a copy of the information provided to the licensee involved, but will not reveal the identity of the requester. Additionally, to prevent an abuse of the system, the Bureau will provide information to any one requesting "on no more than three licensees per week" (16 C.C.R. section 3303.1(e)(f)).

NOTE

LICENSEE INFORMATION ON THE INTERNET: The Bureau is required to provide Internet access to information on the license status of repair dealers, including information on suspensions and revocations of licenses as well as related disciplinary action taken (Bus. Prof. Code section 27).

PRACTICAL TIP

A repair dealer should review the newsletters and information bulletins circulated by the Bureau to be aware of recently adopted or proposed regulations, the outcome of disciplinary actions pursued by the Bureau and other current developments regarding Bureau activities (Bus. Prof. Code section 9882.4).

Alteration of Vehicle by Dealer and Installation of Performance Parts

Altering a new vehicle prior to initial sale or lease is an undertaking fraught with risk. Several federal laws apply to the repair and alteration of vehicle. Most notably, any vehicle sold for the first time must adhere to all Federal Motor Vehicle Safety Standards (FMVSS) that apply to that vehicle. Federal law prohibits dealers or repair professionals (with very limited exception) from rendering safety equipment inoperative. If a vehicle is altered prior to initial sale or lease, the dealership must place an alteration label adjacent to the certification label to indicate that the vehicle complies with all applicable FMVSS. Federal regulations expand upon this labeling requirement to also require an update of the Tire Placard, if necessary. Bottom line: in addition to making sure alterations are conducted in full

compliance with applicable FMVSS, make sure altered vehicles are properly labeled.

California law also governs alterations. Most notably, the California Vehicle Code, which includes California vehicle equipment, safety, and emissions standards and incorporates the FMVSS, prohibits dealers from selling vehicles to the public that are not in compliance with California's legal requirements. California's strict emissions standards also prohibit tampering with a new vehicle's emissions equipment before initial sale, or installing non-certified aftermarket parts on used vehicles prior to sale or as a service to customers.

The key federal laws regarding vehicle alteration can be found at 49 U.S.C. 30101, et seq., and 49 C.F.R. Parts 567 and 571. For California Law, the primary applicable laws are Health and Safety Code Sections 43000, et seq., and Division 12 of the Vehicle Code.

Federal "Make Inoperative" Prohibition

Federal law prohibits dealers and other motor vehicle repair businesses from knowingly making inoperative "any part of a device or element of design installed on or in a motor vehicle or motor vehicle equipment in compliance with an applicable motor vehicle safety standard" unless reasonably believing that the vehicle or device will not be used while inoperative. Known as the "tampering law," this is perhaps the most pervasive part of the FMVSS—repair professionals may not interfere with any safety equipment on a new or used vehicle when the possibility exists that the vehicle or equipment may be operated with such equipment not working as designed. The term "make inoperative" should not be interpreted strictly as "disabling," but much more broadly. NHTSA, which implements the FMVSS, interprets the make inoperative prohibition as encompassing "any action that removes or disables safety equipment or features installed to comply with an applicable standard, or degrades the performance of such equipment or features." Accordingly, the alteration of equipment covered in a safety standard in a manner that takes it outside of the strict tolerances set forth by the FMVSS, even to make the equipment perform more effectively or efficiently, can be interpreted as making the equipment inoperative.

Alteration Defined

When changes to a new vehicle reach such a level to be considered an "alteration," several new duties arise for the service provider. Unfortunately, the law does not clearly define "alteration". Federal law does however, describe activities that render a vehicle repair business an "alterer" by excluding "the addition, substitution, or removal of readily attachable components such as mirrors or tire and rim assemblies, or minor finishing operations such as painting, in such a manner that the vehicle's stated weight ratings are still valid." Despite the lack of a clear definition, one can get a good idea of NHTSA's interpretation of the definition by reading relevant case law and NHTSA Chief Counsel Opinion Letters. Common activities that have been interpreted as alterations include the installation of lift kits or lowering of a vehicle. Dealers should err on the side of caution when determining whether changes to new vehicles should be considered "alterations."

Certification Label

Federal regulations specify that an alterer must determine whether an altered vehicle continues to comply with the applicable federal safety, bumper, and theft deterrent standards, and require that the alterer certify that the altered vehicle remains in compliance with such standards. In doing so, the alterer must affix, adjacent to the manufacturer's certification label, an additional alteration certification label including the following statement:

> "This vehicle was altered by (Dealership Name) in (Month and Year of Alteration Completion) and as altered it conforms to all applicable Federal Motor Vehicle Safety, Bumper and Theft Prevention Standards affected by the alteration and in effect in (Month, Year)."

The second date may not be earlier than the date the vehicle was manufactured or later than the date alterations were completed.

Importantly, if the alteration changes the vehicles GVWR or gross axle weight rating from the values shown on the original certification label, the alteration label must provide the modified values in the same manner as the original certification label. If the alteration changes the vehicle's classification (e.g., from truck to bus), this modified classification must also be provided on the alteration label.

The law also places legal responsibility upon the alterer for all duties and liabilities related to the certification.

The alteration certification label is not required for minor modifications that do not rise to the level of "alterations," such as painting the vehicle, or replacing readily attachable components such as tires, rims, mirrors, unless such modifications affect the vehicle's stated weight rating.

Alteration May Require Re-Placarding

Vehicle manufacturers must install a standardized Tire Placard on the driver's side door jamb on all

passenger vehicles, specifying information such as the vehicle's tire size, recommended inflation pressure and capacity weight rating. Any alteration of a new vehicle affecting the vehicle's capacity weight rating, as shown on the Tire Placard, requires that the alterer modify or substitute the original Tire Placard. Federal regulations clarify that dealers are exempt from the re-labeling requirement if the newly added weight does not exceed the lesser of 100 lbs or 1.5% of the vehicle's weight, and no re-labeling is required when changes result in a reduction in the vehicle's weight. If an alteration exceeds this threshold, however, dealers must re-label the vehicle to correct the load-carrying capacity.

Such re-placarding may be performed by using a generic label that allows for the corrected values to be added using a black, fine-point, indelible marker. Dealers are allowed to use one of three options to modify the Tire Placard:

1. Replace the existing Tire Placard with a new Placard containing correct load-carrying capacity information;

2. Modify the existing Tire Placards so that is displays the corrected load-carrying capacity information, using a Tire Placard Modification Overlay; or

3. If merely changing the vehicle's load-carrying capacity description, attach a supplemental label within 25 millimeters of the existing Tire Placard. This label must contain the following language: "CAUTION: LOAD CARRYING CAPACITY REDUCED."

CAUTION

REGARDING RE-PLACARDING: Original labeling cannot be modified simply by crossing out incorrect values on the original label placard and writing a new value on the original placard.

Re-Placarding when Replacing Tires

If, prior to the initial sale of a new vehicle, a dealer replaces its tires with new tires with different size or inflation pressure, the dealer must re-placard the vehicle as described above.

California General Equipment Requirements

California's Vehicle Code, which incorporates the FMVSS by reference, also prohibits dealers from selling "a new or used vehicle that is not in compliance with [California law], unless the vehicle is sold to another dealer, sold for the purpose of being legally wrecked or dismantled, or sold exclusively for off-highway use."

California Emissions Equipment Requirements

Used Cars. California law strictly governs the installation of emissions equipment on vehicles, stating that no person shall "install, sell, offer for sale, or advertise any device, apparatus, or mechanism intended for use with, or as a part of, a required motor vehicle pollution control device or system that alters or modifies the original design or performance of the motor vehicle pollution control device or system." This blanket prohibition does not apply, however, if the Air Resources Board issues an executive order finding that the equipment does not reduce the effectiveness of a required motor vehicle pollution control device or results in emissions from the altered vehicle that complies with existing state or federal standards for the original vehicle. CARB only issues such executive orders after evaluating the part and determining that it will not affect a vehicle's fuel efficiency, durability, emissions, or warranty coverage. CARB maintains a list of legal aftermarket parts, available online at: http://www.arb.ca.gov/msprog/aftermkt/devices/amquery.php.

New Cars. A dealer may not sell a new vehicle that has not been certified by the Air Resources Board in its existing configuration. Accordingly, a dealer may not alter the emissions system on a new vehicle prior to sale, even if installing parts that have been granted an executive order exemption by CARB. Only after the sale of a new vehicle has been completed and the customer has taken delivery of the vehicle may a customer install an aftermarket emissions-related part, provided that the part has been granted an exemption by the way of a CARB Executive Order.

Vendor Background

In addition to being targeted by emissions system and engine modification equipment vendors, dealers are constantly solicited by vendors to sell other aftermarket performance parts such as performance wheels and lift kits. The sale of such products by an unwary dealer or dealership employees may expose the dealer to significant liability. Before installing such products on vehicles in inventory or otherwise selling them to consumers, dealers should thoroughly investigate performance products. At a minimum, the following issues should be checked:

• **Vendor reputation.** Offering products from a questionable source is not only bad business but could expose the dealer to a claim of negligence or worse.

• **Vendor indemnity/insurance.** Even products from the most respected vendors can fail; how will the vendor back up a dealer faced with a negligence or product liability claim?

• **Vendor warranty.** How will the vendor handle allegations that the product does not function or has interfered with other components of the vehicle?

Compliance with Laws

Does the vendor guarantee and provide satisfactory proof that the products comply with all legal requirements? While performing a due diligence investigation of the product, a dealer should be sure to consider the following

•Equipment prohibitions and requirements (e.g., does the product run afoul of California and Federal prohibitions, or involve removal of required equipment?)

•Federal "make inoperative" prohibitions

•Alteration labeling requirements

• Emissions control laws – federal and California

•CARB Executive Order

• Emission warranties (modifications that would void such warranties are prohibited by law)

• Muffler Noise laws – federal and California

• Audio Equipment noise laws – California

Vehicle Manufacturer and Related Issues

• **Effect on Factory Warranty:** Whether the product may lead to damage not covered under warranty provided by manufacturer.

• **Voiding Vehicle Service Contracts.** Many service contracts may also be voided by the use of certain aftermarket products.

• **Voiding Right to Indemnity from Factory.** Beyond the vehicle warranty, vehicle manufacturers generally agree in their sales and service agreements to defend and indemnify the dealer against product liability claims and lawsuits. These indemnity provisions may exclude circumstances when vehicles are altered or performance parts are installed.

• **Factory-required disclaimers.** Many dealer sales and service agreements require dealers to affirmatively issue written disclaimers to buyers advising them that aftermarket products and performance parts in particular are neither manufactured nor warranted by the vehicle manufacturer. Beyond the dealer agreement itself, other factory delivery requirements may be found in mandatory delivery or RDR checklists. These requirements may also address the subject of aftermarket parts and accessories.

General Product Liability Issues

•**Dealer's Insurance.** Dealers doing any substantial performance parts business should check with their agent and/or legal advisors to determine if it is necessary or advisable to disclose to their insurers that they are engaged in selling and installing performance parts. Failing to do so where required could lead to a denial of coverage.

•**Disclaimers.** Dealers and their insurers may elect to ask buyers of performance parts to sign disclaimers assuming all risks, or otherwise relieving the dealer of liability in the event of an accident or product failure. Care must be taken in drafting these disclaimers to avoid violating applicable state and federal warranty laws. For example, California's Song-Beverly Act prohibits disclaimers of implied warranties on products sold with an express warranty. Further, the law places many limits on the validity of disclaimers and waivers.

• Warnings. Whenever a dealer knows or should know that a performance part will adversely affect the safety or performance of a vehicle or its components, or should be used or maintained in a particular manner to avoid injury or property damage, the dealer should ensure that the customer is warned accordingly. While this could be handled through literature or forms supplied by the performance parts vendor, failing to issue such warnings could open the legal door to claims that go beyond negligence and general product liability (such as fraud) that can give rise to punitive damages or, in certain cases, potentially criminal liability.

LIENS ON VEHICLES AND LIEN SALES

Chapter 11

Contents

LIENS ON VEHICLES AND LIEN SALES

OVERVIEW: Various statutes in the California Civil Code and the California Vehicle Code give a lien to the person who repairs or furnishes labor or material for a vehicle, who stores a vehicle, who tows a vehicle, and who rents a parking space for a vehicle. The lien is a legal claim or charge on the vehicle as security for payment of the amount owing for the labor, material, storing, towing, or rental.

The basic statutes involved are Civil Code sections 3067-3074 and Vehicle Code sections 22650-22855. You can view or print any of these statutes by going to the California Law website at www.leginfo.ca.gov/calaw.html. Check the Code you want, type in the code section, and click on "search". The liens apply to "vehicles." Vehicle Code section 670 defines a vehicle as follows: "A 'vehicle' is a device by which any person or property may be propelled, moved, or drawn upon a highway, excepting a device moved exclusively by human power or used exclusively upon stationary rails or tracks."

The liens referred to in this discussion which are in the Civil Code discussed below do not include any manufactured home, as defined in Health and Safety Code section 18007, any mobilehome, as defined in Health and Safety Code section 18008, or any commercial coach as defined in Health and Safety Code section 18001.8, whether or not the manufactured home, mobilehome, or commercial coach is subject to registration under the Health and Safety Code.

The lien statutes are also set forth in the paperback edition of the Vehicle Code published annually by the Department of Motor Vehicles. That publication, in the Appendix, contains the various Civil Code sections applicable.

The DMV has a section on its website, www.dmv.ca.gov/vr/liensale.htm, which deals with liens on vehicles. The section provides instructions and forms for conducting lien sales. See also Chapter 18, Lien Sales-Abandoned-Abated Vehicles, from the DMV's Handbook of Registration Procedures. Chapter 18 of the Handbook is online on the DMV's website at: http://www.dmv.ca.gov/pubs/reg_hdbk/ch18/toc.htm. This is a very detailed discussion and very helpful when conducting lien sales.

Types of Liens

Labor and Material Liens

To have a lien you must have possession of the vehicle (Civil Code section 3068).

The lien is a charge against the vehicle for the compensation to which you are entitled for making repairs or for performing labor upon, and furnishing supplies or materials for, and for the storage, repair, or safekeeping of, and for the rental of parking spaces for, any vehicle of a type subject to registration under the Vehicle Code, subject to the exceptions noted in the overview above.

No lien for work or services is valid against a legal owner or lessor for more than $1,500, unless, before commencing the work, you have given the legal owner written notice by personal service or registered mail addressed to the legal owner named in the registration certificate, and have obtained the legal owner's written consent to the work, or the legal owner or lessor has requested such work.

CAUTION

REGARDING DEMAND FOR INSPECTION OF THE VEHICLE: Civil Code section 3068(b)(3) provides that any labor and materials lien or storage lien under this section that arises because work or services have been performed on a vehicle with the consent of the registered owner shall be extinguished, and no lien sale shall be conducted, if the lienholder, after written demand made by either personal service or certified mail with return receipt requested by the legal owner or the lessor to inspect the vehicle, fails to permit that inspection by the legal owner or lessor, or his or her agent, within a period of time not sooner than 24 hours nor later than 72 hours after the receipt of that written demand, during the normal business hours of the lienholder.

REGARDING DEMAND FOR COPY OF WORK ORDER OR INVOICE: Civil Code section 3068(b)(4) provides that any labor and materials lien or storage lien that arises because work or services have been performed on a vehicle with the consent of the registered owner shall be extinguished, and no lien sale shall be conducted, if the lienholder, after written demand made by either personal

service or certified mail with return receipt requested by the legal owner or the lessor to receive a written copy of the work order or invoice reflecting the services or repairs performed on the vehicle and the authorization from the registered owner requesting the lienholder to perform the services or repairs, fails to provide that copy to the legal owner or lessor, or his or her agent, within 10 days after the receipt of that written demand.

NOTE

ON MAJOR REPAIRS: If the repairs are substantial, try to obtain the legal owner's consent before beginning the work. If you can obtain the legal owner's consent, or if the lessor or legal owner requests the work, you will have a lien for the entire amount of parts and labor against the legal owner or lessor.

There is no limit to the lien amount against the registered owner. However, the lienholder may not charge the legal owner an amount for release of the vehicle that exceeds the $1,500 for work or services, and an amount which exceeds the amounts allowed for storage discussed below unless the legal owner has consented in writing to the work, or has requested such work.

Storage and Parking Liens

Civil Code section 3068 provides for a lien for storage or safekeeping of a vehicle and for the rental of parking space for a vehicle. If stored by public authorities and others, different rules apply as discussed below in the section of this chapter entitled "TOWING AND STORAGE LIENS FOR VEHICLE AUTHORIZED TO BE REMOVED BY A PUBLIC AGENCY AND OTHERS." That section discusses further limits on storage charges and towing liens.

No lien for storage, safekeeping, or rental of a parking space is valid against the legal owner or lessor for more than $1,025 unless, before commencing the work, you have given the legal owner written notice by personal service or registered mail addressed to the legal owner named in the registration certificate, and have obtained the legal owner's written consent to the work, or the legal owner or lessor has requested such work. If you apply for a lien sale within 30 days after commencement of the storage or safekeeping, you can have a lien valid against the legal owner or lessor without the legal owner's or lessor's consent for up to $1,250. There are no lien limits against the legal owner if the legal owner requests the storage, safekeeping, or rental. There are no lien limits against the lessor if the lessor requests the storage, safekeeping, or rental. You may be able to argue that requesting services also means requesting storage if repairs are not paid for timely.

If any portion of a lien includes charges for the care, storage, or safekeeping of, or for the rental of parking space for, a vehicle for a period in excess of 60 days, the portion of the lien that accrued after the expiration of that period is invalid unless, Vehicle Code sections 10650 and 10652 have been complied with by the holder of the lien. There is a further limitation provided by Vehicle Code section 10652.5 which provides as follows:

(a) Whenever the name and address of the legal owner of a motor vehicle is known, or may be ascertained from the registration records in the vehicle or from the records of the Department of Motor Vehicles, no fee or service charge may be imposed upon the legal owner for the parking and storage of the motor vehicle except as follows: (1) the first 15 days of possession and (2) following that 15-day period, the period commencing three days after written notice is sent by the person in possession to the legal owner by certified mail, return receipt requested, and a continuing for a period not to exceed any applicable time limit set forth in section 3068 or 3068.1 of the Civil Code.

(b) The costs of notifying the legal owner may be charged as part of the storage fee when the motor vehicle has been stored for an indefinite period of time and notice is given no sooner than the third day of possession. This subdivision also applies if the legal owner refuses to claim possession of the motor vehicle.

(c) In any action brought by, or on behalf of, a legal owner of a motor vehicle to which subdivision (a) applies, to recover a motor vehicle alleged to be withheld by the person in possession of the motor vehicle by demanding storage fees or charges for any number of days in excess of that permitted pursuant to subdivision (a), the prevailing party shall be entitled to reasonable attorney's fees, not to exceed one thousand seven hundred fifty dollars ($1,750). The recovery of those fees is in addition to any other right, remedy, or cause of action of that party.

(d) This section is not applicable to any motor vehicle stored by a levying officer acting under the authority of judicial process.

NOTE

ON APPLICABILITY OF VEHICLE CODE SECTIONS 10650-10652.5: Vehicle Code sections 10650-10652.5 appear in Division 4 of the Vehicle Code dealing with Special Antitheft Laws. Although Civil Code section 3068 provides that its storage

amount limits are "subject to the limitations" of section 10652.5, one might argue that Vehicle Code sections 10650-10652.5 do not apply against a registered owner who is also the legal owner when that owner has placed the vehicle in the dealer's possession, or is aware that the vehicle is in the dealer's possession. If you want to consider this argument, you should get advice from your attorney for your particular situation.

Vehicle Code section 10650 provides as follows:

(a) Every operator of a towing service and every keeper of a garage or trailer park shall keep a written record of every vehicle of a type subject to registration under this code stored for a period longer than 12 hours.

(b) The record shall contain the name and address of the person storing the vehicle or requesting the towing, the names of the owner and driver of the vehicle, if ascertainable, and a brief description of the vehicle including the name or make, the motor or other number of the vehicle, the nature of any damage to the vehicle, and the license number and registration number shown by the license plates or registration card, if either of the latter is attached to the vehicle in a clearly discernible place.

(c) All records shall be kept for one year from the commencement of storage and shall be open to inspection by any peace officer.

(d) Upon termination of the storage, a statement shall be added to the record as to the disposition of the vehicle, including the name and address of the person to whom the vehicle was released and the date of such release.

The records required by Vehicle Code section 10650 apply to every operator of a towing service and every keeper of a garage. Vehicle Code section 340 defines a garage as follows: "A 'garage' is a building or other place wherein the business of storing or safekeeping vehicles of a type required to be registered under this code and which belong to members of the general public is conducted for compensation." An argument might be made that a repair shop is a garage if the repair shop charges storage for vehicles left there. A repair shop is not normally a garage; however, to be on the safe side, keep the records required by Vehicle Code section 10650.

Vehicle Code section 10652 provides as follows:

Whenever any vehicle of a type subject to registration under this code has been stored in a garage, repair shop, parking lot, or trailer park for 30 days, the keeper shall report such fact to the Department of Justice in Sacramento by receipt mail, which shall at once notify the legal owner as of record. This section shall not apply to any vehicle stored by a peace officer or employee designated in section 22651 pursuant to Article 3 (commencing with section 22850) of Chapter 10 of Division 11.

The notice should be given as soon as the 30 days have passed.

CAUTION

REGARDING CHARGING FOR STORAGE: It appears that under California law there may be an argument you may not be able to charge storage for the vehicle during the time you are holding it for payment under the lien. California Civil Code section 2892 provides: "One who holds property by virtue of a lien thereon, is not entitled to compensation from the owner thereof for any trouble or expense which he incurs respecting it...." California court cases have interpreted this statute to mean the repair shop owner may not claim storage expenses if the repair shop owner retains the vehicle in exercise of the repairer's lien rights. See Owens v. Pyeatt (1967) 248 Cal. App.2d 840. You might be able to claim storage if there were circumstances requiring you to protect the property from unexpected or unusual injury. If a signed repair order provides for compensation to you for reasonable storage costs if the vehicle is not picked up and paid for within reasonable time after completion of the repairs, you have a good argument for claiming storage expenses and that the expenses are a lien on the vehicle. Also, if the customer has simply failed to pick up the vehicle after it has been repaired and has no argument about the bill, you have a good argument to claim a lien for storage at least until the time the customer should dispute the bill and demand possession of the vehicle. One can also argue that the storage lien in Civil Code section 3068 overrules the Owens case which appears to have been decided before the legislature added the storage lien amounts to Civil Code section 3068.Further, Civil Code section 3068(c)(3) provides as follows:

The charge for the care, storage, or safekeeping of a vehicle which may be charged to the legal owner or lessor shall not exceed that for one day of storage if, 24 hours or less after the vehicle is placed in storage, a request is made for the release of the vehicle. If the request is made more than 24 hours after the vehicle is placed in storage, charges may be imposed on a full, calendar-day basis for each day, or part thereof, that the vehicle is in storage.

Subject to the rules discussed elsewhere in this Guide, there is no limit on the amount of the lien against the registered owner.

Towing and Storage Liens for Vehicles Authorized for Removal by a Public Agency and Others (Civil Code section 3068.1)

Under Civil Code section 3068.1, every person has a lien dependent upon possession for the compensation to which the person is legally entitled for towing, storage, or labor associated with recovery or load salvage of any vehicle subject to registration that has been authorized to be removed by a public agency, a private property owner pursuant to section 22658 of the Vehicle Code, or a lessee, operator, or registered owner of the vehicle. The lien is deemed to arise on the date of possession of the vehicle. Possession is deemed to arise when the vehicle is removed and is in transit, or when vehicle recovery operations or load salvage operations have begun.

CAUTION

REGARDING DIFFERENT STORAGE AMOUNTS FOR VEHICLES REMOVED BY PUBLIC AGENCY: There are statutes in the Vehicle Code generally dealing with removal of parked and abandoned vehicles. If a vehicle is being stored under these statutes, then there are limits on fees that can be charge. Vehicle Code Section 22851 provides as follows:

(a) (1) Whenever a vehicle has been removed to a garage under this chapter and the keeper of the garage has received the notice or notices as provided herein, the keeper shall have a lien dependent upon possession for his or her compensation for towage and for caring for and keeping safe the vehicle for a period not exceeding 60 days or, if an application for an authorization to conduct a lien sale has been filed pursuant to Section 3068.1 of the Civil Code within 30 days after the removal of the vehicle to the garage, 120 days and, if the vehicle is not recovered by the owner within that period or the owner is unknown, the keeper of the garage may satisfy his or her lien in the manner prescribed in this article. The lien shall not be assigned. Possession of the vehicle is deemed to arise when a vehicle is removed and is in transit, or when vehicle recovery operations or load salvage operations that have been requested by a law enforcement agency have begun at the scene.

(2) Whenever a vehicle owner returns to a vehicle that is in possession of a towing company prior to the removal of the vehicle, the owner may regain possession of the vehicle from the towing company if the owner pays the towing company the towing charges.

(b) No lien shall attach to any personal property in or on the vehicle. The personal property in or on the vehicle shall be given to the current registered owner or the owner's authorized agent upon demand and without charge during normal business hours. Notwithstanding any other provision of law, normal business hours are Monday to Friday, inclusive, from 8 a.m. to 5 p.m., inclusive, except state holidays. A gate fee may be charged for returning property after normal business hours, weekends, and state holidays. The maximum hourly charge for non-business hours releases shall be one-half the hourly tow rate charged for initially towing the vehicle, or less. The lienholder is not responsible for property after any vehicle has been disposed of pursuant to this chapter.

Under Civil Code section 3068.1, a person seeking to enforce a lien for the storage and safekeeping of a vehicle shall impose no charge exceeding that for one day of storage if, 24 hours or less after the vehicle placed in storage, the vehicle is released. If the release is made more than 24 hours after the vehicle is placed in storage, charges may be imposed on a full, calendar-day basis for each day, or part thereof, that the vehicle is in storage. If a request to release the vehicle is made and the appropriate fees are tendered and documentation establishing that the person requesting release is entitled to possession of the vehicle, or is the owner's insurance representative, is presented within the initial 24 hours of storage, and the storage facility fails to comply with the request to release the vehicle or is not open for business during normal business hours, then only one day's charge may be required to be paid until after the first business day. A "business day" is any day in which the lienholder is open for business to the public for at least eight hours. If the request is made more than 24 hours after the vehicle is placed in storage, charges may be imposed on a full-calendar day basis for each day or part thereof, that the vehicle is in storage.

If the vehicle has been determined to have a value not exceeding $4,000, the lien shall be satisfied pursuant to Civil Code section 3072, discussed later in the section of this chapter entitled “Sale of Vehicle Valued At $4,000 Or Less”. The lien sale proceedings must commence within 15 days of the date the lien arises (date of possession of the vehicle). No storage shall accrue beyond the 15-day period unless the lien sale proceedings pursuant to section 3072 have commenced. The storage lien may be for a period not exceeding 60 days if a completed notice of a pending lien sale form has been filed pursuant to section 3072 within 15 days after the lien arises. In spite of the 60-day limitation, the storage lien may be for a period not exceeding 120 days if any of the following occurs:

1. A Declaration of Opposition is filed with the department pursuant to section 3072 discussed below.

2. The vehicle has an out-of-state registration.

3. The vehicle identification number was altered or removed.

4. A person who has an interest in the vehicle becomes known to the lienholder after the lienholder has complied with subdivision (b) of section 3072. (Civil Code section 3072(b) is discussed below.)

If the vehicle has been determined to have a value exceeding $4,000 (determined under Vehicle Code section 22670), then the lien is to be satisfied pursuant to Civil Code section 3071 discussed below. The storage lien may be for a period not exceeding 120 days if an application for authorization to conduct a lien sale has been filed in accordance with Civil Code section 3071.

Any lien under Civil Code section 3068.1 shall be extinguished, and no lien sale shall be conducted, if any one of the following occurs:

1. The lienholder, after written demand to inspect the vehicle made by either personal service or certified mail with return receipt requested by the legal owner or the lessor, fails to permit the inspection by the legal owner or lessor, or his or her agent, within a period of time within at least 24 hours, but not to exceed 72 hours, after receipt of that written demand, during the normal business hours of the lienholder. The legal owner or lessor shall comply with inspection and vehicle release policies of the impounding public agency.

2. The amount claimed for storage exceeds the posted rates.

Right of Tow Truck Operator to Deficiency Claim (Civil Code section 3068.2)

A tow truck operator who has a lien on a vehicle pursuant to section 3068.1 has a deficiency claim against the registered owner of the vehicle if the vehicle is not leased or leased with a driver for an amount equal to the towing and storage charges, not to exceed 120 days of storage, and the lien sale processing fee pursuant to section 3074, less the amount received from the sale of the vehicle.

A tow truck operator who has a lien on a vehicle pursuant to section 3068.1 has a deficiency claim against the lessee of the vehicle if the vehicle is leased without a driver for an amount equal to the towing and storage charge, not to exceed 120 days of storage, and the lien sale processing fee described in section 3074, less the amount received from the sale of the vehicle.

Storage costs incurred after the sale shall not be included in calculating the amount received from the sale of the vehicle.

A registered owner who has sold or transferred his or her vehicle prior to the vehicle's removal and who is not responsible for creating the circumstances leading to the removal of the vehicle is not liable for any deficiency under Civil Code section 3068.2 if that registered owner executes a notice pursuant to the section 5900 of the Vehicle Code and submits the notice to the Department of Motor Vehicles. The person identified as the transferee in the notice submitted to the Department of Motor Vehicles shall be liable for the amount of any deficiency only if that person receives notice of the transfer and is responsible for the event leading to abandonment of the vehicle or requested the removal.

Except as provided in section 22524.5 of the Vehicle Code, if the transferee is an insurer and the transferor is its insured or his or her agent or representative, the insurer shall not be liable for any deficiency, unless the insurer agrees at the time of the transfer, to assume liability for the deficiency.

Enforcement of Liens

Under Civil Code section 3068, the lien arises at the time a written bill for the completed work or services is presented to the registered owner, or 15 days after the work or services are completed, whichever occurs first. If the bill is mailed, to be on the safe side use the date the bill is mailed as the date the lien arises. When the bill is mailed, you might, however, be able to argue for a date later than the date of mailing under certain statutes. For evidence of mailing, send the letter certified or registered, return receipt requested. Note on your records the date of mailing or the date of physical presentation of the written bill.

CAUTION

REGARDING THE IMPORTANCE OF DATE BILL PRESENTED: The date the bill is presented triggers certain time periods discussed below. This is an extremely important date. As stated above, the lien arises in any event no later than 15 days after the work or services are completed, or when the bill is presented, whichever occurs first.

Under Civil Code section 3068, the lien for labor and materials is extinguished unless you do one of two things:

a. You apply for authority to conduct the lien sale within 30 days after the first of the following has occurred: the bill has been presented to the registered owner, or 15 days after the work or services are completed. (Reg. form 656 for vehicles valued over $4,000; see later discussion for vehicles valued at $4,000 or less); or

b. You file a court action within 30 days after the first of the following has occurred: the bill has been presented to the registered owner, or 15 days after the work or services are completed.

CAUTION

DO NOT LET LIEN EXPIRE BECAUSE OF FAILURE TO APPLY FOR LIEN SALE OR FILE COURT ACTION: A very common failure of dealers is that they let their lien expire without applying to the DMV for the lien sale or filing a court action within the proper time periods. If the lien expires, you cannot get it back. Also, if the vehicle has been stored in accordance with Civil Code section 3068.1 discussed above, then watch out for the shorter time periods in that section.

DO NOT ALLOW LIEN TO EXPIRE BECAUSE OF FAILURE TO ALLOW INSPECTION: Civil Code section 3068(b)(3) provides that any lien under this section that arises because work or services have been performed on a vehicle with the consent of the registered owner shall be extinguished, and no lien sale shall be conducted, if the lienholder, after written demand made by either personal service or certified mail with return receipt requested by the legal owner or the lessor to inspect the vehicle, fails to permit that inspection by the legal owner or lessor, or his or her agent, within a period of time not sooner than 24 hours nor later than 72 hours after the receipt of that written demand, during the normal business hours of the lienholder.

DO NOT LET LIEN EXPIRE BECAUSE OF FAILURE TO PROVIDE WORK ORDER OR INVOICE: Civil Code Section 3068(b)(4) provides that any lien under this section that arises because work or services have been performed on a vehicle with the consent of the registered owner shall be extinguished, and no lien sale shall be conducted, if the lienholder, after written demand made by either personal service or certified mail with return receipt requested by the legal owner or the lessor to review a written copy of the work order or invoice reflecting the services or repairs performed on the vehicles and the authorization from the registered owner requesting the lienholder to perform the services or repairs, fails to provide that copy to the legal owner or lessor, or his or her gent, within 10 days after the receipt of that written demand.

NOTE

OBLIGATION TO TURN OVER VEHICLE TO LEGAL OWNER WHEN LIEN EXPIRES: Civil Code section 3068 provides that a person whose lien for work or services on a vehicle has been extinguished shall turn over possession of the vehicle, at the place where the work or services were performed, to the legal owner or lessor upon demand of the legal owner or lessor, and upon tender by the legal owner or lessor, by cashier's check or in cash, of only the amount for storage, safekeeping, or parking space rental for the vehicle to which the person is entitled under Civil Code section 3068. Failure to comply with the legal owner's or lessor's demand might additionally subject the repairer to a claim of conversion of property, and thereby a claim for all damages arising from the conversion, including possible punitive damages.

LIABILITY FOR ATTORNEYS' FEES: In any action brought by or on behalf of the legal owner or lessor to recover a vehicle alleged to be wrongfully withheld by the person claiming a lien pursuant to Civil Code section 3068, the prevailing party shall be entitled to reasonable attorneys' fees and costs, not to exceed $1,750.

Tender of Cash and Claims by Legal Owner

Under the California case of *Universal C.I.T. v. Rater* (1963) 214 Cal.App.2d 493, if the legal owner tenders cash to you in the amount of the lien valid against the legal owner, and if you refuse the cash, you have then waived your lien against the legal owner. If the vehicle is subsequently repossessed from you by the legal owner through court proceedings or otherwise, you will not be able to recover any lien amount from the legal owner. Additionally, you can be liable for attorneys' fees up to $1,750.

What if the legal owner wants to repossess the vehicle and states that the customer's contract is in default?

If the legal owner agrees to pay that part of the lien valid against the legal owner, you must consider releasing the vehicle to the legal owner. Before you do this, however, you should attempt to contact the registered owner to advise him or her of the legal owner's claims and to see if the owner agrees with those claims. Then you should consider a sworn statement from the legal owner and also obtain the legal owner's documentation supporting the claim. Finally, before you turn the vehicle over to the legal owner, you should attempt to have the legal owner indemnify and hold you harmless from

any claims against you from the registered owner. However, under a 1988 amendment to Civil Code section 3068, you may not be able to force indemnification from the legal owner if the lien has been extinguished, because that section states that when a lien has been extinguished, possession of the vehicle shall be turned over to the legal owner or lessor upon their demand and upon tender by them of only the amount allowed by law for storage, safekeeping, or parking space rental.

If you withhold the vehicle from valid claims of the legal owner, you run the risk of being subject to a claim of conversion and resulting damages that flow from conversion. The Court of Appeal case of *Messeral v. Fulwider (1988) 199 Cal. App.3d 1324* was a case where the repair shop owner was liable for conversion damages when the repair shop owner refused to turn over a repaired boat to the legal owner. When there are conflicting claims made by the legal owner and your customer, a dealer can file a court action called an "Interpleader" which in effect would require that the legal owner and customer fight it out in court. This releases the dealer from any liability. The dealer, however, cannot without some legal risks stonewall the legal owner and force the legal owner to obtain a court order for possession of the repaired vehicle. As always, the advice of legal counsel should be used when there is any doubt about how to proceed.

Labor and Materials Lien When Registered and Legal Owner the Same

There are no limits on the amount of the labor and materials lien when the registered owner and the legal owner are the same. However, there are limits to storage liens discussed above in the section of this chapter entitled "TOWING AND STORAGE LIENS FOR VEHICLES AUTHORIZED TO BE REMOVED BY A PUBLIC AGENCY AND OTHERS" when the vehicle has been stored by public authorities or others.

Assignment of Liens

Liens for labor and materials, or for storage or safekeeping of a vehicle when abandoned on private property, can be assigned to another in writing accompanied by delivery of possession of the vehicle, and the person to whom the lien has been assigned can exercise the right of the lienholder (Civil Code section 3069). When the lienholder assigns a lien, the dealer must give notice of the assignment, either by personal delivery or registered or certified mail, to the registered and legal owner, including the name and address of the person to whom the lien is assigned. Under Vehicle Code section 22851(a), the lien for storage and towing when a vehicle is removed to a garage under Chapter 10 of Division 11 of the Vehicle Code may not be assigned.

PRACTICAL TIP

There are service companies who will handle lien sales from A to Z for you. They may or may not want you to assign the lien to them pursuant to Civil Code section 3069. If you are going to have a service company lien sell the vehicle, make sure the lien is not extinguished by expiration of the time periods. See discussion in the section above entitled "ENFORCEMENT OF LIENS."

Revival of Lost Liens

Sometimes a dealer loses possession of a vehicle on which there is a lien by trick or fraud of the registered owner. In these cases, the vehicle may be repossessed by the dealer and the repossession revives the lien (Civil Code section 3070). However, if anyone acquires an interest in the vehicle in good faith for value between the loss of possession and the repossession, the dealer's lien is subordinate to the third party's interest. It is a misdemeanor for a person to obtain possession of a vehicle subject to a lien by fraud or trick. However, you must remember that you cannot use the threat of criminal action to help you collect a debt. Using such a threat under the law is extortion.

CAUTION

BEFORE YOU REPOSSESS: Before you repossess a vehicle which was subject to a lien, you should check with legal counsel. There are some traps for the unwary in this area which could subject a dealer to a claim for substantial damages from the customer.

Can I repossess the vehicle if I lose my lien because the registered owner's check bounces?

Always check with legal counsel in this situation. You must be able to show fraud on the part of the customer in order to repossess. To show fraud, you must show an intent on the part of the customer to deceive you at the time the check is presented. If you can show that the bank account on which the check was drawn did not exist, or some similar fraud, you may repossess if you can do so peacefully. A customer's claim that he or she intended to cover the check in an overdrawn account, but was unable to do so because of something unforeseen, would tend to disprove fraud.

Misdemeanor Violations

Civil Code section 3070(c) provides that it is a misdemeanor for any person claiming a lien on a vehicle to knowingly violate any provisions of sections 3067, and following, of the Civil Code dealing with Liens on Vehicles.

Improper Towing or Removal

California Civil Code section 3070(d) provides for damages and attorneys' fees against any person who improperly causes a vehicle to be towed or removed in order to create or acquire a lienhold interest in the vehicle under sections 3067, and following, of the Civil Code. That Code section then goes on to define seven different ways of "improperly causing a vehicle to be towed or removed." Any dealer who causes a vehicle to be towed or removed in order to create or acquire a lienhold interest in the vehicle should be thoroughly familiar with the way this code section defines the improper towing or removal of a vehicle.

Procedures for Conducting Lien Sale

Sale of Vehicles Valued Over $4,000

The following discussion sets forth the DMV forms that must be used and provides for the detailed steps that must be taken to conduct a lien sale for a vehicle valued over $4,000. This discussion assumes that you are taking action before the lien has expired. See prior discussion, Enforcement Of Liens. The DMV sometimes changes the names and numbers of the forms, so confirm with the DMV that you are using the correct forms. See the DMV website entitled "Conduct A Lien Sale For A Vehicle Stored At A Self-Service Storage Facility Or Valued Over $4,000" http://www.dmv.ca.gov/pubs/brochures/howto/htvr8.htm. If you are conducting a lien sale, you should review this section. It contains all the steps and forms to conduct the lien sale. If you have any questions about conducting a lien sale, you may call the DMV Lien Sales Unit at (916) 657-7617.

Civil Code section 3071 provides in detail the procedure for lien-selling a vehicle with a value determined to be over $4,000. An application must be submitted to the DMV with the filing fee (Reg. form 656).

When the DMV receives the application it notifies the registered and legal owners that they have a right to a court hearing over the question of the lien. If a court hearing is desired, a Declaration of Opposition must be signed and returned to the DMV within 10 days. If the Declaration of Opposition is returned to the DMV, you will be able to sell the vehicle only if you obtain a court judgment, or obtain a release from the opposing party, or if the defendant cannot be served as described in subsection (e) of Civil Code section 3071 described below. The release form is on the DMV letter advising you of the opposition. The DMV must notify you within 16 days of its receipt of the Declaration of Opposition. You must then file a court action within 30 days of the notice from the DMV and obtain a judgment after which you may conduct a lien sale.

If a money judgment is entered in favor of the lienholder and the judgment is not paid within five days after becoming final, then the judgment may be enforced by lien sale proceedings conducted pursuant to subdivision (f) of Civil Code section 3071, described below.

Civil Code section 3071(e) provides for an easy way to serve the court action on the opposing party by certified mail, return receipt requested, at the address shown on the Declaration of Opposition. You can also serve the opposing party in person. If the lienholder has served the declarant by certified mail at the address shown on the Declaration of Opposition form and the mail has been returned unclaimed, or if the lienholder has attempted to effect service on the declarant in person with a marshal, sheriff, or a licensed process server and the marshal, sheriff, or licensed process server has been unable to effect service on the declarant, the lienholder may proceed with the judicial proceeding or proceed with the lien sale without a judicial proceeding. The lienholder shall notify the Department of Motor Vehicles of the inability to effect service on the declarant and shall provide the Department of Motor Vehicles with a copy of the documents with which service on the declarant was attempted. Use Reg. form 659 to notify the DMV of the unsuccessful service. Upon receipt of the notification of an unsuccessful service, the Department of Motor Vehicles shall send authorization of the sale to the lienholder and send notification of the authorization to the declarant.

If the DMV receives no Declaration of Opposition to your application to conduct the lien sale, you will receive an authorization from DMV to conduct the lien sale. You should then comply with all of the requirements of Civil Code section 3071(f), (g) and (h). The procedure is as follows:

a. Pick a date for the sale no more than 20 days from the date of the advertisement below. (Do not count the date of sale.)

b. Give notice of the sale by advertising once in a newspaper of general circulation published in the county in which the vehicle is located. The ad-

vertisement must appear at least 5 days, but not more than 20 days, prior to the sale, not counting the day of sale. If there is no newspaper published in the county, notice shall be given by posting a Notice of Sale form in three of the most public places in the town in which the vehicle is located, and at the place where the vehicle is to be sold, for 10 consecutive days prior to and including the day of the sale. In providing information to the newspaper, specify the make, year, model, body type, identification number, engine number, if any, license number (and state of issuance and year of license), state of registration (if available), and the specific date, exact time, and place of sale. For motorcycles, the engine number shall also be included.

c. Send a Notice of Pending Lien Sale (Reg. form 280) 20 days prior to the date of sale (not counting the date of sale) by certified mail, return receipt requested, to the legal owner and to the registered owners of record, if the vehicle is registered in this state, and to any interested parties. The lienholder must also notify the DMV Lien Sale Unit of the sale by certified mail, whether or not the vehicle is registered in this state. The notices shall specify the make, year, model, body type, vehicle identification number and engine number, if any, (engine number for motorcycles), license number (and year of license and state of issuance), and state of registration (if available) of the vehicle, and the specific date, exact time, and place of the sale.

d. Maintain the vehicle for inspection at a location easily accessible to the public for at least one hour before the sale at the place of sale and at the time and date specified in the above notices.

e. Sealed bids are unacceptable.

f. The sale must always be conducted in a commercially reasonable manner.

g. Following the sale of a vehicle, the person who conducts the sale must (1) remove and destroy the vehicle's license plate; and (2) within five days of the sale, submit a completed "Notice of Release of Liability" form to the DMV.

h. Advise buyer of redemption rights of owner discussed below. You should get your money at the time of the sale and not wait for the redemption period to run; otherwise the buyer might not pay and it appears that you would have to start the sale proceedings again. Give the buyer Reg. form 168, Certification of Lien Sale signed by the seller. The buyer will also need Reg. form 343, Application for Title or Registration.

CAUTION

VOID LIEN SALES: Any lien sale under Civil Code section 3071 regarding vehicles valued over $4,000, and any lien sale in accordance with Civil Code section 3072 regarding vehicles valued at $4,000, or less, is void if the lien holder does not comply with the rules in Civil Code sections 3067-3074.Any lien or fees or storage charges for parking and storage of a motor vehicle is subject to section 10652.5 of the Vehicle Code quoted earlier in this Chapter.

Right of Registered or Legal Owner to Redeem Vehicle after Lien Sale

You must hold the vehicle for 10 days because within 10 days after any lien sale (except of a vehicle valued at $4,000 or less), the legal or registered owner may redeem the vehicle upon the payment of the amount of the sale and all costs and expenses of the sale, together with interest on such sum at the rate of 12% per annum from the due date or the date when the same were advanced until the repayment (Civil Code section 3071(i)). If the vehicle is not redeemed, all of the lien sale documents required by the DMV should be completed and delivered to the buyer.

Charges for Lien Sale Preparation

Pursuant to Civil Code section 3074, the lienholder may charge a fee for lien-sale preparation not exceeding seventy dollars ($70) in the case of a vehicle having a value determined to be four thousand dollars ($4,000) or less and not to exceed one hundred dollars ($100) in the case of a vehicle having a value determined to be greater than four thousand dollars ($4,000), from any person who redeems the vehicle prior to disposal or is paid through a lien-sale pursuant to the vehicle lien laws in the Civil Code. These charges may commence and become part of the possessory lien when the lienholder requests the names and addresses of all persons having an interest in the vehicle from the Department of Motor Vehicles. Not more than fifty percent (50%) of the allowable fee may be charged until the lien-sale notifications are mailed to all interested parties and the lienholder or registration service agent has possession of the required lien processing documents. This charge shall not be made in the case of any vehicle redeemed prior to 72 hours from the initial storage.

Release of Owner's Interest in Vehicle

A registered or legal owner may release any interest in a vehicle after the lien has arisen. The release must be dated when signed and a copy given to the

releasing party at the time of signing. Civil Code section 3071.5 gives the details of what must be included in the release.

Sale of Vehicle Valued at $4,000 or Less

This discussion assumes you are taking action before the lien has expired See prior discussion, Enforcement Of Liens. Civil Code section 3072 provides an abbreviated method for a lien sale of a vehicle with a value determined to be $4,000 or less. See the Overview at the beginning of this chapter for how to view or print this code section from the Internet. The statute is also included in the paperback edition of the Vehicle Code published by the Department of Motor Vehicles and for sale at all offices of the DMV for a nominal price.

The DMV has a section on its website entitled "Conduct A Lien Sale For A Vehicle Valued $4,000 or Less" at http://www.dmv.ca.gov/pubs/brochures /howto/htvr7.htm. This section is helpful in explaining the steps to be taken, the forms required in taking those steps, and the forms required to register a vehicle sold at this type of lien sale. If you have any questions about conducting a lien sale, you may call the DMV Lien Sales Unit at (916) 657-7612.

To commence lien sale proceedings on a vehicle valued at $4,000 or less, it appears that the lienholder must make a request for information from the DMV, or in the alternative commence a lawsuit. The request to the DMV must include a description of the vehicle, including make, year, model, identification number, license number, and state of registration. If the vehicle identification number is not available, the Department of Motor Vehicles will request an inspection of the vehicle by a peace officer, licensed vehicle verifier, or departmental employee before releasing the names and addresses of the registered and legal owners and interested parties. (Civil Code section 3072 (a)

PRACTICAL TIP

In most instances the lienholder can secure registered owner and legal owner information through the local DMV office. If this service is not available, the lienholder may secure the information by submitting the Registration Information Request For Lien Sale Vehicle Valued Under $4,000 (form INF 1126), together with the required fee directly to the DEPARTMENT OF MOTOR VEHICLES P.O. Box 944247-Mail Sta G-199, Sacramento, California 94244-2470. The form can be obtained from: http://apps.dmv.ca.gov/forms/inf/inf1126.pdf.

It appears that you must commence the lien sale proceedings under Civil Code section 3072 within 30 days after the lien has arisen to preserve the lien for labor, materials, and storage. If the vehicle has been stored by public authorities and others, the rules and limitations on storage discussed earlier, in the section of this chapter entitled "TOWING AND STORAGE LIENS FOR VEHICLES AUTHORIZED TO BE REMOVED BY A PUBLIC AGENCY AND OTHERS," apply.

CAUTION

REGARDING LIEN DATE WHEN STORED BY PUBLIC AUTHORITIES: The lien for labor, materials, and storage is deemed to arise upon presentation to the registered owner of a bill, or 15 days after the work or services are completed, whichever occurs first. When stored by public agencies or others, the towing and storage lien arises on the date of possession.

See the DMV website section discussed above for the remainder of the steps and forms to use. The Notice of Pending Lien Sale form and Blank Declaration of Opposition form should be mailed immediately after receipt of the names and addresses from the DMV.

When a vehicle valued at $4,000 or less is sold at a lien sale, there are no redemption rights.

Disposition of Lien Sale Proceeds

Under Civil Code section 3073, proceeds of the lien sale go as follows:

a. To the lienholder the amount necessary to discharge the lien and the cost of selling the vehicle, the actual cost of selling not to exceed $70 for each vehicle valued at $4,000 or less, or $100 for each vehicle valued over $4,000.

b. The balance to DMV within 15 days of any sale conducted under Civil Code section 3071 or within 5 days of any sale conducted under Civil Code section 3072.

c. Any person claiming an interest in the funds forwarded to the DMV may file a claim with the DMV. No claim will be honored after 3 years.

Mobilehomes

Former Civil Code section 3075 dealing with mobilehomes was repealed in 1983. However, see the beginning of this chapter for a discussion of the exclusion of manufactured homes, mobilehomes, and commercial coaches from the operation of sections 3067, and following, of the Civil Code.

Removal of Vehicles to Garages by Law Enforcement Authorities

Vehicle Code sections 22650 and following give law enforcement authorities (and, in limited circum-

stances, private parties) the right to remove vehicles to garages or other places of safety under various circumstances.

Vehicle Code sections 22850 and following provide for a detailed procedure concerning liens on such vehicles and lien sales. There are a number of differences between these sections and Civil Code sections 3067-3075 discussed above.

CAUTION

REGARDING OBTAINING PROPER NOTICES: In order to protect your lien rights, be sure that you are given all notices required to be given to you under the Vehicle Code sections mentioned above.

Vehicle Code section 22855 describes the persons who can appraise vehicles for purposes of the above statutes.

There are other sections in the Vehicle Code that deal with removal of vehicles by law enforcement authorities for impoundment and which provide for the rights of registered and legal owners of the vehicle which are different from the laws in the Civil Code regarding labor and material liens on vehicles.

Personal Property in Vehicle

A lien does not attach to personal property in the vehicle.

Personal property in the vehicle must be returned to the owner upon demand.

If the vehicle goes to lien sale and the customer does not claim his or her personal property, you should store the property to avoid future claims or lawsuits.

Frequently Asked Questions

If a customer owes me for work on another vehicle or for other services, can I hold his or her present vehicle for those debts?

No, the lien attaches only to the vehicle on which you have worked and for which the bill remains unpaid. An agreement in your repair order providing for a lien on the repaired vehicle arising out of other obligations of the customer might be legally enforceable as a consensual lien. To enforce the lien, however, it appears that you would have to bring court proceedings. If enforceable, you would be able to hold the repaired vehicle while the legal proceedings were pending.

Can I remove anything I have supplied to the vehicle when, for example, the legal owner repossesses?

For statutory liens that arise under Civil Code section 3068, that section provides as follows: *Upon completion of the work or services, the lienholder shall not dismantle, disengage, remove, or strip from the vehicle the parts used to complete work or services.*

What do I do if I have let the lien lapse for failure to take action within 30 days after the bill has been presented, or 15 days after the work or services are completed, whichever occurs earlier? Can I continue to hold the vehicle?

You have a problem at this point. If you can negotiate an amicable settlement with a customer, do so. Otherwise, it appears that you must return the vehicle to the customer and sue him or her for the amount owing. Hopefully, you will have a signed repair order with an attorney fee clause giving you the right to recover attorney fees in the lawsuit. If your repair order also has language in it giving you the right to retain possession until paid, you could retain the vehicle, but you would not have a lien on it and would not be able to transfer title through a lien sale. In this situation, it would be best to check with legal counsel in order to obtain an attachment lien or judgment lien against the property through litigation, later enabling you to sell it and pass title.

Also, a properly drafted consensual lien in your repair order might give you the right to hold the vehicle and foreclose on the consensual lien by a court action.

If you continue to hold the vehicle when you have no legal right to do so, you are open to a lawsuit for conversion of property in which a claim for all damages suffered would be alleged against you, including possible punitive damages. If there is any doubt in this area, you should consult with your attorney to prevent exposure to a possible large claim.

If you think you may have a lien for storage, consult with your attorney because the storage liens as set forth in this Chapter are quite complicated.

Can the dealer purchase the vehicle at the lien sale?

Yes, the dealer may bid on the vehicle just as anyone else.

Can I accept sealed bids at the lien sale?

No, sales under the Civil Code sections state that sealed bids shall not be accepted. (See Civil Code section 3071(h) and Civil Code section 3072 (g).)

What if someone other than the registered or legal owner, or lessor, authorizes repairs?

Then no lien arises. For example, repairs authorized by a thief who has stolen the vehicle do not give rise to a lien. If an authorized agent of the registered or legal owner, or lessor, authorizes the repairs, then a lien arises. You should verify the identity of the registered owner, or lessor, to insure your lien.

What about enforcing liens on leased vehicles?

If a leasing company is the registered owner, and the repairs have been authorized by the lessee, depending upon the circumstances, you may be able to enforce your lien against the vehicle to the full extent of the repairs and storage on the grounds that the lessor has granted the lessee authority to contract for repairs and/or storage on behalf of the lessor. This might be true whether or not the lessor is the registered owner. When in doubt, you should consult with your attorney. If the lessee is not deemed to be the agent of the lessor, your lien against the legal owner or lessor of a leased vehicle has the same limitations as discussed earlier in this chapter.

SMALL CLAIMS COURT AND COLLECTION OF JUDGMENTS

Chapter 12

Contents

SMALL CLAIMS COURT AND COLLECTION OF JUDGMENTS

OVERVIEW: The Small Claims Court is a legal forum which can have a significant impact on the activities of an automobile dealer. For instance, as a plaintiff, a dealer can use the Small Claims Court to economically pursue dealership claims on such matters as unpaid repair bills. Perhaps more importantly, a dealer as a defendant must be prepared to present a defense to a variety of claims which may be asserted arising out of dealership operations. A working knowledge of the practices and procedures of the Small Claims Court is therefore important to a dealer.

For the most part, these practices and procedures are simple and straightforward, as they are designed to make the Small Claims Court a forum where parties not represented by attorneys can economically and effectively pursue claims considered minor civil disputes. However, the designed simplicity of this forum does not always work and a dealer must adopt a more sophisticated approach to obtain positive results. This chapter highlights information helpful in developing this sophistication by outlining the basic steps involved in the progression of a small claims action.

In addition to the exclusion of attorneys from representing parties at trial, key features of the Small Claims Court include a $5,000 (up to $10,000 for natural persons) jurisdictional limit on claims (subject to a limitation that only two claims per calendar year may be filed which ask for more than $2,500 in damages); a speedy trial; and a right of appeal for defendants only. The basic scenario of a small claims action begins with a plaintiff filing a claim with the court. Thereafter the court issues an order setting a hearing date which must be served upon the defendant along with the claim. At the hearing, both parties present their side of the case to the judge who renders a decision. This decision represents an enforceable judgment unless it is appealed by a defendant. If an appeal is made, the matter is then tried anew in the Superior Court where a final judgment is rendered.

Statutory guidelines for the Small Claims Court are set forth in the Small Claims Act contained in California Code of Civil Procedure sections 116.110 through 116.950 (sometimes hereinafter referred to as Code Civ. Proc.). Additional sections of the Code of Civil Procedure are relevant to other aspects of a small claims action such as the service of papers, place of trial, and enforcement of the judgment. Procedures pertaining to small claims appeals are also addressed in Rules 8.950 through 8.966 of the California Rules of Court.

CAUTION

REGARDING FORMS REFERENCED IN THIS CHAPTER: The forms referred to in this chapter usually may be obtained from the filing window for Small Claims matters at each court location. They are also generally available from the California Courts' website at www.courts.ca.gov under the Forms section (mostly under the form group selections entitled "Small Claims"; "Enforcement of Judgment"; and "Wage Garnishment"). A dealer should always check with the clerk of the Small Claims Court where the dealer's action is pending to verify what forms are current, since the forms are subject to revision at any time.

Commencement of a Small Claims Action

Jurisdiction

Before even considering the use of the Small Claims Court, a dealer should be aware that this court has a jurisdictional limit of $5,000 ($10,000 for natural persons, except that claims for personal injury arising from automotive accidents are limited to $7,500), subject to a very important restriction that no party may file more than two small claims actions in any one calendar year where the amount demanded exceeds $2,500 (Code Civ. Proc. sections 116.220(a)(1), 116.221 and 116.231). This limit simply means that a party not a natural person (for example, a corporation) can file two actions a year in this court which claim amounts in excess of $2,500 and an unlimited number of other actions which claim amounts less than $2,500.

Because of the $5,000 limit, a dealer who has been sued in a small claims action can bring a claim against the plaintiff for an amount up to $5,000 in the same action by way of a counterclaim (Code Civ. Proc. section 116.360(a)).

The Small Claims Court does have authority to issue a conditional judgment as well as to provide equitable relief to a party in the form of rescission, restitution, reformation and specific performance in the place of or as a supplement to money damages. In such instances, the Small Claims Court retains jurisdiction until full payment and performance of any judgment or order (Code Civ. Proc. section 116.220(b)). The Small Claims Court is authorized to provide injunctive relief only if there is a specific statute which expressly provides a Small Claims Court with authority to provide such equitable relief.

NOTE

REGARDING GUARANTORS: A Small Claims Court can only consider claims which do not exceed $2,500 against a defendant guarantor that does not charge a fee for its guarantor or surety services. If the guarantor charges a fee for its services and the claim is made by a natural person, the Small Claims Court has a limit of $6,500 for such claims. Small Claims Court claims brought by an entity other than a natural person against a guarantor that charges a fee or the Registrar of the Contractors' State License Board may not exceed $4,000 (Code Civ. Proc. section 116.220 (c)).

CAUTION

REGARDING SPLITTING CLAIMS: A party may not split its claim arising from a single action and file two or more small claims actions. For example, a dealer plaintiff having a $10,000 claim against a defendant arising from a single transaction cannot file two separate $5,000 claims.

PRACTICAL TIP

A dealer plaintiff may waive the recovery of any amount on a claim in excess of $5,000, or $2,500 if applicable, to keep the matter in the Small Claims Court. This strategy should be strongly considered by a dealer when a claim amount is only slightly in excess of the jurisdictional limit since the dealer can then take advantage of the desirable features of the Small Claims Court. For example by making such a waiver, a dealer can avoid incurring the attorneys' fees normally connected with pursuing an action in a court of higher jurisdiction (a corporation can only appear in such courts represented by counsel). Additionally, a Small Claims Court will schedule a trial date much faster than courts of higher jurisdiction. Such a waiver actually becomes operative when a judgment is rendered (Code Civ. Proc. section 116.220(d)).

NOTE

ON DISHONORED CHECKS: The Small Claims Court can be useful to a dealer pursuing claims arising from dishonored checks. If the dealership receives a bad check which is not made good within 30 days after written demand is made upon the maker of the check, treble damages of not less than $100 and not more than $1,500 may be recoverable, in addition to recovering the amount of the check and the costs of mailing the written demand (subject to the jurisdictional limit of the Small Claims Court) (California Civil Code section 1719). To be able to recover the additional damages, the written demand must be sent certified mail and refer to the statute, the amount of the check and any bad check fee charged by the financial institution involved. The additional damages are not recoverable if the person stops payment in order to resolve a "good faith dispute." Section 1719 does not define what is meant by "costs" of mailing the written demand, but if a dealer has paid an attorney for writing the demand letter, it would appear that the fee charged to the dealer should be recoverable under this section. See the chapter in this Management Guide entitled "Other Important Topics" for a full discussion regarding dishonored checks and the form of the demand letter to be used.

Filing a Claim

The procedure for initiating an action in the Small Claims Court is for a party (the "plaintiff") to file a claim under oath either by mail or in person with the court clerk (Code Civ. Proc. section 116.320). Some Small Claim Courts may allow such claims to be filed by facsimile transmission or electronic means. Generally, the contents of the claim form, which the clerk will normally provide, are the name and address (if known) of the defendant (note there can be more than one defendant); the amount and basis of the claim; that the plaintiff has demanded payment (where possible); that the defendant has refused the demand of the plaintiff to pay the monies or to return the property claimed; and the plaintiff understands the judgment on the claim will be conclusive and without a right of appeal.(Code Civ. Proc. section 116.320(b)).

If the amount of the claim exceeds $2,500, the plaintiff must sign a declaration (part of the claim form) stating under penalty of perjury that the plaintiff has not filed more than two small claims action anywhere in California during the calendar year in

which the amount demanded is more than $2,500. (Code of Civil Procedure section 116.231(b).

If the plaintiff is doing business under a fictitious business name, the plaintiff must sign a fictitious business name declaration under penalty of perjury to be filed with the claim affirming compliance by the plaintiff with the fictitious business name laws which require the executing, filing, and publishing a fictitious business name statement. The declaration form requires the statement number and the expiration date of the fictitious name statement. An action filed by a plaintiff who has not duly filed a fictitious name statement is subject to being dismissed without prejudice to the plaintiff's refiling of the complaint upon complying with the fictitious business name laws (Code Civ. Proc. section 116.430(a)(b)).

A corporate name in itself is not a fictitious name. For example, a corporation incorporated as "ABC Motors" can conduct business under that name without complying with the fictitious business name statutes. If that corporation uses any other name however, it must comply with those statutes (Bus. Prof. Code section 17900 (a)(3)).

When a claim is being submitted in Small Claims Court on behalf of a corporation, it should be signed by an officer of the corporation.

Note

REGARDING ACTIONS TO ENFORCE A DEBT: If a party brings an action to enforce the payment of a debt, the claim should include a statement of calculation of liability which separately states the original debt amount, each payment credited to the debt, each fee and charge added to the debt, each payment credited against those fees and charges, all other debits and charges to the account, and an explanation of the nature of those fees, charges, debits, and all other credits to the debt, by source and amount (Code Civ. Proc. section 116.222).

Filing Fee

At the time a claim is filed, the plaintiff is required to file a declaration stating the number of claims filed by the plaintiff in the last 12 months and to pay a minimal fee which may vary depending on the amount of the claim (Code Civ. Proc. section 116.230). If the plaintiff has filed more than 12 small claims actions within the last year, the filing fee is increased. It should be noted that the increased amount of the filing fee may not be recovered by the plaintiff as a cost (Code Civ. Proc. section 116.610(g)(2)).

PRACTICAL TIP

In connection with filing a claim, a plaintiff should receive an information sheet form from the Small Claims Court which sets out some of the basic ground rules followed by that court. This information sheet should be reviewed as it can answer many simple questions regarding the Small Claims Court process. Additionally, the Small Claims Court clerk and county sponsored programs designed to assist Small Claims Court litigants can also be a useful source of information regarding court practices and procedures. Finally, while a party cannot be represented by counsel for purposes of a small claims trial, the party may consult an attorney regarding any phase of a small claims action, including court practices and procedures.

CAUTION

REGARDING NO ASSIGNMENT OF CLAIMS: Only the original owner of a claim may pursue it in a small claims action (Code Civ. Proc. section 116.420(a)). For example, a dealer having a claim for an unpaid repair bill cannot assign it to another individual or entity if it is to be pursued in the Small Claims Court. Note however, this prohibition does not apply to bankruptcy trustees or holders of certain contracts (for instance retail installment contracts subject to the Rees-Levering Act) purchased for the holder's portfolio (Code Civ. Proc. section 116.420 (b)).

Naming Defendants

A crucial concern of the plaintiff in filing a small claims action should be to properly identify and name any defendant against whom the claim is being filed. This is key because if the defendant is not named correctly, the plaintiff may be precluded from recovering on a judgment since it can only be enforced against assets held by the party named in the judgment. Proper identification of a defendant, including an address, is also important for venue (meaning the action is filed in the proper Small Claims Court location) and service of the claim purposes which are matters discussed later in this chapter.

Individual or Entity

The status of a party to be named as a defendant in a small claims action is what determines how that party is named. If a party is an individual, the individual's name should be correctly spelled out along with any other names that might be used (for example John Jones, an individual, a.k.a. John W. Jones). If the defendant is an individual who is the sole owner of a business, he or she should be named

both individually and with reference to his or her business (for example John Jones, individually and dba Jones' Garden Shop). If the defendant is a partnership, the partnership should be named as well as the individual partners and any other name under which the partnership may be doing business (for example Jones Enterprises, a partnership, dba Jones' Garden Shop; John Jones, a partner, individually; Jane Jones, a partner, individually). If the defendant is a corporation, it should be identified by its corporate name as well as any other name under which it may be doing business (for example Jones Enterprises, Inc., a California corporation, dba Jones' Garden Shop).

PRACTICAL TIP

There are certain sources available to the public which can provide information useful in correctly naming small claims defendants. Such sources include the California Secretary of State's Office in Sacramento, county clerk's offices and city halls. These sources can be used as follows:

a. The Secretary of State's Office (Corporate Status Department) in Sacramento can be a source to find out the correct name of a California corporation; its date of incorporation; whether it's in good standing; a statement number; and the names and addresses of the officers of the corporation and its agent for service. Some of this information is available from the California Secretary of State's website, www.sos.ca.gov. Additional information may be available by telephone or by written request to the Secretary of State's office in Sacramento for a nominal fee.

b. County clerk's offices have indexes which disclose the names and addresses of persons or entities using fictitious business names within a county. These indexes can be viewed in person or a written request by mail can be made for a copy of a particular fictitious name statement (there is a nominal fee for such requests).

c. Many city halls have indexes which disclose the names and addresses of persons or entities having business licenses to conduct business under a particular name at an address within a city. A written request (with a postage-paid return envelope) indicating the business name and address may be a method which will obtain this information (there may be a nominal fee).

If a defendant corporation is not in good standing with the California Secretary of State's office (i.e., having not paid its franchise tax), that corporation cannot legally defend or prosecute an action (California Revenue and Taxation Code section 23301). A dealer can obtain a certified statement from the Secretary of State's office showing an opposing corporation's lack of good standing and present it to the Small Claims Court to secure a favorable judgment.

Doe Defendants

If the name of a defendant cannot be determined, it is possible to name that individual or entity as a Doe defendant (for example Doe 1) (Code Civ. Proc. section 474). In this situation, as long as proper service is accomplished (discussed later in this chapter), the matter may proceed to trial, at which point the true name of the defendant can be ascertained.

In the instance where a claim has been filed against a party operating a business under a fictitious name, the plaintiff should ask the Small Claims Court judge to inquire at the trial as to the true name of the individual or entity conducting the business. If it is determined that the name used by the defendant is different from that used in the plaintiff's claim, the plaintiff should confirm that the court does amend the claim to reflect the correct name. After a judgment is rendered, a plaintiff by motion and for good cause (meaning circumstances justifying the request) may have the judgment amended to reflect the correct legal name of a defendant (Code Civ. Proc. section 116.630).

PRACTICAL TIP

When filing a small claims action, a dealer should name all parties potentially responsible for the claimed damages under any name that they are thought to be using. This practice gives the dealer the best chance of successfully obtaining and satisfying a small claims judgment.

CAUTION

REGARDING CLAIMS AGAINST PUBLIC ENTITIES: To file a small claims action against a public entity, a plaintiff must first comply (and do so promptly) with certain claim procedures (California Government Code sections 810 et. seq.). Information concerning these procedures can be obtained from the public entity, but a plaintiff may wish to contact an attorney since an action may be barred entirely if the procedures are not complied with properly.

Bankruptcy filing by defendant: Just as in other state court actions, a bankruptcy filing by a defendant acts to effectively bar the filing or further pursuit of a small claims action by the plaintiff (11 U.S.C. section 362). Upon receiving notice of a

bankruptcy filing, a dealer should discontinue further efforts regarding the action to avoid violating the automatic stay created by the filing. If questions as to the validity of the bankruptcy filing arise, a dealer should contact an attorney.

Filing a Claim in the Proper Court

Meaning of Venue

To avoid an unnecessary delay, a dealer filing a small claims action should make sure that it is being filed in the proper location of the Small Claims Court (typically, each Superior Court for a county has designated branch courts that handle small claims actions). This determination requires checking the local court rules which may identify the proper court location and also confirming that the action has proper "venue" (basically meaning it is filed in the appropriate county).

Determining Venue

The venue for a small claims action is determined in the same manner applicable to other civil lawsuits (Code Civ. Proc. section 116.370(a)). The ground rules for venue are stated in California Code of Civil Procedure sections 392 through 403. Some consumer laws, such as the Automobile Sales Finance Act (California Civil Code sections 2981 through 2984.4) contain a separate venue statute (for example, Civil Code section 2984.6). Generally, proper venue exists when an action is filed in the county where at least one defendant resides or a corporate defendant does business, regardless of the nature of the claim (Code Civ. Proc. sections 395 and 395.5). Proper venue in actions concerning injury to person or damage to personal property also exists if the injuries or damage occurred within the county where the action is filed (Code Civ. Proc. section 395(a)). Venue in contract actions may be proper in the county where the contract was signed by a defendant, the county where a defendant resided when the contract was signed, or in the county where the contract is to be performed (Code Civ. Proc. sections 395 (a) and 395.5 and Civil Code section 2984.4).

PRACTICAL TIP

A dealer having questions about where to file a Small Claims Court action should check with a court clerk or contact an attorney.

Challenging Venue or Court Location.

Venue requirements are designed to protect a party from being subjected to unduly burdensome travel in defending a claim. A defendant who is being sued in the wrong Small Claims Court may challenge the venue or court location by writing to the court and mailing a copy of the challenge to each of the parties. If this procedure is followed, a defendant is not required to appear at the Small Claims Court trial (a dealer should elect not to appear only if it is confirmed the court has received the written challenge) (Code Civ. Proc. section 116.370(b)). If venue or the court location is challenged and all of the parties are not present, the court will postpone the hearing for at least 15 days and notify all parties by mail of the new hearing date, time and place (Code Civ. Proc. section 116.370(c)(2)). In the event of a challenge where all parties are present and the court determines the venue and court location are proper, the action may be heard. In all cases, the court is required to inquire into the facts sufficient to determine whether the venue and court location are proper and proceed accordingly. If the court determines the action was not commenced in a proper venue and location, it may on its own motion dismiss the action without prejudice or transfer it to the proper location, unless all defendants are present and agree the action may be heard (Code Civ. Proc. section 116.370(c)(1)).

Statute of Limitations

The statute of limitations is the period of time within which a plaintiff must file a legal action to preserve the claim being asserted. If a legal action is not filed with a court within the period of the applicable statute of limitations, the plaintiff is barred from pursuing the action. In fact, a defendant in a small claims action may raise the statute of limitations as an absolute defense. The more common statutes of limitations which a dealer may find relevant are:

a. **Breach of written contract or oral contract for sale of goods**: 4 years from date of breach (Code Civ. Proc. section 337(1) and California Commercial Code section 2725(1)). Note that to be enforceable, a contract for the sale of goods for a price of $500 or more should be reflected in a writing signed by the party against whom it is to be enforceable (Commercial Code section 2201(l)).

b. **Breach of oral contract**: 2 years from date of breach (Code Civ. Proc. section 339(1)).

c. **Injury to person**: 2 years from the date of injury (Code Civ. Proc. section 335.1).

d. **Damage to property**: 3 years from the date of damage (Code Civ. Proc. section 338(c)).

e. **Fraud**: 3 years from the date of the fraud or the date it was discovered (Code Civ. Proc. section 338(d)).

f. **Account stated/book account**: When an account is rendered and agreed to or not objected to within a reasonable time (the "acknowledgment"

does not have to be in writing), a 4 year statute of limitations can apply and will run from the date of the last item (Code Civ. Proc. section 337(2)). This 4 year statute of limitations also applies to a "book account," basically defined as a detailed statement of regular entries kept in permanent book-type form which constitutes the principal record of transactions between a debtor and creditor (Code Civ. Proc. section 337a).

CAUTION

REGARDING AVOIDING BAR OF CLAIM BECAUSE OF STATUTE OF LIMITATIONS: A dealer should act promptly to bring an action in Small Claims Court to avoid any statute of limitations problem. If a dealer has a statute of limitations question, especially regarding the requirements for an account stated or book account, the dealer should consult an attorney.

Setting an Action for Trial

Timing of Hearing

Once a plaintiff files a claim, the Small Claims Court clerk will issue an order directing all parties, including the defendant, to appear at a scheduled hearing date with witnesses and documents to prove any relevant claim or defense. Alternatively, the clerk may mail a copy of the claim to the defendant providing for a return receipt requested. Upon receiving proof the defendant did receive the claim, the clerk will issue an order scheduling the trial which is sent to all parties by return receipt mail. The hearing date will be set between 20 and 70 days from the date the order is issued(Code Civ. Proc. section 116.330).

Service of an Action on the Defendant

Service by Mail

Once a small claims action is initiated by the plaintiff's filing of a claim and the court's issuance of an order setting the hearing, the next step is to cause the delivery (called "service") of those documents to the named defendant. This can be accomplished by several methods. The simplest and most economical method is to have the Small Claims Court clerk serve a defendant with a copy of the claim and order by return receipt mail (Code Civ. Proc. section 116.340(a)(1)). The fee for this type of service is minimal (Code Civ. Proc. section 116.232).

NOTE

REGARDING OUT OF STATE SERVICE: Service of documents in a small claims action is considered valid only if it is made within the State of California, with two exceptions (Code Civ. Proc. section 116.340(e)).

Personal Service

Individual Defendant

The other methods for accomplishing service of the order and claim upon a defendant in a small claims action are those available in connection with any state court lawsuit. These methods tend to be more involved and as a result are more expensive. For instance, the claim and order documents may be personally served upon a defendant (Code Civ. Proc. section 415.10 and 116.340(a)(2)). This personal service may be accomplished by a Sheriff or Marshal of the county where a defendant resides, or by any individual who is over 18 years of age and is not a party to the small claims action (Code Civ. Proc. section 414.10). A plaintiff utilizing this method of service should make sure that the individual actually making the service prepares a declaration of personal service which states under oath the facts of service (i.e., date and time when, and place where the documents were given to the defendant). This declaration form can then be filed with the Small Claims Court if service becomes an issue of controversy.

Corporate Defendant

Where the small claims defendant is a corporation, joint stock company or association, or a corporate association or public entity, there are specific individuals who need to be served to accomplish a valid personal service. For instance, with a corporation, service is valid if the documents are delivered to the agent for service (whose identity must be on file with the Secretary of State's Office pursuant to California Corporations Code section 8210), the president, chief executive officer, or other head of the corporation, a vice president, secretary or assistant secretary, a treasurer or assistant treasurer, a controller or chief financial officer, a general manager, or a person authorized by the corporation to receive service of process; or in the case of a bank, the cashier or assistant cashier (Code Civ. Proc. section 416.10 (a), (b) and (c)).

PRACTICAL TIP

Information as to the identity of a corporation's officers and agent for service can be obtained by contacting the California Secretary of State's

Office in Sacramento as discussed earlier in this chapter.

Partnership Defendant

Regarding a general partnership, personal service upon one of the general partners on behalf of the partnership is effective for purposes of obtaining a judgment against the partnership. Note that the partners of a general partnership should also be served as individuals.

Minor Defendant

Where the defendant being served is a minor, personal service of a small claims action may be accomplished upon the parent, guardian, conservator, or other similar fiduciary or person in charge of that individual (Code Civ. Proc. section 416.60).

Substituted Service

A defendant in a small claims action can be served by a method designated as "substituted service" (Code Civ. Proc. section 415.20 and 116.340(a)(3)). This method of service is accomplished by leaving a copy of the claim and order at a defendant's place of business during usual office hours with a person who is apparently in charge. This method of service may also be accomplished after several unsuccessful attempts of personal service at a residence, by leaving a copy of the documents at the defendant's residence with a competent member of the household who is 18 years or older and who is informed of the contents of the documents served. To complete a substituted service, copies of the claim and order must be mailed to the defendant at either the business or residential address where the documents were left. The date this method of service is deemed completed is 10 days following the mailing of the claim and order (Code Civ. Proc. section 415.20 (a) and (b)). This substituted service approach can also be used at the defendant's usual mailing address (for example, a private mail box) other than a United States Postal Service post office box.

CAUTION

REGARDING ACTION AGAINST PRINCIPAL AND SURETY: When a small claims action involves a claim against a principal and a guarantor or surety pursuant to a guaranty or suretyship agreement, the plaintiff must make a reasonable attempt to complete service on the principal. If that service is not accomplished, the action is to be transferred to the court of appropriate jurisdiction (Code Civ. Proc. section 116.340(h)). If a dealer pursuing a small claims action encounters this or other unique service problems, the dealer should consult an attorney.

Timing of Service

The timing of the service of the claim and order on a defendant in a small claims action is important with respect to the scheduled hearing date. If the service of these documents is made in person or by return receipt requested mail, it must be completed **at least 15 days prior** to the scheduled hearing date when the defendant is a resident of the county where the action is brought, or **at least 20 days prior** to the scheduled hearing date when the defendant is a resident outside the county (Code Civ. Proc. section 116.340(b)). Personal service of the papers is deemed completed on the day the defendant receives the claim and order and the return receipt requested method of service is deemed completed the day the defendant signs the mail return receipt (Code Civ. Proc. section 116.340 (d)). If the plaintiff cannot accomplish service of the documents within this time frame, the small claims trial will be continued for at least 15 days, unless the defendant appears at the hearing and does not request a postponement. Should the defendant not appear, the court is required to send a notice by first class mail to all parties reflecting the new hearing date, time, and place (Code Civ. Proc. section 116.570(b)) Documentary proof (a proof of service form) that a defendant has been served with the claim and order must be filed with the Small Claims Court at least 5 days before the hearing (Civ. Proc. section 116.340(c)).

PRACTICAL TIP

Special attention should be paid to information as to a defendant's physical description and whereabouts since this information can be important in accomplishing the proper service of the claim and order on that person. Service of these documents is essential for a plaintiff to secure a small claims judgment.

Defendant's Role in a Small Claims Action

Response to Plaintiff's Claim

As a defendant in a small claims action, a dealer must affirmatively act to contest the plaintiff's claim or risk an unfavorable judgment. While a defendant is not required to file any kind of written answer to the plaintiff's claim, the defendant should be prepared to present all defenses to the claim at the time of the small claims trial. As discussed in this chapter, a defendant may also consider certain procedural options for responding to a plaintiff's claim

which include requesting: (1) a continuance; (2) the transfer of the matter to a court of higher jurisdiction; or (3) the transfer of the matter to the proper court or dismissal without prejudice (because of improper venue).

Counterclaim

A defendant in a small claims action not only has the right to present a defense, but also has a right to file a claim (sometimes called a cross-claim or counterclaim) against the plaintiff utilizing a form available from the Small Claims Court. This counterclaim does not have to relate to the same subject or event as the plaintiff's claim. In fact, the amount of this counterclaim can determine whether or not the matter remains within the jurisdiction of the Small Claims Court. If the amount of the counterclaim is below the jurisdictional limit ($5,000 for a party not a natural person and $10,000 for a natural person, unless a personal injury claim relating to an automobile accident is involved), the action will proceed in the Small Claims Court on the trial date scheduled, assuming this counterclaim is served upon the plaintiff at least 5 days prior to the hearing date. The deadline for service of the counterclaim changes if the plaintiff's claim was served on the defendant 10 days or less prior to the scheduled hearing date. In that situation, the defendant's counterclaim is timely served if it is served upon the plaintiff at least 1 day prior to the hearing (Code Civ. Proc. section 116.360(c)). To serve the counterclaim, a defendant may use the same methods available to the plaintiff to serve a claim as discussed previously in this chapter (Code Civ. Proc. section 116.360 (b)).

PRACTICAL TIP

In Small Claims Court, it is not compulsory for a dealer to file a counterclaim against the plaintiff on any related causes of action (i.e., claims arising from the same transaction or dispute) (Code Civ. Proc. section 426.60(b);* Davis v. Superior Court *(1980) 102 Cal.App.3d 164). This means that a dealer can technically file a separate action later relating to matters raised in the plaintiff's claim. However, it is recommended that if a dealer has grounds for a counterclaim, it be filed. This is especially important if it is below the applicable $5,000 jurisdictional amount, since this will act to strengthen a dealer's position with respect to opposing the plaintiff's claim.

Transfer to Higher Court

Request for Transfer

In the event a defendant's counterclaim against the plaintiff relates to the same subject or event as the plaintiff's claim and is in excess of the applicable jurisdictional limit (generally $10,000 for natural persons, $5,000 for non-natural persons), the defendant may commence an action against the plaintiff in a court of competent jurisdiction and then request a transfer of the small claim action to that court by filing with the Small Claims Court (where the plaintiff's action is pending) a declaration reflecting the filing of the complaint, (a copy of the complaint should be attached) together with a minimal transmittal fee (Code Civ. Proc. section 116.390(a)(b)). The filing of this declaration should take place at, or before, the time of the hearing on the small claims action and a copy of the declaration should be personally delivered to the plaintiff within that same time frame (Code Civ. Proc. section 116.390 (b)).

Court's Discretion

In considering a request to transfer filed by a defendant, the Small Claims Court has the discretion to: (1) render judgment on the small claims case prior to the transfer; (2) not render judgment and transfer the small claims case; or (3) refuse to transfer the small claims case on the grounds that the ends of justice would not be served (Code Civ. Proc. section 116.390(c)). If a transfer of the matter is ordered, the plaintiff is not required to pay any transfer fees (Code Civ. Proc. section 116.390(e)).

More than likely, if a Small Claims Court judge determines that the defendant's claim is related to the transaction or dispute giving rise to the plaintiff's claim, the action will be transferred to the higher court without deciding the merits of the plaintiff's claim. However, if the claims are totally unrelated, the court may proceed to hear the plaintiff's claim and a defendant should be prepared to present a defense at that time.

PRACTICAL TIP

A dealer who has a claim against the plaintiff in a small claims action may have the ability to remove the entire matter from consideration by the Small Claims Court. Such an option can be strategically significant and a dealer should consult an attorney to discuss the relevant issues.

Conduct of a Small Claims Trial

Representation of the Parties

Just as in other legal proceedings, the preliminary aspects of a small claims action are designed to result in a hearing where the plaintiff may present the evidence supporting the claim being asserted and the defendant, having had proper notice of the hearing, may present evidence supporting any defense to the claim. It is a basic premise of the Small Claims Court that the parties represent themselves in the presentation of their cases at the time of trial, as no attorneys are allowed to participate in that presentation (Code Civ. Proc. section 116.530(a)). Where a party is a corporation, it may be represented by any employee and/or officer or director who has not been employed or retained solely for the purposes of appearing on behalf of the corporation at the hearing (Code Civ. Proc. section 116.540(b)). A person representing a corporation must be prepared to sign and file a declaration under penalty of perjury stating that he or she is authorized to represent the corporation and the basis for such authorization, and that the individual is not employed to represent the corporation in Small Claims Court (Code of Civil Procedure section 116.540(j)).

PRACTICAL TIP

Although attorneys may not represent parties at the trial of a small claims action, they may be consulted in connection with other aspects of a small claims proceeding, including such things as using subpoenas, developing legal arguments, and preparing written legal authorities for use at trial (Code Civ. Proc. section 116.530(c)).

NOTE

REGARDING EXPERT WITNESSES: A party involved in a small claims hearing can receive assistance from a representative of an insurer or other expert, although this assistance may not be given while the actual hearing is being conducted. Experts can also testify on behalf of a party regarding facts they have personal knowledge of and about which they are competent to testify (Code Civ. Proc. section 116.531).

Pre-Trial Preparation

In preparing a presentation for a small claims trial, a dealer should concentrate on presenting testimony and documents in a chronological and straightforward manner which establishes the facts supporting the dealer's position. Written records of all descriptions, including lists of damages and photographs, may be used to increase the effectiveness of a presentation. Subpoenas may be used to require an opposing party or a non-party witness to produce relevant records or other physical evidence (for example, car parts or even a car) at the time of trial. However, formal pre-trial discovery procedures such as interrogatories and request for admissions may not be used for purposes of preparing for a small claims trial or a hearing on a small claims appeal (Code Civ. Proc. sections 116.310(b) and 116.770(b)).

PRACTICAL TIP

In addition to bringing the originals of supporting documents to court at a small claims trial, a dealer should bring extra copies. These copies may often be submitted to the court for consideration, allowing the dealer to retain the originals.

Personal Appearance by Parties

An individual who is a plaintiff or defendant in a small claims action should always personally appear on his or her own behalf at the trial unless certain special circumstances exist which authorize another individual to appear or a written declaration to be submitted in lieu of any appearance. These special circumstances include:

1. If the party is an individual doing business as a sole proprietorship, and the claim involved may be proven or defended against by evidence which consists of business records made in the regular course of business and made at or near the time of the act, condition or event involved ***and there is no other issue of fact in the case***, another person can appear on behalf of the individual. That person must be a custodian or other qualified witness who can authenticate the records by testifying to the identity of the records and the mode of their preparation and this testimony must show a method of preparation which indicates the trustworthiness of the records. Also, that person must be a regular employee who has not been employed solely for the purpose of representing the individual in Small Claims Court (Code Civ. Proc. section 116.540(d)).

2. A plaintiff who is an individual may have another individual appear or may submit declarations to serve as evidence supporting his or her claim if the plaintiff is serving on active duty in the United

States Armed Forces outside the state and was assigned to this duty station after the claim arose and the assignment is for more than 6 months. Any individual appearing on behalf of such a plaintiff must serve without compensation and must not have appeared in small claims actions on behalf of others more than four times during the calendar year (Code Civ. Proc. section 116.540(e)).

3. If a party is an individual incarcerated in a county jail, a Department of Corrections and Rehabilitation facility, or Division of Juvenile Facilities facility, he or she may then have another individual appear or submit a declaration to serve as evidence. Any individual appearing on behalf of an incarcerated party must serve without compensation and must not have appeared in small claims actions on behalf of others more than four times during the calendar year (Code Civ. Proc. section 116.540(f)).

4. If a defendant is a non-resident of California, but owns real property in the state, he or she is not required to personally appear and may submit written declarations to support his or her defense and/or have another individual appear. Any individual appearing on behalf of a non-resident party must serve without compensation and must not have appeared in small claims actions on behalf of others for more than four times during the calendar year (Code Civ. Proc. section 116.540(g)).

5. If a party owns rental real property, the party may have a property agent under contract to manage the rental of that property appear on the party's behalf in a small claims action if the claim relates to the rental property. This property agent may not be an individual retained principally to represent the property owner in small claims court(Code Civ. Proc. section 116.540(h)).

6. A husband or wife may appear on behalf of his or her spouse if a joint claim is involved under the following circumstances: (1) the represented spouse gives his or her consent; and (2) the Small Claims Court determines that the interests of justice would be served (Code Civ. Proc. section 116.540(k)).

7. If a party cannot properly present his or her claim or defense, the Small Claims Court may in its discretion allow another individual to assist that party (Code Civ. Proc. section 116.540(l)).

NOTE

REGARDING AUTHORIZING OTHERS TO APPEAR: In those situations where a party to a small claims action intends that another individual appear on that party's behalf as discussed in items 1 through 5 above, a Small Claims Court will require the filing of a written declaration stating that such an individual is authorized to appear for the party and the basis for the authorization. In those situations discussed in items 1 and 5 above, the declaration will also need to state that the individual is not employed solely to represent the party in Small Claims Court. In the situations discussed in items 2,3 and 4 above, the declaration will need to state that the individual is serving without compensation and has appeared in Small Claims Court on behalf of others no more than four times during the calendar year (Code Civ. Proc. section 116.540 (j)).

Pre-Trial Procedure

A party in a small claims action should appear at the time and courthouse where the matter is scheduled to be heard. At the scheduled place, a list of cases set to be heard that particular day is usually posted which should be checked to verify that the relevant case is listed. Once the matter is called by the judge, the parties will be sworn in and the court will normally entertain any motions or statements by the parties pertaining to procedural matters (i.e. improper service; requests for continuance; jurisdictional problems; etc.), before proceeding to hear the merits of the action.

NOTE

REGARDING POSTPONEMENTS: Any party may submit a written request to a Small Claims Court for postponement of a hearing date for good cause (either by letter or a form available from the Small Claims Court). Such a request must be filed at least 10 days before the hearing date, unless the court determines that the requesting party has good cause for the request being filed later. There is a minimal fee that must be paid to file the request and the requesting party should mail or deliver a copy of the request to all other parties. If the court determines that the "interests of justice" would be served by postponement, the court will reschedule the hearing and notify all parties by mail of the new hearing date, time and place. This determination should occur quickly as a Small Claims Court is required to provide a prompt response by mail to any person making a written request for postponement of the hearing (Code Civ. Proc. section 116.570). The court has the discretion to postpone a hearing under any circumstances it deems appropriate, but will almost always be inclined to continue a hearing to "permit and encourage" the parties to resolve the matter informally or by some other process (Code Civ. Proc. section 116.610(b)).

PRACTICAL TIP

A dealer who wishes to postpone a Small Claims Court hearing date should submit a written request as soon as possible. If a written notice is not received from the court that confirms the granting of the continuation, the dealer should contact the court prior to the scheduled hearing date to determine the status of the postponement request. Unless it is actually determined that a continuance has been granted, the dealer or appropriate corporate representative, if applicable, should appear at the scheduled hearing date.

NOTE

REGARDING TEMPORARY JUDGES: If all parties agree, a small claims matter can be heard by a temporary judge who usually is an attorney empowered by the court to handle such matters (Code Civ. Proc. section 116.240).

REGARDING DISQUALIFYING A JUDGE: If a dealer believes that a particular Small Claims Court judge will not be fair in hearing a small claims action, the dealer may disqualify that judge by following certain procedures. In general, a dealer may file an affidavit for disqualification which in effect contains a statement under oath by the dealer that the judge in question is prejudiced and that the dealer cannot receive a fair and impartial hearing (Code of Civ. Proc. section 170.6). No specific reason for the prejudice must be stated in the affidavit. Form affidavits to disqualify a judge may be available from the County Clerk's office where the matter is being heard.

Dealers should be aware that they must act in a timely manner to disqualify a judge. Specifically, if the identity of a judge is known at least 10 days before the hearing, the affidavit required to disqualify the judge must be filed 5 days before the hearing. If the identity of the judge is learned only at the time of hearing, the disqualification affidavit may be filed at the time of hearing (Code of Civ. Proc. section 170.6). Dealers should carefully consider the ramifications of disqualifying a judge, because it can create significant delays as to when a small claims action will actually be heard and any new judge assigned to hear the matter may not be sympathetic toward the party causing the additional delay.

Trial

The actual trial of a small claims action is conducted informally with the goal being to dispense justice "promptly, fairly, and inexpensively."(Code Civ. Proc. section 116.510). Small Claims Court judges will not expect attorney-like presentations of the evidence and facts and as a result, they will usually be more active than judges in other forums in asking questions of the parties and witnesses as to the evidence presented. Judges for instance may investigate by viewing evidence outside the court room or consulting witnesses and for the most part will consider any evidence, including hearsay, which a party presents. Normally, the plaintiff will present evidence first. Following this presentation, the defendant will then have the opportunity to present evidence. As a general rule, either side has a right to cross-examine any witnesses who testify for the other party. This simply means that once a witness has answered questions for one side, the other party has a right to ask any questions of that witness which might undermine or explain more favorably the testimony previously given.

Burden of Proof

It is important to realize that the plaintiff has the burden of establishing the facts which prove the claim being asserted. For example, a dealer pursuing a claim for an unpaid repair bill should establish by evidence and testimony that the defendant authorized the repairs involved; the repairs authorized were in fact performed; and that the defendant failed to pay the bill for those repairs. Once the dealer has presented evidence proving these facts, the defendant would then have the burden to present evidence as to why the repair bill should not be paid.

To a certain extent, Small Claims Courts have developed a reputation for favoring the plaintiff's position on disputed claims. This tendency will certainly vary in degree from court to court, but may be at least partially attributable to the fact that the plaintiff has no right of appeal in a small claims action.

PRACTICAL TIP

A dealer's small claims trial presentation should be as concise as possible, because as a practical matter Small Claims Court judges have many matters to hear and so will attempt to expedite the hearings by assigning each one an informal time limit.

Evidentiary Concerns

A party should take into consideration certain basic evidentiary principles to present the strongest

case possible at a small claims trial. For instance, whenever possible, a party should present the following:

a. Documentary evidence to support oral testimony of a fact;
b. Testimony of record keeping practices and procedures to enhance the credibility of written records submitted;
c. Testimony as to specific dates, times, and places to support testimony of factual occurrences; and
d. Testimony of a non-party witness with no interest in the outcome of the action to support disputed facts.

Small Claims Judgments

Following the presentation of the evidence by both parties in a small claims action, the judge will either render a decision on the matter at that time or take it under submission (in taking the matter under submission, the judge is simply delaying the decision to a later time, often in order to check legal authorities or review documentary evidence in greater detail). As part of this decision, the court should award court costs to the prevailing party (Code Civ. Proc. section 116.610(g)). Examples of court costs are filing fees and fees for service of papers.

Notice of Judgment

Once the judge renders a decision, the Small Claims Court clerk is required to deliver or mail a Notice of Entry of Judgment to each of the parties in the action (Code Civ. Proc. section 116.610(h)). This notice sets forth the date of judgment; title and case number of the action; the prevailing party; and terms of the judgment rendered. In addition, it normally indicates the date the judgment was entered, which commences the time running for the defendant to file an appeal, and gives information on the respective rights of the parties.

A party should review this Notice of Entry of Judgment carefully to see that it is accurate and, in a case where an oral decision was rendered, to see that the written terms match that oral decision. If there is a discrepancy, the court clerk should be contacted immediately to correct the situation.

Default Judgment

In those instances where a party does not appear and does not have a defense presented at a small claims trial, the court may enter a default judgment against that party. If the plaintiff does not appear and does not have evidence put on supporting the claim, the court will on its own motion (or the defendant should request it) grant judgment in favor of the defendant on the plaintiff's claim. Where a defendant does not appear, the plaintiff is entitled to a default judgment only when proper service of the claim and order were made on the defendant and the plaintiff presents evidence to prove the claim asserted (Code Civ. Proc. section 116.520(b)).

NOTE

ON NON-MILITARY DECLARATION: A plaintiff may be required to file a declaration signed under penalty of perjury that the defendant is not a member of the military service of the United States to obtain a default judgment The reason for this declaration is that the Soldiers and Sailors Civil Relief Act (50 U.S.C. sections 501 et. seq.) generally prohibits the entry of a default judgment against a member of the military.

Motion to Vacate Default Judgment

If a default judgment is entered against a defendant in a small claims action, the defendant can file a motion to vacate it (this means to remove the effect of the judgment) (Code Civ. Proc. section 116.730(a)). The Small Claims Court form for this motion must be filed within 30 days of the date the Notice of Entry of Judgment is mailed to the defendant. The defendant should then appear at the hearing on this motion (the date to be set by the Small Claims Court) to tell the court why the defendant was unable to appear at the prior small claims trial. If the defendant cannot attend the hearing on the motion to vacate, the defendant can in the alternative submit a "written justification for not appearing together with a declaration in support of the motion" (Code Civ. Proc. section 116.730(b)). In any event, the defendant must appear in person or submit the above-referenced written explanation if the defendant is to have the right to appeal should the motion be denied. This right of appeal becomes available once the Small Claims Court denies the motion to vacate. To exercise that right of appeal, a defendant must file a notice of appeal within 10 days after the court has mailed or delivered notice of the motion to vacate being denied (Code Civ. Proc. section 116.730(e)). Regarding such an appeal, the Superior Court will first consider the merits of the motion to vacate and only if the defendant prevails on that issue and all parties are present, will the court hear the merits of the actual dispute. Alternatively, the court may order the transfer of the matter back to the Small Claims Court for hearing (Code of Civil Proc. section 116.730(f)).

If the defendant makes a showing of "good cause", the Small Claims Court may grant the motion to vacate. "Good cause" is defined as "circumstances sufficient to justify the requested order or

action, as determined by the judge" (Code Civ. Proc. section 116.130(j)), which basically means that a party has a very good excuse for not appearing at trial. The Small Claims Court has a great deal of discretion under this standard, so if there is a reasonable excuse for why a defendant did not appear at the trial, the legal principle that a matter should be decided on its merits weighs in favor of the motion being granted.

If the motion to vacate is granted and all parties are present and agree, the court may hear the claim on its merits without rescheduling it (Code Civ. Proc. section 116.730(d)).

NOTE

ON DEFAULT AGAINST PLAINTIFF: If a plaintiff fails to appear at the small claims trial and a default judgment is entered, the plaintiff can file a motion to vacate that judgment and have the matter heard on its merits. This motion, which must be filed within 30 days of the mailing of the Notice of Entry of Judgment, will be granted upon a "showing of good cause." (Code Civ. Proc. section 116.720(a)(c)). A defendant can oppose such a motion by submitting written opposition papers and/or appearing in person to orally argue against the motion. If the motion is granted and all the parties are present and agreeable, the hearing on the merits may be held (Code Civ. Proc. section 116.720 (d)).

Motion to Vacate when Improper Service

If a defendant has not been properly served with the plaintiff's claim and the court's order setting the hearing, the defendant may file a motion to have a default judgment vacated. This motion should be granted on a showing of good cause (Code Civ. Proc. section 116.740). A defendant must bring a motion to vacate within 180 days after the defendant discovers or **should have discovered** that an unfavorable small claims judgment has been entered against the defendant. Pending the hearing on the motion to vacate, the Small Claims Court may order that enforcement of the judgment be suspended. (Code Civ. Proc. section 116.740 (b)).

NOTE

SMALL CLAIMS COURT'S POWER TO CORRECT OR VACATE JUDGMENT: A Small Claims Court judge has the authority to correct clerical mistakes or even judicial errors regarding a judgment under the appropriate circumstances (Code Civ. Proc. section 116.725).

Small Claims Appeal

Defendant's Option Only

Once a judgment is rendered in a small claims action, the clerk is required to notify the parties by mail of the result (Code Civ. Proc. section 116.610(h)). The issue of an appeal then becomes relevant. If a small claims judgment is in favor of the defendant, the plaintiff has no right of appeal and the judgment is final (Code Civ. Proc. section 116.710 (a)). However, if the defendant is successful on a counterclaim against the plaintiff, then the plaintiff will have the right to appeal as to that claim. Note that a defendant who is unsuccessful in prosecuting a counterclaim has no right of appeal regarding the judgment on the counterclaim.

If the small claims judgment is in favor of the plaintiff, the defendant has the right to appeal to the Superior Court of the county where the Small Claims Court is located. If the right of appeal is not properly exercised by the defendant, then the judgment is final. This right of appeal is therefore extremely important to a defendant, since it represents the only way the defendant has a chance to change an unfavorable result.

NOTE

ON APPEAL CORPORATION MAY APPEAR WITHOUT ATTORNEY: Pursuant to Code Civ. Proc. sections 116.770(c) and 116.540(b), a corporation which is a party to a small claims action may appear in a Superior Court for purposes of an appeal through a director, officer, or employee.

ON PLAINTIFF PURSUING SAME CLAIM IN SUPERIOR COURT: There is legal authority based upon the concept of "collateral estoppel", that a plaintiff who is unsuccessful in pursuing a claim in a small claims action is barred from re-litigating that claim in a separate lawsuit brought in the Superior Court, if the record from the small claims action makes it sufficiently clear that the same claim is involved (*Pitzen v. Superior Court *(2004))120 Cal.App.4th 1374).

PRACTICAL TIP

Since a small claims appeal represents a proceeding in the Superior Court, a party may be represented by an attorney both in connection with the filing of the appeal and the hearing of the appeal (Code Civ. Proc. section 116.770(c)).

NOTE

ON APPEAL BY INSURER OF DEFENDANT: The insurer for a defendant may appeal a judgment on a plaintiff's claim that exceeds $2,500, if the insurer stipulates its policy covers the matter to which the judgment applies (Code Civ. Proc. section 116.710(c)).

Procedure for Filing an Appeal

To appeal a small claims judgment, a defendant must file a Notice of Appeal form with the Small Claims Court **within 30 days** of the date the clerk delivers or mails the Notice of Entry of Judgment (Code Civ. Proc. section 116.750(b)). At the time the Notice of Appeal is filed, the defendant must also pay a filing fee (Code Civ. Proc. section 116.760(a)).

CAUTION

REGARDING APPEAL DEADLINE: If the Small Claims Court renders a decision and the clerk of the Small Claims Court fails to send the Notice of Entry of Judgment, the time for filing an appeal should not be considered as extended. A dealer's best strategy under those circumstances is to make sure that the Notice of Appeal is filed within 30 days of the actual trial date. This approach eliminates any chance that there will be no appeal because of a late filing of a Notice of Appeal.

The time period for filing an appeal is not extended by any request to correct a mistake in a judgment. However, if a notice of a modified judgment is delivered or mailed, a new period for filing an appeal commences (Code Civ. Proc. section 116.750(c)).

In the situation where the defendant wants to appeal following a motion to vacate (where the court has denied the motion), the Notice of Appeal must be filed within 10 days after the Small Claims Court has mailed or delivered the notice of the denial of the motion (Code Civ. Proc. section 116.730(e)).

PRACTICAL TIP

A Notice of Appeal form is available from the Small Claims Court and should be used for purposes of exercising the right of appeal. However, there is legal authority that any statement signed by the appealing party (referred to as the "Appellant") or the party's attorney indicating the appeal of a specified judgment or denial of a motion to vacate should suffice to exercise the right of appeal (California Rule of Court 8.954(a)).

Notice to Other Parties

Following the filing of a Notice of Appeal, the Small Claims Court should send a notice of this filing to the other parties in the action. The Small Claims Court should also cause the case file and all related papers to be transmitted to the appropriate branch of the Superior Court (California Rules of Court 8.954(b) and 8.957).

Setting Appeal Hearings

Upon receipt of this record on appeal, the Superior Court will act to set a hearing on the matter for the earliest available date and then cause written notice of that hearing date to be sent to the parties at least 14 days before that date (Code Civ. Proc. section 116.770(e)). Any party may seek to have this hearing date postponed for good cause. The continuance cannot be for more than 30 days unless the situation involves a case of extreme hardship (California Rules of Court 8.960).

NOTE

NO JURY TRIAL: There is no right to a jury trial on a small claims appeal (Code Civ. Proc. section 116.770(b)).

Conduct of an Appeal Hearing

The actual hearing on the appeal of a small claims action is conducted informally like the initial small claims trial, except that attorneys may participate (Code Civ. Proc. section 116.770(b)(c)). Again, the hearing itself basically consists of both sides presenting to a different judicial officer whatever evidence or testimony they have to support their respective positions. Hearsay evidence, such as written declarations from witnesses not present, can be presented at this hearing. However, Superior Court judges may tend to discount hearsay evidence unless there are convincing reasons why better evidence could not be presented (*Houghtaling v. Superior Court* (1993) 17 Cal.App.4th 1128).

CAUTION

APPEAL IS NEW TRIAL: It is important to realize that this hearing represents a totally new trial of all of the claims of all parties and the Superior Court judge is not bound in any way by what happened at the Small Claims Court trial (Code Civ. Proc. section 116.770(a)(d)). This means that claims against other defendants who did not file an appeal and even the counterclaims of defendants will be given new consideration (Lin-

ton v. Superior Court *(1997) 53 Cal.App.4th 1097; Universal City Nissan, Inc. v. Superior Court (1998) 65 Cal.App.4th 203). It is therefore crucial that a dealer be prepared to again fully present at the appeal hearing the evidence supporting the dealer's claim as well as the evidence needed to defend any claim made against the dealer.*

NOTE

ON APPEAL AS NEW TRIAL: Although a small claims appeal should be handled as a totally new trial, there is some legal authority (however new trial, there is some legal authority (however more recently reported court decisions have declined to follow this authority) that a superior court judge is prohibited from granting an award of damages to an appellant appealing a judgment in favor of the small claims plaintiff (*Township Homes v. Superior Court *(1994) 22 Cal.App.4th 1587).

PRACTICAL TIP

A dealer's preparation for the presentation of the case at the hearing on appeal should take advantage of any lessons to be learned from the previous small claims trial. Steps that can be taken to strengthen a presentation at the appeal hearing include subpoenaing further witnesses or documents and citing additional legal authorities which are applicable to the relevant issues. A dealer may also want to ask the court to return exhibits from the small claims trial which are in the court file so they can be used again in the appeal presentation. In any event, a party's presentation at a hearing on appeal should be as clear and concise as possible because the congestion of the Superior Court will often dictate that only a small amount of time is available to hear a small claims appeal. If a dealer is the appellant and at the hearing on appeal the opposing party does not appear, the dealer should make sure the court finds in the dealer's favor to remove the effect of the Small Claims Court judgment.

Dismissal of Appeal

If a small claims appellant for some reason (for example a voluntary settlement of the dispute) decides not to pursue a small claims appeal, the appellant can file with the Superior Court a written request to have it dismissed or a stipulation for dismissal signed by the opposing party (California Rule of Court 8.963).

The Decision of The Superior Court on Appeal

The decision of the Superior Court on a small claims appeal is final and cannot be appealed (Code Civ. Proc. section 116.780(a)). As part of that judgment, the Superior Court may "for good cause and where necessary to achieve substantial justice" award attorney's fees actually and reasonably incurred in connection with the appeal in an amount not to exceed $150 dollars. Actual loss of earnings and expenses of transportation and lodging actually and reasonably incurred in connection with the appeal in an amount not to exceed $150 dollars may also be awarded (Code Civ. Proc. section 116.780 (c)).

NOTE

ON ATTORNEY'S FEE FOR FRIVOLOUS APPEALS: If the Superior Court judge hearing the small claims appeal determines that a defendant (or a plaintiff appealing a defendant's counterclaim) filed it without substantial merit and for purposes of delay or harassment, the judge may award attorneys' fees of up to $1,000 to the prevailing party and also any actual loss of earnings and expenses of transportation and lodging reasonably incurred in connection with the appeal in an amount up to $1,000 (Code Civ. Proc. section 116.790). A party requesting loss of earnings and transportation and lodging expense should be ready to provide records supporting the requested amounts.

It should be pointed out that some authority exists indicating that the Superior Court does have the power to vacate its decision and order a rehearing where the court is convinced a mistake was made. (*Adamson v. Superior Court* (1980) 113 Cal.App.3d 505). However, this type of rehearing is very unlikely to occur and would probably only be possible if there had been a fraud on the court or the court had acted in excess of its jurisdictional powers (Era-*Trotter Girouard v. Superior Court* (1996) 50 Cal.App.4th 1851). Also, it should be noted that procedural issues pertaining to small claims actions are subject to appellate court review by extraordinary writ (*Universal City Nissan, Inc. v. Superior Court* (1998) 65 Cal.App.4th 203; *General Electric Capital Auto Financial Services, Inc. v. The Appellate Division of the Superior Court of Los Angeles County* (2001) 88 Cal.App.4th 136).

Collecting on a Small Claims Judgment

Once a favorable judgment is obtained from the Small Claims Court and there is no appeal or it is affirmed on appeal by the Superior Court, the judgment becomes final. At that time, the prevailing plaintiff (designated as the "judgment creditor") often faces a difficult challenge of collecting on the judgment from the defendant (designated as the "judgment debtor"). Although an unsuccessful defendant (or cross-defendant) is supposed to pay a judgment "immediately" or pursuant to any terms or conditions the court may order (Code Civ. Proc. section 116.620(a)), this in reality will not always happen. In any event, a successful plaintiff should make a demand on the defendant for payment of the amount awarded before taking other steps to collect the judgment.

If the judgment is not paid voluntarily, certain legal procedures are available to a judgment creditor to collect the sums due. Among the most useful of these procedures are abstracts of judgment, judgment liens on business personal property, writs of execution, wage garnishment, and use of a keeper. These procedures, which vary in terms of application and complexity, are discussed briefly in this chapter to communicate a basic understanding of their approach and practicality in collecting a small claims judgment. Note that the costs incurred in employing these procedures are recoverable from the judgment debtor as a general rule (Code Civ. Proc. section 685.040 and 116.820(c)).

PRACTICAL TIP

Judgment enforcement procedures discussed in this chapter are those which are available and commonly used to enforce any state court judgment. If questions arise regarding their use, a dealer should consult an attorney.

Stay of Judgment

Under any circumstance, a small claims judgment cannot be enforced until the time for filing an appeal has expired, or if an appeal was filed, until it has been determined. This stay on the enforcement of a judgment occurs automatically and does not require the defendant to file a bond (Code Civ. Proc. section 116.810).

NOTE

JUDGMENT ON VEHICLE ACCIDENT: To assist in the collection of small claims judgments which are in the amount of $750 or less and are against a driver of a motor vehicle involved in a motor vehicle accident, Code Civ. Proc. section 116.880 allows a judgment creditor, in those instances where the judgment remains unsatisfied for more than 90 days, to file with the DMV a notice stating that the judgment has not been satisfied. There is a minimal fee required for filing this notice, which can lead to the suspension of the driver's privilege to operate a motor vehicle for a period of 90 days. This suspension will be lifted if the judgment is paid and proof of payment as required by the statute is submitted to the DMV.

Obtaining Financial Information about the Judgment Debtor

To make the best use of the judgment enforcement procedures available, a judgment creditor needs to secure information as to the financial situation of the judgment debtor. The more a judgment creditor knows about the nature and location of a judgment debtor's assets, including income sources, bank accounts, real property, and personal property, the more likely a small claims judgment will be successfully collected.

Prior Business Dealings

As a result of prior business dealings, a dealer may have ready access to financial information (for example, bank locations, bank account numbers, employer names and addresses, and residential/business property addresses) which is useful in collecting a small claims judgment from a former customer who is now the judgment debtor. If business records do not disclose specific information that is useful, they can reveal leads which, with minimal investigation, can develop more useful information. For example, the visual inspection of the home address of a judgment debtor followed up by a check of the county tax assessor's records may lead to a determination that the property is a residence in which the judgment debtor has an ownership interest.

Court Questionnaire

An alternative source of financial information concerning a judgment debtor may be a procedure initiated by the Small Claims Court itself. At the time a judgment is rendered, or when Notice of Entry of Judgment is mailed, the Small Claims Court clerk should deliver or mail to the judgment debtor a form "containing questions regarding the nature

and location of assets" (Code Civ. Proc. section 116.830(a)). The judgment debtor is required to complete the form and deliver it to the judgment creditor within 30 days of the date the Notice of Entry of Judgment is mailed (Code Civ. Proc. section 116.830(b)). If a motion to vacate or appeal was filed, the judgment debtor has 30 days to complete the form from the date the clerk mailed or delivered notice of denial of the motion to vacate or notice of dismissal of or entry of judgment on the appeal (Code of Civ. Proc. section 116.830(c)).

If a judgment debtor willfully fails to complete this form as required by statute, a judgment creditor theoretically can request the Small Claims Court for sanctions against that party (Code Civ. Proc. section 116.830(d)). Upon such a request, the Small Claims Court is authorized pursuant to Code of Civil Procedure section 708.170(a)(1) to issue a warrant to have the judgment debtor brought before the court to answer for the failure to return the statement of assets form and to face possible punishment for contempt. Additionally, the court may award attorney's fees to the judgment creditor for efforts involved in requesting these sanctions (Code Civ. Proc. section 708.170 (a)(2)).

PRACTICAL TIP

As a practical matter, the statement of assets questionnaire represents a voluntary effort on the part of the judgment debtor and thus is of limited value. Many times this form, even if it is returned, will contain incomplete or inaccurate information. Although statutory authority exists for the Small Claims Court to order sanctions against a judgment debtor who fails to return the questionnaire, this will not necessarily happen.

Judgment Debtor's Exam

A judgment creditor's best chance to obtain financial information about the judgment debtor utilizing the judicial process is to set up a judgment debtor's exam (Code Civ. Proc. section 708.110). This procedure involves personal service (usually by a Marshal or Sheriff) of an order on the judgment debtor to appear at a hearing where the judgment creditor is able to ask the judgment debtor (who is put under oath) questions regarding his or her assets. If a dealer has a desire to pursue this procedure, the dealer should check with the court clerk and/or an attorney regarding the steps necessary to set up an exam.

A judgment debtor who fails to appear at a judgment debtor's exam when properly served with the necessary order is subject to sanctions under Code Civ. Proc. section 708.170 (see prior discussion of these sanctions in connection with the Court Questionnaire). Under such circumstances, a judgment creditor should be successful in having a bench warrant issued by the court against the judgment debtor.

Use of an Investigator

There are investigative services available which for approximately $300 may be able to provide a dealer with the location of a bank account or other valuable assets of a judgment debtor. The costs of an investigative service, however, will not be recoverable.

Collection Procedures

Abstract of Judgment (For Real Property)

If it is determined that a judgment debtor has or could possibly in the future possess an interest in real property, a judgment creditor should strongly consider establishing a judgment lien against that property as a method of enforcing a small claims judgment.

How to Establish

This particular lien is established by completing an Abstract of Judgment form and then submitting it to the clerk of the court where the judgment was rendered along with a minimal fee. The form itself basically contains information as to the case number, court, title, date of entry of judgment, terms of the judgment, existence of any judgment stay (meaning any court order that the judgment cannot be collected now), and the names and addresses and other identifying information as to the judgment creditor and judgment debtor (Code Civ. Proc. section 674). The court then "issues" the Abstract of Judgment (which basically means that a clerk gives it a stamp of approval) and returns it to the judgment creditor who should take it or mail it (with the appropriate number of copies) to the county recorder's office for the county within which the judgment debtor is believed to possess an interest in real property for recording. There is a nominal fee to record an Abstract of Judgment.

Effect

By recording an Abstract of Judgment, a judgment creditor creates a judgment lien against any and all real property interests presently held or even acquired later by the judgment debtor within that county. The practical effect of this lien is that the judgment debtor cannot transfer real property interests without the lien being satisfied. The effect of this lien, however, has some limitation as it does not necessarily force the immediate payment of the

judgment or deny the judgment debtor of the present use of the property.

PRACTICAL TIP

Because this procedure is so simple and cost effective, it is highly recommended that a dealer judgment creditor use an Abstract of Judgment to assist in the collection of a small claims judgment in any instance where the dealer believes the judgment debtor possesses an interest in real property. Although this judgment lien can be enforced by levy and sale pursuant to a Writ of Execution, this procedure is very complicated and therefore impractical.

NOTE

ON ABSTRACTS OF JUDGMENT: An Abstract of Judgment is valid only in the county where it is recorded. Therefore, if a judgment debtor has, or may acquire, interests in real property located in more than one county, a judgment creditor should record an Abstract of Judgment in each of those counties to have the best chance to collect on the judgment.

Judgment Lien (For Business Personal Property)

If a dealer obtains a small claims judgment against a judgment debtor who is the owner of a business, the dealer can create a judgment lien against the personal property of that business in an effort to collect a small claims judgment (Code Civ. Proc. section 697.510).

How to Establish

To establish this type of judgment lien against business personal property (generally defined to be accounts receivable; chattel paper; equipment; farm products; inventory; and negotiable documents of title (Code Civ. Proc. section 697.530)), a dealer needs to file a Notice of Judgment Lien with the California Secretary of State's office in Sacramento. This form (available online from the Secretary of State's website) should be completed with the required information including the court title; case number; date of notice; date the judgment was entered; terms of the judgment; the names and addresses of the judgment debtor and judgment creditor; and a statement to the effect that the judgment lien is established as to all personal property to which a judgment lien may attach under California Code of Civil Procedure section 697.530 (Code Civ. Proc. section 697.550). The completed form is then filed with the Secretary of State's office together with a minimal filing fee. While the judgment creditor is required to serve a copy of the Notice of Judgment Lien on the judgment debtor either in person or by mail, a failure to do so does not "affect the validity of the judgment lien" (Code Civ. Proc. section 697.560).

Effect

The effect of this lien in collecting a small claims judgment is similar to the Abstract of Judgment lien discussed previously, except as applied to business personal property. The lien does not necessarily cause payment of the judgment immediately or even deprive the judgment debtor of the use of the personal property involved. However, it does normally (there are exceptions) prevent any bulk transfer of that property without the lien being satisfied (Code Civ. Proc. section 697.610).

Writ of Execution (For Personal or Real Property)

In contrast to the two types of liens discussed previously, a Writ of Execution is a more direct (and often more expensive) judgment enforcement procedure available to a dealer to enforce a small claims judgment. This procedure is applicable to both real and personal property and basically involves a Sheriff or Marshal levying upon a specific asset held by the judgment debtor which is not exempted by statute (an example of an exempted asset is the loan value of an unmatured life insurance policy (Code Civ. Proc. section 699.720(a)(6)). Following such a levy, if the judgment remains unpaid, the asset in question can be sold (or collected) by the levying officer in an attempt to satisfy the judgment (this assumes that certain statutory requirements are met regarding the sale) (Code Civ. Proc. section 701.510).

CAUTION

REGARDING WRITS OF EXECUTION: The use of a Writ of Execution is discussed in this chapter only in very basic terms. The actual application of this procedure can be quite complicated even when trying to enforce a small claims judgment. A dealer should therefore not hesitate to contact an attorney regarding any questions that may arise concerning this procedure.

How to Obtain a Writ

To obtain a Writ of Execution, a dealer must first complete a Writ of Execution form and then submit it (usually with 2 copies and a minimal fee) for issuance to the clerk of the Small Claims Court. Some courts require a separate application form to be submitted with the Writ of Execution form as part of the process. The Writ of Execution form requests a variety of information concerning the law-

suit and the parties involved (Code Civ. Proc. section 699.520). Specific instructions as to how to fill out such a form are set forth in the example below, but for purposes of a small claims judgment, the main idea is to indicate accurately on the form the amount of the judgment awarded which is still unpaid. Other calculations as to post-judgment costs and interest to which a judgment creditor may be entitled should not be a major concern.

Instructions for Writ of Execution Form

Instructions for completing a Writ of Execution form are provided below based upon a hypothetical fact situation where "Quality Dealer, Inc." seeks to enforce a judgment rendered by a Small Claims Court against "John Jones." The judgment, which is in the amount of $1,000 ($980 in principal and $20 in costs), was entered on June 1, 2013 and the Writ of Execution is submitted for issuance on June 30, 2013.

Instructions:

Caption (boxes at top of form)

- Fill in the name and address of Quality Dealer as the judgment creditor;
- Fill in the address of the Small Claims Court;
- Fill in the names of the plaintiff and defendant;
- Fill in the case number; and
- Check the box for execution on money judgment.

Item 1: Fill in the county where the property to be levied upon is located since that will designate the proper Marshal or Sheriff to be used.

Item 2: Not normally applicable.

Item 3: Check the box indicating judgment creditor and fill in the name of Quality Dealer.

Item 4: Fill in the name of John Jones as the judgment debtor and his last known address. If there is more than one judgment debtor, additional names and addresses should be listed on the reverse side of the form.

Item 5: Fill in June 1, 2013 as the date the judgment was entered.

Items 6, 7, 8, 9, and 10: These items are not normally applicable in pursuing a small claims judgment for money. They should be left blank.

Item 11: Fill in the total amount (including principal, interest, and costs) awarded by the trial court. In the example, this amount is $1,000.

Item 12: Costs after judgment are usually is not worth being concerned about in pursuing a small claims judgment; however, a judgment creditor may, by filing a Memorandum of Costs form, claim costs incurred in collecting a judgment (for example, the cost of issuing an Abstract of Judgment could be claimed in this fashion).

Item 13: Fill in the total of items 11 and 12.

Item 14: This item is applicable only if some part of the judgment has been collected previously.

Item 15: Fill in the total per the form instructions.

Item 16: A judgment creditor is entitled to 10% interest (Code Civ. Proc. section 685.010(a)) on the amount of a judgment awarded starting from the date it is entered and ending on the date of collection. Interest on a small claims judgment is usually a small amount and therefore not a major concern. If this interest is claimed, a judgment creditor must file a declaration under penalty of perjury (court clerks may have forms that can be used for this purpose) which shows the calculation of interest by the judgment creditor. The interest is calculated at a daily rate and then applied as a practical matter to the time from the entry of judgment to the date the Writ of Execution is submitted for issuance. Under the hypothetical given, the daily rate is $0.27 per day (10% times $1,000 divided by 365) and for thirty days (the time from June 1, 2013 to June 30, 2013), the interest total is $8.10. If a declaration is not filed, the judgment creditor should simply leave this space blank.

Item 17: Fill in the fee paid to the court for issuing a Writ of Execution.

Item 18: Fill in the total of items 15, 16 and 17.

Item 19: (a) Fill in the interest rate calculated by multiplying 10% times the total shown on item 15 and then dividing that amount by 365. In the example, this is $0.27. Part (b) of this item is not applicable.

Item 20: This item is applicable only if there is more than one judgment debtor and the amounts differ as to each individually.

Reverse Side:

The reverse side of this form is usually not applicable unless there is more than one judgment debtor.

A Writ of Execution can be issued for more than one county (Code Civ. Proc. section 699.510(a)). In fact, such a Writ is necessary if the judgment creditor wants to pursue an asset held by the judgment debtor in a different county.

While more than one Writ of Execution can be out for levy at one time (i.e. when assets located in two different counties are being pursued), a dealer should avoid this unless the dealer has consulted with an attorney. The reason for this caution is that excessive levying can be a grounds for an abuse of process lawsuit (*White Lightning Co. v. Wolfson* (1968) 68 Cal.2d 336).

Instructing the Levying Officer

Once the Writ of Execution is issued by the court, the judgment creditor must deliver it together with the appropriate number of copies, levy instructions, and levy fees to the Sheriff or Marshal in the county where the levy is to be made. Information as to the number of Writ copies required and the fees for levy can be obtained by contacting the particular Sheriff's or Marshal's office involved. It should be noted that the levy fees are based upon the type of asset to be levied upon and can be substantial in amount. For instance, the fee to levy upon an automobile is in excess of $900 in Los Angeles County. The levy instructions should be written (some Sheriff's or Marshal's offices have pre-printed forms) and need to accurately describe the asset to be levied upon, its location, and if the property involved is a dwelling, whether or not it is real or personal property (for instance a house trailer) (Code Civ. Proc. section 687.010).

PRACTICAL TIP

For example, a dealer trying to collect a small claims judgment against a judgment debtor by levying upon a bank account should inform the levying officer of the name and address of the bank branch where the judgment debtor is believed to have bank accounts; instruct the officer to levy upon any such accounts held in the judgment debtor's name; and indicate any specific account numbers if known.

EXAMPLE

A sample instruction is as follows:

"Please levy upon any and all personal property in possession of Bank of America, 6300 Sunset, Hollywood, California, including, but not limited to, all checking accounts, savings accounts, passbook accounts, savings certificates, securities, bonds, accounts receivable, safe deposit boxes, and any other accounts or property interests held by the defendant John Jones."

Effect of the Writ

The effect of a levy pursuant to a Writ of Execution depends upon the nature of the asset involved. Code Civ. Proc. sections 700.010 through 700.200 direct the levying officer as to how to levy on a wide variety of personal property (i.e. securities, accounts receivable, bank accounts, safe deposit boxes, etc.) as well as real property interests. Code Civ. Proc. sections 701.510 through 701.680 direct the levying officer as to procedures concerning the sale and collection of the various kinds of property subject to levy.

Personal property: In general terms, personal property levied upon is either physically taken possession of by the levying officer (for example this would be the approach regarding an automobile) or in effect "frozen" (this would be the approach for a bank account). In either situation, the judgment debtor basically loses the use of the property involved and can only regain the property by either causing the judgment to be paid or claiming an exemption (see the discussion of exemptions later in this chapter).

If the judgment is not paid, personal property which is in the possession of a levying officer can be sold assuming certain statutory requirements (for instance notice requirements under Code Civ. Proc. section 701.530) are complied with and the proceeds of such a sale can be applied to pay off the outstanding judgment (Code Civ. Proc. sections 701.810 and 701.820). Personal property described as frozen can be collected by the levying officer for further disposition toward the satisfaction of a judgment (Code Civ. Proc. section 701.520). For instance in the case of a bank account, the bank officer forwards funds from the account levied upon directly to the levying officer (Code Civ. Proc. section 700.140(e)) who in turn can distribute them to the judgment creditor.

Real property: When real property is levied upon, the Writ of Execution is recorded (Code Civ. Proc. section 700.015) and a lien established (Code Civ. Proc. section 697.710). While this lien may be enforced by a sale of real property, the complicated procedures involved make this an inefficient - method to collect a small claims judgment.

PRACTICAL TIP

A dealer trying to collect on a small claims judgment should strongly consider using a Writ of Execution to pursue specific personal property assets of the judgment debtor which are believed to be valuable enough to satisfy the judgment, if they are collected or sold. If real property interests are being pursued, a recorded Abstract of Judgment is the more practical approach.

Exemptions

Nature: It should be noted that the effectiveness of collecting a small claims judgment using a Writ of Execution may be reduced by exemptions which a judgment debtor may claim regarding certain types of property. These exemptions are created by statute and are covered by Code Civ. Proc. sections 703.010 through 704.995. In general, these exemp-

tions represent protection against the enforcement of money judgments on certain property or portions thereof, which might be described as necessary to the basic livelihood and well being of the judgment debtor.

Examples: Some of the exemptions a judgment debtor is entitled to include: an exemption worth $2,300 as to any equity in his or her motor vehicles (Code Civ. Proc. section 704.010) (note that if the judgment debtor has only one motor vehicle this exemption is automatic with no filed claim required); a total exemption for household furnishings, clothes, and personal effects "ordinarily and reasonably necessary" (Code Civ. Proc. section 704.020); an exemption worth $6,075 as to tools used in the judgment debtor's trade (Code Civ. Proc. section 704.060(a)(1)); and an exemption typically worth $75,000 as to the equity a judgment debtor may have in his or her principal place of residence (if it is a homestead) (Code Civ. Proc. section 704.730(a)(1)).

NOTE

ON EXEMPTIONS FOR NATURAL PERSONS: Exemptions apply only to property interests of natural persons (for instance they do not apply to property interests of a corporation) (Code Civ. Proc. section 703.020(a)).

Effect: The effect of a judgment debtor filing a claim of exemption can be the release of the levied property by the levying officer to the extent of the claimed exemption (Code Civ. Proc. section 703.550) (Note that certain exemptions, for example the one described above concerning equity in a single motor vehicle, apply without a claim being filed). This release will occur if the judgment debtor files a timely claim of exemption with the levying officer. To be timely, a claim of exemption must be filed within 10 days of the service date of the Notice of Levy on the judgment debtor (Code Civ. Proc. section 703.520). If the judgment creditor chooses to oppose the claim of exemption (for instance, the judgment creditor thinks it is either invalid or has not been timely filed), the judgment creditor must file timely opposition papers with the levying officer and the court, and also notice a motion for a court hearing to determine the dispute. Such opposition papers are timely if they are filed within 10 days of the service of the Notice of Claim of Exemption on the judgment creditor (Code Civ. Proc. section 703.550).

PRACTICAL TIP

As is readily apparent from the brief discussion above, claims of exemption can lead to rather involved legal proceedings. A dealer receiving a Notice of a Claim of Exemption is advised to contact an attorney immediately to discuss available options.

Third Party Claims

Nature: A dealer using a Writ of Execution to attempt to collect a small claims judgment should be aware that in trying to levy (through the efforts of the levying officer) upon assets held by the judgment debtor, third party claims may be encountered. In making such a claim, a third party basically contends that the third party has an ownership interest in or a right to possession of the asset levied upon. Third party claims are dealt with by Code Civ. Proc. section 720.110 through 720.660.

Effect: The effect of a third party claim on levied property is similar to the effect of a claim of exemption filed by a judgment debtor. If a timely claim is filed by the third party with the levying officer and the judgment creditor does not file the required undertaking in response to protect that third party's interest, the levied property will be released (Code Civ. Proc. section 720.270).

PRACTICAL TIP

As a practical matter, a dealer should be most concerned about third party claims in connection with an effort to levy upon a judgment debtor's automobile which may be subject to a third party's security interest. Such an effort is probably worthwhile only if the dealer can clearly determine that the judgment debtor has substantial equity in the subject vehicle. This is true since even if the dealer takes those steps necessary to allow the sale of the vehicle to go forward (i.e., filing an undertaking), as the proceeds from such a sale will be distributed to the third party before they can be applied to the outstanding judgment. Additionally, as discussed in this chapter previously, the judgment debtor can claim an exemption of $2,300 as to the sale proceeds (Code Civ. Proc. section 704.010(d)).

Wage Garnishment

A specialized judgment enforcement procedure which utilizes a Writ of Execution to collect wages of a judgment debtor directly from an employer is called "wage garnishment" (covered in Code Civ. Proc. sections 706.010 through 706.154). This procedure should be considered by a dealer pursuing a

small claims judgment where information has been developed as to the name and address of the judgment debtor's employer.

How to Obtain a Wage Garnishment

As mentioned above, a judgment creditor must first have a Writ of Execution issued (see prior discussion on how to accomplish this) to take advantage of the wage garnishment procedure. This Writ should be issued for the county where the judgment debtor's employer is located. It should then be submitted to the Sheriff's or Marshal's office for that county with a completed Application for Earnings Withholding Order form (Code Civ. Proc. section 706.102). This Application is signed under penalty of perjury and includes information as to the identity, address, and social security number of the judgment debtor if known; the name and address of the judgment creditor; the title of the court; the date the judgment was entered; the date the Writ of Execution was issued; the amount to satisfy the Writ of Execution plus the levying officer's statutory fee for service of the order; the individual or entity to whom withheld money should be paid; and the name and address of the employer (Code Civ. Proc. section 706.121).

Effect

Following the receipt of the Writ of Execution and a properly completed Application for Earnings Withholding Order, the levying officer will issue an Earnings Withholding Order (Code Civ. Proc. section 706.102(a)). This Order will then be served on the employer identified in the application, who as a result of the service is required to withhold the judgment debtor's wages during the "withholding period" as defined in Code Civ. Proc. section 706.022(a). Any funds withheld are then turned over to the levying officer, who will forward them to the judgment creditor or a representative as designated in the Application for Earnings Withholding Order.

Exemptions Applying to Wage Garnishment

Regarding wage garnishment, a dealer should be aware that statutory exemptions exist which restrict the amount of a judgment debtor's wages available for garnishment. For instance, automatically 75% of an individual's wages are basically exempted from wage garnishment pursuant to federal law (15 U.S.C. section 1673(a)). Additionally, wages necessary to support the judgment debtor's family are also exempt (Code Civ. Proc. section 706.051). To claim this latter exemption, a judgment debtor must basically follow the same procedures described previously in this chapter relating to exemptions applicable to Writs of Execution. Also as discussed previously, a judgment creditor can contest the claim of exemption by filing timely opposition and bringing the matter to a hearing before the court.

PRACTICAL TIP

A wage garnishment procedure can be quite effective in collecting a small claims judgment since it has a direct impact on the judgment debtor's employer. Often, a judgment debtor will act immediately to pay off the judgment so that the wage garnishment will cease.

CAUTION

CANCEL LEVIES WHEN PAID IN FULL: If a dealer is paid in full on a small claims judgment by the judgment debtor during a period when judgment collection procedures (such as a wage garnishment) are being employed, the dealer should act promptly to contact the Sheriff's or Marshal's office involved to request that these collection efforts cease immediately.

Use of a Keeper

Another specialized judgment enforcement procedure which utilizes a Writ of Execution is the employment of a keeper. This approach should be considered by a dealer if the judgment debtor has an ongoing business. Basically, a keeper is a representative of the Sheriff or Marshal, who is stationed at the judgment debtor's place of business to collect directly the receipts of this business for application to the unsatisfied judgment (Code Civ. Proc. section 700.070).

To use a keeper, the judgment creditor must first obtain a Writ of Execution for the county in which the place of business is located. Basically this Writ is then submitted to the Marshal's or Sheriff's office for that county, together with written instructions informing the levying officer of the name and location of the business where a keeper is to be installed and the number of hours he or she should be there. A deposit fee (not minimal) is required as well and depends on the length of time the keeper is to remain. If a dealer has any questions as to how to install a keeper, the dealer should contact directly the Sheriff's or Marshal's office in the county where the judgment debtor's business is located to determine the exact procedures involved.

PRACTICAL TIP

A keeper is a drastic judgment collection procedure which can be quite effective, but expensive. A judgment debtor is highly motivated to arrange to pay off a judgment when faced with

an outsider (the keeper) collecting the judgment debtor's daily business proceeds.

Satisfaction of a Judgment

If a small claims judgment is collected, a judgment creditor should immediately file with the Small Claims Court a Satisfaction of Judgment form (Code Civ. Proc. section 116.850(a)). This is important, because if the form is not filed, the judgment debtor can request one to be filed and if that request is not honored by the judgment creditor within 14 days, the judgment creditor can be liable to the judgment debtor for damages, plus a penalty of $50 (Code Civ. Proc. section 116.850 (b)). If an Abstract of Judgment has been recorded with the County Recorder in an effort to collect the judgment, a copy of the Satisfaction of Judgment should be served (either in person or by mail) upon the judgment debtor (Code Civ. Proc. section 724.040). Where a judgment debtor has proof of payment of a judgment such as a cancelled check, the judgment debtor may request the court clerk to enter a satisfaction of judgment (Code Civ. Proc. section 116.850(c)).

A judgment debtor has the option to deposit the funds necessary to satisfy a judgment with the Court where the judgment was entered. The judgment debtor must submit a declaration form and pay a small fee to use this procedure (Code Civ. Proc. section 116.860). This procedure can be useful to a dealer who receives an unfavorable judgment and wants to avoid further direct dealings with the judgment creditor regarding the matter

DMV INVESTIGATIONS AND ACCUSATIONS

Chapter 13

Contents

DMV INVESTIGATIONS AND ACCUSATIONS

OVERVIEW: The right of a person to obtain and retain an automobile dealer's license is constitutionally protected and cannot be impaired without providing the applicant or dealer with procedural due process.

Before a person can be finally denied a dealer's license, or before such a license once issued may be suspended, revoked, conditioned or otherwise limited, the party affected must be provided an administrative hearing. In the case of an action against a dealer, the process is initiated by the filing of an accusation by the Department of Motor Vehicles (hereinafter "DMV") against the dealer. Because some form of a DMV investigation necessarily precedes the filing of an accusation, a discussion of the two topics goes hand in hand.

The Vehicle Code and Government Code set forth the rights of the DMV to investigate a dealer's business activities and to inspect a dealer's records. The Vehicle Code further sets forth the grounds upon which the DMV may impose license discipline upon a dealer and the grounds for refusing to issue a license to a dealer, and provides that such action may be taken only after notice and hearing. The notice and hearing requirements authorizing the filing by the DMV of accusations against dealers, and statements of issues when new car dealer applicants are denied a license, and the procedures to be followed, are set forth in the Administrative Procedure Act and the provisions for Administrative Adjudication found in Government Code sections 11500 through 11528. These are designed to provide a dealer or applicant procedural due process in conformity with both state and federal constitutional requirements.

Although the incidents of accusations being filed against new car dealers are fortunately quite small, perhaps as little as one or three percent of new car dealers annually are served with an accusation, it is extremely important that every dealer be familiar with what triggers an accusation and what dealers must and should do in the event their dealership becomes a target of a DMV investigation and is served with an accusation.

It will be the purpose of this chapter to review the following topics: the extent of the DMV's authority to conduct investigations and to inspect records; DMV investigative procedures leading up to the potential filing of an accusation; grounds for license revocation or suspension; matters typically investigated by the DMV; how a dealer should conduct himself or herself if the dealership is undergoing a DMV review; the pre-hearing, hearing and post-hearing procedures governing accusations; appeals to the New Motor Vehicle Board; judicial review of a final Board decision; and the effect license discipline has upon a dealer and the dealership's officers and managerial employees. Grounds upon which the DMV may deny a license to an applicant for a new car dealer's license and the applicant's rights in the event of a denial will likewise be covered.

A discussion of the alternatives to a hearing on an accusation, namely a settlement in lieu of the accusation or a settlement of the accusation itself, and practical considerations involving such settlements are at the end this chapter.

DMV Investigations and Inspections

Statutory Authority

The requirement that a dealer obtain a license before engaging in the business of operating an automobile dealership has long been recognized as a valid exercise of police power to be exercised for the public good. The exercise of this power over the issuance of dealer licenses and dealership activities and operations is entrusted to the Department of Motor Vehicles of the State of California.

Vehicle Code section 1655 provides that the director and deputy director of the DMV, the Deputy Director, Investigations, the Chief, Field Investigations Branch, and the investigators of the department, including rank-and-file supervisory, and management personnel, shall have the powers of peace officers for the purpose of enforcing those provisions of law committed to the administration of the Department.

Government Code section 11180 provides that the head of each state department "...may make investigations and prosecute actions concerning":

(a) All matters relating to the business activities and subjects under the jurisdiction of the Department.

(b) Violations of any law or rule or order of the Department.

(c) Such other matters as may be provided by law.

In connection with these investigations, Government Code section 11181 gives the director the authority to do the following:

(a) Inspect books and records.

(b) Hear complaints.

(c) Administer oaths.

(d) Certify to all official acts.

(e) Issue subpoenas for the attendance of witnesses and the production of papers, books, accounts, documents and testimony pertinent or material to any inquiry, investigation, hearing, proceeding, or action conducted in any part of the state. *(emphasis added)*

(f) Promulgate interrogatories pertinent or material to any inquiry; investigation, hearing, proceeding, or action.

(g) Divulge evidence of unlawful activity discovered from records or testimony not otherwise privileged or confidential to the Attorney General or to any prosecuting attorney who has a responsibility for investigating the unlawful activity discovered, or to any governmental agency responsible for enforcing laws related to the unlawful activity discovered.

In addition, Vehicle Code section 1670 (lifted intact from former Vehicle Code section 320(b)) provides that a licensee issued an occupational license by the Department and conducting more than one type of business from an established place of business shall provide a clear physical division between the types of business and concludes with a sentence reading as follows: "The established place of business shall be open to inspection of the premises, pertinent records, and vehicles by any peace officer during business hours."

The DMV has consistently taken the position that the quoted language from section 1670 gives it the unlimited right to inspect the premises of a dealership and its pertinent records which by regulation it defines as those records of a dealership "...maintained in the regular course of business insofar as those records are directly concerned with the purchase, sale, rental or lease of a vehicle." (13 C.C.R. section 272).

This position was originally rejected by the Court of Appeal in *Addison v. Department of Motor Vehicles* (1977) 69 Cal.App. 3d 486, which held that the right of inspection was limited to those instances only where the licensee conducted more than one type of business on the premises; however another Court of Appeal decision *in People v. Shope* (1982) 128 Cal.App.3d 816 held that the authorization to inspect found in Vehicle Code section 320(b) (now section 1670) applied to all dealerships. In *Terry York Imports v. DMV* (1987) 197 Cal.App.3d 307 the Court of Appeal held that the Shope interpretation of section 320 was not necessary to affirm the conviction in that case and that its interpretation of legislative intent concerning that section was questionable. ***The Court in the Terry York case then went on to squarely hold that section 320(b) (now section 1670) did not give the DMV investigators the right to conduct a warrantless and unlimited search of the business records of a retail car dealership***. It noted that under the facts in the *Terry York* case, the DMV investigator refused to identify what "pertinent records" it sought. Although the door might still be slightly open for the DMV to claim the right to inspect records at a dealership without a subpoena where the DMV specifies the exact records it seeks, the language of the *Terry York* case would appear to bar even such a limited inspection unless the dealership was conducting more than one type of business at the premises.

Finally, Vehicle Code section 11714(e) provides that the DMV shall furnish dealers books and forms as it determines necessary and goes on to state: **"Such books and forms are and shall remain the property of the Department and may be taken up at any time for inspection."** The Terry York decision has no applicability to the right of the DMV under this section to pick up the report of sale books at a dealership at any time for inspection.

Routine DMV Inspections or Inquiries

Inspections of dealership records are generally associated with two types of investigations, namely a limited inquiry into a particular consumer complaint or complaints or practice which has come to the attention of the Department, or a dealer review where a team of investigators, usually two, makes a comprehensive review of the entire range of a dealer's sales practices and procedures, or a comprehensive review of a particular facet of a dealer's activities, such as for example, advertising.

Because one of the paramount responsibilities of the DMV is consumer protection, it routinely investigates customer complaints against dealers. It is the policy of the Department to require that a complaint be put in writing before it will look into it, usually on a Department form, and this form provides a place for the investigator to indicate the action taken, disposition of the complaint and whether a violation of a law or regulation was found on the part of the dealer against whom the complaint was lodged. Regardless of whether any violation of law or wrongdoing is found to exist, the record of the complaint is placed in the dealer's file maintained by the Department, unless the Department determines that the complaint was totally unfounded.

These files are not open to the public except by subpoena; however, a dealer may view the file upon request. (See also the discussion What's In A Dealer File in the chapter in this Management Guide entitled Other Important Topics.)

A review of hundreds of these complaint reports reflect that in a majority of instances, the dealer has already resolved the complaint or is in the process of resolving it, and the dealer's cooperation is duly noted in the report. A great many of the complaints deal with warranty and service related problems, rather than sales related problems, and in a majority of instances there is a notation that no violation was found to exist. Where a violation of law is found or substantiated, one of the investigator's duties is to explain the violation and recommend corrective action.

CAUTION

REGARDING NUMBER AND FREQUENCY OF COMPLAINTS: As will be seen, one of the factors that may lead to a full DMV review and ultimately a potential accusation is the number and frequency of complaints registered against a particular dealer. Lack of awareness on the part of the dealer of such complaints is not a good defense. New Motor Vehicle Board decisions, on appeals by dealers who have had discipline imposed upon their licenses as a result of accusations, are replete with statements that a dealer is responsible for knowing what is going on at the dealership. A procedure for speedy and expeditious handling of all consumer complaints by a dealership, and one which insures that the dealer is advised of all complaints and their resolution, is an essential precaution which should eliminate any potential problem developing which might lead to a dealer review or ultimately to the filing of an accusation.

Tips for Responding to a DMV Visit

- **Determine the Purpose of the Visit.** Although sometimes there may random compliance inspections, government agencies generally will not take the time and expense to pay you a visit unless they've received a complaint—either from a customer, employee, union, or competitor. Politely ask whether the visit is a random visit or an investigation, and what sparked their visit. The more information you obtain, the better you'll be able to cooperate with their requests in a targeted manner, and the better you'll be able to get to the bottom of the problem.
- **Be Courteous.** Government agencies do not respond to rudeness and intimidation by cowering away. If anything, such defensive stances will lead them to believe that their suspicions of wrongdoing have been confirmed. For instance, if the agency is asking for a customer file, responding "get a warrant" will probably lead them to do just that. A better response would be "We'd really like to give this to you, but state and federal laws do not allow us to provide confidential customer information without a warrant or subpoena. We can call our attorney to see if we can find another way to get you the information you need."
- **Call Your Attorney.** If the DMV investigates your dealership, make sure to call competent counsel to get advice—and do so immediately.
- **Know Your Rights.** Although agencies generally have the right to inspect public areas for compliance (e.g., checking whether required signs are posted or observing how you handle and label Hazardous Materials), they have limited rights to look further into your customer and business records. Make sure you do not give the agencies information or files to which they are not entitled. For instance, although California law specifically provides DMV with access to your Report-of-Sale books, no such law grants DMV access to deal jackets or other business records without a warrant or subpoena. Your attorney should be able to prevent overly-aggressive investigators from accessing inappropriate files.
- **Let CNCDA Know.** CNCDA tracks enforcement trends, allowing it to get the word out to other dealers to assist in compliance. The ability to do so, however, is limited to the feedback it receives from CNCDA members. If you find yourself visited by an agency, please give CNCDA a call at (916) 441-2599.

Dealer Reviews

Unlike occasional inquiries relating to customer complaints or relating, for example, to a particular ad run by a dealer, where the investigator may give the dealer or his or her representative a phone call or make an appointment to discuss the matter, a dealer review is a comprehensive and systematic investigation which usually extends to a dealer's entire sales and reporting practices. A review is initiated by either the DMV field supervisor for your area or DMV headquarters in Sacramento. Although procedures may vary depending upon the particular district or investigators involved, the following is generally typical of what transpires during a review.

What Triggers a Dealer Review

There are a number of "red flags" which may trigger a review. These include an excessive or unusual number of consumer complaints; unusual advertising claims; questionable or apparently misleading advertising observed during routine moni-

toring of ads by the DMV or consumer law sections of the Attorney General, City Attorney and District Attorney's Offices; dishonored checks submitted to the Department by the dealer; a claim by a financial institution that a dealer is out of trust; a claim that the dealer has bounced drafts given to another dealer; excessive administrative service fees based upon improper or late reporting of sales to the Department; and information from other licensees indicating participation in unlawful or improper activities. Although it was formerly standard practice for the Department to conduct some dealer reviews on a random sampling basis without any particular triggering event, this policy apparently has been discontinued and reviews today appear only to be initiated for cause.

How the Dealer Review Commences

The review is commenced by advising the dealer that a review has been initiated by the Department and an appointment is made to pick up the dealer's report of sale books. At this time, the investigators are required to explain to the dealer or an officer of the dealership the review procedure. If the dealer's advertising triggered the review, the dealer may be asked at the same time or at a later date to furnish copies of all newspaper ads or the scripts of all radio or TV ads for a specified period. Once the report of sale books have been taken by the investigators, there is an apparent lull in the investigation which may last anywhere from a week to a couple of months during which the investigators examine the report of sale books.

Why Your Report of Sale Books are Picked Up

The report of sale books provide a fountain of information to the investigators and play a significant role in any review. To begin with, they help the investigators pinpoint the particular sales jackets which may later be requested. Not only do the report of sale books provide the name and address of each purchaser and the vehicle identification number of each vehicle sold, as well as the date of sale and the date of first operation, they also reflect whether vehicles were sold as new or used and whether any reported sale was subsequently unwound and the vehicle identified therein resold. Names of customers who bought unwinds can be obtained and names of customers who purchased vehicles during the period of any particular advertising or incentive campaign, or who purchased specified advertised vehicles, are thus obtained.

What Follows the Taking of The Report of Sale Books

The Inspection of Selected Sales Jackets

Following the review of the report of sale books, the investigators go back to the dealership and request that certain sales jackets be pulled. Although this may appear to be an at random listing, it is usually a list of files which will more likely reveal, if such is the case, possible violations of law based upon the investigators' expertise, preliminary review of the report of sale books, dealer advertising, and a review of any prior consumer complaints. In light of the right to refuse such an inspection given by the *Terry York* case, it would be advisable at this stage of the investigation to consult your attorney as to whether you wish to volunteer the requested records or force the DMV to use its subpoena power under Government Code section 11181.

Selected sales jackets involving rollbacks, for example, might show that the vehicle was described as new on the conditional sale contract covering its resale. A review of the sale of advertised vehicles or sales of vehicles sold during the applicable period of an advertising campaign, as a further example, may show that a vehicle was not sold as advertised or that a customer did not get an advertised incentive, or that a vehicle continued to be advertised for sale more than 48 hours after its sale. Also, the reported date of sale and of first operation may not correspond with the date of a customer's contract or date of delivery. Finally, the sales jackets which are pulled may turn up possible violations of law beyond the scope of the initial reason for pulling the file. The review of a number of files relating to advertising will also provide a random sampling of conditional sale contracts which may possibly reflect Automobile Sales Financing Act or Leasing Act violations. An investigator, for example, might find that a conditional sale contract is not properly filled out or does not properly document a side loan, and if this is the case, additional files might be requested.

The Interviewing of Customers

Following the examination of the dealer's records and sales jackets, and depending on what has been revealed so far, there may be another apparent lull in the investigation. If the dealer has not been told that the investigation has been concluded, it can be assumed that during this period investigators are interviewing customers to clear up questions raised thus far by the investigation. For example, where an unwind was reported sold on a used report of sale, but the vehicle was described as new on the conditional sale contract, the customer might be asked what he or she was told by the salesperson about the vehicle at the time of sale. In the case of an adver-

tised vehicle or incentive, the file might not be clear as to whether the customer got the benefit of the ad and an interview would clear the matter up.

It is not uncommon during this phase of the review for a dealer to get a call from a customer asking the dealer why he or she is being interviewed by the DMV. The dealer should in this event get from the customer as complete an account of the interview as possible and make a written memorandum of the telephone interview. It is important to attempt to determine the manner in which the investigator interviewed the customer. For example, did the interviewer ask leading questions, attempt to put words in the mouth of the customer or violate any of the DMV guidelines set forth in the section below entitled "THE CONDUCT OF INVESTIGATORS". If so, this conduct should be immediately reported to the supervising investigator.

Also, this information will assist your attorney in cross examining the customer and the investigators and may help show bias on the part of the investigators in the event an accusation results from the investigation. For example, a number of accusations have been filed alleging that a dealer has resold unwinds as new vehicles. In some of these cases it has not been uncommon to find that questions were put to the dealer's customers by investigators such as: "You thought you were buying a new car, didn't you?" or "Did you know that you were buying a used car?" or "Did you know that the vehicle you bought was previously registered and operated on the public streets?" A "yes" answer to the first question and a "no" answer to the latter two questions may lead after further questioning to a report that the dealer has misrepresented a used vehicle as being new. At the hearing, however, it may very well develop that the customer knew that the car had a few miles on it because a previous buyer could not get financing, but felt that because of the warranty and the low mileage that it was like buying a new car.

Does the DMV have a right to go out and interview my customers?

Of all aspects of a dealer review, the interviewing of a dealer's customers by DMV investigators is the most annoying and troublesome. No one seriously questions the right of the DMV to listen to and investigate complaints initiated by a customer. But what about the customer who isn't complaining? "What right does the DMV have to go out and disturb one of my customers" is perhaps the most frequently asked question by a dealer who is undergoing a review. An argument can be made that subsection (b) of Government Code section 11181 which sets forth the powers of a department in connection with investigations merely states "Hear complaints," and the section does not specifically say that non-complaining customers may be interviewed. The DMV would argue that the right to interview customers is included within the broad authority given a department head by Government Code section 11180 quoted earlier.

Furthermore, the power to subpoena witnesses is expressly given and it might be counter-productive to insist that the Department use its subpoena in order to conduct a customer interview. One question to be addressed is under what circumstances may a customer be interviewed and how should the interview be conducted. The DMV in the exercise of its police power cannot unreasonably interfere with a dealer's relationship with the dealer's customers and any at random interviewing of a dealer's customers without some legitimate basis for the interview would certainly appear to be an abuse of the police power.

When the customer interview does legitimately fall within the scope of the investigation, the investigator is not entitled to solicit a complaint from the customer or imply to the customer that the dealer has done anything wrong, or promise or infer that some benefit might come to the customer in exchange for the customer's cooperation against the dealer. Any such actions would be contrary to DMV policy and should result in disciplinary action against any investigator employing such tactics. (See the section below, in this chapter, entitled "THE CONDUCT OF INVESTIGATORS").

How the Review is Concluded

The Dealer Resume

Except in the rare instances where a criminal filing is pending or intended, a resume of the review, sometimes referred to as the exit interview, is held with the dealer or an executive officer of the dealership. This is almost always done by specific appointment for that purpose.

At the resume, the investigators review the results of their findings. Any violations of law found to exist are explained to the dealer or are again reviewed with the dealer and corrective action is recommended. (If during a review the investigators discover some violation of a law or regulation which is being committed on an ongoing basis, they are instructed to immediately advise the dealer. There was a tendency at one time by some investigators to let the violations build up so as to strengthen a case against a dealer, but this tendency was at such odds with the Department's primary purpose of protecting the public, that investigators are strictly advised to call ongoing violations to the attention of the dealer at the time of discovery.) During the resume, the investigators may also ask the dealer questions about particular transactions or ask the dealer to ex-

plain some aspect of a transaction. As a general rule, it is strongly recommended that a dealer never call into the meeting any of the dealership personnel to answer questions in the presence of the investigators. Answers might be given too quickly and without adequate review of the file and knowledge of the particular issue involved and yet these answers may become a part of the investigator's report and may be used to impeach an employee who gives a different, although more accurate, account of the event at the time of the hearing based on a more careful review of the file. As a matter of practice, if the dealer is not able to answer an investigator's question without resort to other personnel or to a particular file, the dealer should defer an answer and simply state that he or she will have to look into the matter.

A dealer should consult an attorney regarding the advisability of having an attorney present at the resume.

In addition to reviewing the results of the investigation with the dealer and affording the dealer an opportunity to rebut any asserted violations of law, investigators are instructed to advise the dealer of the recommended course of action to be taken by the Department relative to such violations. Furthermore, if administrative action (the filing of an accusation) is the recommended course of action, the district supervisor may accompany the investigator or investigators and be present at the exit interview with the dealer.

The Investigator's Report

Following the resume, the investigators prepare a report of their review and submit it to their supervising investigator for review. The report will detail what the investigators did, who they talked to at the dealership, the number of files reviewed, the advertising or other documents reviewed, results of interviews with customers and the conclusions of the investigators as to whether any violations were found to exist. The number and type of violations and the code sections or regulations violated will be listed and the witnesses and documents which support each violation, together with a summary of the evidence accumulated thus far, will be given. The attitude of the dealer and the degree to which the dealer cooperated with the investigators is reported as well as the results of the dealer resume. The report contains the recommendation of the investigators which may or may not include a recommendation that an accusation be filed, and finally, the number of hours spent on the entire investigation is listed.

The investigator's report is submitted to the supervising investigator for review, and the supervising investigator makes the final determination on whether to recommend that the Department "go administrative," in which case the report together with a recommendation is submitted to the Office of the Chief of Compliance in Sacramento. Where administrative action is deemed appropriate, supporting documents and other evidence are submitted to the Department's legal staff for review and preparation of an official accusation.

The Conduct of Investigators

Whether it be in connection with a customer's solicitation for help from the Department in resolving a problem or misunderstanding with a dealer, or in connection with a customer complaint, or in connection with a full dealer review, investigators are strictly prohibited by the Department from coercive and prejudicial conduct. A bulletin prepared by the Division of Compliance on the subject matter of the obligations and procedures of DMV investigators distributed to dealers in July, 1977, and redistributed September 30, 1980, is, according to DMV representatives, no longer incorporated in DMV materials. In connection with the handling of consumer solicitations for help, the resolving of consumer complaints with dealers, and the interviewing of consumers in the course of an investigation, the bulletin provided the following guidelines to be followed by investigators:

- *Regardless of the fact that consumer complaint follow-ups receive high priority, investigators are prohibited from coaxing or coercing a buyer into making a complaint against a dealer.*
- *In the course of resolving the complaint with the licensee, the investigator shall not use a threat of a departmental audit or the filing of a complaint with the district attorney to effect resolution of the complaint.*
- *Departmental employees are made aware of dealers' concern for good customer relations. It should be clearly explained (on DMV initiated customer interviews) that the Department licenses and routinely inspects dealers; merely contacting a customer does not mean there is anything wrong with a dealer or his or her transactions. All information received from the customer, positive or negative, shall, be included in the report.*
- *Investigators, by the nature of their work, should be assertive and inquisitive, but there is no excuse for anyone to be abusive. The Department expects investigators to conduct themselves in a courteous, polite, and professional manner.*

In the event that any dealer feels that an investigator has violated any of these former guidelines or otherwise acted in an abusive or unprofessional manner, the dealer should report the incident to the supervising investigator of his or her district or directly to the office of the Chief of Compliance in Sacramento and should request a written response

to the complaint and the action that has been taken by the Department in connection with the complaint. There is a current DMV Investigations Manual used by investigators. The four guidelines listed above are not phrased in exactly the way they were formerly, but are stated in more general terms.

Recommended Actions for Dealer under Review

Once a dealer has been advised that the DMV intends to conduct a review of the dealership, it is essential that the dealer give the matter utmost attention. In view of the fact that the review may ultimately lead to the filing of an accusation, the dealer should keep the dealership attorney advised of the course and scope of the review. The following recommendations are not intended as a substitute for, or to supersede, the advice of your attorney and are to be considered only as general guidelines of what to do in the event of a DMV review of your dealership:

a. The threshold question will be whether or not you volunteer to produce specified records for the investigators or insist that records will only be produced if subpoenaed, and it is strongly advised that you consult your attorney in this regard. If a decision is made to permit an inspection of records, with the exception of the report of sale books, insist in advance that the investigators provide you with a written list of the files and documents that they wish to review and arrange a mutually convenient time for the inspection. If the investigators attempt to argue with you about your request for either a list of files and/or the time of the inspection, you have every right to insist upon notice of the specific documents requested and a reasonable time to produce them. You may point out to them that if they had to subpoena the records, you would be given at least ten (10) days to respond to the subpoena after one was finally prepared and served, and the records sought would have to be specified in the subpoena anyway.

b. Never permit investigators to go through your files at random. They are not entitled to go on a fishing expedition through your records.

c. Always have a responsible employee in the presence of the investigators during their inspection of records.

d. Assist the investigators in making copies of requested documents. In this way you will know exactly what records they deem of significance and you should keep a separate duplicate file for your attorney of records copied by the DMV.

e. A list of sales jackets reviewed by the investigators should be kept.

f. If a customer calls and advises someone at your dealership that he or she has been contacted by the DMV, you should personally talk to the customer or have one of your managers talk to the customer and obtain as much detail as you can get from the customer about what was said. As a general rule, resolve any legitimate customer complaint related to the review at the earliest possible moment it comes to your attention and do not wait for the conclusion of the review; however, there are situations where based on the nature of the dispute, your resolution of the complaint might be deemed an admission, so obtain your attorney's concurrence before reaching a resolution of the dispute.

g. Do not permit the investigators to interview your personnel regarding a sales transaction or business practice without giving you advance notice of their request and the subject matter of the request and so advise your employees. You or your manager should be present at any such interview and a memorandum made of same. As to whether to permit the interview depends on the circumstances of each case and your attorney should be consulted if you are in doubt.

h. Because your sales personnel are also licensees, they may be the focal point of an investigation and the investigator should let you and any salesperson involved know who is being investigated.

i. Finally, unless you are absolutely convinced that the calling in of a particular employee will help clarify a matter in your favor, do not volunteer or permit any of your employees to be questioned at the resume for the reasons previously stated (See the subsection to “How The Review Is Concluded” entitled “The Dealer Resume” contained earlier in this chapter).

Once a dealer review has been completed and a report prepared, even assuming administrative action has been recommended, the actual filing of an accusation may be delayed as much as six months to even a year depending upon the urgency the Division of Compliance attaches to the manner, the time it takes for the preparation of the evidence, and the backlog that exists in the legal section of the Department.

Accusations

Proceedings before Hearing

Authority for Filing of Accusation

Vehicle Code section 11705(a) provides that the DMV, after notice and hearing, may suspend or re-

voke the license issued to a dealer for any of the reasons given in the statute, and section 11705(c) provides that every hearing shall be conducted pursuant to the provisions of the Administrative Procedure Act covering administrative adjudication found in Government Code Sections 11500 through 11528. These provisions are designed to afford a dealer constitutional due process. Government Code section 11503 provides that the method by which a hearing is initiated to revoke or suspend a license is the filing by the Department of an accusation.

Content of Accusation

Government Code section 11503 also provides that the accusation shall set forth in ordinary and concise language a written statement of charges to place the dealer on notice of the acts or omissions with which the dealer is charged sufficient to enable the dealer to prepare a defense. The accusation must also specify the laws and regulations the dealer is alleged to have violated. Throughout the accusation and the proceedings, the dealer is referred to as the respondent and the accusation is titled "In the Matter of the Accusation Against (name of dealer) Respondent" under the heading of the Department of Motor Vehicles. The accusation is signed by the Department's Chief, Division of Investigations and Occupational Licensing.

If the dealer has previously been disciplined by the Department, the accusation will usually recite this fact and a copy of the prior decision imposing discipline is attached to the accusation and later introduced into evidence on the issue of the penalty to be imposed. The accusation uniformly prays for a revocation or suspension of the Respondent's license, which is the only remedy available to the Department. The Department does not have authority to seek punitive damages, money damages or costs, including the cost of the Department's investigation and witness fees.

Grounds for Accusations in Filing Against New Car Dealers

The grounds upon which an accusation may be brought extend to almost the entire spectrum of dealership operations. Vehicle Code section 11705 sets forth a list of 16 grounds for suspending or revoking a dealer's or manufacturer's license, the majority of which pertain to dealers. These grounds incorporate a wide range of laws and regulations which, if violated by a dealer, may lead to the filing of an accusation and license discipline.

Included among these grounds are the following:

a. Filing of any false information with the Department or concealing any material fact in connection with any application for a dealer's license or in any application for registration of a vehicle;

b. Misuse of dealer plates;

c. Failure to transfer title to a transferee lawfully entitled thereto;

d. Failure to comply with the vehicle registration requirements and requirements for the use and filing of reports of sale and payment of fees as required by Division 3 of the Vehicle Code (Sections 4000 through 9802);

e. Violation of Vehicle Code sections 11700 through 11740 and Regulations adopted pursuant thereto. (These sections contain the many prohibitions set forth in sections 11713, 11713.1, 11713.16, 11713.18, 11713.19, 11713.20, 11713.27, and 11713.26, which include the truth-in-advertising statutes and regulations adopted thereunder);

f. Violation of the Rees-Levering Act commencing with Civil Code section 2981. The requirements of Rees-Levering governing conditional sale contracts which also encompass the disclosure requirements of Regulation Z (Truth-In-Lending) are discussed in detail in the chapter on the Automobile Sales Finance Act in this Management Guide;

g. Violation of the Vehicle License Fee Law (Revenue and Taxation Code Sections 10701 et al.);

h. Violation of any of the terms or provisions of Health & Safety Code Sections 43151, 43152, 43153, or 44072.10(b). These sections have been enforced by the ARB by way of an action for injunctive relief and civil penalties up to $5,000 per violation brought by the office of the Attorney General. Violations of these sections may now also be grounds for license discipline. These sections in general prohibit the acquiring or importing of new vehicles for resale or the sale of new vehicles which are not certified as meeting California's stricter emission control standards. For purposes of these sections, a motor vehicle with an odometer reading of less than 7,500 miles is conclusively presumed to be a new vehicle unless the vehicle is a "new direct import vehicle," that is, a vehicle manufactured in another country and not intended for sale within the United States. A new direct import vehicle regardless of mileage is conclusively presumed to be a new vehicle for the purposes of these sections if it is less than two years old. See Health and Safety Code section 43156. In the case of *People ex rel. State Air Resources Bd. v. Wilmshurst (1999) 64 Cal.App.4th 1332*, the court upheld the validity of this statute. The court also upheld the judgment of the trial court assessing a penalty against the dealer individually and the dealer corporation, rejecting the argument that this was an unconstitutional double punishment. The court said: "If both may be li-

able for the violations, then each must suffer the consequences of the violations."

i. Submitting bad checks to the Department for any obligation or fee due the state;

j. Any act or omission which has caused any person to suffer any loss or damage by reason of any fraud or deceit practiced on that person in the course of the dealership business.

The last of the grounds listed was placed in bold print because this is perhaps the most serious and frequently a grounds for license discipline along with false and misleading advertising. The Department over recent years has shied away from bringing or basing an accusation upon technical violations, violations due to sloppy paperwork, or violations involving simple negligence unless these violations have occurred in relatively large numbers or have continued to occur after a warning letter from the Department. Instead, the Department has concentrated on cases which require some meaningful discipline, such as an actual license suspension for a day or more, and these types of violations most frequently involve situations where a customer has been caused a monetary loss or where false and misleading advertising forms the basis for the complaint, or both. When the Department does file an accusation on these grounds, however, it also as a matter of practice throws in any technical violations or violations due to sloppy paperwork that may be found to exist, which when considered along with the other violations serves to enhance the chances of an actual license suspension.

It should be stressed that to be held responsible for "fraud" or "deceit" as those terms are used in Vehicle Code section 11705(a)(14), there is no requirement that the alleged misrepresentations be made with fraudulent intent; negligent misrepresentations will suffice. Failure to disclose a material fact intentionally or due to gross negligence is likewise included within these terms. The responsibility of the dealer for the acts and omissions of the dealership employees must also be considered in guarding against potential license discipline. Fraud is defined in this section as follows: *For purposes of this paragraph, "fraud" includes any act or omission which is included within the definition of either "actual fraud" or "constructive fraud" as defined in Sections 1572 and 1573 of the Civil Code, and "deceit" has the same meaning as defined in Section 1710 of the Civil Code. In addition, "fraud" and "deceit" include, but are not limited to, a misrepresentation in any manner, whether intentionally false or due to gross negligence, of a material fact; a promise or representation not made honestly and in good faith; an intentional failure to disclose a material fact; and any act within Section 484 of the Penal Code.* In addition to its advertising prohibitions, Vehicle Code section 11713 also makes as a ground for license discipline the employment of a person as a salesperson who does not have a valid salesperson's license, permitting someone else to use a dealer's report of sale books, failure to pay over sales tax collected to the Franchise Tax Board, the selling of a vehicle that does not meet the safety and equipment requirements of the Code, the overcharging of DMV fees and the failure to refund the excess to customers, and the setting back or disconnecting of an odometer with the intent to alter the number of miles indicated on its gauge. It goes without saying that odometer violations are most serious and are always dealt with harshly, usually resulting in a revocation or at the very least, a lengthy actual suspension.

Typical Dealer Violations

According to the DMV, typical violations for dealers are:

- failure to transfer title/registration to the buyer
- failure to pay-off a trade-in when doing so is agreed upon
- failure to return any downpayment or trade-in when the buyer is not approved for credit
- failure to pay lienholders for vehicles after sale to retail customers
- failure to display an FTC Buyers Guide on used vehicles for sale
- misuse of dealer Report of Sale books and supplies
- failure to refund excess DMV fees to the buyer
- selling vehicles which do not comply with Vehicle Code smog, safety, and equipment requirements
- negotiating the terms of a contract and then adding charges to the contract without first disclosing and receiving customer consent for the added charges
- falsifying information provided on credit applications
- out and out false or misleading advertising
- failure to sell at the advertised price

- false savings claims
- deceptive incentive advertising
- advertising a vehicle not available for sale
- failure to withdraw an ad within forty-eight (48) hours of a sale of the advertised vehicle or vehicles
- misrepresentations relating to a vehicle being sold
- misrepresentation of a used vehicle as new
- misrepresentation of a vehicle as being a demonstrator when it is not
- filing of false certificates of non-operation
- filing of false dates of sale
- employment of unlicensed salespersons
- overcharging of DMV fees
- illegal recoupment of credit card fees when a customer uses a credit card
- failure to provide the customer with an inspection sheet when a certified used vehicle is sold
- failure to renew DMV license
- failure to properly display the dealer and salesperson licenses
- failure to report to the DMV the hiring and termination of salespersons

Although seldom the sole basis for an accusation, frequently the failure to refund DMV overcharges is alleged in accusations. This is almost always due to carelessness; however, it is extremely embarrassing when it comes up at a hearing on an accusation, and every dealership should have a procedure which insures that DMV overcharges are promptly refunded.

DMV enforcement officials have advised CNCDA personnel in recent years that the DMV has noticed increased dealer non-compliance in the following areas:

- **Failure to Disclose Dealer Participation Affecting Cost.** If a factory incentive program requires the dealer to contribute to the incentive program, the dealer must clearly and conspicuously disclose this fact in any advertisement of the program. For more information on this requirement, see Chapter 29 "Incentives-Dealer Participation" in the California Auto Dealer Advertising Law Manual.
- **Making an Underselling Claim Without Survey to Substantiate Claim.** Dealers may not make any underselling claim, such as "we have the lowest prices," or "we will beat any dealer's price" unless the dealer has conducted a recent survey showing that the dealer sells its vehicles at the lowest prices in its trade area, and maintains records to substantiate such claims. For more information on this requirement, see Chapter 57 "Underselling Claims" in the California Auto Dealer Advertising Law Manual.
- **Advertising Free Merchandise, Services, or Gifts With Purchase.** Dealers are prohibited from advertising free goods or services provided by the dealer contingent upon the purchase of a vehicle. This prohibition also extends to offering goods or services below the dealer's cost. In some circumstances, advertising certain vehicle-related goods or services (e.g., truck bedliners) as "included in price," or "included with purchase" is permissible. For more information on this requirement, see Chapter 22 "Free Goods and Services" in the California Auto Dealer Advertising Law Manual.
- **Rebate Stacking.** One of the noticeable compliance issues for dealers is the advertising of various rebate programs by including several available (sometimes conflicting) rebates in the arithmetic to arrive at an artificially low price for which very few, if any, consumers would qualify. DMV's enforcement team is aware of this practice and actively investigates dealerships about this. For more information on rebate advertising, see Chapter 46 "Rebates and Cash Back" in the California Auto Dealer Advertising Law Manual.
- **Late/Failure to Transfer of Registration or Title to New Registered Owner**. Dealers are required to meet strict deadlines in reporting the sale of a vehicle and submitting appropriate fees. The DMV has seen an increase in late filing by dealers, and has subsequently cited many dealers for this fact. CNCDA is aware of some circumstances under which dealers have been wrongfully cited due to processing delays caused by DMV, and dealers should not hesitate to use such facts in their defense if appropriate.
- **Failure to Report Salesperson Employment or Termination within 10 Days.** Within 10 days of hiring a salesperson or the salesperson leaving a dealer's employ, the dealer must file DMV Form OL 16-A with DMV Headquarters.

While this law had not been regularly enforced in previous years, DMV is beginning to check compliance. This form is available on the DMV's website at http://dmv.ca.gov/forms/ol/ol16a.pdf for printing and mailing to DMV. For more information on this requirement, see the discussion in Chapter 20, Dealership Opening, Closing, and Licensing.

- **Failure to Pay Lien on Trade-In Vehicle within 21 Calendar Days.** In the midst of the vehicle sales depression, a number of dealers failed to pay off liens on customer trade-ins. This problem was spotlighted in several high-profile media accounts during the economic crisis. In response, the Legislature passed a law requiring dealers to pay, within 21 calendar days of acquiring the vehicle in trade, the agreed-upon amount of a credit or lease balance on the traded-in vehicle, or the entire credit or lease balance amount (if no amount was specified). For more information on this requirement, see the discussion in Chapter22, Other Important Topics.
- **Certified Used Car Inspection Reports.** As part of 2005's Car Buyers Bill of Rights, the Legislature put restrictions on the then-unregulated sale of Certified Used Cars. Used car dealers, in particular, would label inventory as certified, despite the complete lack of any certification program. While the Car Buyers Bill of Rights didn't put together a list of standards that vehicles must meet to be sold as certified, it did prohibit selling vehicles with certain characteristics (such as tampered odometers, frame damage, or branded titles) as certified. One key requirement of the Car Buyers Bill of Rights is that dealers must provide customers with a completed inspection report showing all of the components that were inspected as part of the certification process prior to selling the vehicle. The law doesn't specify what needs to be put on the inspection report, but states that the report must disclose which components were inspected. The failure to provide this report was specifically highlighted by the DMV official when asked about new car dealer compliance problems. Since most, if not all, factory-sponsored certified used car programs contain a checklist of inspected components, make sure that your staff is fully aware of this requirement and that the checklist is provided to the customer prior to sale.
- **Credit Card Processing Fees.** Sometimes after the contract is signed, a frequent-flyer-mile-hungry customer says that he or she will use a MasterCard to pay for a large downpayment, or even the vehicle itself–putting a 2-3% transaction fee on the dealership's back. The first instinct of a salesperson may be to attempt to recoup this transaction fee by renegotiating the transaction to pass the fee on to the customer, or to simply deny the use of a credit card. Dealers need to keep in mind a few things when handling credit card payments:
  - **Hidden Finance Charges.** If a dealer imposes a fee for the use of a credit card, or increases the price of the vehicle to recoup the transaction fee, the increased amount may be considered an undisclosed or hidden finance charge under the federal Truth In Lending Act.
  - **Credit Card Surcharge Prohibition.** California Civil Code Section 1748.1 specifically prohibits retailers from imposing a surcharge on a cardholder, but allows for retailers to offer discounts to induce payment by alternative means.
  - **Credit Card Agreements.** In addition to the more serious legal prohibitions, most credit card agreements strictly prohibit merchants from imposing a surcharge to recoup the transaction fee–mandating that credit card purchases be charged as any other purchase, but allowing for cash discounts. Furthermore, some credit card agreements prohibit merchants from imposing a maximum transaction amount for acceptance of a credit card. Dealers should check their credit card agreements to determine which rules govern your acceptance of credit cards for the purchase of vehicles.

While state and federal laws permit providing discounts for purchases paid in cash or by check, this becomes difficult to implement during a negotiated transaction because whether the discount is a true cash price reduction becomes unclear. When seeking to establish policies governing the acceptance and use of credit cards be sure to consult with competent legal counsel.

CAUTION

REGARDING OWNERS: Existing grounds for license discipline carry over to new owners of a dealership after stock purchase.

The vast majority of dealer licenses are issued in the name of a corporation. When a dealership changes hands by way of a sale of the stock of the dealership corporation, the dealer license, having been issued to the corporation, remains the same; there is simply a change in the ownership of the corporation. Accordingly, if grounds for discipline exist against the dealer license by reason of the activities of the selling owner, they continue to exist

notwithstanding that the new owner was not personally responsible for the prior wrongful acts and knew nothing about them, and notwithstanding that there has been a complete change in the officers and management of the corporation. These facts may be considered as mitigating evidence insofar as the penalty is concerned; however, they do not constitute a defense.

Furthermore, since the licensing laws do not provide a means for disciplining the prior owner and/or management except by means of action against the license, if the prior violations were of a serious nature, the department would be strongly motivated to pursue an accusation against the corporate license. Under Vehicle Code sections 11703 and 11806 an application for a dealer's or salesperson's license may be refused if the applicant was an owner or managerial employee of a dealership whose license was revoked and never reissued, or was suspended and the terms of suspension have not been fulfilled. Accordingly, if the DMV pursues an accusation against the dealership license after the change of ownership, and obtains, for example, a suspension stayed on terms of a two (2) year probation, and the prior owner and/or manager then applied for either a dealer's or salesperson's license, the DMV could deny the application at least until after the period of probation.

Also, on a change of ownership by reason of a stock sale as opposed to a sale of the assets of the dealership to a new corporation, the corporation remains civilly liable for wrongful acts of the corporation committed prior to the change of ownership upon actions brought by customers, who were damaged by the prior conduct or upon an action brought for civil penalties and/or an injunction by the consumer protection sections of the offices of the Attorney General, District Attorney or City Attorney.

Therefore, it is essential that before entering into a stock purchase agreement to acquire a dealership that the DMV be contacted for confirmation that the dealership being acquired is not under investigation and that there is no action pending or contemplated against the dealership license. One factor which frequently motivates a stock purchase rather than an asset purchase is the benefit of a loss-carry forward and yet, the fact a dealership had been suffering losses is often indicative of lack of effective control or management, which are factors which frequently lie at the root of violations supporting an accusation.

Filing and Service

Filing Date and Statute of Limitations

Although under Government Code section 11502 all hearings on accusations are conducted by Administrative Law Judges on the staff of the Office of Administrative Hearings established by the Administrative Procedure Act, the Act makes no provision for the mechanics of the filing of an accusation. The filing date of an accusation is deemed to be the date that the Department itself stamps upon the face of the accusation, which in practice is done by the legal section of the Department after it has prepared and obtained the appropriate signatures to the accusation. It appears that there is no statute of limitations for the filing of an accusation by the Department; however, upon petition to the Superior Court, an accusation may be dismissed if there has been prejudicial delay in the filing of the accusation or in the prosecution of the accusation following its filing by the Department. For purposes of this determination, the filing date is the Department's own stamped date and not the date that the accusation is sent to the Office of Administrative Hearings.

Service of Accusation, Required Accompanying Documents, Notice of Time and Place of Hearing and DMV Report

Following the preparation, signing and date stamping of the accusation, the Department serves the accusation upon the dealer. This may be done by any means selected by the Department, but in practice is usually done by registered mail or by personal service.

Government Code section 11505 requires that the Department include with the accusation a Notice of Defense which when signed and returned to the Department by the dealer, constitutes a valid answer to the accusation and a request for a hearing. The accusation when served also must be accompanied by copies of Government Code Sections 11507.5, 11507.6 and 11507.7 which explain the dealer's right to discovery. A notice that the dealer has 15 days to file the Notice of Defense attached or one which complies with Government Code section 11506 within 15 days from the date of service of the accusation must likewise be included, together with a statement that if no Notice of Defense is filed, the Department may proceed against the dealer's license without a hearing. The Notice of Defense may be signed by the dealer or an officer of the dealership or by the dealer's attorney and it need not be verified.

In practice, the DMV periodically receives blocks of time reserved by the Office of Administrative Hearings for hearings on DMV accusations. The DMV sometimes at the time it serves the accusation also serves a notice of time and place of hearing. Copies of the accusation and this notice of time and place of hearing are filed with the Office of Administrative Hearings at the same time the dealer is being served.

The DMV as a matter of practice also serves a request for discovery upon the dealer at the time of service of the accusation and further provides the dealer with a copy of the DMV investigators report.

Responsive Pleadings by Dealer

The dealer served with an accusation must file a response and request for hearing with the Department within fifteen (15) days of the date of service of an accusation. See Government Code section 11506. This is normally done simply by signing the Notice of Defense which is served with the accusation and returning it to the address clearly indicated for that purpose in the papers served upon the dealer by the Department. Although the dealer may sign the Notice of Defense, it is strongly recommended that the dealer deliver all of the papers with which he or she was served to his or her attorney and have the attorney sign and file the Notice of Defense. It may well be that the attorney will want to object to all or portions of the accusation and raise certain special defenses or file a mitigating statement. The Notice of Defense serves as a general denial of all of the material allegations of the accusation; however, in addition to filing this Notice of Defense, the Government Code permits an objection to an accusation upon the ground that it does not state facts or omissions upon which the Department may proceed, an objection to the form of the accusation on the ground of uncertainty, and the raising of affirmative defenses. Although Administrative Law Judges are generally extremely liberal in permitting attacks on the sufficiency of the allegations and in permitting evidence on matters which more properly should have been raised affirmatively in the Notice of Defense, it is far better not to take any chances and to raise such matters along with the basic Notice of Defense. A claim that the allegations are uncertain, however, should always be raised at the outset or the party failing to raise it may be precluded from doing so at the time of the hearing on the ground that no opportunity was afforded the Department to correct the uncertainty. A mitigating statement may also be filed, but it is not necessary to the introduction of mitigating evidence and is therefore seldom utilized.

In practice, issues relating to the sufficiency of the allegations to state a cause of action are normally not ruled upon until the time of the hearing and issues relating to uncertainty are usually settled before the hearing between the parties. There is nothing to prevent the parties, however, from requesting a hearing in advance of the trial date to resolve issues relating to the pleadings and, where the pleading issues are significant, it is recommended practice.

Discovery

The Government Code provides the exclusive method for discovery in administrative hearings and it differs significantly from discovery in civil proceedings. Depositions, interrogatories and requests for admissions are not used with the limited exception that a deposition may be taken and used in lieu of testimony when the witness is unavailable at the hearing and cannot be compelled to attend the hearing. See Government Code section 11507.6 and 11511.

Discovery, other than depositions, is limited to the parties themselves, that is, to an exchange between the parties of the items listed in the Government Code as being discoverable. Discovery is permitted as to the following: the names and addresses of witnesses known to the other party, including, but not limited to, those intended to be called to testify at the hearing; the right to inspect and copy statements taken from third party witnesses such as a dealer's customers; statements of witnesses proposed to be called and of others having personal knowledge of the acts or omissions or events which are the basis for the proceeding not otherwise included above; all documents or writings relevant to the proceedings; and certain portions of the Department's investigative reports. (The DMV as a matter of practice, however, makes all of its investigative reports available.) See Government Code section 11507.6.

Discovery must be requested within thirty (30) days from the date of the service of the accusation, and in the case of the service of an amended accusation, within fifteen (15) days as to any new matters alleged. See Government Code Section 11507.6. It is initiated by a simple written request for discovery sent by ordinary mail and need not specify more than that the serving party requests the names of all witnesses and statements and writings discoverable under Government Code section 11507.6. There is no time specified in the Code as to when a response must be given to a request, but certainly the response should be provided in sufficient time to enable the requesting party to prepare for trial.

Although the Department supplies copies of its investigative report to the dealer at the time of the service of the accusation, the dealer should still at the time the Notice of Defense is filed also serve an all encompassing request for discovery. The allegations of an accusation specify that the violations alleged are related to a numerical listing of vehicles by I.D. number contained in a schedule or schedules attached to the accusation. The names of the customers whose transactions with the dealer involved each vehicle listed and the date of sale where applicable are included in the schedule. With respect to each item number listed on the schedule, the DMV

investigators prepare a separate corresponding numbered **"evidence folder."** This evidence folder contains the originals or copies of all documents the Department intends to rely upon to prove the allegations of the accusation relating to that particular item including relevant portions of its investigative report and any statements of witnesses. Upon request, the Department is required to permit you or your attorney to review these **evidence folders**, and this is normally **a must** for a proper defense of the action.

Failure to make a formal request for discovery waives the right to compel discovery in the event that the department does not furnish a dealer with all of the items discoverable under Government Code section 11507.6, and would further waive the right to object to the introduction of otherwise relevant evidence upon the ground that it was not furnished to the dealer before the hearing. Under Government Code section 11507.7, a party claiming that a request for discovery has not been complied with may file a motion with the administrative law judge to compel disclosure of the information sought.

PRACTICAL TIP

OBTAINING THE NAMES OF ALL CUSTOMERS INTERVIEWED: It should be noted that discovery is not limited to witnesses intended to be called by the department, but extends to witnesses to the subject matter of the accusation whether intended to be called or not. See Government Code Section 11507.6. This fact, coupled with the Department's own guidelines for its investigators that they should include in their report all information received from the customer, positive or negative, may be used to the benefit of the dealer.

Quite frequently, the DMV, if it intends to interview a number of a dealer's customers, sends a letter or card to the customers asking them to contact the Department. The question arises as to how many customers the investigators interviewed before coming up with the few who will testify at trial. Although required to do so, it appears that investigators seldom report interviews with customers whose account of their dealings is favorable to the dealer. Demanding in advance of hearing the names of all customers interviewed and/or the names of all customers to whom letters or cards were sent, and the subsequent interviewing of such customers, may not only turn up evidence favorable to the dealer, but may also provide a basis for establishing bias on the part of the investigators and thus, taint the Department's entire case. For example, assume that the Department brought three or four counts alleging that the dealer represented unwinds as new cars. It may well be that the DMV interviewed twenty-five purchasers of unwinds during the period under investigation and the remaining twenty-one or twenty-two customers all clearly understood that they were buying used cars. Establishing these additional facts not disclosed in the investigator's report would not only tend to discredit the stories of the three or four complaining witnesses, but would also tend to discredit the Department's entire case.

Administrative Procedures Act of 1995

In the 1995-1996 legislative session, California enacted Chapter 938 which contains many new provisions regarding administrative adjudication hearings. The general provisions of the Act are found in Government Code sections 11400, and following. The following is a brief overview of some of these laws:

- With the consent of the parties, the DMV may refer a dispute that is the subject of an adjudicative proceeding for resolution through mediation by a neutral mediator, or binding arbitration by a neutral arbitrator or nonbinding arbitration by a neutral arbitrator. See Government Code section 11420.10, and following.
- The Act contains what is known as an Administrative Adjudication Bill of Rights. The Bill of Rights provides for such matters as public observation of the hearing; separation of the adjudicative function from the investigative, prosecutorial, and advocacy functions within the DMV; the subjecting of the presiding officer to disqualification for bias, prejudice, or interest; and other procedural due process safeguards. See Government Code sections 11425.10, and following.
- While an adjudicative proceeding is pending there is to be no communication, direct or indirect, regarding any issue in the proceeding, to the presiding officer from an employee or representative of the DMV without notice and opportunity for all parties to participate in the communication. See Government Code sections 11430.10, and following.
- Language assistance must be provided in the proceeding if necessary. See Government Code sections 11435.05, and following.
- There are general procedural provisions. See Government Code sections 11440.10, and following.
- Procedures are provided for an informal hearing in a manner that is simple and more expeditious than regular hearing procedures. There is a specific statutory authorization for the use of the informal procedure when a disciplinary sanc-

tion against a licensee does not involve an actual revocation of a license or an actual suspension of a license for more than five days. See Government Code sections 11445.10, and following.

- There are detailed provisions for the issuance of subpoenas. See Government Code sections 11450.05, and following.
- Contempt sanctions are available in adjudicative proceedings in specific situations. See Government Code sections 11455.10, and following.
- Procedures are set forth for the conduct of adjudicative proceedings when there is an immediate danger to the public health, safety, or welfare that requires immediate agency action. See Government Code sections 11460.10, and following.
- A person may apply to the DMV for a declaratory decision or ruling concerning the applicability to specific circumstances of a statute, regulation or decision within the primary jurisdiction of the DMV. See Government Code sections 11465.10, and following. The DMV has discretion not to issues such a ruling.

Hearing Procedure

Formality and Chronology of Hearing

Although hearings on accusations are somewhat less formal, the proceedings are conducted substantially the same as those employed in municipal or superior court non-jury civil trials. The hearing is presided over by an Administrative Law Judge employed by the Office of Administrative Hearings and who functions much as a judge functions at a civil court trial. See Government Code section 11513. Administrative Law Judges must be attorneys admitted to practice law in the State for a minimum of five (5) years. See Government Code Section 11502. Prior to the hearing, a pre-hearing conference and/or settlement conference may occur.

The hearings are normally held at the Office of Administrative Hearings nearest to the dealer's location and if such an office is not nearby, the Administrative Law Judge will travel to a location nearby where some public building has space available for the hearing.

The Administrative Law Judge calls the matter for hearing and asks the parties and their counsel to identify themselves for the record. The proceedings must be recorded and this is normally done by utilizing some type of a tape recording machine. The pleadings are next marked as exhibits and made a part of the record and the Administrative Law Judge generally takes judicial notice of the status of the dealer and the Department.

After the parties are given an opportunity to make opening statements, the DMV, which has the burden of proof on accusations, then presents its evidence by calling witnesses and introducing relevant documents. The DMV's witnesses normally include the department's investigators and the dealer's customers. After the department concludes its case, the dealer puts on evidence both in defense of the case and in mitigation at the same time. Each side is permitted rebuttal and closing argument and the case is then taken under submission by the hearing officer.

Distinctions between Accusations and Other Proceedings

When Dealer May Be Called as Witness

Unlike at a civil trial where the plaintiff may during the presentation of the case call the opposing party to the stand, at hearings on accusations the DMV cannot call the dealer or its officers as witnesses until the dealer has had the opportunity to present his or her case. See Government Code section 11513. **Thus, a dealer may attend the hearing and listen to the Department's case without the fear of suddenly being called as a witness**. Once called as a witness by the dealer's own attorney, however, the dealer is subject to cross-examination by the department's attorney. Furthermore, unlike criminal procedure, the Department may subpoena and compel the dealer and the dealership officers to testify after the dealer has presented a defense whether or not they have taken the stand as part of the defense. The dealer's attorney may thus have the strategic option to keep a dealer and/or one or more of the dealership officers, if not subpoenaed, away from the hearing.

Liberal Rules of Evidence and Admissibility of Hearsay

The rules of evidence at administrative hearings are generally much more liberal than at civil trials. Although adherence to the strict and technical rules of evidence is not required, counsel nevertheless should be prepared to produce to the extent feasible the same type of evidence he or she would introduce at a civil trial. The degree to which the stricter rules of evidence are applied varies with Administrative Law Judges and the better the form of the evidence, the more likely it will be favorably received or reviewed in the case of an appeal.

Hearsay evidence is admissible to supplement or explain other evidence and is freely admitted at administrative hearings subject to one important qualification, namely, that a finding cannot alone be supported by what in court would be inadmissible hearsay evidence. See Government Code section 11513. For this reason, objections should always be

made to the introduction of hearsay evidence. Although the objections will generally be overruled, they do have the effect of pointing out to the Administrative Law Judge the limited value of the evidence and they will preserve a later motion to strike the hearsay evidence where it has been the only evidence introduced to support a finding on a particular issue. An objection is also timely if made before submission of the case or on a reconsideration.

Cross-Examination and Impeachment of Witnesses

At hearings on accusations, another party's witnesses may be cross-examined on any relevant topic irrespective of the limited scope of the direct testimony of such witnesses. Also, at hearings on accusations, a party may impeach the party's own witnesses without the necessity of showing surprise or damage. See Government Code section 11513.

Use of Affidavits

A party may introduce the testimony of a witness by way of an affidavit made under the penalty of perjury in lieu of the witness appearing at the hearing provided a copy of the affidavit is mailed to the other party at least ten (10) days before the hearing with a notice that the other party has the right to demand cross-examination of the witness within seven (7) days. If a demand for cross-examination is made, the witness must be produced by the other party for cross-examination and, if this happens, generally the witness is put on the stand for his or her direct examination instead of introducing the affidavit. If the witness is not produced for cross-examination, the affidavit may be introduced in evidence, but shall be given only the same effect as other hearsay evidence. See Government Code section 11514.

At one time, the department made extensive use of affidavits of customers; however, this practice has almost been completely abandoned because the DMV investigators lacked the skill to properly prepare them and their use gave to the dealer's attorney a tremendous tactical advantage. Affidavits are still used to present evidence of DMV procedures and to authenticate DMV records in Sacramento where there is no real need to cross-examine the witness.

CAUTION

REGARDING AFFIDAVITS: If the Department does intend to use affidavits at the hearing, it normally would serve the affidavits with the accusation. A dealer should not be mislead by the fact that there are fifteen (15) days within which to file a notice of defense; only seven (7) are allowed to demand cross-examination of witnesses and this right to compel the department to produce the witnesses is waived unless the demand to cross-examine is mailed within seven (7) days. Therefore it is essential that a dealer carefully review all of the papers with which he or she is initially served, and if affidavits of witnesses are included, the dealer should immediately consult an attorney. See Government Code section 11514.

The Administrative Law Judge's Decision

The effect of the Administrative Law Judge's decision is so significantly different from the decision of a judge in a civil proceeding that it is discussed as a separate topic later in this chapter.

Trial Tactics and the Use of Mitigating Evidence

Although a dealer at a hearing on an accusation naturally makes every effort to show that the dealership has not committed the violations alleged in the accusation, it is seldom the case following a hearing that there are not at least some violations found to exist. The question of penalty thus may be the most important matter in the case. Since the finding of almost any violation routinely results in the dealer being issued a probationary license, the primary consideration for the dealer is to avoid any actual suspension of the dealership license which necessitates the shutting down of the dealership's sales activities.

Because of the severe impact even a relatively brief suspension may have on a dealership's business, the presentation of mitigating evidence is of the utmost importance at these hearings.

A threshold decision should be made at the outset as to whether to admit certain alleged violations and simply offer evidence in mitigation. A dealer is normally better off admitting allegations to which he or she has no valid defense and concentrating on presenting mitigating evidence. Attempting to deny the obvious serves only to weaken the dealer's entire defense.

Consideration must also be given to what facts will come out in the hearing in connection with the Department's attempted proof of an allegation in the accusation. Standing alone, a particular allegation as it appears in the Department's pleadings may not seem too bad, but if the issue is contested, certain facts may get into evidence which put the dealership in a more unfavorable light. If the allegation is admitted, the dealer's attorney will more likely be able to keep the more unfavorable facts from getting into evidence.

EXAMPLE

A classic example of the wisdom of the foregoing suggestions may be found in a Court of Appeal decision involving a dealer who attempted to disprove that his dealership overcharged DMV fees on nine occasions. Had he merely admitted the nine overcharges and showed that refunds were later made to the customers and that he had established some procedural changes to lessen the chances of overcharges and to insure prompt payment of refunds, the case never would have gone to an appeal. In attempting to rebut the proof of the overcharges, the dealer produced evidence of the dealership's accounting procedures which ultimately revealed that the dealer had a credit balance of some $16,500 at the end of a year's accounting period in the expense account to which the dealer credited refunds, giving rise to an implied finding that there were $16,500 in overcharged DMV fees for the year which had not been refunded. The Court of Appeals held that although these implied violations had not been charged, they could nevertheless be considered by the Administrative Law Judge and the New Motor Vehicle Board on Appeal on the issue of penalty and the terms of probation. What would have undoubtedly been a case of straight probation ended up resulting in an actual ten days suspension of the dealer's license. See Ralph Williams Ford v. New Car Dealers Policy and Appeals Board (1973) 30 Cal.App.3d 494.

Mitigating factors frequently relied upon in hearings on accusations are:

a. Length of time the dealer has been licensed;

b. Length of time the dealer has been in the automobile business;

c. Absence of prior discipline;

d. Restitution to any injured customer (which is particularly helpful to a dealer if the customer was satisfied before any urging to do so on the part of the DMV);

e. The dealer's reputation in the industry;

f. The dealer's general background and reputation (the use of character witnesses is permissible);

g. The economic impact on the dealer that a suspension would entail;

h. The number of employees who would be deprived of work if the license is suspended or if the business fails because of a suspension;

i. Efforts made to avoid a repetition of the offense or offenses **(this type of evidence is extremely important and should never be overlooked);** and

j. When the offense charged is due to acts of the dealer's employees, careful hiring practices of the dealer, lack of dealer knowledge notwithstanding an adequate system of supervision, and the absence of the dealer ratification of the alleged wrongful act.

It should be noted that although the dealer may introduce evidence in mitigation, the Department may introduce evidence in aggravation on the issue of penalty. In this connection, the Department may show prior warning letters sent to the dealer, prior discipline imposed on the dealer, the relationship of the dealer and its officers and directors with other dealerships with which they were connected which had been disciplined, related violations of laws and regulations even though not specifically alleged in the Accusation, and various hardships suffered by customers caused by the alleged violations.

Recovery of Costs and Expenses

There does not appear to be any provision in the law for the recovery by the DMV in accusation hearings of investigative costs and attorney fees. Vehicle Code section 11705(a) provides that a dealer's license may be suspended or revoked, and Vehicle Code section 11705(c) requires that such hearings be conducted pursuant to the Administrative Procedures Act. If the DMV claims it is entitled to recover these fees and costs, the dealer or the dealer's attorney should ask for the legal authority supporting such a claim.

The Administrative Law Judge's Decision and Its Approval or Rejection

The Administrative Law Judge's Decision is Merely a Recommended Decision

Unlike a decision by a judge following a civil trial, which decision constitutes a final adjudication of the case unless appealed, the decision of the Administrative Law Judge is merely a proposed decision submitted to the DMV for its approval and is not binding on the department. **The department makes the final decision and is thus both prosecutor and judge, although in the vast majority of cases, the department does in fact adopt the Administrative Law Judge's recommended decision**. See Government Code section 11517.

The Administrative Law Judge is required to make a proposed written decision within thirty (30) days following the submission of the case for decision. The thirty (30) days begins to run when the hearing is concluded unless written argument is to be submitted to the Administrative Law Judge, in which case the thirty (30) days begins to run when the final written argument is submitted to the Ad-

ministrative Law Judge. See Government Code section 11517.

The Administrative Law Judge's decision consists of findings of fact and a determination of issues, that is, a determination whether the facts support each of the alleged violations of law and thus constitute cause for suspension or revocation of the dealer's license. A proposed order of suspension or revocation is made which usually contains terms of probation, and the decision is submitted to the DMV with a recommendation that it be adopted as the decision of the Department.

Where a suspension is recommended by the Administrative Law Judge, all or a substantial portion of it is generally stayed upon the express condition that the dealer comply with specified terms of probation. For example, the Administrative Law Judge may propose that the license be suspended for fifteen (15) days and that all but three (3) days of the suspension be stayed provided that for a one or two year period the dealer be issued a probationary license and abide by specified terms of probation, which if found after notice and hearing to have been violated, may result in a revocation of the probation and imposition of the remaining portion of the actual suspension.

Although the authority to make wide ranging orders of probation is extended to the Administrative Law Judge, this authority is seldom used in practice, nor does the Department seek such orders in contested cases. The typical terms of probation are that the dealer refrain from further violations of the type alleged and that the dealership abide by all state and federal laws and regulations. (See, however, the section later in this chapter entitled "SETTLEMENT AS ALTERNATIVE TO ACCUSATION HEARING" involving settlements of accusations and the section, LANGUAGE OF DECISIONS, below).

Once a dealer has been issued a probationary license as the result of an accusation, the DMV cannot revoke the probation and impose the stayed portion of a suspension or revocation without first providing the dealer with notice and a full hearing on the alleged grounds for revoking the terms of probation. In practice, the DMV does not go out of its way to find grounds for revoking terms of probation and such hearings are rare.

Language of Decisions

The California Code of Regulations provides Occupational and Disciplinary Guidelines for decisions on accusations. It provides as follows:

In reaching a decision on a licensing or disciplinary action under Division 5 of the Vehicle Code and the Administrative Procedure Act (Government Code section 11400, et seq.), the Director of Motor Vehicles or his or her designee shall consider the guidelines entitled "Occupational Licensing and Disciplinary Guidelines" (Rev. 11/2007), which are hereby incorporated by reference, and any and all other sanctions provided by relevant statutes and regulations. Deviation from these guidelines and orders, including standard terms of probation, is appropriate where the Director or his or her designee, in his or her sole discretion, determines that the facts of the particular case warrant such a deviation, for example, the presence of mitigating factors, the age of the case, and evidentiary problems.

The Occupational Licensing and Disciplinary Guidelines referred to in the regulation are posted on the DMV's website at: www.dmv.ca.gov/about/lad/pdfs/ol_disc_guidelines/oldg_handbook.pdf.

The Department's Options regarding the Administrative Law Judge's Recommended Decision

The first option open to the Department upon receipt of the Administrative Law Judge's recommended decision is to adopt it in its entirety. This occurs in the vast majority of cases and usually within thirty (30) days from the Department's receipt of the proposed decision. The Department may also reduce the proposed penalty and adopt the remaining portion of the decision. The Department may take either of these actions without reading or reviewing the evidence and without going beyond the information contained in the Administrative Law Judge's proposed decision. See Government Code section 11517.

The Department has one hundred (100) days from its receipt of the Administrative Law Judge's proposed decision within which to approve it or take some other action; and if it takes no action, the proposed decision shall be deemed adopted at the expiration of the one hundred (100) days. **The Department must, irrespective of any action it takes, file the proposed decision as a public record and serve a copy of it on the dealer and his attorney within thirty (30) days from its receipt of the decision from the Administrative Law Judge**. See Government Code section 11517.

If the Department wishes to reject the proposed decision and make different findings or determinations of issues, or if the Department wishes to increase the penalty, the Department must order a transcript of the hearing and independently review the evidence, as well as provide the dealer with the further opportunity to present either oral or written argument to the Department. This argument is usually presented directly to the Director. Sometimes the first hint of how the Administrative Law Judge decided the case comes when the Office of Admin-

istrative Hearings calls the dealer's attorney and asks the attorney whether he or she wants a copy of the transcript which has been ordered by the Department. See Government Code section 11517.

Once the Department makes known its decision that it will decide the case upon its own review of the evidence and requests a transcript of the trial proceedings, the Department must hear further argument, if requested, and decide the case within one hundred (100) days of its receipt of the transcript, which period may be extended thirty (30) days for special circumstances. See Government Code section 11517.

Service and Effective Date of Decision

Once the Department has either adopted the Administrative Law Judge's decision or made its own decision, the decision must be personally served on the dealer and his or her attorney or be served by registered or certified mail. See Government Code section 11518. The decision becomes effective thirty (30) days after it is delivered or mailed unless the Department orders that it become effective sooner or a reconsideration is ordered. See Government Code section 11519.

Right to Petition for Reconsideration

The DMV itself may order a reconsideration of all or part of the case on its own motion or on petition of any party. The power to order a reconsideration expires 30 days after the delivery or mailing of a decision to dealer, or on the date set by the DMV as the effective date of the decision if that date occurs prior to expiration of the 30-day period or at the termination of a stay not to exceed 30 days which the DMV may grant for the purpose of filing an application for reconsideration. If additional time is needed to evaluate a petition for reconsideration filed prior to the expiration of any of the applicable periods, an agency may grant a stay of that expiration for no more than 10 days solely for the purpose of considering the petition. If no action is taken on a petition within the time allowed for ordering reconsideration, the petition shall be deemed denied. The case may be reconsidered by the DMV itself on all the pertinent parts of the record and such additional evidence and argument as may be permitted, or may be assigned to a administrative law judge. A reconsideration assigned to an administrative law judge is subject to the procedure provided in Government Code section 11521. If oral evidence is introduced before the DMV itself, no DMV personnel may vote unless he or she heard the evidence. See Government Code section 11521.

Appeal of Decision to the New Motor Vehicle Board

Dealer's Right to Appeal and Stay Effect of Decision

The Management Guide chapter on the New Motor Vehicle Board covers extensively the creation, jurisdiction and make-up of the New Motor Vehicle Board and its various activities relating to dealer petitions and protests, and concludes with a general description of the power of the Board to hear appeals by dealers from decisions of the Department imposing license discipline following a hearing on an accusation. **One of the initial purposes for the establishment of the New Motor Vehicle Board with its make-up of four dealer and five public members was to benefit dealers aggrieved by a decision of the DMV by offering them a review by their peers of decisions of the Department imposing license discipline.**

If the Department as a result of an accusation imposed license discipline upon a dealer, such as an actual suspension or revocation of a dealer's license, prior to the creation of the New Motor Vehicle Board, the dealer's only remedy was to petition the Superior Court for a writ seeking to overturn the decision and the dealer had to affirmatively seek a stay of execution by the Superior Court to stop the suspension or revocation from going into immediate effect. This remedy was not only costly, but the chances of success were limited to the somewhat narrow grounds upon which the Superior Court is authorized to reverse the Department's decision.

The New Motor Vehicle Board by its creation in 1967 was authorized to hear appeals by new car dealers from decisions of the Department imposing license discipline. **The law creating the Board further provided that immediately upon the filing of an appeal to the Board, the effect of the decision of the Department is stayed until such time as a final order is made by the Board**. The value and importance of this right of a dealer to appeal a decision of the director cannot be exaggerated. See Vehicle Code section 3051.

Time for Filing and Contents of Notice of Appeal

A Notice of Appeal, **accompanied by a $200 filing fee (the Board also now accepts credit card payments and a waiver of the fee can be requested for good cause) made payable to the Board** (13 C.C.R. 553.40), must be filed on or before the tenth day after the last day on which the Department can order reconsideration of its decision (Vehicle Code section 3052.) This means an appeal must be filed within ten (10) days following the effective date of a decision if no stay has been

granted by the Department, and if a stay has been granted, within ten (10) days following the expiration of the stay. (13 C.C.R. 566) Of course, if an actual suspension or revocation is involved, the Notice of Appeal as a practical matter should be filed prior to the effective date of the decision to prevent the suspension or revocation from going into effect.

The Notice of Appeal must merely recite that the appellant is a new car dealer; specify those portions of the Vehicle Code (Sections 3054 and/or 3055 discussed below) providing a basis for the appeal; confirm that appellant has ordered from the Office of Administrative Hearings, and advanced costs for, the administrative record or the portions thereof the dealer desires to file with the Board, or in lieu thereof, specify that the case is being submitted on an agreed statement; and state that a hearing before the Board is desired. There are additional stringent requirements where the appellant desires to present additional evidence to the Board which must be supported by an affidavit establishing in detail the nature and relevancy of the evidence and why it could not have been produced with due diligence at the hearing or why it was improperly excluded by the Administrative Law Judge. Vehicle Code section 3054(e) and 13 C.C.R. 569.

Appeals Hearing Procedures

Once the original and three copies of the administrative record are filed with the Board, the executive director of the Board notifies the parties of the dates written arguments (briefs) must be submitted to the Board. The Board must decide the case within sixty (60) days from the date the record on appeal is filed, and accordingly, the schedule for briefs is reasonably tight. See Vehicle Code section 3056.

Upon request of the parties, the executive director of the Board will schedule a settlement conference to facilitate a disposition of the case prior to the date set for oral argument.

Unlike hearings on protests and petitions where the Board assigns an Administrative Law Judge officer to hear the case, the Board on appeals does hear oral argument on behalf of the parties and is - required to give at least twenty (20) days notice to the parties of the date set for hearing argument. Also, unlike hearings on protests, the dealer members of the Board participate fully in the hearing and decision making progress. See 13 C.C.R. 574-576.

Following oral argument, which is limited to twenty (20) minutes per side unless the Board extends the time because of its questions to the attorneys, the members of the Board usually go into executive session and arrive at their decision and direct the executive director of the Board to prepare a written opinion and order in accordance therewith. The Board's decision is final upon its delivery or mailing and no reconsideration or rehearing is permitted by the Board. The Board is authorized to fix an effective date of its order not more than thirty (30) days from the date of its service or remand the case to the DMV for fixing an effective date. See Vehicle Code section 3057. A dealer not satisfied with the Board's decision has thirty (30) days from the date which the final order is delivered to the parties personally or sent to them by registered mail to petition the Superior Court for a Writ of Mandamus, and the procedure is the same as that set forth in the chapter on the New Motor Vehicle Board. See Vehicle Code section 3058.

The Power of the Board and How It is Exercised

In hearing appeals, the Board under Vehicle Code section 3054 has the power to reverse or amend the decision of the Department if it finds that any of the following has occurred: the Department exceeded its jurisdiction or acted contrary to law; the decision is not supported by the findings or that the findings are not supported by the evidence; there was relevant evidence, which in the exercise of reasonable diligence, could not have been produced or which was improperly excluded at the hearing; or that the penalty is not commensurate with the findings. Irrespective of whether the Board finds any of the above, it also has the power under Vehicle Code section 3055 to amend, modify or reverse the penalty of the Department. **This power has been used on numerous occasions to reduce penalties imposed by the Department such as reducing the number of days of an actual suspension or reducing an entire suspension and placing the dealer on probation; however, the power to amend or modify the penalty of the Department also includes the power to increase the penalty, and the Board has not hesitated on occasion to increase the penalty imposed by the Department.**

The Board in hearing appeals is authorized to use its independent judgment when reviewing the evidence and is not bound by the findings of the Administrative Law Judge or the Department.

In reviewing appeals from dealers, the Board is guided by the following principles quoted from, and frequently appearing in, its decisions:

- *A dealer owes a solemn duty to the public to supervise the operation of his dealership in a manner calculated to insure compliance with all applicable laws and to achieve and maintain a high standard of business ethics.*
- *A corporate licensee is responsible for all acts of its officers, agents and employees acting in the course and scope of their employment. A contrary rule would, of course, preclude meaningful license discipline.*

- *We can only observe that supervision extends upwards and at the top of the ladder is the dealer-corporation which must bear its burden for failing to exercise proper supervision. Accordingly, in considering mitigation, we can attach little weight to the argument that the dealer's problems resulted from "poor supervision."*

These principles are tempered by the following:

- *The primary purpose of proceedings to discipline new car dealer licensees is to protect the general public from wrongful acts of the licensee.*
- *Factors in mitigation of the penalty do not amount to a justification or an excuse for a wrongful act. They are, however, relevant to the determination of the appropriate administrative sanction to be imposed upon a licensee for Vehicle Code violations. It is a well established principle that administrative proceedings have as a primary purpose the protection of the public, not the punishment of the wrongdoer.*
- *We believe that the public welfare will be adequately served if the opportunity to place its dealership in proper working order without an immediate suspension of its business activities is given appellant.*

Generally speaking, the Board has relied more upon the latter three quoted provisions and has been inclined to reduce actual suspensions where the violations involved, even though substantial in number, were more of a technical or careless nature and did not involve actual fraud or deceit resulting in injury to members of the public. Even where isolated instances of fraud were found to exist, where the dealer and top management were not actively involved and had taken strong corrective action, and the dealer's record was otherwise good, the Board has tended to be more lenient than the Department.

On the other hand, where there has been any pattern of fraud, deceit or false advertising, the Board has relied more upon the principles set forth in the first three quotes above and regularly sustains and even at times increases the penalty imposed by the Department.

Effect of License Discipline Upon Dealer and Officers

In addition to the actual discipline imposed upon a dealership as the result of an accusation, the officers, directors, and managerial employees of the dealership may be denied a dealer's or salesperson's license, or a corporation with which they are affiliated may be denied a dealer's license in connection with subsequent applications. See Vehicle Code section 11703. This topic is discussed later in this chapter.

CAUTION

A DEALER CANNOT AVOID DISCIPLINE BY SURRENDERING THE DEALERSHIPS LICENSE: The foregoing consequences cannot be avoided by voluntarily surrendering a dealership's license which may be threatened by an accusation. Vehicle Code section 11721(c) specifically provides that the surrender of a dealer's license or the dealer's cessation of business shall not prevent the filing of an accusation for the revocation or suspension of the surrendered license.

Settlement - Alternative to Accusation Hearing

Once an accusation has been filed, consideration should always be given to a possible settlement with the Department. The basic reasons for attempting to settle an accusation are to avoid the risk of what may happen if a hearing is held, and in particular the risk of an actual suspension of the dealership's license; to avoid the possible damage to the good will of the dealership resulting from the subpoenaing of its customers to testify at the hearing; and to avoid the cost of litigation.

For years a dealer served with an accusation had no alternative to avoid these risks and was forced to trial on the accusation because the Department took the position that it had no authority to enter into monetary settlements; however, starting in approximately 1975, and well before the enactment of Vehicle Code section 11707, the Department changed its position and decided that it could enter into monetary settlements. Pursuant to such a settlement, the dealer would stipulate without admitting the truth of the allegations that the Department could establish prima facie proof of the allegations contained in the accusation and stipulate to some form of a suspension, all of which would normally be stayed pursuant to a specified term of probation. By including in the terms of probation an agreement to pay a monetary penalty to the Department and to pay the Department's investigative costs, and/or an agreement to make restitution to certain customers of the dealer, the Department got around the need for specific statutory authority to make such settlements. Some settlements include probation only, without any suspension being mentioned, and some settlements are made without any probation.

Vehicle Code section 11707 specifically authorizing monetary settlements became effective in January 1977. As originally enacted, it permitted a monetary settlement only in cases where there were no allegations of fraud or conduct injurious to the

public, and such settlements were strictly in lieu of any other form of penalty against the dealer, such as a suspension or the imposition of terms of probation. Vehicle Code section 11707 has, however, been amended over the years so that in its present form, it authorizes settlements similar to those being entered into by the Department prior to its enactment.

Vehicle Code section 11707 requires that the Department by regulation establish minimum and maximum penalties for specified types of violations with a ceiling of $1,000 per violation and authorizes the Department to enter into settlements with licensees which may include, but is not limited to, a period of probation or monetary penalties or both. This regulation establishes three categories of violations. The first category establishes penalties ranging from a minimum of $15 to a maximum of $300 for each violation of some 28 designated Vehicle Code sections; the second category establishes penalties ranging from $50 to $750 for each violation of some 32 designated Vehicle Code sections; and the third category establishes penalties ranging from $100 to a maximum of $1,000 for each violation of some 12 designated Vehicle Code sections. A complete listing of these sections and the corresponding penalty may be found in section 314 of Title 13, California Code of Regulations.

Settlements under Vehicle Code section 11707 are advantageous to both the dealer and the Department. In substance, the dealer is in a position to buy his or her peace. Where the charges are serious and could, if taken to a hearing, result in an actual suspension of the dealer's license, a dealer is in the position to avoid the risk of any suspension by payment of a lump sum of money to the Department. The DMV settlements are often constructed to show a number of days of suspension, but allowing the dealer to buy out of the suspension by a certain monetary payment for each day of suspension bought out. In particularly serious cases, a dealer might even agree to a one or two day suspension to avoid the risk of a much longer suspension. In the serious cases, the Department will normally insist on at least some period of probation (usually a year or two) and may insist on restitution to certain customers and payment of the Department's expenses in conducting the investigation. In the less serious cases, the dealer may by payment of a monetary settlement avoid any terms of probation whatsoever. By making such settlements, the Department which is relatively understaffed in its legal section not only lessens its heavy case load, but also recovers for the benefit of the State the monetary portion of the settlement and its expenses, and in appropriate cases obtains an agreement that restitution be made to injured customers of the dealer. Since the Department can get none of these advantages if it tries the accusation, the Department is far better off settling cases for money with the exception of those few cases where the public interest demands that the dealer's license be revoked or suspended for a substantial period of time. Accordingly, the dealer's attorney in the typical case, where the maximum risk is an actual suspension ranging anywhere from one to fifteen days, should know it generally does not make sense for the Department to try these cases. The actual suspension is not really needed for the protection of the public good, and yet if the Department tries the case, it forgoes the opportunity of recovering the monetary benefits of such settlements for the State.

Practical Considerations Involving Settlements

Where the allegations in an accusation are relatively serious and particularly where they involve false advertising, some fraudulent pattern or scheme, or arise out of consumer complaints, there is always the possibility that disposing of the accusation will not be the end of the matter for the dealer. As pointed out earlier as well as in the chapter on advertising, the filing of an accusation does not preclude the filing of a complaint by the consumer protection section of the office of the Attorney General, District Attorney or City Attorney for civil penalties up to $5,000, or more, per violation. As pointed out Chapter 40 of the CNCDA Auto Dealer Advertising Law Manual, Penalties for Unlawful Advertising, these offices can measure the number of violations by the number of people who have read, viewed, or heard an advertisement.

Before settling an accusation where this possibility exists, some discreet investigation should be conducted to determine if the complaints relating to the customers named in the accusation are also in the hands of the Attorney General, District Attorney or City Attorney. Sometimes this is not even necessary because the dealer will already have been contacted by one of these offices or it will be apparent that the DMV has forwarded a copy of its investigative report to one of these offices. The reverse is also true and at times the complaints originate with one of these offices and are forwarded from there to the DMV.

A dealer faced with the problem of defending against or settling both an accusation and an action for civil penalties has a number of practical considerations to weigh. Although it is beyond the scope of this chapter to discuss these in any detail, some of these considerations are as follows:

a. If a dealer feels the cases cannot or should not be settled, or that it is too early to attempt a settlement, consideration should be given to telling the Attorney General, District Attorney or City At-

torney that you are not interested in settlement in order to provoke the filing of a civil complaint at the earliest possible time, so long as it can be served upon you before the hearing on the accusation. Since discovery is extremely limited in accusations, by having the civil complaint filed and served, your attorney will be in the position to take depositions in the civil case such as those of the DMV investigators or customers whose testimony the DMV intends to use, which depositions may be invaluable to your attorney in connection with the hearing on the accusation.

b. If an accusation has been filed and the Attorney General, District Attorney or City Attorney is aware of the case, but has made no indication of its intentions, it is sometimes possible, and it is at least worth the try, to attempt to settle the accusation on the condition no civil complaint will be filed. Although the DMV will never make an agreement abdicating its responsibility over license discipline, sometimes the offices of the Attorney General, District Attorney or City Attorney will back off if they feel the dealer's settlement with the DMV is adequate under the circumstances to protect the consuming public.

c. If it is apparent both cases are going to be prosecuted and a settlement is indicated, with whom does the dealer first attempt to settle? One consideration is to settle with the agency which in your opinion views the case least seriously. A substantial settlement with the agency viewing the case most seriously might make the other agency reevaluate its position. For example, if your attorney feels the case can be settled with the DMV without an actual suspension and for a relatively nominal sum of money, and your attorney feels that he or she would recommend a substantially higher sum to settle the other agency's complaint, settle the DMV case first. If you settle with the other agency for a substantial sum, the DMV might decide its case is worth at least an actual suspension.

d. Naturally, after you have concluded a settlement with the agency which views the case least seriously, you are in a position to use that relatively modest settlement as a leverage to get the other agency to come down on its demands because it has obviously overvalued its case.

e. It is often extremely helpful that the dealer and the dealership attorney meet in Sacramento with the Department's attorney and the Chief of Compliance or his or her Deputy to discuss and conclude a settlement.

The following case reflects a court ruling that a dealer can be disciplined for license violations and also be subject to suit by other enforcement authorities:

The Bureau of Automotive Repair ("BAR") filed an action against a repair shop owner alleging various violations of the Automotive Repair Act, including false representations that repair work had been done, failure to give written estimates, charging in excess of estimates, failure to document additional customer authorization for revised estimates, performing unnecessary work, and failure to record odometer readings on work orders. The hearing was held before an administrative law judge who issued a decision to place the repair shop on probation for three years, with the license suspended for fourteen days, and ordering payment of $4,600 in reimbursement for investigation costs. The repair shop owner's license was also revoked, but the revocation was stayed for a three year probation period, with the stay to become permanent if the probationary period was successfully completed without further violation.

Several months later the District Attorney for the county in which the repair shop did business filed a civil complaint against the repair shop alleging unfair competition and false advertising under the California Business and Professions Code. The District Attorney's complaint basically alleged the same violations as were alleged in the administrative proceeding. The District Attorney sought monetary civil penalties against the repair shop.

The repair shop attempted to defend against the District Attorney's action by claiming various legal defenses, including the defense that the repair shop was being subjected to "double jeopardy" violation of the Fifth Amendment of the United States Constitution which provides in part that no person shall "be subject for the same offense to be twice put in jeopardy of life or limb…" The Court of Appeal ruled against the repair shop holding that the double jeopardy argument did not apply, explaining that the purpose of an administrative proceeding was not to penalize the dealer, but rather to protect the public by license enforcement; whereas, the action under the Business and Professions Code was for civil damages as a penalty. The court thus ruled that since administrative actions do not involve punishment, they do not prohibit subsequent criminal or civil proceedings against the licensee.

This case illustrates the difficult decisions that licensees sometimes have to make when there is a license accusation. Sometimes an administrative license action is filed by the DMV, it gets settled, and that is the end of any further action. At other times, and following the license action, the Attorney General, District Attorney or City Attorney files an action against the licensee for civil penalties, or files a criminal action against the licensee. The Court of Appeal in this case emphasized that the administrative action decision against the repair shop did not constitute a penalty. Auto dealers, however, should

take note of the fact that Vehicle Code section 11707 provides that with regard to a license accusation against an auto dealer, the dealer may settle the accusation with the DMV by paying monetary penalties which shall not exceed $1,000 for each violation. It thus appears possible that under the principles of this Court of Appeal case, there could be an argument of double jeopardy if there was a subsequent proceeding brought by other enforcement authorities for penalties or punishment, and if monetary penalties had been paid to the DMV under a settlement. (*People vs. Damon* (1996) 59 Cal.Rptr.2d 504)

SALES AND USE TAX

Chapter 14

Contents

SALES AND USE TAX

OVERVIEW: California's sales and use tax laws have an impact upon virtually every area of dealership operations, affecting everything from vehicle sales to shop supplies consumed by the service department.

By managing operations wisely and with close attention to the various applicable laws, a dealer can manage sales tax liabilities in an efficient manner.

California law imposes sales and use taxes upon retailers for the privilege of selling or leasing tangible personal property at retail. However, the law gives retailers the right to seek reimbursement from customers. Civil Code section 1656.1 creates a presumption that the buyer agreed to reimburse the seller under any of the following circumstances: (1) the sales agreement expressly provides for the addition of sales tax reimbursement; or (2) sales tax reimbursement is shown on the sales check; or (3) the retailer by price tag, advertisement, other printed material directed to purchasers or posted notice informs purchasers that sales tax will be added.

This chapter examines various aspects of sales and use tax laws, including policies of the State Board of Equalization. This chapter should be taken as an overview of the laws governing sales and use taxes as they apply to vehicle dealers in California, but in no case should dealers rely upon this chapter alone in managing their specific sales and use tax requirements. Questions regarding specific interpretations of sales and use tax laws should be reviewed with competent tax attorneys and accountants.

State Board of Equalization

The State Board of Equalization is the agency responsible for collecting sales and use taxes. The Board regularly updates two major publications specifically relating to dealership operations that are available free of charge: Publication 34 (Motor Vehicle Dealers), and Publication 25, (Auto Repair Garages). The publications are available by online at www. boe.ca.gov/pdf/pub34.pdf and www.boe.ca.gov/pdf /pub25.pdf. Although these and other Board of Equalization publications are very helpful reference guides that each dealership should have around, they do not carry the force of law or regulation, and may not be relied upon in case of conflict with law or regulation.

Sales and Use Tax Permits

Retailers are required to obtain a free permit from the Board of Equalization authorizing them to collect and remit sales and use tax. If a dealer has more than one place of business (located on different premises), a separate permit may be needed for each location. However, in some instances it may be possible to obtain a consolidated permit for multiple business outlets if listing all outlets on the initial application.

Authority: Revenue & Taxation. Code sections 6066-6067; 18 California Code of Regulations section 1699; BOE Publication 73.

Filing Returns

Pursuant to Revenue & Taxation Code section 6471, any person whose estimated measure of tax liability averages $17,000 or more per month is required to make monthly tax prepayments to the Board in addition to quarterly filings. All quarterly filings must be made and the taxes paid in full by the last day of the month succeeding each quarter. Prepayments must be made in one of the manners that follows, depending upon whether the dealer will use the current or previous year's accounting records:

- For those using the current year's accounting records:
  - In the first, third, and fourth calendar quarters, prepay at least 90% of the amount of state and local tax liability for each of the first two months of the quarter;
  - In the second calendar quarter, make a first prepayment of 90% of the amount of state and local tax liability for the first month of the quarter, and a second prepayment of either;
  - 90% of the amount of state and local tax liability for the second month of the quarter plus 90% of the amount of state and local tax liability for the first 15 days of the third month of the quarter, or
  - 90% of the amount of state and local tax liability for the second month of the quarter, plus 50% of 90% of the state and local tax liability for the second month of the quarter

- Those businesses using the previous year's accounting records (which requires having been in business during the entire previous year), may make prepayments as follows:
  - For the first, third and fourth quarters, pay an amount equal to one third of the tax liability reported on the return(s) filed for the quarterly period of the previous year, but multiplied by the currently applicable state and local tax rate.
  - For the second quarter, make a first prepayment in an amount equal to 1/3 of the tax liability reported, and a second prepayment in an amount equal to 50% of the tax liability reported on the return(s) filed for the previous year's quarter, multiplied by the current applicable state and local tax rate
- For both methods of prepayment, payment should be made and report submitted to the Board of Equalization as follows:
  - For the first, third and fourth quarters, by the 24th of each of the first two months of the quarter.
  - For the second quarter:
    - A first prepayment and report by the 24th of the second month covering the first month of the quarter.
    - A second prepayment and report by the 24th of the third month covering the entire second quarter and the first 15 days of the third month of the quarter.

Authority: Revenue and Taxation Code sections 6451, 6471-6472.

Penalties for Overdue Filings and Payments

- Late Prepayment Penalties:
  - The penalty for late monthly prepayments is 6% of the prepayment amount, if received before the last day of the month succeeding the quarter in which the prepayment is due.
  - If the prepayment is paid later than that date, but the quarterly payment and return are paid and filed in a timely manner, the penalty increases to 6% of 90% of the tax liability for each of the periods during that quarterly period for which the prepayment was not made.
  - For both of these situations, the penalty for failing to make a payment due to negligent or intentional disregard for these requirements is increased to 10%.
- Late Quarterly Payment Penalties:
  - The penalty for late quarterly payments is 10% of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.
  - The penalty for knowingly collecting sales or use tax reimbursement and failing to make a timely remittance of sales or use tax reimbursement is 40% of the amount not timely remitted, unless the taxpayer can demonstrate that the cause of the late payment was reasonable and outside of the taxpayer's control This tough standard and steep penalty makes on-time tax remittance crucial, and dealers should ensure that the appropriate employees remit taxes on time. Dealers should also establish a sufficient support system is in place to ensure that the mistake of a single employee does not put the dealership at risk of a major penalty.

Authority: Revenue & Taxation Code sections 6476-6478, 6591, 6597.

Electronic Filing Requirement

Any person whose average monthly tax payments exceed $10,000 is required to remit sales and use tax electronically. If filed later than the applicable deadlines (discussed above), that person is liable for a 10% penalty on the amount of taxes, exclusive of prepayments, due for that period. A person who remits a tax payment in a non-electronic manner when required to do so electronically is subject to a penalty of 10% of the taxes incorrectly remitted; for prepayments incorrectly submitted, however, the penalty is reduced to 6% of the prepayment amount incorrectly submitted. These penalties are in addition to those discussed above with regard to late payment. Dealers can establish an E-File account with the BOE for simplified electronic filing and payment by following the instructions found in BOE Publication 159EFT, available online at: www.boe.ca.gov /pdf/pub159eft.pdf. Questions regarding Electronic Funds Transfers (EFT) can be directed by telephone to your local Board office or to the Board's EFT Helpline at (916) 327-4229 (7:30 a.m.-4:30 p.m. weekdays), or in writing to: Return Analysis Section, State Board of Equalization, 450 N Street, MIC:35, P.O. Box 942879, Sacramento, CA 94279-0035.

Authority: Revenue & Taxation. Code section 6479.3.

Audits

If the BOE is not satisfied with a tax return, it may compute and determine the amount required on the basis of facts in its possession, or that it may gather. This "fact gathering" may take place

through an audit, which the BOE may undertake without any particular reason. While no dealer looks forward to being audited, all dealers must be prepared for handling an audit, should that day come. Dealers can minimize the inevitable inconvenience of an audit by keeping meticulous records and adhering to applicable tax rules. Auditors have the right to check all aspects of a dealer's practice, but have primary goals of determining the following about the return filed:

- Whether the dealer reported all gross receipts from sales of tangible personal property and taxable labor and services
- Whether the dealer reported the cost of all business equipment and supplies purchased without tax either from out-of-state vendors or for resale
- Whether the dealer properly claimed deductions
- Whether the dealer properly allocated local tax
- Whether the dealer used the correct rate of tax when reporting sales in special tax districts; and
- Whether the dealer properly applied tax to his sales and uses of tangible personal property

The Auditor will contact the dealer and schedule an audit appointment, specifying the materials and documents the dealer must provide, and giving the dealer two to three weeks to collect the necessary information. During the audit, the Auditor will perform an investigation into the dealer's records and determine whether the dealership paid too much, too little, or the correct amount of sales and use tax. Based on the investigation, the BOE will prepare a letter stating that the correct amount was paid, or prepare a Notice of Determination (Billing) or a Notice of Refund. For more information on the audit process, consult BOE Publication 76, available online at: www.boe.ca.gov/pdf/ pub76. pdf. Dealers can prepare for a sales and use tax audit by familiarizing themselves with the Chapter of the Board of Equalizations Audit Manual for Vehicle, Vessel, and Aircraft Dealers, available online at: www.boe.ca.gov/sutax/manuals/ am-06.pdf.

Authority: Revenue and Taxation Code section 6481, 7054-7060

Managed Audit Program

As an alternative to a full audit by the Board, the Legislature granted the Board the authority to use a Managed Audit Program (MAP) in which a taxpayer can perform an audit of their own books and records, with limited guidance from the Board, in order to determine any tax deficiencies. In return for performing the managed audit, the taxpayer will be liable for only one-half of the interest usually imposed under a regular audit. If the Board offers you this option, you may wish to consider this program as a potential means to minimize additional interest liability.

Authority: Revenue & Taxation Code sections 7076, 7076.1-7076.5 BOE publication 53 (www.boe.ca. gov/pdf/ pub53.pdf).

Appealing an Audit

If your dealership is audited by the Board of Equalization and you dispute the audit findings, the following progressive steps are generally available to appeal such findings:

1. Consultation with the auditor: (a) during the audit, and (b) after completion of the audit.

2. Consultation with the auditor's field supervisor.

3. Discussion before a local Board office representative.

4. Petition for redetermination: (a) presentation of additional documents to audit staff; (b) conference before Appeals Review section attorney or auditor; and (c) hearing before Board of Equalization members.

5. Payment and claim for refund.

6. Court proceedings.

The Board also maintains an alternative settlement program for civil tax matters that is designed to reduce the time and expense involved in the normal appeals process. The Board's staff can negotiate a proposed settlement agreement that differs from the original billing notice. That agreement is subject to approval by the Attorney General's office. Only active cases for which a petition for redetermination or claim for refund has been filed can qualify for settlement consideration. For more information, contact the Settlement section at (916) 324-2836 (sales and use tax cases).

Authority: Revenue & Taxation Code sections 6561-6566 6481 , 6901-6937; 18 California Code of Regulations section 1703; BOE Publications 17 (www.boe.ca.gov/ pdf/pub17.pdf) and 76 (www.boe.ca.gov/pdf/ pub76.pdf); and BOE Sales & Use Tax Audit Manual, Chapter 6 www.boe.ca.gov/sutax/manuals /am-06.pdf.

Record Keeping Requirements

Pursuant to Revenue and Taxation Code section 7053, the Board of Equalization requires retailers to keep adequate records showing:

- Gross receipts from sales or leases of tangible personal property, whether the retailer considers the receipts as taxable or non-taxable;
- All deductions allowed by law and claimed in filing returns; and

- The total purchase price of all tangible personal property purchased for sale, consumption, or lease.

These records must include:

- The normal books of account;
- All bills, receipts, invoices, repair orders, vehicle orders, contracts, or other documents of original entry supporting the entries in the books of account;
- All schedules or working papers used in connection with the preparation of tax returns.

Documentation supporting the timely payment of tax on the purchase price of leased property must be maintained at least until the property is no longer in rental service.

Authority: Revenue & Taxation Code section 7053; BOE Publications 34 (www.boe.ca.gov/pdf/pub34.pdf), 58A (www.boe.ca.gov/pdf/pub58a.pdf), 73 (www.boe.ca.gov/pdf/ pub73.pdf) and 116 (www.boe.ca.gov/pdf/pub116.pdf).

Note

ON REPORT OF SALE RECORDS: The Board of Equalization has voiced concern regarding Dealer maintenance of Report of Sale Slips registered with the DMV, particularly when sales are subsequently voided. During an audit, the Board will check the Dealer's records against the DMV's list of recorded Reports of Sale. When a Dealer is missing a Report of Sale record regarding a sale originally reported to the DMV, the Board takes the position that the missing record represents an undocumented sale and will attribute an average vehicle cost to which it will apply sales tax. The DMV does not keep records of voided transactions, but only retains the original Report of Sale. To avoid such an occurrence, Dealers are strongly advised to keep complete records of voided transactions in case of audit.

Application of Sales and Use Tax Laws

California's basic sales and use tax rate was temporarily increased in 2013 by 0.25% to 7.5%, broken out as shown below:

Rate	Jurisdiction	Purpose
3.9375%	State	State General Fund
0.25%	State	State Fiscal Recovery Fund (Bond Payment)
0.25%	State	Education Protection Fund (through 2016)
0.50%	State	Local Public Safety (Criminal Justice)
0.50%	State	Local Revenue Fund (Health and Safety)
1.0625%	State	Local Revenue Fund (2011 Realignment)
0.75%	Local	City and County Operations
0.25%	Local	County Transportation Funds

This 1% increase will expire July 1, 2017, at which time the base rate will decrease to 7.25%.

In addition to this base rate, many counties have increased their rates by enacting additional district taxes, usually to support public transportation agencies. Dealers can look up the current sales and use tax rates in effect in a particular jurisdiction on the BOE website at: www.boe.ca.gov/cgibin/ rates.cgi.

District Taxes

The sales and use tax rate that applies to the sale or lease of a vehicle is determined by where the customer registers the vehicle. Different counties (and even some cities) have raised their sales tax rates well above 7.5% by enacting district taxes (commonly to support local transit districts). However, dealers located within special taxing districts are not required to collect district tax on sales made in their district to buyers who register such vehicles at an address that is not located within a special taxing district. In such cases, the dealer must obtain a signed declaration from the purchaser under penalty of perjury stating that the vehicle will be registered to, operated from, and stored at an address outside the special taxing district. Sample declaration forms for passenger and commercial vehicles can be found as part of the regulation online at: http://www.boe.ca.gov/pdf/reg1823-5.pdf.

The Regulation 1823.5(d) further states that any seller claiming that a certain transaction is exempt from district taxes "must retain in his records the declaration executed in the prescribed form. If the exemption claimed relates to the sale of a vehicle, the seller also must retain in his or her records a copy of either the Department of Motor Vehicles report of sale or other documentary evidence showing the out-of-district address to which the vehicle is registered."

Authority: Revenue & Taxation Code sections 7261, 7262; 18 California Code of Regulations 1823.5; BOE Publications 28

(www.boe.ca.gov/pdf/pub28.pdf), 34 (www.boe.ca.gov/pdf/pub34.pdf), 44 (www.boe.ca.gov/pdf/pub 44. pdf), 71 (www.boe.ca.gov/pdf/pub71.pdf), 105 (www.boe.ca.gov/pdf/pub105.pdf).

Tax Calculations

Retailers are required to utilize sales and use tax tables approved by the Board of Equalization. However, because tax tables apply only to transactions under $100 (adjusted with CPI) tables apply only to transactions under $100, the Board allows retailers to use the following formula:

"Reimbursement on sales prices in excess of those shown in the schedules provided by the Board may be computed by applying the applicable tax rate to the sales price, rounded off to the nearest cent by eliminating any fraction less than one-half cent and increasing any fraction of one-half cent or over to the next higher cent."

Authority: Civil Code section 1656.1; 18 California Code of Regulations section 1700.

Amounts Subject to Sales Tax

The selling price of a vehicle is subject to sales tax. "Sales price" is defined as "the total amount for which tangible personal property is sold or leased or rented...without any deduction on account of any of the following: (1) the cost of the property sold, (2) the cost of materials used, labor or service cost, interest charged, losses, or any other expenses, (3) the cost of transportation of the property, except as excluded by other provisions of this section."

Accordingly, the total charge, including installation labor charges, for options installed by a dealer on a vehicle prior to its delivery (including, but not limited to: alarms, air conditioners, and stereos) are subject to tax. Document processing charges are also taxable. Many intangible items sold in the F&I Office, however, are not considered subject to sales tax as long as separately itemized. The following chart provides an easy reference for common items:

Item	Taxable?
Document Processing Charge	Yes
Smog Fee Paid to Seller	Yes
Hard Accessories (plus installation labor)	Yes
Surface Protection Products	Yes
Electronic Vehicle Registration or Transfer Charge	No
Service Contracts	No
GAP Contracts	No
Contract Cancellation Option Agreement	No
VLF, Tire, Smog Certification, and Registration Fees	No

Taxes also apply to vehicles sold at auction, even when the purchaser does so without ever receiving the property himself, or where the bidder is to be immediately reimbursed by the party taking possession of the vehicle. Leased vehicles are considered to be continuing sales and are also subject to tax, as discussed in further detail below.

Manufacturer rebates cannot be deducted from the amount subject to tax. However, the vast majority of factory-to-dealer incentives that enable a dealer to sell a car for a lower price effectively reduce the amount subject to tax. The exception to the general rule applies when an incentive program specifically *requires* a dealer to reduce the price of a vehicle by the specific incentive amount. In such cases that incentive amount would be subject to sales tax. In an audit situation, the BOE would expect the dealer to have retained documentation showing that the program does not require a specific price reduction, highlighting the importance of retaining documentation concerning all incentive program payments.

Authority: Revenue & Taxation Code sections 6066, 6006.1, 6006.3, 6010, 6011, 6012, 6051-6051.4, 6201-6207; 18 California Code of Regulations section 1610, 1620, 1660, and 1671.1; BOE Publications 25 (www.boe.ca.gov/ pdf/pub25.pdf), and 34 (www.boe.ca.gov/ pdf/pub34.pdf).

Trade-In Vehicles

A dealer's purchase of a customer's vehicle is not subject to sales tax, since it is acquired for resale. However, when a trade-in is accepted on a purchase, the allowance for the trade-in cannot be excluded from the amount on which tax is based.

Authority: Revenue & Taxation Code sections 6011, 6012; 18 California Code of Regulations section 1654; BOE Publication 34 (www.boe.ca.gov/pdf/pub34.pdf).

Courtesy Deliveries

A California dealer who, at the manufacturer's request, makes a courtesy delivery of a vehicle sold by an out-of-state dealer is considered to have made a retail sale under Revenue and Taxation Code section 6007. The dealer must therefore collect sales tax on the transaction. Similarly, a courtesy delivery of a vehicle in a California dealer's own inventory to the customer of an out-of-state dealer is also considered a retail sale subject to tax under section 6007. Courtesy deliveries can also come up in the context of Internet sales. A courtesy delivery customer may try to claim a sales tax credit for sales tax paid to an out-of-state dealer who sold the customer the vehicle. Exercise caution in such circumstances. The potential problems with such a scenario occurred in one real world example where a

customer had ordered a Corvette via the Internet from a Florida dealer, to be picked up at a California dealership. The Florida dealer collected the sales tax and advised the customer to go to the local California State Board of Equalization (BOE) office, obtain a California sales tax return, and claim a credit for the sales tax paid to the Florida dealer. The BOE, however, advised the California dealer not to recognize the customer's claim of a credit, and to collect sales tax. The BOE's advice was based upon its interpretation of California Revenue and Taxation Code section 6007 which provides in relevant part: "…the person making the delivery shall be deemed the retailer of that property…." (emphasis added) The BOE advised the California dealer that it would be liable for sales tax not collected from the customer and remitted to BOE.

Authority: Revenue & Taxation Code section 6007; BOE Publication 34 (www.boe.ca.gov/pdf/pub34.pdf).

Drop Shipments

If a dealer makes drop shipments to consumers in California on behalf of out-of-state retailers, the dealer is not liable for sales and use tax if the out-of-state retailer holds or is required to hold a California seller's permit or a Certificate of Registration-Use Tax. Otherwise, unless the sale and use of the vehicle are exempt from taxation, drop shippers must pay sales or use tax on the retail selling price of the vehicle. Dealers should note that the special calculation provisions of Regulation 1706(c)(2) do not apply to drop shipments of vehicles. If a California customer is purchasing property for resale, drop shippers are not liable for tax if they obtain a valid resale certificate from the California customer.

Authority: BOE Regulation 1706, BOE Tax Information Bulletin, December 2002.

Internet Sales

Sales of tangible goods made via the Internet to California purchasers should be taxed in the same manner as a sale made at a dealership. If the sale is made for delivery outside of California, however, the transaction may not be subject to California sales tax. Take note of the discussion concerning out-of-state sales of vehicles, below.

Resale Certificates

Dealers should be aware that the Board of Equalization actively enforces regulations relating to resale certificates. Under Sales and Use Tax Regulation 1668, the burden of proving that sale of tangible personal property is not at retail is upon the seller, unless the seller accepts in a timely manner a certificate from the purchaser stating that the property is being purchased for resale. If the certificate is taken in good faith from a person engaged in the business of selling tangible personal property that holds a California seller's permit, the certificate relieves the seller from the liability for any sales tax and the duty of collecting any use tax.

To be timely, a resale certificate must be obtained before the purchaser is billed for the property being sold, or within the dealer's normal billing and payment cycle, or any time at or prior to the delivery of the property to the purchaser. If a dealer fails to obtain a resale certificate in a timely manner, the dealer cannot later obtain one to apply retroactively. Under such circumstances, the dealer will be liable for the tax unless the dealer can present satisfactory evidence that the specific property sold met one the following conditions:

1. The property was in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration or display while the purchaser held it for sale in the regular course of business; or,

2. The property is being held for resale by the purchaser and has not been used by the purchaser for any purpose other than retention, demonstration or display while the purchaser held it for sale in the regular course of business; or,

3. The property was consumed by the purchaser and tax was reported directly to the Board by the purchaser on the purchaser's sales and use tax return, or

4. The property was consumed by the purchaser and tax was paid to the Board by the purchaser pursuant to an assessment against or audit of the purchaser developed either on an actual basis or test basis.

If a dealer sells a vehicle to a purchaser who is not regularly engaged in selling or leasing vehicles, a dealer should accept a resale certificate only if it contains a statement that the specific vehicle is being purchased for resale in the regular course of the purchaser's business. Dealers should note, however, that under Sales and Use Tax Regulation 1566(b), a resale certificate will not be honored by the Board and tax will be due if the person named as a purchaser on the resale certificate is not named on the dealer's report of sale and application for registration.

Sales and Use Tax Regulation 1668(b) provides a description of the minimum requirements for a resale certificate form and should be closely followed by dealers to avoid controversy. Appendix A of Regulation 1668 provides a model for a general resale certificate. Appendix B provides a model form specifically for the auto body repair and painting industry. However, any document obtained in a timely manner from the purchaser which contains

the following information can serve as a resale certificate:

1. The signature of the purchaser (or purchaser's agent or employee).

2. The name and address of the purchaser.

3. The number of the seller's permit held by the purchaser.

4. A statement that the property described in the document is purchased for resale (the phrases "for resale," "resale=yes," "non-taxable," or "taxable=no" should be used). The regulation specifically disallows sellers to rely on purchase orders that merely designate $0 as the amount of tax to be charged, or fail to provide any statement as to the taxability of items purchased. The property to be purchased under the certificate must be described either by an itemized list of the particular property to be purchased for resale, or by general description of the kind of property to be purchased for resale.

5. The date the document was signed.

This regulation does allow a purchaser to issue a "blanket" resale certificate to apply to a series of transactions, if the certificate provides a general description of the items to be purchased.

Special Requirement for Auto Auction Resale Certificates: A law took effect in 2013 creating a rebuttable presumption that a vehicle purchased at an auto auction is purchased at retail (and subject to sales tax). The presumption may be rebutted by taking a resale certificate from any of the following entities, bearing the applicable occupational license or registration number:

(1) An entity that certifies it is licensed, registered, regulated, or certificated under the Health and Safety Code or the Vehicle Code as a dealer or dismantler.

(2) An entity that certifies it is licensed, registered, regulated, or certificated under the Business and Professions Code as an automotive repair dealer, or is qualified as a scrap metal processor as described in the Vehicle Code.

(3) An entity that certifies it is licensed, registered, regulated, certificated, or otherwise authorized by another state, country, or jurisdiction to do business as a dealer, dismantler, automotive repairer, or scrap metal processor.

Dealers should ensure that the resale certificates kept on file at each auto auction contains the required occupational license or registration numbers, and that the auto auction does not allow entry to non-licensed or registered individuals.

Authority: Revenue & Taxation Code sections 6091, 6092, 6093, 6094, 6095, 6241-6249; 18 California Code of Regulations section 1566, 1668, 1669.5; BOE Publications 34, 42, 103.

NOTE

REGARDING SALE OF VEHICLES ON HOLD FOR RESALE BASIS: Under California Vehicle Code section 11713.1(f), a dealer is prohibited from purchasing for resale any new vehicle of a line make for which the dealer does not hold a franchise, subject to certain specific exceptions. Given this prohibition, a dealer selling a new vehicle to another dealer not franchised to sell the type of vehicle purchased should be careful to have documentation that the sale qualifies for one of the limited "hold for resale" exceptions (i.e. mobile home; recreational vehicle; commercial coach; off-highway motor vehicle; manufactured home; new vehicle substantially altered by a converter; commercial vehicle with gross vehicle weight rating of more than 10,000 pounds; or a vehicle purchased for export outside the United States) if sales tax is not being paid based upon a resale certificate obtained from the purchasing dealer. Without this documentary evidence, the selling dealer's acceptance of the resale certificate would probably not be in good faith—a requirement to avoid tax liability.

The Board of Equalization's Audit Manual contains a discussion in the chapter relating to, *Vehicle Vessel and Aircraft Dealers* that provides further guidance on treatment of transactions on a hold-for-resale basis. Section 0601.50 of the Audit Manual now provides:

The Vehicle Code prohibits a dealer-broker from purchasing a new motor vehicle for resale of a line-make for which the dealer-broker does not hold a franchise. *This violation of the dealer's license would provide sufficient cause to disallow acceptance of a resale certificate in good faith. New car dealers should be advised not to accept a resale certificate for this type of transaction. The violation of Vehicle Code section 11713.1 is sufficient to overcome the presumption of a good faith acceptance of a resale certificate, whether or not it contains a statement that the specific vehicle is being purchased for resale in the regular course of business.*

When these types of transactions are encountered in audits of franchised dealers, BOE-1164 should be prepared for questionable transactions, e.g., a Ford dealer accepting a resale certificate for the purchase of a new Ford vehicle from a dealer not franchised to sell Ford vehicles.

Except for those specific types of transactions mentioned in the Note above, it is improper to accept a resale certificate when selling a new motor vehicle to another dealer who is not also franchised to sell that line-make. Unless the transaction is a

true dealer-trade (Ford dealer to Ford dealer), or you can document that a new vehicle was sold to a bona fide leasing company and in fact leased, sales tax should be collected and remitted, or you will face an audit chargeback and risk a DMV investigation.

Availability of Sales Tax Refunds in Unwind Situations

Dealers should be aware that a refund of sales tax can be obtained as the result of the rescission ("unwind") of a contract pertaining to the sale of a motor vehicle. However to obtain such a refund or sales tax credit, the Board of Equalization, based upon California Revenue and Taxation Code section 6011 and Sales and Use Tax Regulation 1655, takes the position that the customer must receive a full refund of the "sales price" of the motor vehicle, including the portion designated as sales tax, and the customer, in order to obtain the refund or credit, is not required to purchase other property at a price greater than the amount charged for the returned property.

Although Regulation 1655 does allow an amount to be withheld from the refunded sales price for "rehandling and restocking costs," those costs are may not exceed the actual costs of rehandling and restocking the vehicle, and are specifically defined not to include compensation for "increased overhead costs because of the return, for refinishing or restoring the property to saleable condition where the necessity therefore is occasioned by customer usage, or for any expense prior to sale." However, in lieu of using the actual cost for each transaction, the amount withheld for rehandling and restocking may be a percentage of the sales price determined by the average cost of rehandling and restocking returned merchandise during the previous accounting cycle (generally one year). If the seller elects to withhold rehandling and restocking amounts based on a percentage of sales price, however, the seller is bound by that election for the entire accounting cycle for which the election is made and must apply that percentage in lieu of actual cost during that period on all returned vehicle transactions for which rehandling and restocking costs are withheld.

Because of the language of this regulation and its application by the Board of Equalization, a dealer could not obtain a sales tax refund, if as part of unwinding a deal, the dealer deducts from the refunded sales price a charge for the customer's use of the motor vehicle. It is noteworthy that a sales tax refund could probably still be obtained if DMV license and registration fees were not refunded to a customer as part of an unwind, since it is apparently the Board's position that such fees are not part of the "sales price."

Dealers should be aware that pursuant to California Vehicle Code section 11713(g) they are prohibited from including "as an added cost to the selling price of a vehicle, an amount for licensing or transferring of title of the vehicle, which is not due to the state unless, prior to the sale, that amount has been paid by a dealer to the state in order to avoid penalties that would have accrued because of the late payment of the fees." This statute does recognize, however, that a dealer can collect a prorated registration fee from a second purchaser of a vehicle where the vehicle had been previously sold by the dealer and that transaction had been rescinded and all license and registration fees were returned to the first purchaser of the vehicle.

Authority: Revenue & Taxation Code sections 6011, 6012; 18 California Code of Regulations section 1655.

Contract Cancellation Option Agreements

When a dealership sells a contract cancellation option on a used vehicle, the price of the option and potential subsequent restocking fee are exempt from sales tax. The amount refunded to the customer pursuant to the exercise of contract cancellation option agreement is also exempt from sales tax.

Authority: Revenue & Taxation Code section 6012.3; Vehicle Code Section 11713.21; 18 California Code of Regulations sections 1566 and 1655.

Lemon Law and Sales Tax Refunds

When a vehicle has been returned in accordance with California's Lemon Law and the consumer seeks restitution instead of replacement of the vehicle, the manufacturer may file a claim for refund of that amount with the board. The claim must include a statement that the claim is submitted in accordance with the provisions of California's Lemon Law as well as documents evidencing that restitution was made pursuant to, and in complete compliance with, subdivision (d)(2) of California Civil Code section 1793.2. The claim must include the following materials:

1. a copy of the original sales agreement between the buyer and the dealer of the non-conforming motor vehicle;
2. copies of documents showing all deductions made in calculating the amount of restitution paid to the buyer along with full explanations for those deductions, including settlement documents and odometer statements;
3. a copy of the title branded "Lemon Law Buyback" for the non-conforming motor vehicle returned by the buyer;

4. proof that the decal the manufacturer is required to affix to that motor vehicle has been so affixed in accordance with section 11713.12 of the Vehicle Code;
5. the seller's permit number of the dealer who made the retail sale of the non-conforming motor vehicle to the buyer; and
6. evidence that the dealer had reported and paid sales tax on the gross receipts from that sale.

If the consumer instead elects to have the vehicle replaced under the Lemon Law with a new vehicle substantially identical to the non-conforming vehicle, the transaction is treated as acting under the terms of the mandatory warranty. The BOE regulations on the subject state that no additional tax is due unless the consumer is required to pay additional amounts for the replacement vehicle, in which case tax would be due on the additional amount. If the manufacturer is required to pay an additional amount to the consumer in addition to replacement of the vehicle, this amount can be considered restitution, and a sales tax refund may be owed if the requirements outlined above are fulfilled. Note: The factory may not file a claim for refund if the consumer is allowed a credit toward the purchase of a new vehicle rather than restitution or a replacement vehicle under the Lemon Law.

While the restitution and replacement options seem to solely involve the manufacturer, The June, 2001 BOE Tax Information Bulletin provides that "A manufacturer may allow an authorized dealer to act as its agent for purposes of determining the amount of restitution that is due or to provide a replacement vehicle."

Authority: Revenue & Taxation Code section 6011; Civil Code section 1793.2-1793.25; Vehicle Code section 11713.12 18 California Code of Regulations section 1655(2); BOE Publication 34 (http://www.boe.ca.gov/pdf/pub34.pdf)

Refunds for Charged Off Accounts and Losses

If a dealer charges off an account that has a remaining balance that is deemed unrecoverable and charged off for income tax purposes (or pursuant to generally accepted accounting principles if not required to file income tax returns), and the dealer remitted sales tax on the charged-off account, the dealer is entitled to make an application of the Board of Equalization for a pro-rata deduction or refund of the sales tax remitted.

Finance companies may also apply for a pro-rata deduction or sales tax refund on assigned accounts that meet the same criteria. However, in order to be eligible for a sales tax deduction or refund, the finance company must first obtain an irrevocable agreement from the dealer stating that the finance company is the only entity entitled to claim the deduction or refund. Although most dealers assigned conditional sale contracts and lease contracts to finance companies without recourse, a dealer should carefully review any agreements that a finance company requests to be signed to ensure that the agreement does not conflict with any of the warranty provisions in its master retail agreement which may require the dealer to repurchase a contract due to a breach of one or more of the warranties.

Authority: Revenue & Taxation Code sections 6055 and 6203.5; 18 California Code of Regulations Section 1642.

Gasoline

Dealerships generally purchase gasoline to either operate dealership vehicles, or to fill the tanks of vehicles they sell. Gasoline purchased to operate dealership vehicles is subject to sales and use taxes. However, gasoline contained in the tanks of sold vehicles is not subject to sales tax, since it is considered to be sold as part of the vehicle.

If a dealer did not pay sales tax when purchasing the gasoline from a distributor, the dealer should pay use tax (the equivalent of sales tax in this example) on a portion of the gasoline purchased. The use tax would be based on the purchase price of the portion of the gasoline used by dealership vehicles (see California Revenue and Taxation Code section 6094) and should be declared on the dealership's quarterly sales tax return.

If a dealer paid sales tax when purchasing the gasoline, the dealer is entitled to a refund or credit for sales tax paid which is attributed to the portion of the gasoline contained in tanks of sold vehicles (See California Revenue and Taxation Code section 6012 (a)).

Pursuant to Sales and Use Tax Regulation 1701 "Tax-Paid Purchases Resold," a dealer should take a deduction for such sales tax paid on the sales tax return for the period when the sales of the vehicles involved occurred. If the deduction is not taken in the proper quarter, a refund claim should be filed.

Authority: Revenue & Taxation Code sections 6012, 6094; 18 California Code of Regulations section 1701; BOE Publication 25, 34 (www.boe.ca.gov/pdf/pub34.pdf).

Dealership Vehicles

Vehicles used as service vehicles, parts and service department vehicles, tow trucks, etc., are subject to use tax based on the purchase price of the vehicle if they were purchased without tax. If tax was paid when these vehicles were purchased, no additional tax is due. If the vehicle is used as a

demonstrator and held for sale at the same time as it is being used for the above-mentioned purposes, a tricky situation arises whereby the dealer must pay a use tax according to the fair rental value of the vehicle for the time it is being used for business or personal purposes. This circumstance is discussed in further detail below in reference to Demonstrator Vehicles.

Authority: Revenue & Taxation. Code sections 6094, 6244; 18 California Code of Regulations section 1669.5; BOE Publication 34 (http://www.boe.ca.gov/pdf/pub34.pdf).

Loaned Vehicles

Treatment of Dealers

If a dealer purchases a vehicle to be used exclusively as a loaner for service department customers, the vehicle is considered a company vehicle and not to be held for resale or lease. As a result, the dealer cannot use a resale certificate to purchase the vehicle and tax applies to the sale of the vehicle to the dealer. If the dealer subsequently sells the vehicle, the dealer must report tax on the selling price.

Repairs Under Manufacturer's Warranty

The tax treatment of vehicles loaned to customers awaiting repairs depends on two factors: (1) whether the repairs are being made pursuant to the manufacturer's warranty; and, (2) whether the vehicle being repaired is leased or owned by the customer.

According to the Board's June 1998 *Tax Information Bulletin*, the following tax treatment applies to the loan of vehicles without charge to customers while their own vehicle is being repaired. The information provided only applies when the loan of the vehicle is in fulfillment of the contract requirements of a manufacturer's warranty upon which tax was paid at the time of sale. How the tax applies to the loan of the vehicle depends on whether the customer is the owner or the lessee of the vehicle being repaired.

Vehicle Being Repaired is Owned by Customer:-Tax does not apply to the loaner vehicle, which is regarded as part of the original taxable sale, upon which the proper tax has already been paid.

Vehicle Being Repaired is Leased by Customer:- If the lessee pays tax on rentals payable (a "continuing sale"), the loan is not subject to tax so long as regular rental and tax payments continue to accrue on the lease. The regular lease payments are considered by the Board to cover the use of the loaned vehicle.

For certain unusually structured leases, however, the loan of the vehicle may be subject to tax. If the lease is not a continuing sale (tax was paid on the purchase price up front, and is not collected on rentals payable), the dealer is deemed to have made a taxable use of the loaned vehicle. Tax is due on such use, generally measured by rentals payable (if the dealer rents the vehicle from another source) or the fair rental value (if the dealer takes the vehicle from resale inventory).

Loaner Provided While Vehicle is Being Repaired Under Service Contract: Because optional warranties (i.e., service contracts) are not subject to sales tax, loaners provided without charge under optional warranties are subject to tax.

Customer-Paid Repairs or Vehicles Loaned to Customers Awaiting Delivery of Another Vehicle

Loans of vehicle to customers paying for their repairs at a dealership (outside of the manufacturer's warranty), or awaiting delivery of another vehicle are not considered part of the original purchase and are thus subject to tax. The measure of tax liability in instances where the vehicle loan is subject to tax is discussed in Regulation 1669.53. Accordingly, taxes should be charged based on the fair rental value of the vehicle for the time it is loaned to the customer. The term "fair rental value" is defined by the regulation to be "the amount for which the dealer rents similar vehicles for similar periods to persons who are not customers awaiting delivery of vehicles purchased or leased from the dealer or being repaired by the dealer."

The regulation also provides that "if the dealer does not rent vehicles under such circumstances, the fair rental value is the amount for which other dealers in the area rent vehicles for similar periods to persons who are not customers awaiting delivery of vehicles purchased or leased from the other dealers or being repaired by the other dealers."

Authority: 18 California Code of Regulations 1669.5; Tax Information Bulletin, June 1998; BOE Publication 34 (www.boe.ca.gov/pdf/pub34. pdf).

Demonstrator Vehicles

Under Regulation 1669.5, the measure of use tax owed for demonstrator vehicles depends on three factors: 1) how the vehicle is used, 2) by whom, and 3) for how long. Vehicles used solely for demonstration and display while being held for resale in the regular course of business are exempt from taxation. On the other hand, vehicles that are not frequently demonstrated or displayed for sale, but are used for personal or business purposes are subject to use tax based on the full purchase price. The complexity arises in "combined use" situations, where vehicles are used for frequent demonstration or display, but are also used for personal or business purposes. As explained below, use tax based on fair rental value may be paid on vehicles assigned to sales personnel or other employees, for a period not

exceeding 12 months and used for combined demonstration and other purposes.

A vehicle assigned to "sales personnel" (salespeople, sales managers, sole proprietors, partners, or corporate officers) directly participating in negotiating sales for combined demonstration and other use (whether business or personal), for a period not exceeding 12 months, is subject to use tax based on 1/60th of the purchase price for each month of such use.

A vehicle assigned to an employee or officer not classified as "sales personnel" for combined demonstration and other use (whether business or personal) for a period not exceeding 12 months is subject to use tax based on 1/40th of the purchase price for each month of such use.

If the anticipated duration of combined use is unknown at the time the vehicle is assigned, use tax may be paid (based on the appropriate formula for the type of employee using the vehicle) until 12 months have elapsed. At that point, use tax must be paid based upon the vehicle's cost, minus the measure of tax previously reported.

Finally, vehicles assigned to persons other than officers or employees cannot be classified as demonstrators, and are subject to use tax based on the full purchase price. Copies of Sales and Use Tax Regulation 1669.5 are available online or from your local State Board of Equalization office.

Exemptions

The Sales and Use Tax Law contains specific exemptions for various types of transactions, including sales to the United States Government, and sales to foreign diplomats. For information regarding other potential exemptions for which your dealership may be eligible, contact your local Board of Equalization office.

Sales to the United States Government

Exemption: Pursuant to Sales and Use Tax Regulation 1614, sales tax does not apply to sales to: (a) the United States government or its unincorporated agencies and instrumentalities; (b) any incorporated agency or instrumentality of the United States owned wholly either by the United States or by a corporation wholly owned by the United States; (c) the American National Red Cross, its chapters and branches; or, (d) incorporated federal instrumentalities not wholly owned by the United States, unless federal law permits taxing the instrumentality. Examples of the incorporated federal instrumentalities exempt from tax are federal reserve banks, federal credit unions, federal land banks, and federal home loan banks.

Evidence: Dealers should obtain and retain government purchase orders or remittance advises to support such exemptions. (Please note: This exemption applies only to federal government agencies. Sales to state and local agencies are generally taxable.)

Authority: Revenue & Taxation. Code sections 6012, 6352, 6381; 18 California Code of Regulations section 1614; BOE Publications 34 (www.boe.ca.gov/pdf/pub34.pdf), 61 (www.boe.ca.gov/pdf/pub61.pdf), 102 (www.boe.ca.gov/pdf/pub102.pdf).

Sales to Foreign Diplomats

Exemption: Sales tax does not apply to sales of vehicles to foreign consular officers, employees, and members of their families if those persons have been granted immunity from tax according to treaties or other diplomatic agreements with the United States. .

Evidence: The United States Department of State's Office of Foreign Missions recently changed its policy concerning authorized sales and use tax exemptions. Under the revised policy, the tax exemption will only be granted if the Office of Foreign Missions issues a Motor Vehicle Tax-Exemption Letter to the dealership. Crucially, Diplomatic Tax Exemption Cards *may not* be used in lieu of a Tax Exemption Letter. Accordingly, prior to executing a vehicle sale or lease agreement, the dealership must directly contact the Office of Foreign Missions to request the issuance of the Exemption Letter, and provide the following information:

1. Dealership name, mailing address, and telephone and fax numbers;
2. Color, year, make, and model of the motor vehicle that the mission or accredited mission member is planning to acquired; and
3. For **official** motor vehicles: the name of the foreign mission that is purchasing or leasing the vehicle; or
4. For **personal** motor vehicles:
    a. the name (as it appears on the current "A-series" or "G-series" visa) of the accredited mission member or their dependent who is purchasing or leasing the vehicle;
    b. the individual's Department-issued Personal Identification Number (PID); and
    c. the dealership must be presented with proof of the individual's diplomatic or consular status (i.e., valid passport

containing a current "A-series" or "G-Series" visa, or Department-issued protocol identification card, or Department-issued driver's license, or Department-issued Diplomatic Tax Exemption Card.)

The Office of Foreign Missions anticipates that a Motor Vehicle Tax-Exemption Letter should normally be issued within two hours of receiving the request, if requested during normal business hours. Dealers must then follow the instructions contained within the letter, which will allow for the issuance of a federal vehicle registration card and license plates, title to be issued to the lienholder, and authorize the use of the Temporary Operating Copy of the DMV Report of Sale form.

Authority: Revenue & Taxation. Code sections 6352; 18 California Code of Regulations section 1614; BOE Publications 34 (www.boe.ca.gov/pdf/pub34.pdf), 61 (www.boe.ca.gov/pdf/pub61.pdf), 102 (www.boe.ca.gov/pdf/pub102.pdf), Department of State Letter re Tax Exemption Letters dated December 27, 2012.

Out-of-State Sales

Exemption: Generally, Tax Regulation 1620 holds that vehicles purchased and delivered outside of California , for use outside of California, are not subject to sales or use tax. Given the history of abuses of this law by consumers and businesses, many conditions have been placed up on this exemption. Dealers should note that the BOE views out-of-state sales by California dealers with a suspicious eye.

Current Law. The BOE views vehicles sold by California dealers as being subject to sales or use tax, even if sold to a non-resident for use out of state, unless several strict requirements are met. In fact, if the purchaser even brings the vehicle into California during the first 12 months of sale, the vehicle is presumed as having been purchased for use in California and therefore subject to use tax. Vehicles sold for use out-of-state are exempt from California sales and use tax only if *all* of the following conditions are met:

1. Title and possession to the vehicle must be transferred to a purchaser outside California. The fact that the purchaser accompanied the dealer's agent to an out-of-state location does not negate the exemption. Dealers should note, however, that tax applies to all merchandise *delivered* in California regardless of its ultimate destination.
2. The vehicle must not be sold for use in this state. If the vehicle is brought back into the state within the first 12 months after being delivered out-of-state, or if it is used more in-state than out-of state during the first 12 months after being purchased out-of-state, a rebuttable presumption is established that the vehicle has been purchased for use in this state and is subject to tax.
3. **Evidence**: To prove the applicability of this exemption, retaining an abundance of evidence that the sale took place out of state is crucial. Dealers should obtain and retain:
   a. Evidence of the customer's out-of-state address;
   b. Evidence demonstrating that the vehicle was delivered to an out-of-state location, the dealer needs to retain
      i. Documents showing delivery or shipment out-of-state, such as bills of lading or other shipping documents (if delivered by a common carrier auto transporter), or a delivery employee's expense claims, etc.; and,
      ii. A statement signed by the delivery person and the purchaser, certifying delivery of the vehicle to an out-of-state location. They should have the statement notarized at the out-of-state delivery point, with the delivery person and the purchaser both present before the notary. The dealer can use Board Form BT-448 or a statement that is substantially similar to that found in Form BT-448.

Repairs of Vehicles Sold for Use Out-of-State. While out-of-state vehicles brought into California within the first 12 months after purchase are generally presumed to have been purchased for use within California, this presumption may be rebutted if the owner provides documentary evidence demonstrating that the vehicle was brought into California exclusively for the limited purpose of warranty or repair service and was used or stored in this state for that purpose for 30 days or less. The presumption that the vehicle was bought for use in California (and therefore subject to use tax) can be rebutted: by documentation, which must include both 1)a work order that includes the dates that the vehicle is in the possession of the warranty or repair facility and 2) a statement by the owner of the vehicle specifying dates of travel to and from the warranty or repair facility. The 30-day clock begins when the vehicle enters this state, includes any time of travel to and from the warranty or repair facility, and ends when the vehicle is returned to a point outside the state.

Foreign Delivery Programs. Occasionally, import dealers make special arrangements to enable a customer traveling abroad to take delivery of the vehicle directly from the manufacturer in the foreign country. The customer temporarily uses the

vehicle abroad, and then has it shipped back to a California dealership. If the vehicle was used outside California for more than 365 days, the question sometimes arises as to whether the dealer is required to collect sales tax. Because the vehicle is intended to be used in California, the dealer should collect the tax.

Policy Changes May Be Coming. To address ongoing budget difficulties, the legislature has frequently changed the policy in the last several years to expand the number of would-be out-of–state vehicle sales subject to use tax. The legislature may do so again in the future. CNCDA will inform dealers of such changes through Bulletin articles and our annual Legislative Summary.

Authority: Revenue & Taxation. Code sections 6010, 6247, 6248, 6352, 6366.2, 6387, 6396; 18 California Code of Regulations sections 1610, 1620; BOE Publication 34.

Purchases by California Residents for use Out of State

The BOE views vehicle purchases by California residents from California dealers for use out of state as *particularly* suspicious, and presumes that such vehicles are intended for use within the state unless even more documentation is obtained. If a buyer claims the vehicle is being purchased for use outside California and the dealer knows the customer is a resident of this state (e.g. has a California driver's license, or a California address, regardless of whether he or she lives in the state only seasonally or periodically), the dealer must obtain a signed statement certifying that the vehicle is being purchased for use outside California. The dealer can use form BT-447, which can be ordered from the Board, or a statement that is substantially similar to that found in form BT-447. This form requires a statement by the buyer that the vehicle will be used outside California, and allows the dealer to overcome this presumption if accepted at the time of sale and taken in good faith. The Board requires the dealer to retain the original forms.

If the dealer does not obtain a signed statement from the customer, the vehicle is considered to be purchased for use in this state, and the dealer must collect tax on the sale.

Although the dealer is not required to pay or collect tax on a vehicle purchased and delivered for use outside California (as described above), the buyer may be required to pay use tax. In general, a customer who purchases a vehicle for delivery outside California is liable for use tax if, following the purchase, he or she:

• First uses the vehicle outside of California but brings it into the state within 12 months of the date of purchase;

• First functionally uses the vehicle in California; or

• Otherwise causes the vehicle to become subject to California vehicle registration requirements.

Authority: Revenue & Taxation Code sections6247 and 6248; BOE Publication 34 (www.boe.ca.gov/pdf/pub34.pdf).

If Out-of-State Delivery is Made by a Method Other Than a Common Carrier Auto Transporter

The Board designed Form BT-448 (Statement of Delivery Outside California) for proper documentation when delivery is made by a method other than a common carrier auto transporter (if an auto transporter makes delivery, a bill of lading or other shipping document can be used). Although its use is not mandatory, Form BT-448 helps to ensure proper documentation of an exemption. Form BT-448 is available from the Board.

Authority: Revenue & Taxation. Code sections 6247, 6248; 18 California Code of Regulations section 1610; BOE Publication 34' BOE Tax Information Bulletin Sept. 2004.

Vehicles Sold to Native Americans and Delivered on a Reservation

Exemption*: California sales and use tax does not apply to the sale of a vehicle to a Native Americans where delivery is made and ownership transfers on the reservation.*

Dealers that do not remit sales tax on such transactions, however, are often the target of Board of Equalization auditors, particularly when the transaction involves luxury and exotic vehicles.

Evidence: Dealers selling vehicle to Native Americans and delivering the vehicle to a reservation to avoid the application of sales tax must be careful to collect and maintain evidence sufficient to prove that the vehicle purchaser is Native American, that the parties agree that delivery will take place on the reservation, and that delivery does, in fact, take place on the reservation. As such, dealers selling to Native Americans should seek all of the following:

Proof of Native American Status. Dealers must establish that the purchaser of the vehicle is Native American and lives on their reservation. This can be done by requiring both:

- Identification from the tribe that the purchaser is a tribal member; and
- Proof of residency on the reservation.

Delivery Instructions. In order to ensure that the transaction is exempt from sales tax, the parties

should insert a provision in the contract specifying that delivery is to take place on the reservation.

Because standard sale and lease contracts do not include a place to provide delivery instructions, such instructions must be incorporated by reference and integrated into the contract. This may be done through the following steps:

- On the first page of the original and all copies of the contract, insert a conspicuous statement integrating the delivery instructions, such as "Delivery Instructions are attached to and made a part of this agreement;"
- Staple the original delivery instructions to the contract, and a copy of the instructions to each copy of the contract; and
- On the first page of the delivery instructions, include a statement confirming that the instructions are part of the contract terms, such as "this document is attached to and made a part of [identify the specific contract, including the purchaser's name and transaction date]."

Note

REGARDING ASSIGNMENT OF CONTRACTS: Beware that some financial institutions may not purchase contracts that have additional documents attached. Be sure to check with your finance source before using this method.

Delivery on the Reservation. Most importantly, the dealer must physically deliver the vehicle on the reservation. Proving that delivery took place on the reservation is key to defending against a claim by auditors that sales tax is due on the transaction. The BOE recommends using as many pieces of evidence as possible to prove that the delivery actually took place on the reservation, including the following:

- Mileage logs
- Expense Reports
- Time and hour sheets
- Photographic evidence
- Delivery receipts signed by the purchaser or lessee, referring to the specific contract; and
- Form BOE-146-RES. The BOE has created a form to assist in providing evidence that delivery took place on the reservation. This form includes sections for the buyer, seller and a public notary to sign upon delivery to establish evidence of the location of transfer.

Enforcement. If the regulatory conditions are met, the vehicle purchase should be exempt from sales tax. Some dealers have fulfilled the general requirements for an exemption, but have not sufficiently documented the transaction and could not prove to the satisfaction of the BOE auditors that these requirements have been fulfilled. In such cases, the BOE has sought the amount of tax, plus penalties, from the selling dealer. To prevent such a result, make sure to instruct dealership personnel to collect as much information as possible to prove that the requirements described above are satisfied for such transactions. Remember, BOE auditors are often looking to collect revenue from your dealership—you have the burden of rebutting their predisposition to believe that the requirements have not been fulfilled. The more evidence you can produce to establish that your transaction was legitimate, the better your chance of rebuttal.

Keep in mind that several of the concerns connected with Out-of-State Vehicle Sales also apply to sales to Native Americans.

Authority: 18 California Code of Regulations section 1616; BOE Publication 34 (www.boe.ca.gov/pdf/pub34.pdf).

Vehicles Loaned to State University Employees

Exemption: Revenue and Taxation Code section 6202.7 specifies that a dealer who loans any motor vehicle to any employee of the University of California or the California State University shall only be liable for the use tax on the loan of that vehicle equal to the amount of tax that would have applied if the vehicle had been leased at fair rental value for that period. To qualify for this favorable use tax treatment (which prevents dealers from being assessed use tax based on the vehicle's acquisition cost), the loan must satisfy each of the following conditions: (1) the vehicle is loaned for the employee's exclusive use; (2) the loan is approved by the school chancellor or president; and (3) it is demonstrated that the loan is not dependent upon the retailer receiving any automotive-related business from the university.

Evidence: The dealer should obtain and retain documentation establishing that the loan of the vehicle met the conditions described above.

Authority: Revenue & Taxation. Code section 6202.7.

Vehicles used in Interstate or Foreign Commerce

Exemption: Sales and Use Tax Regulation 1620(b)(2)(B)1 exempts from the use tax any vehicles used in interstate or foreign commerce prior to their entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California.

Authority: 18 California Code of Regulations section 1602(b)(2)(B)1.

Vehicles for Physically Disabled Persons

Exemption: Sales and Use Tax Regulation 1591.3 exempts from the sales and use tax items and materials used to modify a vehicle for physically disabled persons when such items are necessary to enable the vehicle to be used to transport a physically disabled person or persons. Tax does not apply whether the property is installed by the retailer or is sold for installation by other persons. However, sales or purchases of tools and supplies used in modifying the vehicles and which are not incorporated into, attached to, or installed on the vehicle are subject to tax.

Tax does not apply to the gross receipts attributable to the portion of a vehicle that has been modified to enable the vehicle to transport a physically disabled person or persons when the modified vehicle is sold to a physically disabled person.

Tax does not apply to the sale or use of items and materials used to repair the modified portion (the portion that contains equipment previously used to modify the vehicle) of a vehicle used to transport a physically disabled person or persons. Once installed, such "repair parts" qualify as items and materials used to modify a vehicle in order for the vehicle to be used to transport a physically disabled person or persons.

Evidence: The dealer should obtain and retain repair orders and other documentation establishing modification and repair costs to enable the vehicle to transport a physically disabled person.

Authority: 18 California Code of Regulations section 1591.3.

Lease Taxation

The tax treatment of a leased vehicle depends on whether it is classified as "mobile transportation equipment" (generally trucks, buses, hearses, bogies, dollies, etc.) or as a passenger vehicle. Regardless of how the vehicle is classified, leased vehicles must be registered in the lessor's name only, or to lessor/lessee jointly. If a vehicle is registered to a lessee only, the transaction will be taxed as a sale. License fees separately stated in a monthly charge to the lessee are not subject to tax, nor are late charges (if reasonable in amount). Interest charges and deficiency charges are subject to tax.

Authority: Revenue & Taxation. Code sections 6006, 6006.1, 6006.3, 6009, 6010, 6010.1, 6011, 6012, 6094; 18 California Code of Regulations section 1660; BOE Publications 34 (www.boe.ca.gov/pdf/pub34. pdf), 46 (www.boe.ca.gov/pdf/pub46.pdf).

Passenger Vehicles

The general rule is that leases of vehicles (other than mobile transportation equipment) are subject to tax based on the rental payments. However, dealers are not required to report and pay tax on the vehicle lease if the vehicle is leased in substantially the same form as acquired and sales tax reimbursement was paid to the vendor when the vehicle was purchased; or when the dealer reported and paid California use tax on the purchase price of the vehicle on a timely basis (by the due date of the return for the reporting period in which the vehicle was first leased).

The vast majority of lessors choose to report use tax based on rental proceeds because it substantially lowers the initial tax burden, and spreads the remaining use tax payments over the life of the lease.

CNCDA requested that the Board of Equalization provide clarification regarding a dealer's responsibility to collect and remit sales and use tax on certain amounts paid by a lessee at lease inception. In a letter to the Association dated May 29, 1998, the Board issued its response, which states, in relevant part:

In virtually all retail motor vehicle lease transactions conducted by your dealer members, the dealer is initially the owner of the leased vehicle and appears on the lease contract as the lessor. At the lease inception, the dealer generally collects from the lessee various 'up front' or 'drive away' charges. You have asked how tax applies to those charges, and the statutory basis for our answer… In short, basically all [lease inception] charges are taxable, with the exception of those excluded from the tax by [Revenue and Taxation Code] section 6011, such as title and registration fees.

Security Deposit. *.....tax does not apply to a refundable security fee when the fee is collected. This is a deposit. Tax* ***does*** *apply to the fee, if it is applied against an obligation of the lessee, when it is so applied.*

Capitalized Cost Reductions. *Tax applies to capitalized cost reductions. This is an additional charge to use and possess the property.*

Document Fees. *Tax applies to dealer document preparation charges. Such charges are for services [that are] a part of the sale, and capture for the lessor a cost of its doing business…*

Bank Fees. *Tax likewise applies to any amount designated as a 'bank fee,' 'acquisition fee,' or 'booking fee.' This is a charge for the service [that*

is] a part of the sale and represents a reimbursement of an expense…

Excessive Wear and Tear. *Please note that tax would also apply to 'excessive wear and use charges,' which may be collected at the end of the lease term.*

Dealer Is Responsible for Collecting and Remitting Tax. *You have an additional question with respect to who is responsible for collecting and remitting taxes on the lease at its inception, when the 'drive away' charges are collected from the customer. You point out that it is the business practice of some financial institutions to insist that the tax on a capitalized cost reduction and use tax on the first month's lease payment be remitted by the financial institution as assignee of the lease, even though the assignee was not the original lessor and did not collect the taxable receipts from the lessee at lease inception…[A]lmost all leases are executed in the name of the dealer. This means that it is the dealer's responsibility to collect and remit the tax at the time the transaction is entered into. Thus, even though the lease contract may be assigned to the financial institution shortly after its inception and within the quarterly tax reporting period within which the lease is executed, it is the dealer that is obligated to collect and remit the tax on the first month's rental charge, including those 'drive away' charges regarded as taxable, as outlined above…Only if the original contract is executed by the financial institution would the financial institution be responsible for collecting and remitting the tax on the drive away charges.*

Resales by Lessees

If a lessee transfers title and registration to a third party within 10 days of the date the lessee acquired title from the lessor at the expiration or termination of a lease, there arises a presumption that a transfer of the vehicle from the lessor to the lessee was a sale for resale. The presumption may be rebutted by evidence that the sale was not for resale prior to use.

Authority: Revenue & Taxation Code section 6277

Local Use Taxes on Leases

Revenue & Taxation Code section 7205.1 provides the basis for the way use taxes on leases are allocated to cities. If the lessor is a California new motor vehicle dealer, or a leasing company, the place of use of the leased vehicle is deemed to be the city in which the lessor's place of business is located. If a lessor is not a new motor vehicle dealer or a leasing company, and the lessor purchased the vehicle from a new motor vehicle dealer or a leasing company, the place of use of the leased vehicle is deemed to be the city in which the place of business of the person from whom the lessor acquires the vehicle is located. If the lessor does not fall into the categories described above, the use tax is reported and distributed through the countywide pool of the county in which the lessee resides.

Authority: Revenue & Taxation Code section 7205.1

Service and Repair

Sales tax principally applies to the retail sale (including exchange or barter) of personal property, while use tax principally applies to the use of such property upon which sales tax was not imposed (for example, leased property). Generally, charges for labor or services are not subject to either sales or use tax if separately stated on a customer invoice. However, labor that is used to make a part is usually taxable, and installation labor may be taxable if a dealer makes an installation on a new vehicle.

For more detailed information regarding taxation of shop supplies, please consult Board pamphlet number 25 "Auto Repair Garages and Service Stations".

Authority: Revenue & Taxation. Code sections 6006, 6010, 6011, 6012, 6015; 18 California Code of Regulations sections 1546, 1654; BOE Publications 25 (www.boe.ca.gov/ pdf/pub25.pdf), 34 (www.boe.ca.gov/pdf/pub34. pdf).

Taxable Sales of Goods

According to the Board, the sale or use of the following is generally subject to tax:

- New, used, or rebuilt automobile parts. This includes both general repair or maintenance parts such as spark plugs, points and condensers, belts, tires, batteries, PCV valves, or brake shoes or pads; and replacement parts such as engines, transmissions, alternators, water pumps, fenders or bumpers.
- Parts which a dealer manufactures. Included in the taxable selling price of the part is the labor for its manufacture.
- Lubricating products such as oils and greases.
- Fluids such as brake or transmission fluid.
- Fuel (see "Gasoline" section, above).

Authority: BOE Publication 25 (www.boe.ca.gov /pdf/pub25.pdf).

Non-Taxable Services

According to the Board, charges for the following services or labor are generally not subject to tax:

- Installation labor on used vehicles such as putting in spark plugs, replacing brake shoes or pads,

removing and installing engines, or installing sound systems.

- Repair labor to bring a vehicle back to its original condition, including rebuilding carburetors or heads, replacing parts in engines or transmissions, and performing body and fender work (including the painting of new repair parts).
- Maintenance services such as tune-ups, oil changes, or radiator flushes.
- Services such as towing or battery charging.

Authority: BOE Publication 25 (www.boe.ca.gov/pdf/pub25.pdf).

Hazardous Waste Fees

Hazardous waste fees are not subject to sales tax if directly related to a nontaxable repair or service, such as providing an oil change Tax applies to hazardous waste fees charged in connection with the taxable sale of parts, such as when charging a fee to cover disposal of contaminated soil in connection with the sale of a used engine.

Authority: BOE Publication 25 (www.boe.ca.gov/pdf/pub25.pdf).

Core Charges for Vehicle Repair Parts

The following appeared in the Board of Equalization's June, 2001, Tax Information Bulletin.

Putting the "parts" together in figuring out taxes can be just as challenging as putting the parts together on a vehicle. The parts must fit right to get the right results.

For example, a common problem area is how to apply tax when there is a "core" charge.

Core charges are trade-in allowances included in the selling price of a part. They are designed to encourage the return of old parts that can be remanufactured. Auto parts sellers often include a core charge when they sell parts such as batteries, water pumps, brake shoes, and alternators.

Example

A seller sells a battery for $54, which includes a $7 core charge. If the buyer trades in his or her old battery, the seller will give the buyer a $7 credit toward the purchase.

***How tax applies** How you calculate the taxable selling price of the part will depend on whether you are selling a new or used part, or a reconditioned or rebuilt part.*

***New or used parts** You are liable for tax on the selling price of the new or used part, including the core charge. Tax applies to the core charge because the allowance for the trade-in is considered part of your "payment" for the sale.*

Example

Selling price of new battery (includes a $7 core charge)	*$54.00*
Tax ($54 x 7%)	*3.78*
Trade-in allowance	*- 7.00*
Total	*$50.78*

Some sellers separately invoice the trade-in allowance for an old battery as a "core charge." Even though the trade-in is separately invoiced, tax must still be calculated on the selling price before the trade-in.

***Reconditioned or rebuilt parts** On sales of reconditioned or rebuilt parts, tax applies to the "exchange price." The exchange price is the total selling price of the part, including any core charge, less any credit you give the customer for turning in a worn part.*

You should not tax the core charge credit whether you give it to the customer at the time of the sale or at some later point. If you refund a core charge to your customer after the original sale, you must also be sure to refund any tax you collected on the charge. Any tax you do not refund must be paid to the Board.

Example

Rebuilt alternator (including $9 core charge)	*$120.00*
Core charge credit	*- 9.00*
Taxable selling price	*111.00*
Tax ($111.00 x 7%)	*7.77*
Total	*$118.77*

Tax does not apply to the core charge because you are selling a reconditioned or rebuilt part.

Discounts

A discount given to a customer is not taxable–provided the dealer is not reimbursed for it by a manufacturer or distributor. For example, if a dealer sells an engine (whether new or rebuilt) for $5,000 less a 10 percent discount of $500, the taxable selling price is $4,500 ($5,000-$500).

However, if a dealer sells an engine for $5,000 less an $500 manufacturer's rebate, the taxable selling price is $5,000. Tax applies to the total gross receipts from the sale, even though the dealer receives partial payment from the customer ($4,500) and the balance from the manufacturer ($500). In other words, tax applies to the selling price of the engine before the dealer deducts the rebate amount.

Invoices

To avoid possible errors in computing tax on sales, dealers should clearly identify on their invoice those amounts being allowed for trade-ins, core charges, and discounts. Dealers should also be

careful to calculate tax on the full selling price of a new or used part before subtracting out any trade-in allowance. Invoices and other documents related to the sale should be kept with other business records.

Authority: BOE Publication 25 (www.boe.ca.gov/pdf/pub25.pdf); Tax Information Bulletin, June 2001.

Sublet Repairs

Resale certificates should be given to subrepairers when sending out work to be performed on behalf of the dealer. The dealer should request the subrepairer to separately itemize parts and labor on the invoice. The dealer should, of course, also segregate parts and labor on the customer's invoice. The dealer should charge their customers tax on any parts furnished by the subrepairer, including dealer markup.

Authority: BOE Publication 25 (www.boe.ca.gov/pdf/pub25.pdf).

Exchanged Parts

If allowing a discount for tires, batteries, and other merchandise traded-in, a dealer must charge sales tax on the full price of the item (without any deduction for the trade-in). If a sale involves both a discount and a trade-in, each amount should be separately itemized.

Authority: 18 California Code of Regulation section 1654; BOE Publication 25 (www.boe.ca.gov/pdf/pub25.pdf).

Supplies used for Repairs

The Board of Equalization takes the position that supplies such as sandpaper, paint thinner, abrasives, and masking tape which are used by a repair dealer in making repairs and which do not attach to the vehicle being repaired are consumed by the dealer. This means that sales tax is due when those supplies are purchased by the dealer from a supplier. Automotive repair shops are prohibited from making a nonspecific or general charge to cover supply costs (see discussion of miscellaneous shop supplies in chapter entitled "Vehicle Repair and Modification" in this Management Guide). Such costs must be separately itemized to identify the supply item charged to the customer. If the dealer did not pay tax or tax reimbursement when the items were purchased, they should report the cost of the purchase on their sales and use tax return under "Purchases Subject to Use Tax".

Authority: BOE Publication 25 (www.boe.ca.gov/pdf/pub25.pdf).

Warranty and Service Contract Repairs

The following appeared in the Board of Equalization's June, 2001, Tax Information Bulletin.

Regulation 1655, Returns, Defects and Replacements, was recently revised to clarify how tax applies to warranties that include a customer deductible. Although the regulation applies to warranties in general, deductibles are common with both mandatory and optional vehicle warranty contracts. The following information explains the application of tax to typical vehicle warranty contracts.

Mandatory Warranties. *A warranty is mandatory if the buyer, as a condition of sale, is required to purchase the warranty from the seller. In general, a manufacturer's warranty is a warranty provided by the vehicle manufacturer and is included in the selling price of the vehicle when sold by the dealer. A manufacturer's warranty is considered a mandatory warranty.*

Taxability when there is no deductible under a mandatory warranty. *Tax does not apply to charges for parts used for the repair. Although the repairer will charge the manufacturer for the parts used in the repair, those parts are considered a sale for resale and are not subject to tax under a mandatory warranty. They are considered sold to the customer as part of the original sale of the vehicle.*

Taxability when there is a deductible under a mandatory warranty. *If the customer pays a deductible, tax does apply. The tax amount is measured by the amount of the deductible allocable to the sale of the parts to the customer.*

Unless otherwise stated in the warranty contract, when the warranty provides that the customer will pay a deductible towards repairs and services provided under the warranty, the person providing the warranty contract is liable for any tax or tax reimbursement otherwise payable by the customer with respect to that deductible.

Example 1 A customer is required to pay a $50 deductible under a manufacturer's mandatory warranty. The repairer bills $200 for the repair work (not including tax): $75 for parts and $125 for labor. The portion of the deductible subject to tax would be: $75 ÷ $200 = 37.50% x $50 deductible = $18.75. Tax due on the deductible payment equals $1.31 ($18.75 x 7% tax rate).

The total charge for the job would be $201.31. The repairer would charge $50 (deductible) to the customer and the balance, $151.31, to the manufacturer ($200 parts/labor + $1.31 sales tax - $50 deductible).

Note: In this example, we have assumed there is no provision in the warranty contract stating that the customer is responsible for sales tax on the portion of the deductible related to the sale of tangible personal property (parts).

Optional Warranties. *A warranty is optional when the buyer is not required to purchase the warranty from the seller, but may optionally purchase the warranty from the seller or someone of his/her own choosing. Optional vehicle warranties can be offered by both the manufacturer and the dealer.*

Optional warranties offered by the dealer. *If the customer is not obligated to pay a deductible, the dealer (repairer) is considered the end user of the repair parts and owes tax on his or her cost for the parts. (In other words, the repairer is not a seller of the parts and tax does not apply to the transfer of the parts to the customer.)*

If the customer is obligated to pay a deductible, the repairer is considered the end user of a portion of the parts and a seller of the remainder (see Example 1 for an example of how to prorate a portion of the deductible as a seller).

Unless otherwise stated in the warranty contract, when the warranty provides that the customer will pay a deductible towards repairs and services provided under the warranty, the person providing the warranty contract is liable for any tax or tax reimbursement otherwise payable by the customer with respect to that deductible.

Optional warranties offered by the manufacturer. *The manufacturer is considered the consumer of the repair parts for tax purposes. As a result, tax applies to the retail sale of parts to the manufacturer by the dealer (repairer). The repairer performing the repairs under the optional warranty is considered the retailer of the parts to the manufacturer and is responsible for reporting sales tax on the retail selling price of the parts (cost plus the markup).*

Example 2 A customer is required to pay a $50 deductible under a manufacturer's optional warranty. The repairer bills $200 for the repair work (not including tax): $75 for parts and $125 for labor. Under an optional warranty, sales tax would apply to the full charge for parts ($75 x 7% tax rate = $5.25 tax).

The total charges for the job would be $205.25 ($200 parts/labor + $5.25 tax). The repairer would charge $50 (deductible) to the customer and $155.25 to the manufacturer ($200 parts/labor + $5.25 sales tax - $50 deductible).

Note: In this example, we have assumed there is no provision in the warranty contract stating that the customer is responsible for sales tax on the portion of the deductible related to the sale of tangible personal property (parts). If the warranty contract does provide that the customer is liable for tax or tax reimbursement on the portion of the deductible related to parts, the repairer must prorate any charges for sales tax reimbursement between the customer and the manufacturer. This calculation can be complicated. Please call the Board's Information Center for assistance.

Authority: Revenue & Taxation Code sections 6006-6012; 18 California Code of Regulations 1655; Tax Information Bulletin, June 2001; BOE Publication 25 (www.boe.ca.gov/pdf/pub 25.pdf).

Responsible Persons for Sales and Use Tax Liability

Sales and Use Tax Regulation 1702.5 makes a responsible person who willfully fails to pay sales and use taxes under certain circumstances personally liable for payment. Personal liability applies if the Board of Equalization establishes that while the individual was a "responsible person" for the corporation, partnership, limited partnership, limited liability partnership or limited liability company, the taxpaying entity: (1) sold tangible personal property in the conduct of its business and collected sales tax reimbursement on the selling price and failed to remit such tax when due; or (2) consumed tangible personal property and failed to pay the applicable tax to the seller or the board; or (3) issued a receipt for use tax and failed to report and pay the tax.

The Regulation defines a responsible person as "any officer, member, manager, employee, director, shareholder, partner, or other person having control or supervision of, or who is charged with the responsibility for, the filing of returns or the payment of tax or who has a duty to act for the corporation, partnership, limited partnership, limited liability partnership, or limited liability company in complying with any provision of the Sales and Use Tax Law. The term 'responsible person' does not include any person who would otherwise qualify but is serving in the capacity as an unpaid volunteer for a non-profit organization."

The word "willful" in the Regulation means voluntary, conscious and intentional. A failure to pay or cause to be paid may be willful even though such failure was not done with a bad purpose or evil motive.

These rules apply to unpaid taxes and interest and penalties which were not paid upon termination, dissolution, or abandonment of the business of the corporation, partnership, limited partnership, limited liability partnership, or limited liability com-

pany. The word "termination" includes discontinuance or cessation of business activities.

When businesses are failing, dealers may be tempted to refuse to pay sales or use tax in an effort to keep the business alive. Sales and use taxes are not the type of debt that should go unpaid, however, since "responsible persons" are personally liable for the payment of such taxes under this Regulation.

Authority: Revenue and Taxation Code Section 6829; 18 California Code of Regulations 1702.5; BOE Publication 73 (www.boe.ca.gov/ pdf/ pub73.pdf).

WAGES AND HOURS

Chapter 15

Contents

WAGES AND HOURS

OVERVIEW: Wages and hours are governed by both federal and California law. Where California law provides more protection for employees than federal law, California law governs. Where federal law provides more protection for employees than California law, federal law governs. This guide will not attempt to discuss all of the differences between federal and California law, but will identify certain important areas of the law that California automobile dealers must follow, whether that law is California or federal.

The basic federal law applicable to wages and hours is the Fair Labor Standards Act of 1938 that, among other matters, requires payment of a minimum wage and overtime pay, and sets forth guidelines for employment of minors. In California, the Industrial Welfare Commission (IWC) regulates wages, hours, and working conditions in various industries. The Commission has promulgated orders for various businesses. The IWC, in Wage Order 7-2001 (which is the Order applicable to most automobile dealerships) effectively repealed Wage Order 7-98 and reinstated most of the provisions of Wage Order 7-80. The Labor Code also contains various provisions applicable to the operation of an automobile dealership.

These changes have not altered the plan former Governor Davis signed into law that restored daily overtime requirements and instituted a number of other restrictive wage-hour provisions. Significantly, many of these provisions, previously found only in the Wage Orders promulgated by the IWC – such as the requirements for meal periods and make up work time – are now codified in the Labor Code. Violation of these provisions now carries potential civil and criminal penalties as described below in "Enforcement of Wage And Hour Laws." In light of these changes and the potential heightened liabilities, automobile dealers should closely monitor employee time on a daily basis and carefully review timekeeping procedures to avoid overtime liability.

Because of the complexity of wage and hour law, this Guide cannot cover all of the situations which may arise in a dealership. The Guide's purpose is to give the general principles of law relating to wages and hours. You should consult with labor and employment counsel regarding individual situations.

The discussion below will quote various provisions of Wage Order 7-2001, applicable to the operation of an automobile dealership and comment will be made where appropriate. The current version of Wage Order 7-2001 can be viewed at http://www.dir.ca.gov/IWC/IWCArticle7.pdf. The current version of Wage Order 7-2001 must be posted in the dealership in a place where it can be seen by all employees. The current version of Wage Order 7-2001 is contained in the Employment Poster Set provided by The Reynolds and Reynolds Company in conjunction with CNCDA. Federal law relating to wages and hours, when applicable, will be discussed. Finally, other areas of law relating to wages and hours not contained in the Order will be discussed. When the Order or any statutes or regulations are quoted, the quoted materials will appear in italics.

Scope of Wage and Hour Law and Exemptions

State and federal law provide for exemptions from certain aspects of wage and hour law. Some exemptions exempt one completely from wage and hour law; others only provide exemption from certain aspects of wage and hour law. While some exemptions discussed in this Guide relieve the employer from overtime pay as well as from certain other wage and hour law requirements, our concern is particularly with the exemption from overtime pay.

Both the California and federal exemptions are discussed below. **When there is a variation between state law and federal law, the law containing the higher standard generally applies.**

California White-Collar Exemptions

Labor Code section 515 generally describes the duties and remuneration tests which, if met, qualify an executive, administrative or professional employee for exemption from overtime. Additionally, Wage Order 7-2001 clarifies the tests for executive, administrative and professional employees that, if met, qualify such an employee for exemption from Sections 3 through 12 of Wage Order 7-2001. These sections of the Order address matters including hours and days of work, minimum wage, and overtime pay. The relevant tests provide as follows:

1. Executive Exemption. A person employed in an executive capacity means any employee:

(a) Whose duties and responsibilities involve the management of the enterprise in which he/she is

employed or of a customarily recognized department or subdivision thereof; and

(b) Who customarily and regularly directs the work of two or more other employees therein; and

(c) Who has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring or firing and as to the advancement and promotion or any other change of status of other employees will be given particular weight; and

(d) Who customarily and regularly exercises discretion and independent judgment ; and

(e) Who is primarily engaged in duties which meet the test of the exemption. The activities constituting exempt work and non-exempt work shall be construed in the same manner as such terms are construed in the following regulations under the Fair Labor Standards Act effective as of the date of this order: 29 C.F.R. sections 541.102, 541.104-111, and 541.115-116. Exempt work shall include, for example, all work that is directly and closely related to exempt work and work which is properly viewed as a means for carrying out exempt functions. The work actually performed by the employee during the course of the work week must, first and foremost, be examined and the amount of time the employee spends on such work, together with the employer's realistic expectations and the realistic requirements of the job, shall be considered in determining whether the employee satisfies this requirement.

(f) Such an employee must also earn a monthly salary equivalent to no less than two (2) times the state minimum wage for full-time employment. Full-time employment is defined in Labor Code section 515(c) as 40 hours per week.

2. Administrative Exemption. A person employed in an administrative capacity means any employee:

(a) Whose duties and responsibilities involve either:

(i) The performance of office or non-manual work directly related to management policies or general business operations of his/her employer or his/her employer's customers; or

(ii) The performance of functions in the administration of a school system, or educational establishment or institution, or of a department or subdivision thereof, in work directly related to the academic instruction or training carried on therein; and

(b) Who customarily and regularly exercises discretion and independent judgment; and

(c) Who regularly and directly assists a proprietor, or an employee employed in a bona fide executive or administrative capacity (as such terms are defined for purposes of this section), or

(d) Who performs under only general supervision work along specialized or technical lines requiring special training, experience, or knowledge, or

(e) Who executes under only general supervision special assignments and tasks; ***and***

(f) Who is primarily engaged in duties which meet the test of the exemption. The activities constituting exempt work and non-exempt work shall be construed in the same manner as such terms are construed in the following regulations under the Fair Labor Standards Act effective as of the date of this order: 29 C.F.R. sections 541.201-205, 541.207-208, and 541.210, and 541.215. Exempt work shall include, for example, all work that is directly and closely related to exempt work and work which is properly viewed as a means for carrying out exempt functions. The work actually performed by the employee during the course of the work week must, first and foremost, be examined and the amount of time the employee spends on such work, together with the employer's realistic expectations and the realistic requirements of the job, shall be considered in determining whether the employee satisfies this requirement.

(g) Such employee must also earn a monthly salary equivalent to no less than two (2) times the state minimum wage for full-time employment. Full-time employment is defined in Labor Code Section 515(c) as 40 hours per week.

3. Professional Exemption. A person employed in a professional capacity means any employee who meets all of the following requirements:

(a) Who is licensed or certified by the State of California and is primarily engaged in the practice of one of the following recognized professions: law, medicine, dentistry, optometry, architecture, engineering, teaching, or accounting; or

(b) Who is primarily engaged in an occupation commonly recognized as a learned or artistic profession. For the purposes of this subsection, "learned or artistic profession" means an employee who is primarily engaged in the performance of:

(i) Work requiring knowledge of an advanced type in a field or science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education and from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes, or work that is an essential part of or necessarily incident to any of the above work; or

(ii) Work that is original and creative in character in a recognized field of artistic endeavor (as opposed to work which can be produced by a person endowed with general manual or intellectual ability and training), and the result of which depends primarily on the invention, imagination, or talent of

the employee or work that is an essential part of or necessarily incident to any of the above work; and

(iii) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(c) Who customarily and regularly exercises discretion and independent judgment in the performance of the duties set forth in subparagraphs (a) and (b).

(d) Who earns a monthly salary equivalent to no less than two (2) times the state minimum wage for full-time employment. Full-time employment as defined in Labor Code Section 515(c) as 40 hours per week.

(e) Subparagraph (b) above is intended to be construed in accordance with the following provisions of federal law as they existed as of the date of this wage order: 29 C.F.R. Sections 541.207, 541.301 (a) - (d), 541.302, 541.306, 541.307, 541.308, and 541.310.

Under the IWC's most recent language, an employee cannot be exempt unless over 50% of his or her time is spent engaged in exempt activities. Additionally, under all three of the above-described exemptions, an employee must earn a weekly salary of at least twice the state minimum wage, $8.00/hr. as of January 1, 2008. Thus, an exempt employee must earn a salary of at least $640.00 per week ($2773.33 per month). Although an employee must be salaried to qualify for an exemption under any of the above-described tests, merely being salaried is not sufficient. A careful analysis of an employee's duties, and the time engaged in exempt activities will decide the question.

At many California dealerships, for example, employees classified as administrative assistants, Assistant Managers of various departments, Warranty Administrators, Customer Relations Managers, Dispatchers, and the like, often fail to meet the exemption test, particularly if they spend over 50% of their time doing the same work that non-exempt employees do. The IWC has adopted language that clarifies the issue of how to consider an employee's time where he or she is performing the same work as non-exempt employees. The IWC's adopted language provides in relevant part: *The activities constituting exempt work and non-exempt work shall include, for example, all work that is directly and closely related to exempt work and work which is properly viewed as a means for carrying out exempt functions.* The California Labor Commissioner, however, often narrowly construes the IWC exemptions for executive, administrative, and professional employees. Moreover, the burden rests with an employer to establish an exempt classification for an employee. A dealership, thus, should consult with labor and employment counsel in reviewing employee classifications.

Executive Exemption – Federal Law

An employee meets the federal "executive exemption" from minimum wage and overtime requirements if executive employees: (1) are compensated on a salary basis of at least $455 per week; (2) have as their "primary duty" management of the enterprise or customarily recognized department or subdivision; (3) "customarily and regularly" direct the work of two or more other employees; and (4) have the authority to hire or fire other employees, or their suggestions and recommendations as to hiring, firing, promotion, etc. are given "particular weight."

For purposes of federal law, a good rule of thumb for "primary duty" would mean over 50% of the employee's time is spent on such activity. Time is not the only test, however, and other factors may be considered in determining whether the "primary duty" aspect of the test has been met.

Administrative Exemption – Federal Law

The federal administrative exemption from minimum wage and overtime applies to employees who perform office or non-manual work directly related to management policies or general business operations of the employer or the employer's customers. Administrative employees generally do not supervise other employees but work as executive or administrative assistants to top officers, work in a staff capacity such as a personnel director or purchasing agent, or perform special assignments.

An employee meets the federal "administrative exemption" if the administrative employees (1) are compensated on a salary basis of at least $455 per week; (2) have as their "primary duty the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers"; and (3) their "primary duty includes the exercise of discretion and independent judgment with respect to matters of significance."

NOTE

SALARY TEST: The federal exemptions mentioned above require payment on a salary basis, or, when applicable, a fee basis. The employee's salary can be reduced to an hourly basis for computerizing of the payroll or the payment of discretionary overtime. The employee is paid on a salary basis when the employee receives his or her full salary for any week in which the employee works, without regard for the number of

days or hours worked, or the amount of his or her work. Deductions (of one or more whole days) can be made for "personal leave," for sick leave if there is a plan for compensating for loss of salary by reason of sickness, or if there is a penalty for violations of safety rules. Before pro-rating a salary, you should contact competent labor and employment counsel.

Combination of Exemptions

The rules permit various aspects of the exemptions to be combined so that an employee could be exempt under a combination of exemptions, even though the employee would not be exempt under any single exemption. In combination exemptions, however, the employee must meet the stricter of the requirements on salary and non-exempt work. In combining exemptions, there are also certain federal requirements discussed in the publication above regarding the percent of time one may be engaged in non-exempt work.

Because of their general inapplicability to an automobile dealership, the outside salesperson and professional federal exemptions are not discussed in this Guide.

Common Problems

Problems in this area abound. For example, under the Executive, Administrative, and Professional exemptions, the employee must meet the "duties" test of the exemptions – more than 50 percent of the time must be spent performing exempt functions – as well as receive a fixed salary of at least twice the minimum wage based on a forty-hour workweek (i.e., at least $2,773.33 per month as of January 1, 2008). Most dealers would probably assume that a Fixed Operations Manager who makes a percentage of the department exceeding $100,000 a year is exempt from overtime. Even if we assume the Manager meets the "duties" test of the exemption, where is the salary in this common example? It's missing and this employee would be entitled to overtime at an astronomical hourly rate! But the solution here is simple: guarantee the employee at least $2,773.33 a month ($640.00 per week) as a guaranteed payment (draw/advance) against the monthly percentage of the department. Assuming the Manager meets the duties test, he or she will be exempt because a guaranteed payment is the equivalent of a salary even if it is offset against commissions.

A position often misclassified as exempt by auto dealerships is the salaried Parts Manager making, say, $60,000 per year. This person is responsible for the Parts Department and usually supervises a number of parts counter employees and might also manage a parts driver. Those are bona-fide supervisory duties. This "manager" may also end up spending more than fifty percent of his/her time actually working the counter or stocking parts. That's a problem. Working the counter or stocking parts are not exempt duties under the Professional, Administrative, or Professional exemptions. If the Parts Manager is not spending at least fifty percent of the time performing exempt duties – such as managing employees – then he or she is not exempt from overtime. The solution in this case is fairly straightforward: convert the manager's salary to an equivalent commission pay plan with a guaranteed draw (usually in the amount of the former salary) and make sure he/she meets the requirements listed below for the commission sales exemption.

Likewise, if you pay a Customer Relations Manager or a Warranty Administrator a salary without paying overtime, you should consult competent labor and employment counsel right away for a solution to this possible overtime violation.

CAUTION

REGARDING APPLICABLE EXEMPTIONS: Remember that between the California and federal Exemptions, the higher standard is the one you must apply. California law is generally tougher on exemptions.

Specific Wage and Hour Requirements

Working Hours, Overtime Pay, And Employment Of Minors

Section 3 of Wage Order 7-2001 sets out the rules for overtime payment, and employment of minors, and provides as follows:

Regular vs. Overtime

Section 3(A) of the Order and Labor Code section 510 require that employers pay daily overtime at a rate of at least one and one-half times the regular rate of pay for: (1) hours worked beyond eight hours in a day; (2) hours worked beyond forty in a workweek; and (3) the first eight hours worked on the seventh consecutive day of work in a workweek. Additionally, employers must pay twice the regular rate of pay for hours worked: (1) beyond twelve hours in a day; and (2) over eight hours on the seventh consecutive day of work in the same workweek.

As an initial matter, employers need to make sure they are counting all hours **worked**. For example, work done at home or at the office is still hours worked for overtime purposes. In addition, training time is considered hours worked if it's required by

the employer or if the training, whether required or voluntary, benefits the employer. Also, all time an employee is permitted or suffered to work is hours worked. Thus, even if an employee works a different shift or schedule or starts an hour early, as long as the employer knew or should have known the employee was working, the work time is hours worked.

One of the most common errors made by employers in calculating the regular rate of pay for overtime purposes is failing to take into account the amount of bonuses (e.g., CSI, Up-Sell, menu bonuses, etc.) paid to non-exempt personnel. Such bonuses must be taken into account in determining the regular rate of pay in order to calculate the overtime rate of pay. For example, assuming a technician is paid $25.00 per flag hour based on a flat rate pay plan, the tech flags 50 hours and works 42 hours during the week, two hours of which are overtime at one and one-half times the regular rate of pay. The tech was also paid a bonus for the week of $50.00. Most dealers would do the following math to determine the regular rate of pay: $25.00 x 50 hours = $1250.00; $1250.00 ÷ 42 hours = $29.76 per hour as the regular rate of pay. Such a calculation would be in error because the bonus must be added into the total earnings in order to determine the regular rate of pay. The calculation should be: $25.00 x 50 hours = $1250.00; $1250.00 + $50.00 = $1300.00; $1300.00 ÷ 42 hours = $30.95 per hour as the regular rate of pay. Thus, the technician would be entitled to an additional $15.48 ($30.95 ÷ 2) for the two hours of overtime

Alternative Workweeks

Additionally, Section 3 (B) of the Order and Labor Code section 511, restore alternative workweek schedules. Employees may agree to up to a 10-hour per day, four-day workweek schedule (with some variation) without the payment of daily overtime. Such a schedule will not impose daily overtime liability on an employer as long as: (1) two-thirds of the employees in a work unit approve the schedule by secret ballot election after a required notice of explanation to the affected employees, (2) the results are reported to the state, and (3) the employer makes reasonable efforts to accommodate any employee who is unable to work the alternative hours. Strict compliance with these requirements is necessary to avoid overtime liability. It may be necessary to refer to the specific language contained in Section 3(B) of the Order. Any automobile dealer considering an alternative workweek schedule should first consult with competent employment counsel.

Make Up Time

Labor Code section 513 permits an employee to submit a prior written request to make up any hours that will be missed during the same workweek due to a personal obligation of the employee. If the employer approves an employee's request for make up time, the lost time can be made up only during the same week in which the time was initially lost. The employer will not incur overtime liability as long as no workday exceeds eleven hours and as long as the workweek does not exceed forty hours. Finally, the employer may not require, solicit or encourage an employee to request make up time.

Commissioned Employee Exemption

Pursuant to Section 3(D) of the Order, hours of work and overtime provisions are inapplicable to certain employees primarily engaged in sales whose earnings exceed one and one-half (1-1/2) times the minimum wage for every hour worked if more than half of the employee's earnings represent sales commissions. Care must be taken, however, in accurately identifying whether or not an employee's compensation is "sales commission" based, as that term is defined under California law. Even flat rate service technicians, for example, are **not** considered to be earning a sales commission.

Pay plans for employees who are regarded as sales commission exempt should be carefully drafted to ensure that the commission is a bona fide commission and not a bonus.

Hours and Overtime for Minors

Section 3(E) of the Order provides that one and one-half (1-1/2) times the minor's regular rate of pay must be paid for all hours worked over 40 in any workweek.

Minors 16 and 17 years old who are not required by law to attend school may be employed for the same hours as an adult. In such event, the normal adult overtime rules apply.

Labor Code section 1391 was amended in 1994 to significantly limit the amount of time a minor, 14-17 years of age, may be employed while school is in session. (Section 1391(b) defines "school day" as "any day in which a minor is required to attend school for 240 minutes or more.") Thus, with the exception of special rules for messengers and minors employed in the entertainment industry, section 1391 now provides as follows:

1. While school is not in session: No minor 15 years of age or younger shall be employed more than 8 hours in one day of 24 hours, or more than 40 hours in 1 week, or before 7 a.m. or after 7 p.m. except that from June 1 through Labor Day, a minor

15 years of age or younger may work the hours authorized by this section until 9 p.m. in the evening.

2. While school is in session: The rules set forth immediately above apply, and in addition, no minor 14 or 15 years of age shall be employed for more than 3 hours in any school day, or more than 18 hours in one week, and any such working hours must not be during school hours. (An exception to the foregoing exists with regard to a minor employed pursuant to a school-supervised work experience program.)

3. While school is not in session: No minor 16 or 17 years of age shall be employed more than 8 hours in one day of 24 hours or more than 48 hours in one week, or before 5 a.m., or after 10 p.m. on any day preceding a school day. However, a minor 16 or 17 years of age may work the hours authorized by this section during any evening preceding a nonschool day until 12:30 a.m. of the nonschool day.

4. While school is in session: The rules set forth immediately above apply, and, in addition, no minor 16 or 17 years of age shall be employed more than 4 hours in any school day. Exceptions are made for minors who have been issued work permits pursuant to Education Code section 49112(c), minors who are engaged in school-approved work experience, or cooperative vocational education programs, and minors who are employed in "personal attendant occupations" (most commonly, baby-sitters, or personal attendants for the elderly).

There are substantial penalties for violating rules regarding the employment of minors.

Minors in Work Experience Program

Minors 16 and 17 years of age who are enrolled in work experience education programs approved by the State Department of Education or in work experience education programs conducted by private schools, may work after 10 p.m. but not later than 12:30 a.m. providing such employment is not detrimental to the health, education or welfare of the minor and the approval of the parent and the work experience coordinator has been obtained. However, any such minor who works any time during the hours from 10 p.m. to 12:30 a.m., must be paid for work during that time at a rate which is not less than the minimum wage required for adults.

Exceptions for Collective Bargaining Agreement

Hours of work and overtime requirements do not apply to any employee covered by a collective bargaining agreement if the agreement provides:

- Premium wage rates for overtime work; and
- A cash wage rate of at least 30% more than the minimum wage ($8.00 X 130% = $10.40).

Discussion of Overtime

General Rules

There is no legal notice required to be given to employees before requiring overtime.

Administrative or executive employees, to be exempt from overtime pay, must meet the tests described in the beginning of this Guide.

Labor Code section 515(d) provides, "For the purpose of computing the overtime rate of compensation required to be paid to a nonexempt full-time salaried employee, the employee's regular hourly rate shall be 1/40th of the employee's weekly salary." Thus, in calculating overtime for non-exempt salaried employees with fluctuating workweeks, an employer in California is limited to using a 40-hour workweek in arriving at the regular, hourly rate of pay. Under federal law, in contrast, an employer may calculate an employee's hourly rate by using a workweek of greater than 40 hours when the employee works a fluctuating workweek.

There is no blanket exemption for mechanics and parts persons in California as there is under federal law.

Mechanics

The California Division of Labor Standards Enforcement has taken the position that mechanics are not commissioned sales employees, and therefore they are not exempt from overtime pay. The Division's position is that mechanics who are paid on a flat rate or any other so-called commission basis are in fact "piece rate" workers who, the Division says, do not receive a commission wage. The only California appellate court to address the issue agreed with the commission. In *Keyes Motors, Inc. v. The Division of Labor Standards Enforcement* ((1987) 242 Cal. Rptr. 873), a Los Angeles-area automobile dealer sought a declaratory judgment that its mechanics, paid on a flat rate basis, came within the overtime exemption provided under the Order. The trial court ruled in favor of the dealer, but the court of appeals reversed. In removing automobile dealer mechanics from those exempt from overtime under section 3(C) of the Order, (now Section 3(D)), the court relied on Labor Code section 204.1 which contains a partial definition of the term "commissions." The court held:

Labor Code section 204.1 sets up two requirements, both of which must be met before a compensation scheme is deemed to constitute "commissioned wages." First, the employees must be involved principally in selling a product or service, not making the product or the service. Second, the

amount of their compensation must be a percent of the price of the product or service. Mechanics are engaged in rendering a service, not selling it.

The court was not impressed with arguments that the recommendations made by the mechanics ultimately led to sales. The court ruled flatly that "a mechanic performs labor, not sales."

In light of the decision in *Keyes*, the Division believes that its long standing position on this issue has now been made the law of the state and will almost certainly rule that all mechanics must be paid overtime for any overtime hours worked. It is therefore very important for dealers to maintain complete and accurate time records of actual time spent on the job by their mechanics and not just flat-rate hours completed. A time-clock or other such system is highly recommended. A discussion concerning calculation of mechanics overtime in light of *Keyes* appears below under "Calculating Overtime."

Service Advisors

As long as Service Advisors (Service Writers) are primarily engaged in the sale of the dealer's services to the public, they may come within the commissioned employee overtime exemption provided that more than half of their compensation comes from sales commissions and they earn at least one and one-half (1-1/2) times the minimum wage each pay period for every hour worked. The decision in *Keyes* might cause the Division to inquire more closely into the activities of service advisors. In fact, the exemption has apparently been called into question where the service advisor does insignificant "selling" and has considerable non-selling duties. Your service advisor pay plan should be carefully drafted to preserve this exemption and clearly use the term "commissions." It is also recommended that service advisors be referred to as "Service Sales Advisors" and that their written pay plans be very clear that their compensation is based on sales efforts, not just doing paperwork on warranty claims.

The federal Fair Labor Standards Act has an overtime exemption similar to section 3(D) of the Order in addition to the blanket exemption from overtime for partsmen, mechanics, and salesmen. (See 29 U.S.C. § 207(i).) This provision (29 U.S.C. § 207(i)) has an additional requirement that the employer meet the Department of Labor's 75% retail test. A dealership will not meet such test if it derives over 25% of its gross annual volume of sales from (a) wholesale selling; (b) fleet selling; (c) sales made pursuant to formal bid invitations; (d) heavy truck sales; or any combination of these types of sales.

Partspersons

Keyes established a new requirement under the overtime exemption rules: that the employee have an opportunity to directly sell the product or service to the customer. If you have partspersons who are paid on a commission basis, but who do not deal face-to-face with your customers, it would appear unlikely that they could qualify for the overtime exemption, even if the nature of their contact with in-house personnel requiring parts is substantially the same as it would be if they had contact with outside customers requiring parts.

For a partsperson to qualify under the overtime exemption, at least 50% of his or her total pay should come from commissions for sales made directly by the salesperson to the dealership's customers.

In addition, federal law requires that for partspersons to be exempt from overtime pay, the partsperson must spend over one-half (1/2) of his or her time in requisitioning, checking, stocking, dispensing, or selling parts; and the dealership must derive over 50% of its annual dollar volume of sales from selling automobiles, trucks, or farm implements to customers not buying for resale.

CAUTION

REGARDING BACK PARTS COUNTER PERSONNEL: Back Parts Counter personnel are likely not primarily selling parts directly to the customer, since the Service Advisor likely sold the service and the parts to the customers. Be aware that such Back Parts Counter personnel may not meet the commission exemption and will be entitled to overtime pay.

CAUTION

REGARDING MECHANICS' TIME RECORDS: The best record to show that mechanics have not worked more than 8 hours per day or 40 hours per week would be time clock records. Dealers who do not maintain accurate time records may be exposed to substantial overtime claims as well as claims for damages for failing to keep accurate time records as required by Labor Code section 226.

Salespersons

Subject to special rules discussed below under "Compensation To Salespersons," salespersons generally qualify for the exemption from overtime pay provided that at least half of their earnings are derived from sales commissions, and their total earnings exceed one and one-half (1-1/2) times the minimum wage for every hour worked. This analy-

sis can be substantially affected by the salesperson's pay plan. Please see the discussion below entitled, "Compensation To Salespersons".

Calculating Overtime

Mechanics

Both hourly and flat-rate technicians are entitled to overtime. Calculating overtime for an hourly technician is straightforward; overtime is calculated like any other hourly employee. The overtime calculation for flat-rate technicians, however, can be a bit tricky. The Division of Labor Standards Enforcement allows two procedures for calculating mechanics' overtime. In the first, careful time records are used to find out when a mechanic is working overtime hours as opposed to regular hours. Any jobs that are performed during the overtime hours will earn the mechanic one and one-half (1-1/2) times his or her flat rate for the work performed during that time.

The second method requires computation of an average hourly rate of pay for each workweek by figuring the total amount of wages the mechanic would be owed that workweek without reference to the overtime rate, and dividing such total by the number of hours worked. The result is the average hourly rate for that workweek. A mechanic would be entitled to be paid for overtime hours at the rate of one-half (1/2) the average hourly rate for any overtime hours worked. This method of calculating overtime for mechanics usually is the least expensive way for employers. The reasoning behind this alternative is that the earnings paid under the flat rate method of compensation are treated as straight time pay for all hours worked. Thus, the amount due for overtime work is the additional one-half (1/2) of the average hourly rate for the workweek. For example, if a mechanic earned $1000 in a week of flat rate compensation and worked 50 hours in the week, $1,000 divided by 50 would give an average hourly rate of $20 an hour. Overtime compensation for the 10 hours in excess of 40 would be at the rate of $10 per hour, or $100 in overtime compensation, for a total compensation for the week of $1,100. Remember, if any bonus is paid, the dollar amount of the bonus must be added into the employee's earnings before determining the regular rate of pay.

Dealers should consult with their employment counsel to ensure the method of overtime calculation is correct.

Regardless of the method chosen above, the employer must consistently apply that option, and must never allow the regular rate of pay to become less than the minimum wage, or two times the state minimum wage if the technician is required to provide his/her own tools.

Calculating the Regular Rate

Hourly rate employees: If the employee is paid on an hourly rate, the hourly rate is the regular or straight rate on which overtime is to be calculated.

Weekly salaried employees: If the employee is employed solely on a weekly salary basis, his or her regular or straight rate of pay is computed by dividing the salary by the number of hours in the employee's standard non-overtime workweek for which the salary is intended to compensate. However, the number of hours used in the calculation may not exceed 40. (See above discussion for limitation of 40 hours.) Remember, if any bonus is paid, the dollar amount of the bonus must be added into the employee's earnings before determining the regular rate of pay.

Salaried employees with other pay periods: Where the salary covers a period longer than a workweek, such as a month, it must be reduced to its workweek equivalent. A monthly salary is subject to translation to its equivalent weekly wage by multiplying by 12 (the number of months) and dividing by 52 (the number of weeks). A semi-monthly salary is translated into its equivalent weekly wage by multiplying by 24 and dividing by 52. Once the weekly wage is arrived at, the regular hourly rate of pay will be calculated as indicated above. The resultant rate in such a case must not be less than the statutory minimum wage.

Fixed salary for fluctuating hours: The computation of overtime for employees on a fixed salary for fluctuating hours differs under California and federal law. A fluctuating workweek guarantees a fixed minimum salary to employees who work varying hours from week to week.

Under California law, a fixed salary for fluctuating hours is not permitted. The regular hourly rate is calculated by dividing the weekly salary by 40 hours. Please see the prior discussion regarding Labor Code section 515(d)**.** Moreover, under California law, the employer and the employee cannot agree that a fixed salary is intended to cover overtime hours. Such an arrangement will not be recognized by the DLSE or the courts.

Commissioned employees: If a commission-paid employee is not exempt from overtime, such employee must be paid overtime for any overtime hours worked. The regular rate on commission earnings is computed based on total commissions attributed to the week divided by all hours worked in that week. The resulting regular rate is halved, and that figure, the overtime premium, must be paid for all overtime hours worked. For example, an employee paid a salary of $400 for the week, works 50

hours. As explained above, DLSE considers the salary to cover only the first 40 hours worked. Therefore the regular rate is $10 per hour ($400 divided by 40) and the overtime rate is $15 per hour. The salary component of this employee's compensation results in $150 of overtime pay (10 hours times $15 per hour). If this same employee also earns a commission of $200 for the same workweek, the calculation is quite different. The total commission ($200) is divided by *all* hours worked (50) and this results in a regular rate (on the commission) of $4 per hour. This regular rate is halved to produce the overtime premium or overtime rate of $2 per hour. The overtime premium for the commission is therefore $2 times 10 hours, or $20. This salary/commission earning employee should thus be paid a total of $400 regular salary, $150 in overtime on the salary, a commission of $200, plus overtime on the commission of an additional $20, for a total compensation due of $770.

Payments that may be excluded from the "Regular Rate:" The federal rules allow certain items to be excluded from the "regular rate." Briefly, they cover such things as gifts; rewards for service; payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause; traveling expenses; discretionary bonuses; payments made to a bona fide profit-sharing plan or trust or a bona fide thrift or savings plan, meeting the requirements of administrative regulations of the Secretary of Labor; certain benefit plan contributions; extra compensation paid for overtime; and other miscellaneous exclusions.

CAUTION

REGARDING OVERTIME FOR HOURS PERMITTED TO WORK: You will have to pay overtime for all extra hours you suffer or permit the employee to work even though you do not require the extra hours. An employer may even be liable for overtime hours the employer permits the employee to work even if the employer has a rule or a statement on the time card or other document that overtime pay will not be paid unless an appropriate manager or supervisor has authorized in advance the overtime. In section 2(G) of the Order, described above, "hours worked" includes all the time the employee is permitted to work whether or not required to do so. By having time clocks the hours worked can be monitored.

REGARDING TRAVEL TIME: Under federal law, travel time away from home outside of regular working hours as a passenger on an airplane, train, boat, bus or automobile is generally not considered working time. However, the California Labor Commissioner's office in early 2002 wrote an opinion letter that conflicts with this federal policy and the Labor Commissioner may enforce the rules differently. This opinion letter also stated that time spent during travel such as eating a meal, sleeping or engaging in purely personal pursuits not connected with the traveling would not be compensable and that the employer could establish, in advance, a different rate of pay for such travel time, as long as the rate meets or exceeds the minimum wage.

REGARDING ADDITIONAL BONUS OR INCENTIVE PAY: Many dealers pay non-exempt employees a salary or an hourly wage, but also provide incentive pay. Such incentive pay also must be considered wages for computing overtime. For example, many hourly paid mechanics receive an incentive based on a formula dealing with productivity or efficiency. For example, in a work week a mechanic paid $25 per hour may work 45 hours, and as a result of his pay plan, received a formula bonus of $90. The dealer of course has to pay the mechanic $37.50 for each of the five hours of overtime (or $187.50). However, the incentive or bonus of $90 also has an overtime obligation. As with flat rate mechanics, the $90 was earned over all 45 hours worked. Therefore, this portion of his compensation results in a "regular rate" of $2/hour. Overtime pay is half this figure, or $1/hour, and for the 5 hours results is an additional requirement of overtime pay of $5 on top of the $187.50 discussed above.

Compensation to Salespersons

Timing of Wage Payments to Salespersons

Commission wages paid to employees of a licensed vehicle dealer can be paid once a month. Labor Code section 204.1 provides:

Commission wages paid to any person employed by an employer licensed as a vehicle dealer by the Department of Motor Vehicles are due and payable once during each calendar month on a day designated in advance by the employer as the regular payday. Commission wages are compensation paid to any person for services rendered in the sale of such employer's property or services and based proportionately upon the amount or value thereof. The provisions of this section shall not apply if there exists a collective bargaining agreement between the employer and his employees which provides for the date on which wages shall be paid.

Pay Plans

Commissions with a draw: California law allows you to settle commissions with a salesperson once a month. You can compensate a salesperson

monthly with commissions according to a schedule. The salesperson can receive an advance against commissions every week, two weeks, or half-month. Dealers must set the draw in an amount that is equivalent to at least the minimum wage and overtime due for all hours worked in the period preceding the draw. The dealer may reconcile draws that are paid as an advance on commissions, to the extent the draw exceeded the minimum wage requirements, provided that there is a specific written agreement permitting the reconciliation. This draw arrangement should be set out in a written, signed pay plan. Likewise, in order to recover draws paid in excess of the earned commission at the time of termination, there must be a specific written agreement providing for that right. The salesperson is paid monthly commissions at the end of the month, less earlier draws in the month. To avoid the requirement of overtime pay, the salesperson's hourly wage for the month must equal one and one-half (1-1/2) times the minimum wage for every hour worked and more than 50% of the compensation must derive from commissions. If overtime is required, you would calculate the overtime on the basis of the rules discussed above.

It is important that you have an accurate system for keeping track of the hours worked by salespersons.

If, when settlement is made on the commissions, the commissions amount to less than the minimum wage, you cannot then or later recover the difference by deduction from subsequently earned commissions. This rule is the reason why it is advisable for dealers to settle monthly on commissions, rather than more frequently. If the dealer settles commissions weekly the dealer cannot take credit in subsequent weeks when in one week the commissions exceed the minimum wage and in a subsequent week the salesperson earns no commissions. The salesperson must still be paid the minimum wage in a subsequent week. If, when commissions are settled (settlement must be done at least monthly), the commissions do not exceed the minimum wage, then the minimum wage must be paid. If an employee's commissions are to be settled monthly and the commissions do not exceed one and one-half (1-1/2) times the minimum wage and not more than one-half (1/2) of the employee's compensation represents commissions, the employee must be paid overtime in accordance with the overtime rules stated above.

NOTE

ON ADVANCES: Payments made by advances or draws in excess of commissions earned may be carried forward provided that minimum wage and overtime requirements have been satisfied and there is a written pay plan providing for such carry-overs.

Salary plus commission: The salary must be paid at least semi-monthly in accordance with the rules discussed later in the chapter, in the section entitled "Time of Payment of Wages," and must meet the minimum wage standards for each pay period. The commissions must be settled and paid at least monthly. Overtime must be paid for each pay period unless the employee's earnings for the month (if settled monthly) exceed one and one-half (1-1/2) times the minimum wage for hours worked and the commissions earned are more than 50% of the employee's total compensation for the month.

NOTE

California Labor Code section 2751 requires that any compensation agreement providing for the payment of commissions must be in writing and must include the method for calculating the commissions, a description of when commissions are earned and how they will be paid, and a signed receipt indicating that the employee received a copy of the compensation agreement signed by the employee and the employer. Accordingly, all pay plans for commissioned employees such as salespersons, service advisors, sales managers and F & I personnel (and any other employee who is paid a commission as a component of his or her pay plan) must be set forth in writing and be signed by the employee and the dealership. The pay plans should describe in detail how commissions are calculated and what items will be excluded from the calculation, such as factory incentives and holdbacks. Similarly if other deductions, such as fees, "packs," advertising and the like, are used in the calculation of the ultimate commission, these items should be listed and identified in the signed pay plan, preferably with a dollar figure associated with the particular item. This is important both in order to take advantage of potential defenses to wage-hour claims, and to help prevent disputes over compensation. Specificity is particularly important with respect to the following items:

FORFEITURES OF COMMISSIONS: While it may be lawful to provide in an employment contract that a salesperson must be employed on the date of vehicle delivery to receive the commission on that sale, such a provision should be explicitly stated. Otherwise, you might be faced with a claim for commissions deriving from ongoing business which was generated by one who is no longer an employee.

***DEDUCTIONS FOR DAMAGE:** Any policy of deducting charges for damage to demos or other dealership property should be clearly stated, and should be consistent with the rules covering deductions and breakage. (But, see the discussions later in this chapter in the sections entitled "Authorized Deductions From Wages" and "Charging Employee For Cash Shortage Or Breakage.") Please note that the Division of Labor Standards Enforcement construes these provisions quite narrowly. Any expense taken into account in the calculation of commissions (e.g., lot damage or advertising) might be argued to be a legally-impermissible "cost of doing business" and hence subject to challenge. Dealers should contact competent labor and employment counsel to review their pay plans to ensure legal compliance.*

***CHARGEBACKS:** If any deductions from the commissions of salespersons or F& I producers are made to account for chargebacks, it is recommended that this be expressly stated in the pay plan and any such chargebacks must be deducted only to the extent that the particular employee was originally paid on the particular transaction.*

***EMPLOYMENT-AT-WILL DISCLAIMER:** The pay plan should contain a disclaimer stating that the document does not create a contract of employment for any period and both the employee and the dealership continue to have the option to terminate the employment relationship without notice at any time and for any reason. (See the chapter in this Management Guide entitled "Discharge Of Employees, Preventative Measures," for a discussion of the language to be included in such an at-will employment disclaimer.)*

CAUTION

***REGARDING USE OF PACKS AND CERTAIN "COST OF DOING BUSINESS" THAT REDUCE THE COMMISSIONABLE GROSS PROFIT:** Be extremely careful if you have a new or used car "Pack" which precludes a commissioned employee from receiving commissions on a portion of the otherwise commissionable gross profit on the sale of a product or service. If you have such "Packs", they must be clearly disclosed including the exact dollar amount, in the written pay plan. However, be aware that various challenges are being made by employees against dealers who use "Packs" in calculating commissions. Employees claim that the "Pack" is an impermissible charge against commissionable gross profit used to recover the "cost of doing business." "Costs of doing business" such as insurability items, breakage, lot damage, inventory shortage, worker's compensation costs, etc., cannot be used to calculate commissionable gross profit as it adversely affects the amount of commission received by an employee. Attorneys representing these employees argue that the "Packs" are just a disguised way of recovering those "costs of doing business" without saying it outright. Because this area of the law is quite uncertain, dealers should contact competent labor and employment counsel before using "Packs" and/or before charging items that could be identified as "costs of doing business" against the commissionable gross profit.*

Minimum Wages

Section 4(A) of the Order requires every employer to pay each employee, on the established payday for the period involved, at least the applicable minimum wage for all hours worked in the payroll period, whether the remuneration is measured by time, piece, commission or otherwise. (See, however, the earlier section entitled "Compensation to Salespersons" regarding once a month payment to commissioned employees.)

The minimum wage under California law is $8.00 as of January 1, 2008. Note that this figure is higher than the federal minimum wage. Of course a Dealership must comply with the higher figure. Dealers should watch Association Bulletins for potential changes in the California minimum wage, either by the Legislature or by the IWC.

The minimum wage for certain "learners" is contained in section 4(A) of the Order as follows:

> *LEARNERS. Employees 18 during their first 160 hours of employment in occupations in which they have no previous similar or related experience, may be paid not less than eighty-five percent (85%) of the minimum wage rounded to the nearest nickel.*

An important distinction to note between federal and California law is that although both provide that learners may be paid less than the minimum wage (eighty-five percent (85%) of the minimum wage if certain conditions are met), only California provides a minimum wage exception for minors. The Industrial Welfare Commission has stated that minors may be paid eighty-five percent (85%) of the minimum wage provided that Labor Code section 1391.2(b) is complied with and that the minors employed at such lower rates do not exceed twenty-five percent (25%) of the establishment's work force. (The twenty-five percent (25%) work force limitation does not apply during school vacations.) Thus, since federal law makes no similar wage rate exceptions for minors, federal law could be construed as being stricter than California law in this respect, requiring payment of the minimum wage to minors.

Pay for split shifts: When an employee works a split shift (defined in the Order as a work schedule which is interrupted by non-paid non-working periods established by the employer, other than bona fide rest or meal periods), the employee must be paid one hour's pay at the minimum wage in addition to the minimum wage for that workday, except when the employee resides at the place of employment, or unless the employee's actual earnings are the equivalent of minimum wage for every hour worked with an additional hour of minimum wages added on. For example, if an employee works an eight-hour split shift, the employee's minimum earnings must be at least $72.00 (9 hours x $8.00).

Pay for Reporting to Work

Section 5 of Wage Order 7-2001 provides rules for situations where an employee reports to work as required, but is not put to work or is furnished less than one-half his or her usual day's work. There are exceptions to this rule due to unusual circumstances. Section 5 of the Order provides as follows:

(A) Each workday an employee is required to report for work and does report, but is not put to work or is furnished less than one-half said employee's usual or scheduled day's work, the employee shall be paid for half the usual or scheduled day's work, but in no event for less than two (2) hours nor more than four (4) hours, at the employee's regular rate of pay, which shall not be less than the minimum wage.

(B) If any employee is required to report for work a second time in any one workday and is furnished less than two (2) hours of work on the second reporting, said employee shall be paid for two (2) hours at the employee's regular rate of pay, which shall not be less than the minimum wage.

(C) The foregoing reporting time pay provisions are not applicable when:

(1) Operations cannot commence or continue due to threats to employees or property; or when recommended by civil authorities; or

(2) Public utilities fail to supply electricity, water, or gas, or there is a failure in the public utilities, or sewer system; or

(3) The interruption of work is caused by an Act of God or other cause not within the employer's control.

(D) This section shall not apply to an employee on paid standby status who is called to perform assigned work at a time other than the employee's scheduled reporting time.

NOTE

TRIAL LAWYERS CHALLENGING PIECE-RATE COMPENSATION IN COURT: Several lawsuits have been filed challenging the propriety of the long-established piece-rate system under California's Wage Orders. In order to reduce risks, some dealers have moved away from compensating their technicians on a piece-rate basis and are instead providing compensation on an hourly basis and providing a productivity bonus based upon flag hours earned.

Meals, Breaks, and Facilities

Meals

Labor Code section 512 requires an employer to provide at least a 30-minute meal period for any employee who works five or more hours in a day. If, however, the total workday does not exceed six hours, the employer and employee can mutually agree to waive the meal period. An employee who works more than 10 hours in a workday is entitled to a second 30-minute meal period. If the total workday is less than 12 hours and the employee has not waived his or her first meal period, the employer and employee can mutually agree to waive the second meal period. The first meal period must be provided at some point in the first five hours worked in a given shift. Similarly, Section 11 of Wage Order 7-2001 states as follows with respect to meal periods:

(A) No employer shall employ any person for a work period of more than five (5) hours without a meal period of not less than 30 minutes, except that when a work period of not more than six (6) hours will complete the day's work the meal period may be waived by mutual consent of the employer and the employee.

(B) An employer may not employ an employee for a work period of more than ten (10) hours per day without providing the employee with a second meal period of not less than 30 minutes, except that if the total hours worked is no more than twelve (12) hours, the second meal period may be waived by mutual consent of the employer and the employee only if the first meal period was not waived.

(C) Unless the employee is relieved of all duty during a 30 minute meal period, the meal period shall be considered an "on duty" meal period and counted as time worked. An "on duty" meal period shall be permitted only when the nature of

the work prevents an employee from being relieved of all duty and when by written agreement between the parties an on-the-job paid meal period is agreed to. The written agreement shall state that the employee may, in writing, revoke the agreement at any time.

(D) If an employer fails to provide an employee a meal period in accordance with the applicable provisions of this order, the employer shall pay the employee one (1) hour of pay at the employee's regular rate of compensation for each work day that the meal period is not provided.

(E) In all places of employment where employees are required to eat on the premises, a suitable place for that purpose shall be designated.

Rest Periods

Section 12 of Wage Order 7-2001 provides for the following regarding rest periods for employees:

(A) Every employer shall authorize and permit all employees to take rest periods, which insofar as practicable shall be in the middle of each work period. The authorized rest period time shall be based on the total hours worked daily at the rate of ten (10) minutes net rest time per four (4) hours or major fraction thereof.

However, a rest period need not be authorized for employees whose total daily work time is less than three and one-half (3-1/2) hours. Authorized rest period time shall be counted as hours worked for which there shall be no deduction from wages.

(B) If an employer fails to provide an employee a rest period in accordance with the applicable provisions of this order, the employer shall pay the employee one (1) hour of pay at the employee's regular rate of compensation for each workday that the rest period is not provided.

Employer Responsibility in Providing Meal and Rest Periods

On April 12, 2012, the California Supreme Court issued its long-awaited decision in *Brinker Restaurant Corp. v. Superior Court (Hohnbaum) (2012)* 53 Cal. 4th 1004, a case with implications for nearly every California employer. For years, advocates for both sides argued over whether an employer need only "provide" each required meal period or whether the employer must "ensure" that eligible employees take the meal period and perform no work during meal periods. In its decision, the California Supreme Court confirmed that employers need only ***provide*** the meal period, but with qualifications. Because the Court's definition of "provide" a meal period emphasizes the employer's duty to relieve employees of all duties and relinquish control over their activities—and requires that the employer be sure to avoid any policies or practices that might be found to discourage employees from taking their meal periods or incentivize them to skip meal periods—the practical effect of the decision is that employers need to take some affirmative steps to allow employees to easily take their meal periods.

What does it mean to "provide" meal and rest periods? The key is employee freedom.

Though the Supreme Court made it clear that an employer need not ***ensure*** that meal breaks and rest periods are actually taken nor that the employee is forced by the employer not to perform work during the meal breaks, the Court made it equally clear that an employer must still provide the meal break, relinquish all control during the meal break, and make sure that it does not engage in any activity that limits an employee's level of freedom during a meal break. Those elements will determine whether the employer has satisfied its obligation to *provide* legally compliant meal breaks and rest periods. According to the Court, an employer satisfies its obligation to "provide" a meal period if it (1) relieves its employees of all duty; (2) relinquishes control over their activities and permits them a reasonable opportunity to take an uninterrupted 30-minute break; and (3) does not impede or discourage them from doing so, or incentivize them to forego the meal breaks. In other words, the Court made it clear that the law does not permit employers to influence employees into foregoing or changing the nature of their meal breaks, whether through the carrot or the stick. So implicit or explicit incentives and/or threats will likely lead to continued liability.

What must the employer do to affirmatively "relieve employees" of all duty?

The Court was not clear on just what an employer must do to meet its obligations on this requirement. At one extreme the Court rejected the argument that an employer has an affirmative obligation to ensure that workers are not performing any work during the meal break. On the other extreme would be a bare-bones policy instructing the employee of their right to take the meal period, without any ongoing monitoring, training, or reminders. Because the *Brinker* rule is clear that the employer must "relinquish control" over the employee and their activities, most prudent employers will put in place a more interactive policy to ensure that employees are relieved of duty for the required meal periods. A conservative approach should include several elements.

First, every employer should have a written policy in their employee handbook that includes a clear statement of the rule: every employee is relieved of all duties during their meal periods. This policy statement should also be presented to each employee to sign an acknowledgment as part of a new-

hire packet or at issuance of the policy. That is, every personnel file should have a signed acknowledgment from the employee confirming that they know and understand the rule.

Second, the employer should ensure that managers and employees alike are properly trained in the meal period policy and its practical implications. Policy-specific training in this area will ensure that employees understand that what they choose to do during their lunch period is up to them. And it will ensure that managers understand what to watch out for in identifying and preventing abuse of the policy.

Third, the employer should establish a monitoring process to empower managers to oversee and document compliance with the policy. Employers should require employees to confirm in writing that they understand the policy and that they have been relieved of all duties and actually provided the required meal periods. Any exceptions should be logged and explained. These certifications will also complement the management and employee training, opening up a dialogue between management and employees about how the policy is intended to work in practice.

What must an employer do to avoid creating incentives to forego legally required breaks? What types of policies or practices might be considered impediments to or discouragement of employee meal periods?

Nothing in the *Brinker* decision raised more unanswered questions about employer obligations than its pronouncement that "[t]he wage orders and governing statute do not countenance an employer's exerting coercion against the taking of, creating incentives to forego, or otherwise encouraging the skipping of legally protected breaks." On one extreme the Court has reprimanded employers who establish such tight schedules that employees who elect to take an uninterrupted, duty-free meal period cannot finish their work on time. On the other hand, what about a commission pay plan or flat-rate compensation plan that, by its very nature, provides a financial incentive for employees to work as much as possible? An example of this might be a flat-rate incentive pay program that pays increasing flag rates based on efficiency—thereby incentivizing the employee (perhaps with the employer's knowledge) to flag hours "off-the-clock" to increase efficiency rates. Or, perhaps the employer's practice or rule is that when a salesperson is on a meal break and a customer comes in and asks for the salesperson, the employer requires that another salesperson who is not on break assist the customer and received ½ of the commission and unit credit; or, perhaps where a salesperson loses his/her place in the "UP" queue if he/she takes a meal break. What about a technician who feels pressure to complete work for which a customer is waiting, knowing that his or her CSI bonus may be affected by lunch period delay? These are all examples of where plaintiffs' attorneys will argue that policies/practices of the employer discouraged from taking and/or incentivized the employee not to take the meal break.

While it would not appear that the Court intended to do away with such incentive-based compensation agreements as a whole, it did warn employers that policies and practices that punish employees for taking breaks or reward them for skipping breaks will be suspect. Watch the CNCDA bulletin to see how these rules will be applied.

The first step to managing compliance here is to ensure that the policy language and training components make it clear that the employer is employing neither a carrot nor a stick to undermine the employees' opportunity to take the legally permitted meal periods. Policy language should make it clear that neither managers nor other employees are permitted to do anything to interfere with any other employee's meal period, whether through incentives, coercion, impeding, discouraging, or dissuading. Employees should be trained to act: if any other employee, including managers, attempts to incentivize the employee to forego, exerts coercion against taking, or attempts to impede, discourage or dissuade in any way from taking a meal or rest period as described herein or required by law, they are to contact senior management immediately. In addition, employees should be informed (in policy statements, in training materials, and in compensation agreements) that nothing in the compensation agreement is intended to imply any incentive or impediment to employee enjoyment of their duty-free meal periods. Employees should be encouraged to contact senior management immediately if they believe that any provision in their compensation agreement might seem to suggest otherwise.

More important, however, will be the ongoing compliance monitoring. Through time card certifications and management vigilance, employers should be able to identify any practice which its employees may feel provides a practical impediment to meal periods. As questions are raised, employers should consult with employment counsel for guidance as the law develops in this area.

How can employers prove after-the-fact that any decision to work through a statutory meal period was the employee's decision, uninfluenced by the employer?

Again, the three steps discussed above will help employers not only to establish a policy that works both in theory and in practice, but each will be important to demonstrate the employer's good-faith compliance with the requirements. Establishing a

policy that each employee acknowledges in writing (both as part of the handbook and as a stand-alone document during the new-hire process) will show that the each employee understood the rules. Conducting training (with attendance certification) will underscore this. And periodic timecard certification and monitoring by management will generate ongoing documentary evidence that the employer is serious about meeting its obligations.

Clarification by Court of Meal Period and Rest Period Timing Requirements

The Court also addressed the timing of meal and rest breaks. The Court ruled that meal periods must be taken anytime within the first five hours of work (or the second meal break within the first ten hours of work) and rejected arguments that meal periods must fall in the middle of shifts. The Court clarified the timing for rest periods as well. Generally, employees will receive one 10 minute rest period for shifts from 3.5 to 6 hours in length, two 10 minute rest periods for shifts of more 6 hours up to 10 hours in length, and three 10 minute rest periods for each four hours thereafter on the same basis. Employers still have a "duty to make a good faith effort to authorize and permit rest breaks in the middle of each period," but exceptions may be made for practical considerations. If you believe that such practical considerations exist in your workplace, you may want to contact employment counsel to review your options.

Compliance Recommendations

The significance of this ruling has made waves throughout the state, with many commentators, industry organizations, and advocacy groups hailing the pro-employer core of the decision as seen through their rose-colored glasses. But as with most such decisions, the devil remains in the details, and while employers should applaud the Court's recognition of an employee's right to work through lunch, the decision is too complex and too important to let sound bites drive company policies and practices. It is recommended that employers review their existing policies, training regimens, employee acknowledgment forms, and recordkeeping procedures to ensure not only that they are in compliance with these court-clarified standards, but that the employer is prepared to meet any challenge with documentary evidence to prove that it met its legal obligations.

CAUTION

Meal and rest period litigation is very common, and liability for missed meal and rest periods can be significant as employees are allowed to seek penalties going back at least three years, and sometimes four years. The failure of an employer to provide a duty-free meal and rest periods can easily run in the thousands of dollars per employee. Therefore, accurate records must be maintained showing that lunch periods were taken and while rest periods are not recorded on time cards, some time cards provide for a certification by an employee that he/she was provided all required meal and rest periods. Dealers should make sure they have a policy in place notifying employees of their rights to meal breaks and rest periods.

Uniforms and Equipment

Section 9 of Wage Order 7-2001 provides the rules for when uniforms or tools are required by the employer. The part of the Order applicable to automobile dealers provides:

(A) When uniforms are required by the employer to be worn by the employee as a condition of employment, such uniforms shall be provided and maintained by the employer. The term 'uniform' includes wearing apparel and accessories of distinctive design or color.

NOTE: This section shall not apply to protective apparel regulated by the Occupational Safety and Health Standards Board.

(B) When tools or equipment are required by the employer or are necessary to the performance of a job, such tools and equipment shall be provided and maintained by the employer, except that an employee whose wages are at least two (2) times the minimum wage provided herein may be required to provide and maintain hand tools and equipment customarily required by the trade or craft. Notwithstanding any other provision of this section, employees in beauty salons, schools of beauty culture offering beauty care to the public for a fee, and barber shops may be required to furnish their own manicure implements, curling irons, rollers, clips, haircutting scissors, combs, blowers, razors, and eyebrow tweezers. This Subsection (B) shall not apply to apprentices regularly indentured under the State Division of Apprenticeship Standards.

NOTE: This section shall not apply to protective equipment and safety devices on tools regulated by the Occupational Safety and Health Standards Board

(C) A reasonable deposit may be required as security for the return of the items furnished by the employer under provisions of subsections (A) and (B) of this section upon issuance of a receipt to the employee for such deposit. Such deposits shall be made pursuant to section 400 and following of the Labor Code or an employer with prior written authorization of the employee may

deduct from the employee's last check the cost of an item furnished pursuant to (A) and (B) above in the event said item is not returned. No deduction shall be made at any time for normal wear and tear. All items furnished by the employer shall be returned by the employee upon completion of the job.

CAUTION

With the minimum wage in California of $8.00 per hour, this 2X requirement results in a $16.00 hourly rate, which is often much higher than lube mechanics and helpers are typically paid. Therefore, any employee paid less than this figure cannot be required to provide his own tools and the dealership should provide such tools. If an employee who is paid less than $16.00 per hour nevertheless wishes to voluntarily provide his own tools and not use the dealership's tools, the dealership should document in writing this voluntary agreement and have the employee sign such a document.

NOTE

REGARDING EMPLOYER'S LIABILITY FOR LOST OR STOLEN TOOLS: Under the California wage orders, an employee whose wages are at least two times the minimum wage may be required by his or her employer to provide and maintain hand tools and equipment customarily required by the trade or craft. In the event an employee is required to provide tools for his or her job, the question arises as to whether the employer may be held liable for lost or stolen tools of the employee left on the employer's premises.

This issue was decided in a case in which a mechanic was required to supply his own tools for performance of his duties, and because the tools were too heavy to be transported routinely to and from work, the employee left the tools on his employer's premises at night and over the weekend. Although the tools were secured inside a locked inner building of the employer, the tools were stolen in a burglary which occurred over a weekend. The mechanic's tools were valued at over $8,000 and he asked the employer for reimbursement for the value of the tools. The employer refused to reimburse the mechanic because it was not at fault nor negligent in connection with the theft of the tools.

The Court of Appeal disagreed with the employer and held that the employer was required to indemnify the employee for the loss of his tools. The court relied on section 2802 of the California Labor Code which requires an employer to "indemnify his employee for all that the employee necessarily expends or loses in direct consequence of the discharge of his duties. . . ."

The court reasoned that where the custom of the trade requires the employee to supply his own tools for the performance of his duties, and although not required to be left on the employer's premises, the tools are too heavy to be transported routinely to and from the place of employment, the employer will be responsible to indemnify the employee for such losses because they were incurred in direct consequence of the discharge of the employee's duties.

In light of the court decision, and because the Labor Commissioner also takes the position that an employer cannot insist that the employee insure the tools as a condition of employment, an employer may wish to weigh the cost of insuring the employee's tools left overnight at the premises against the risk of being self-insured in this area. (See Machinists Automotive Trades District Lodge No. 190 of Northern California v. Utility Trailer Sales Co. (1983) 190 Cal. Rptr. 98.)

Change Rooms and Resting Facilities

Section 13 of Wage Order 7-2001 provides:

(A) Employers shall provide suitable lockers, closets, or equivalent for the safekeeping of employees' outer clothing during working hours, and when required, their work clothing during non-working hours. When the occupation requires a change of clothing, change rooms or equivalent space shall be provided in order that employees may change their clothing in reasonable privacy and comfort. These rooms or spaces may be adjacent to but shall be separate from toilet rooms and shall be kept clean.

NOTE: This section shall not apply to change rooms and storage facilities regulated by the Occupational Safety and Health Standards Board

(B) Suitable resting facilities shall be provided in an area separate from the toilet rooms and shall be available to employees during work hours.

An earlier requirement for couch rooms for women was discontinued. A resting facility is a place where an employee can rest for a short period of time in an area separate from the toilet room.

Miscellaneous Requirements

Disabled workers: Section 6 of the Order provides for the obtaining of a license to pay persons disabled by physical or mental deficiencies less than the minimum wage.

Meals and lodging: Section 10 of the Order allows a deduction from the minimum wage for meals or lodging provided to an employee and sets forth the maximum amount that can be deducted.

Seats: Section 14 of the Order provides that employees shall be provided with suitable seats when the nature of the work reasonably permits the use of seats. When the employees are not engaged in the active duties of their employment and the nature of the work requires standing, an adequate number of suitable seats shall be placed in reasonable proximity to the work area and employees shall be permitted to use such seats when it does not interfere with the performance of their duties.

Temperature: Section 15 of the Order provides:

(A) The temperature maintained in each work area shall provide reasonable comfort consistent with industry-wide standards for the nature of the process and the work performed.

(B) If excessive heat or humidity is created by the work process, the employer shall take all feasible means to reduce such excessive heat or humidity to a degree providing reasonable comfort. Where the nature of the employment requires a temperature of less than 60 degrees F., a heated room shall be provided to which employees may retire for warmth, and such room shall be maintained at not less than 68 degrees.

(C) A temperature of not less than 68 degrees shall be maintained in the toilet rooms, resting rooms, and change rooms during hours of use.

(D) Federal and State energy guidelines shall prevail over any conflicting provision of this section.

***Elevators**: Section 16 of the Order requires elevator or escalator service when employees are employed four or more floors above or below ground level.*

Penalties: Labor Code section 1199 provides that any failure, refusal, or neglect to comply with any of the provisions of the Order is a violation of the Labor Code and is punishable by fine or imprisonment or both.

Posting of order: Section 22 of the Order requires that every employer keep a copy of the Order posted in an area frequented by employees where it may be easily read during the work day. Where the location of the work or other conditions make this impractical, every employer must keep a copy of the Order and make it available to every employee upon request.

CNCDA provides this poster, along with the other employment posters required under California and federal laws, to CNCDA members who wish to order this convenient "all in one" poster kit.

Exemptions for Employer based upon Undue Hardship

Section 17 of the Order allows an employer to apply for an exemption from various provisions of the Order based upon undue hardship. Section 17 provides as follows:

- *If, in the opinion of the Division after due investigation, it is found that the enforcement of any provision contained in Section 7, Records; ; Section 12, Rest Periods; Section 13, Change Rooms and Resting Facilities; Section 14, Seats; Section 15, Temperature; or Section 16, Elevators, would not materially affect the welfare or comfort of employees and would work an undue hardship on the employer, exemption may be made at the discretion of the Division. Such exemptions shall be in writing to be effective and may be revoked after reasonable notice is given in writing. Application for exemption shall be made by the employer or by the employee and/or the employee's representative to the Division in writing. A copy of the application shall be posted at the place of employment at the time the application is filed with the Division.*

Paying Wages and Record Keeping

Time of Payment of Wages

Labor Code section 204 requires that with certain exceptions, **wages earned are due and payable twice during the calendar month on days designated in advance by the employer as regular paydays**. Labor performed between the 1st and 15th days, inclusive, of any calendar month must be paid for between the 16th and the 26th day of the month during which the labor was performed, and labor performed between the 16th and the last day, inclusive, of any calendar month, must be paid for between the 1st and 10th day of the following month. The requirements of this section are deemed satisfied by the payment of wages for weekly, biweekly, or semimonthly payroll, if such wages are paid not more than seven (7) calendar days following the close of the payroll period.

Exemptions for Executive, Administrative And Professional Employees

Labor Code section 204 provides that salaries of executive, administrative and professional employees of employers covered by the Fair Labor Standards Act may be paid once a month on or before the 26th day of the month during which the labor

was performed if the entire month's salary, including the unearned portion between the date of payment and the last day of the month, is paid at that time.

The distinction between these two sections is that section 204 applies to the executive, administrative and professional employees of employers who are subject to the Fair Labor Standards Act, whereas section 204(c) applies to those high-level employees who are not subject to the Act. Consequently, before disregarding the payment schedule set forth in section 204 in favor of the payment schedule prescribed by section 204(c), it is advisable to consult your attorney.

Payment of Wages to Employees Paid Weekly

Labor Code section 204(b) provides as follows:

- *Labor performed by a weekly-paid employee during any calendar week, and prior to or on the regular payday shall be paid for not later than the regular payday of the employer for such weekly paid employee, falling during the following calendar week.*
- *Labor performed by a weekly-paid employee during any calendar week, and subsequent to the regular payday shall be paid for not later than 7 days after the regular payday of the employer for such weekly-paid employee, falling during the following calendar week.*

Time of Payment of Commission Wages

Labor Code section 204.1 provides that commission wages paid to any person employed by an employer, licensed as a vehicle dealer by the Department of Motor Vehicles, are due and payable once during the calendar month on a day designated in advance by the employer as the regular payday. Commission wages are compensation paid to any person for services rendered in the sale of such employer's property or services and based proportionately on the amount or value thereof. The provisions of this section do not apply if there is a collective bargaining agreement between the employer and employees which provides for the date on which wages shall be paid.

Payment of Wages upon Termination Of Employment

When an employee is discharged, the wages earned and unpaid at the time of discharge are due and payable immediately. See Labor Code section 201.

If an employee not having a written contract for a definite period quits, his or her wages shall become due and payable not later than seventy-two (72) hours thereafter, unless the employee has given seventy-two (72) hours previous notice of the intention to terminate, in which case the employee is entitled to his or her wages at the time of termination. However, an employee who quits without providing a 72-hour notice is entitled to receive payment by mail if he or she so requests and designates a mailing address. The date of the mailing constitutes the date of payment for purposes of the requirement to provide payment within 72 hours of the notice of quitting. See Labor Code section 202.

If the employer willfully fails to make payments required by Labor Code sections 201 and 202 above, the wages of such employees shall continue as a penalty until they are paid, or until an action is commenced for them, or for 30 days, whichever occurs earlier. See Labor Code section 203. Note that the Labor Commissioner often interprets the "willful" requirement *against* the employer and the 30-day penalty has also been interpreted by the Labor Commissioner and the courts to require 30 work days of pay, not 30 calendar days (meaning for most employees six weeks of pay as penalty, instead of single month's worth) of pay. This penalty therefore often exceeds the underlying wage claim and means that dealers must pay careful attention to these rules. See Labor Code section 203.

In the case of a dispute with an employee over wages, the employer must pay the amount it concedes is due, leaving the employee to all remedies the employee might otherwise be entitled to as any balance claimed. See Labor Code section 206. It is normally a very bad idea to hold an employee's wages "hostage" in order to achieve some sort of action or response from the employee.

Labor Code section 207 requires the employer to keep posted conspicuously at the place of work, if practical, or otherwise where it can be seen as employees come or go to their places of work, a notice specifying the regular paydays and the time and place of payment.

It is a misdemeanor if the employer, having the ability to pay, willfully refuses to pay wages due and payable after demand has been made. It is also a misdemeanor if the employer falsely denies the amount or validity of wages, or that wages are due, with the intent to secure for himself or herself or any other person any discount upon the wages due, or with an intent to annoy, harass, oppress, hinder, delay or defraud the person to whom such wages are due. See Labor Code section 216.

NOTE

REGARDING EMPLOYER'S COMPLIANCE WITH CALIFORNIA WAGE AND HOURS LAWS: The importance

of an employer's compliance with California wage and hours laws was well illustrated in the court decision of Gould v. Maryland Sound Industries, Inc. (1995) 37 Cal.Rptr.2d 718. In Gould, an employee brought an action against his employer for the tort of wrongful discharge, alleging that he had been fired in retaliation for reporting to company management violations by the company of certain overtime wage laws. The court in upholding his cause of action for tortuous wrongful discharge held that the prompt payment of wages due an employee is a "fundamental public policy" of California which fosters society's interest in a stable job market. The court reiterated that "wage and hour laws concern not only the health and welfare of the workers themselves, but also the public health and general welfare," and that this is evidenced by the California legislature's decision to criminalize certain employer conduct in violation of such wage and hour laws.

REGARDING FINAL WAGES FOR COMMISSIONED EMPLOYEES: It may be difficult at times to pay an employee all wages earned through the date of termination where the employee is paid a commission on sales that have not yet completed or if the employee is paid on a percentage of the department sales or profits. The California Labor Commissioner takes the position that all wages that are earned and calculable must be paid upon termination of employment or as soon as they become earned and calculable. Dealers cannot wait until the next regular pay period after the date of separation to make such final wage payments.

Records that Must Be Kept

Section 7 of Wage Order 7-2001 requires that employers keep various employee records to assist in the resolution of disputes and in the employees' dealings with taxing agencies. Certain information must be provided to the employee upon request. Section 7 of the Order requires employers to keep accurate information with respect to each employee, including the following:

(1) Full name, home address, occupation and social security number.

(2) Birth date, if under 18 years, and designation as a minor.

(3) Time records showing when the employee begins and ends each work period. Meal periods, split shift intervals and total daily hours worked shall also be recorded. Meal periods during which operations cease and authorized rest periods need not be recorded.

(4) Total wages paid each payroll period, including value of board, lodging, or other compensation actually furnished to the employee.

(5) Total hours worked in the payroll period, and applicable rates of pay. This information shall be made readily available to the employee upon reasonable request.

(6) When a piece rate or incentive plan is in operation, piece rates or an explanation of the incentive plan formula shall be provided to employees. An accurate production record shall be maintained by the employer.

Federal law is mildly stricter concerning the employer's record keeping requirements for each employee covered by the law. The Department of Labor requires the employer to keep the following records in addition to those required under Industrial Welfare Commission Order 7-2001: (a) the total weekly straight-time earnings or wages and (b) total weekly overtime excess compensation. Federal law also requires a record of the sex of each employee and the birth date for all employees under the age of 19 (California requires the date of birth for all employees under the age of 18.)

Labor Code section 226 provides, in pertinent part, as follows:

*(a) Every Employer shall, semimonthly or at the time of each payment of wages, furnish each of his or her employees, either as a detachable part of the check, draft, or voucher paying the employee's wages, or separately when wages are paid by personal check or cash, an **accurate** itemized statement in writing showing (1) gross wages earned, (2) total hours worked by the employee, except for any employee whose compensation is solely based on a salary and who is exempt from payment of overtime under subdivision (a) of Section 515 or any applicable order of the Industrial Welfare Commission, (3) the number of piece-rate units earned and any applicable piece rate if the employee is paid on a piece-rate basis, (4) all deductions, provided that all deductions made on written orders of the employee may be aggregated and shown as one item, (5) net wages earned, (6) the inclusive dates of the period for which the employee is paid, (7) the name of the employee and only the last four digits of his or her social security number or an employee identification number other than a social security number, (8) the name and address of the legal entity that is the employer, and…(9) all applicable hourly rates in effect during the pay period and the corresponding number of hours worked at each hourly rate by the employee… The deductions made from payment of wages shall be recorded in ink or other indelible form, properly dated, showing the month, day, and*

year, and a copy of the statement or a record of the deductions shall be kept on file by the employer for at least three years at the place of employment or at a central location within the State of California.

(b) Any employer that is required by this code or any regulation adopted pursuant to this code to keep the information required by subdivision (a) shall afford current and former employees the right to inspect or copy the records pertaining to that current or former employee, upon reasonable request to the employer. The employer may take reasonable steps to assure the identity of a current or former employee. If the employer provides copies of the records, the actual cost of reproduction may be charged to the current or former employee.

(c) An employer who receives a written or oral request to inspect or copy records pursuant to subdivision (b) pertaining to a current or former employee shall comply with the request as soon as practicable, but no later than 21 calendar days from the date of the request. A violation of this subdivision is an infraction. Impossibility of performance, not caused by or a result of a violation of law, shall be an affirmative defense for an employer in any action alleging a violation of this subdivision. An employer may designate the person to whom a request under this subdivision will be made.

(d) This section does not apply to any employer of any person employed by the owner or occupant of a residential dwelling whose duties are incidental to the ownership, maintenance, or use of the dwelling, including the care and supervision of children, or whose duties are personal and not in the course of the trade, business, profession, or occupation of the owner or occupant.

(e) (1) An employee suffering injury as a result of a knowing and intentional failure by an employer to comply with subdivision (a) is entitled to recover the greater of all actual damages of fifty dollars ($50) for the initial pay period in which a violation occurs and one hundred dollars ($100) per employee for each violation in a subsequent pay period, not exceeding an aggregate penalty of four thousand dollars ($4,000), and is entitled to an award of costs and reasonable attorney's fees.

(2)(A) An employee is deemed to suffer injury for purposes of this subdivision if the employer fails to provide a wage statement.

(B)An employee is deemed to suffer injury for purposes of this subdivision if the employer fails to provide accurate information as required by any one or more of items (1) to (9), inclusive, of subdivision (a) and the employee cannot promptly and easily determine from the wage statement alone one or more of the following:

(i) The amount of gross wages or net wages paid to the employee during the pay period or any of the other information required to be provided on the itemized wage statement pursuant to items (2) to (4) inclusive, (6), and (9) of subdivision (a).

(ii) Which deductions the employer made from gross wages to determine the net wages paid to the employee during the pay period. Nothing in this subdivision alters the ability of the employer to aggregate deductions consistent with the requirements of item (4) of subdivision (a).

(iii) The name and address of the employer….

(iv) The name of the employee and only the last four digits of his or her social security number or an employee identification number other than a social security number.

(C) For purposes of this paragraph, "promptly and easily determine" means a reasonable person would be able to readily ascertain the information without reference to other documents or information.

(3) For purposes of this subdivision, a "knowing and intentional failure" does not include an isolated an unintentional payroll error due to a clerical or inadvertent mistake. In reviewing for compliance with this section, the factfinder may consider as a relevant factor whether the employer, prior to an alleged violation, has adopted and is in compliance with a set of policies, procedures, and practices that fully comply with this section.

(f) A failure by an employer to permit a current or former employee to inspect or copy records within the time set forth in subdivision (c) entitles the current or former employee or the Labor Commissioner to recover a seven hundred fifty dollar ($750) penalty from the employer.

(g) An employee may also bring an action for injunctive relief to ensure compliance with this section, and is entitled to an award of costs and reasonable attorney's fees.

CAUTION

Under existing law, an employer must maintain records on and provide upon request certain information regarding employee compensation and deductions therefrom. For example, an employer must maintain records on gross wages earned, total hours worked by the employee, deductions taken from payments of wages, and more. Labor Code section 226 requires employers to comply with any request from an employee to inspect or copy his or her payroll records within 21 days from the date of the re-

quest. A failure to comply with such a request can result in, among other things, a civil penalty of up to $750.00 per occurrence and injunctive relief. In addition, an employer must maintain personnel records for three years, permit inspection of those records and provide, upon request, copies of personnel records. The employer must comply with any request to inspect and/or produce personnel files within 30 days from the date of such request. A failure to comply with such a request can result in, among other things, a civil penalty of up to $750.00 per occurrence and injunctive relief.

The employer must retain personnel files for at least 3 years following termination of employment. The employer may charge for copies of the file, but no more than the actual cost of reproduction.

Equal Pay for Equal Work

The Equal Pay Act of 1963 prohibits an employer from paying any employee wage rates less than those paid to employees of the opposite sex for jobs that require equal skill, effort, and responsibility and that are performed under similar conditions. Specifically excepted from the scope of this Act are differentials based upon a seniority system, merit system, incentive system, or on factors other than sex. Job titles or job classifications are not the determinative factor.

The equal pay requirement depends upon the content of the job, the job requirements and the employee's performance. In addition, the employer may not comply with the Act by reducing the wages of any employees, but instead must increase the discriminatory lower rate. Finally, an employer who replaces a male employee with a female in the same position cannot lawfully pay the female a lower wage, even though employees of both sexes may not currently be working in the job involved.

The Act's coverage extends to all employees subject to the Fair Labor Standards Act, which means virtually all employees. Also, on January 29, 2009, President Obama signed into law the Lily Ledbetter Fair Pay Act of 2009, which basically "resets" the statute of limitations on federal Fair Pay Act claims each time an employee's paycheck is issued. In California, employees have 300 days from the discriminatory act to file a claim. Accordingly, is it more important than ever for dealers to review their pay plans to ensure that employees are receiving equal pay for equal work.

California also has an Equal Pay Act which prohibits wage differentials based solely upon the employee's sex. See Labor Code section 1197.5. This Act also specifically excludes from its provisions wage variations based upon factors such as seniority and ability and differences in duties or services performed. The provisions of the California Act are administered and enforced by the Division of Labor Standards Enforcement (i.e., the Labor Commissioner).

CAUTION

REGARDING FINES AND PENALTIES: Violations of the Equal Pay Acts can result in large monetary fines and other penalties.

Assignment of Wages and Wage Garnishment

Assignment of Wages

Labor Code section 300 allows an employee to assign to a creditor no more than 50% of the employee's wages or salary. All of the very detailed and strict requirements of section 300 must be met and no assignment should be recognized by an employer unless all requirements of section 300 have been complied with. No assignment is valid unless at the time it is made the wages or salary assigned have been earned, except that salary to be earned can be assigned for the necessities of life to the person directly furnishing the necessities and only for the amount needed to furnish the necessities.

Garnishment

The law provides for various methods of satisfying a court order or judgment out of the debtor's wages. Some are as follows:

a. An earnings withholding order for support.

b. An earnings withholding order for taxes.

c. An earnings withholding order.

If you receive an earnings withholding order, the order will contain specific instructions to you concerning when you are to begin withholding wages, the amount to withhold, and what to do with the money.

It is against the law to fire an employee because of earnings withholding orders for the payment of only one indebtedness. No matter how many orders you receive, so long as they all relate to a single indebtedness (no matter how many debts are represented in that judgment), the employee may not be fired. It is also illegal to avoid an earnings withholding order by postponing or advancing the payment of earnings. The employee's pay period must not be changed to prevent the order from taking effect. It is illegal not to pay amounts withheld pursuant to the earnings withholding order to the levying officer.

Authorized Deductions from Wages

Labor Code section 224 allows an employer to withhold or divert any portion of any employee's wages when the employer is required or empowered to do so by state or federal law or when a deduction is expressly authorized in writing from the employee to cover insurance premiums, hospital or medical dues, or other deductions not amounting to a rebate or deduction from the standard wage arrived at by collective bargaining or pursuant to wage agreement or statute, or when a deduction to cover health and welfare or pension plan contributions is expressly authorized by collective bargaining or wage agreement.

With the exception of withholding required by state or federal law, all deductions or withholdings from wages must be authorized in writing by the employee. Moreover, a 1944 Attorney General opinion states that voluntary withholdings requested in writing by the employee must be **for the benefit of the employee**.

CAUTION

ORAL AUTHORIZATIONS NOT PROPER: Oral authorizations by the employee for deductions from wages are insufficient, even if the deduction is for the benefit of the employee. The authorization must be in writing.

The entire area of offsets against and withholding from wages was thrown into considerable confusion by the court case of *Barnhill v. Robert Saunders & Co.* (1981) 177 Cal. Rptr. 803.

In that case, an employee executed a promissory note to the employer for $487.50. On its face the note stated: "To be paid by payroll deduction or on demand." The parties then orally agreed that the employer would deduct $37.50 every two weeks from the employee's wages. The employee was subsequently terminated and at the time of termination there was $475 owing on the note. The employer deducted the amount owing on the note from the employee's final paycheck by way of offset. The court held that this was not permissible. The court reasoned that an employee's wages cannot be attached under California attachment law and that the employer could not do indirectly what the law directly prohibits.

In recent opinions the Labor Commissioner has stated that deductions are permitted for losses due to dishonest, willful, or grossly negligent acts, as well as deductions authorized by the employee in writing to repay indebtedness to the employer created either by a loan or by the employee's voluntary purchase of goods or services from the employer. The Labor Commissioner stated, however, that a deduction from an employee's final check can be only in the amount appropriate to pay the normal installment payment; and that the full balance cannot be accelerated to recover a balloon payment unless, at or before the time of termination, the employee expressly authorizes a deduction of the total balance from the final paycheck.

Because of the above, if you take a setoff or a deduction against an employee's wages, you do so at your own risk and may also risk the waiting time penalties mentioned in the section earlier in this chapter entitled "Time of Payment of Wages."

Neither the *Barnhill* case nor the Labor Commissioner's opinion addresses all of the issues relating to deductions from and setoffs against wages. Because of the lack of clear law in this area, all setoffs to and deductions from wages, unless required by law, are of some risk to employers. Transactions leading to deductions and setoffs should be avoided if at all possible. Because of the lack of clarity in this area, you should consult with your attorney regarding particular situations in the area of deductions and setoffs.

This situation should be distinguished, however, from the situation where a dealer pays an advance (draw) against future earned commission, and pursuant to a written pay plan provision, reconciles that advance against future earned commission wages. For this reason, it is important that all written pay plans provide that all payments to employees are considered advances and are reconciled against future earned commissions.

CAUTION

REGARDING DEDUCTIONS FOR POOR PERFORMANCE: Because many manufacturers have tied compensation to dealers based on C.S.I. performance, some dealers have been changing pay plans to charge a deduction against a salesperson or F&I person for substandard C.S.I. performance. This practice is illegal and constitutes an unlawful deduction from wages resulting in significant liability, including penalties and attorney's fees.

Employers who wish to tie increased compensation to positive C.S.I. performance should, therefore, take caution in implementing pay plans that provide a bonus for good scores, and not a deduction for low scores.

NOTE

ON UNIFORMS AND TOOLS: The Order allows for a deduction from the last check in certain situations in relation to tools and uniforms if prior written consent is obtained. (See the previous

section in this chapter entitled, "Uniforms and Equipment".)

Labor Code section 206.5 further provides that no employer shall require the execution of any release of any claim or right on account of wages due, or to become due, or made as an advance on wages to be earned, unless payment of those wages has been made. A release required or executed in violation of the provisions of this section shall be null and void as between the employer and the employee and the violation of the provisions of this section shall be a misdemeanor.

Charging Employee for Cash Shortage or Breakage

Section 8 of Wage Order 7-2001 describes the circumstances under which an employer can charge the employee for cash shortage or breakage. Section 8 provides as follows:

- *No employer shall make any deduction from the wage or require any reimbursement from an employee for any cash shortage, breakage, or loss of equipment, unless it can be shown that the shortage, breakage, or loss is caused by a dishonest or willful act, or by the gross negligence of the employee.*

This deduction problem has caused many dealerships great difficulty when wage claims are heard by the Labor Commissioner. Even when an employee, such as a mechanic, has earlier signed a written authorization or handbook provision that he will pay the dealer's insurance deductible (such as $500) for any accident due to his or her negligence, this authorization may be deemed unacceptable by the Labor Commissioner. The Labor Commissioner often takes the position that no money can be deducted from an employee's wages for cash shortage or breakage even if there is willful misconduct or gross negligence. The Labor Commissioner also generally takes the position that all such losses must be recovered through a small claims action or some other legal remedy. It may be possible that a new signed voluntary authorization by the employee at the time of the cash shortage or breakage voluntarily agreeing to reimburse the dealer for the loss or the deductible might be upheld. A dealership should consult employment counsel on this subject for specific advice.

Vacations and Other Time Off

"Day's Rest"

Eight (8) hours of labor constitutes a day's work, unless it is otherwise expressly stipulated by the parties to a contract. See Labor Code section 510.

Every person employed in any occupation of labor is entitled to one day's rest in seven. See Labor Code section 551.

A "day's rest" applies to all situations whether the employee is engaged by the day, week, month, or year, and whether the work performed is done in the day or nighttime. See Labor Code section 550.

No employer of labor shall cause employees to work more than six days in seven. See Labor Code section 552.

The above rules do not apply in any cases of emergency or in the case of a collective bargaining agreement that provides differently. The above rules do not prevent an accumulation of days of rest when the nature of the employment reasonably requires that the employee work seven or more consecutive days, providing that in each calendar month the employee receives days of rest equivalent to one day's rest in seven. Also, the above rules do not apply to any employer or employee when the total hours of employment do not exceed thirty hours in any week or six hours in any one day thereof. See Labor Code sections 554 and 556.

Sick Leave

Under California law, an employer is not required to provide paid sick leave. Dealers located in San Francisco, however, do have a mandatory sick leave requirement. Any employer who does provide sick leave is now required to permit employees to use at least half of their accrued paid sick leave to attend to an illness of a child, parent, registered domestic partner, or spouse of the employee. (See Labor Code section 233, added in 1999.)

Labor Code Section 234 precludes an employer from maintaining an absence control policy which allows the employer to use as a basis for discipline, demotion, discharge, or suspension, the employee's use of sick leave to attend to an illness of a child, parent, spouse, or registered domestic partner. Such a policy would be a per se violation of the law, entitling an employee to appropriate relief.

California also permits state disability compensation for any individual unable to work due to the illness of a child, spouse, parent or domestic partner. This law establishes up to "six weeks of wage

replacement benefits to workers who take time off to care for a seriously ill child, spouse, parent, domestic partner, or to bond with a new child." The weekly benefit amount to be paid to employees varies according to salary level and when the injury/sickness was sustained. The state disability insurance program will provide the funds for this paid disability leave with California employees bearing the brunt of these additional costs.

Vacations and Vacation Pay

An employer is not obligated to provide vacations for employees, but rights to vacation may arise by contract, employer policy, practice, or collective bargaining agreements. Vacation benefits are treated as wages under California law.

When an employee is terminated the employee is entitled to payment for all vested vacation time. Labor Code section 227.3 provides:

- *Unless otherwise provided by a collective-bargaining agreement, whenever a contract of employment or employer policy provides for paid vacations, and an employee is terminated without having taken off his vested vacation time, all vested vacation shall be paid to him as wages at his final rate in accordance with such contract of employment or employer policy respecting eligibility or time served; provided, however, that an employment contract or employer policy shall not provide for forfeiture of vested vacation time upon termination. The Labor Commissioner or a designated representative, in the resolution of any dispute with regard to vested vacation time, shall apply the principles of equity and fairness.*

In a California Supreme Court case entitled *Suastez v. Plastic Dress-up Co*. (1982) 183 Cal. Rptr. 846, the Court dealt with a situation where an employee was entitled to a paid vacation under the company policy at the time of the anniversary of employment. The company argued that under its vacation policy employees were not eligible for any vacation pay unless they were still employed on the anniversary of the day they began work. Suastez argued that an employee who works for some part of the year has a "vested" right to a proportionate share of vacation pay. The court agreed with Suastez and stated that vacation pay is simply a form of deferred compensation, similar to pension or retirement benefits. The court held that vacation pay "vests" as it is earned and that the company's requirement of employment on the anniversary date cannot prevent the right to pay from vesting. The court concluded that a proportionate right to a paid vacation "vests" as the labor is rendered and that on termination of employment the employer is required to pay the employee in wages for a pro-rata share of his or her vacation pay.

Significantly, the broad holding of the *Suastez* case, above, was limited by a Court of Appeal decision entitled *Boothby v. Atlas Mechanical, Inc.* (1992) 8 Cal.Rptr.2d 600. In *Boothby*, the court held that an employer could permissibly adopt a "no additional accrual" policy, as opposed to an impermissible "use it or lose it" vacation policy. Thus, an employer may validly declare "a level beyond which additional vacation time [will] no longer accrue." This would "prevent additional vacation time from vesting after a certain level [has] been reached." Therefore, under the principle announced in *Boothby*, an employer may adopt a "no additional accrual" policy, which would limit the employer's potential liability for vacation pay to payment for the maximum amount of accruable vacation time set by the employer.

The issue of vacation pay was also addressed in the court decision of *Sequeria v. Rincon-Vitova Insectaries, Inc*. (1995) 38 Cal.Rptr.2d 264. In *Sequeria,* a former management employee sued his former employer for payment of all unused vacation time he accumulated over the twelve years he was employed. The court held that the former employee's cause of action for accumulated unused vacation time accrued, for purposes of the four year statute of limitations, as soon as the employee earned the vacation and therefore, he could only recover compensation for unused vacation he earned during the four years before his termination. In so holding, the court held that this did not result in a forfeiture of the former employee's vacation time in violation of Labor Code section 227.3 because the employer placed no penalty on the employee's choice to accumulate vacation time and the employer permitted the employee to take it any time he designated to do so while he was under contract with the firm. Because the employer did not exact a "use it or lose it" ultimatum, the employee suffered no forfeiture and no equitable tolling of the four year statute of limitations occurred.

EXAMPLES

(A) An employee receives, and in previous years, takes, a 2 week paid vacation each year, which accrues on the anniversary date of his or her employment. Prior to using any of the current year's vacation time, the employee is terminated six months prior to his or her anniversary date. He or she would be entitled to be paid (in the form of vacation pay) 1 week's wages, even though by agreement or policy no vacation rights would have accrued or vested until the anniversary date.

(B) An employee receives, but never takes, a 2 week paid vacation, for each year of his or her

employment. The employer has a policy that an employee is precluded from accruing more vacation time after two weeks of unused vacation time has been accumulated. In the event the employee is terminated, regardless of how many years the employee has worked for the employer, the most the employee is entitled to be paid, in the form of vacation pay, is two weeks' wages.

CAUTION

REGARDING VACATION PAY ON TERMINATION: The California Supreme Court case cited above and Labor Code section 227.3 both deal with the case where an employee is discharged. However, following the rationale of the Supreme Court case that a proportionate right to a paid vacation "vests" as the labor is rendered, it follows that an employee should be paid for a prorata share of his or her vacation pay in cases of voluntary termination as well as involuntary termination. Failure to make such a payment might subject an employer to the penalties mentioned in Labor Code section 203 above. The Suastez case may not apply where there is a collective bargaining agreement.

Time Off for Voting

If an employee does not have sufficient time outside of working hours to vote at a state-wide election, the employee may, without loss of pay, take off enough working time which when added to the voting time available outside of working hours will enable him or her to vote. The amount the employee can take off without loss of pay is limited to two hours. Also, the time off for voting shall be only at the beginning or end of the regular working shift, whichever allows the most free time for voting and the least time off from the regular shift. If the employee on the third working day prior to the day of the election, knows or has reason to believe that time off will be necessary for the employee to be able to vote on election day, the employee shall give the employer at least two working days notice that time off for voting is desired. (See Elections Code section 14000.)

At least 10 days before every state-wide election, every employer must keep posted conspicuously at the place of work, where it can be seen as employees come or go, a notice setting forth the provisions of Elections Code section 14000 referred to immediately above. (See Elections Code section 14001.)

No person shall be suspended or discharged from any service or employment because of absence while serving as an election officer on election day. The employees are not, however, entitled to pay for absence to serve as an election officer. (See Elections Code section 12312.)

Service of Employee as Juror or Witness

An employer may not discharge or in any manner discriminate against the employee for taking time off to serve as required by law as a juror or as a witness in court if the employee, prior to taking the time off, gives reasonable notice to the employer that he or she is required to appear in court.

An employee who is discharged, threatened with discharge, demoted, suspended, or in any other manner discriminated against, for taking time off as a juror or to appear in court as a witness will be entitled to reinstatement and reimbursement for lost wages and work benefits caused by any acts of the employer. An employer can be guilty of a misdemeanor if there is a willful refusal to hire, promote, or otherwise restore an employee whose eligibility has been determined by specified procedures. (See Labor Code section 230.)

The employer has no duty to pay an employee for hours of work missed if the employee serves as a juror or is called as a witness.

Leave for Crime Victims

California law provides an unpaid leave for an employee who is the victim of a crime or who is related to a crime victim in order to attend judicial proceedings related to the crime. Employees may file a complaint with the Labor Commissioner to enforce this right. (See Labor Code section 230.2.)

Military Service

It is a misdemeanor to discriminate against, discharge from employment or refuse to hire any person because of membership in any state or United States military or naval force for performance of an ordered military duty or training. (See Military and Veterans Code section 394.)

Any employee who is a member of the Reserve Corps of the Armed Forces of the United States or of the National Guard or the Naval Militia is entitled to a temporary leave of absence without pay while engaged in military duty ordered for purposes of military training, drills, encampment, naval cruises, special exercise (or the like, as such member), provided certain requirements are met. Dealers should contact competent employment legal counsel to determine what rights a member of the military may have in any given circumstances. (See Military and Veterans Code section 394.5.)

Family leave is also available for military service. On January 28, 2008, President Bush signed into law the National Defense Authorization Act for FY 2008 (NDAA), Public Law 110-181. Section 585(a)

of the NDAA amended the Family and Medical Leave Act to provide eligible employees working for covered employers two important new leave rights related to military service:

(1) New Qualifying Reason for Leave. Eligible employees are entitled to up to 12 weeks of leave because of "any qualifying exigency" arising out of the fact that the spouse, son, daughter, or parent of the employee is on active duty, or has been notified of an impending call to active duty status, in support of a contingency operation.

(2) New Leave Entitlement. An eligible employee who is the spouse, son, daughter, parent, or next of kin of a covered servicemember who is recovering from a serious illness or injury sustained in the line of duty on active duty is entitled to up to 26 weeks of leave in a single 12-month period to care for the servicemember (which can include current servicemembers as well as some veterans). This provision became effective immediately upon enactment. This military caregiver leave is available during "a single 12-month period" during which an eligible employee is entitled to a combined total of 26 weeks of all types of FMLA leave. Additional information on the military leave provisions of the FMLA are available at http://www.dol.gov/whd/fmla/ index.htm.

Independent Contractor or Employee

In recent years, a number of California dealers have come under scrutiny by the California Employment Development Department ("EDD") for the nonpayment of unemployment taxes and other taxes. These audits have been triggered because unemployment compensation claims were filed against dealers who had not reported the person claiming benefits as an "employee", and therefore had not reported the applicable "wages" and the required deductions. The dealers claimed that these persons were "independent contractors."

The most recent examples of these audits have occurred with respect to "drivers" who are engaged by various dealers to shuttle cars from place to place. The dealer would pay these drivers directly through some form of fixed fee, perhaps with some expenses added. Often these drivers are retired individuals who wish to pick up some additional income without having taxes taken out of their monies, and thus avoid losing some Social Security benefits. The dealer often regards these persons as "independent contractors" and does not treat the monies paid as wages. When such an individual is released, laid off, or terminated, they might file for unemployment benefits against the dealer who let them go. When the unemployment office notes that the person has no reported wages, they send the auditors to look at the employer's wage records regarding that individual and also any others similarly treated. If EDD determines (as it usually does) that the individuals are employees, the various state income taxes and unemployment contributions, plus penalties and interest, are due. This audit usually covers a state income tax assessment and could also lead to a federal tax audit. The monies can be significant, but are often not so large to permit the dealer to hire counsel to put up a real fight. It appears that these agencies are looking for additional revenue in these days of tight budgets.

Whether someone is an "employee" or an "independent contractor" is frequently tested in various agencies and courts. There is at times a presumption that someone providing services is doing so as an "employee" and the burden of proving otherwise is often on the employer. The most important factor is the right to control the manner and means of accomplishing the result desired. If a dealer has the authority to exercise complete control over the details of the services performed, then the person is an employee. Even a written contract can be disregarded if the facts point otherwise. An independent contractor relationship is more likely to be found when the person performs services for many businesses, the work performed is a traditionally distinct business, the person has particular skills (as opposed to unskilled work), and the person uses their own equipment or supplies. The IRS has a recently updated multi--factor test it uses to determine independent contractor status. This IRS publication can be obtained from the IRS website.

California Labor Code section 226.8 and section 2753 include new increased penalties for willfully misclassifying employees as an "independent contractor." "Willful misclassification" means "avoiding employee status for an individual by voluntarily and knowingly misclassifying that individual as an independent contractor." Employers are also prohibited from attempting to assess charges or fees against the misclassified worker if doing so would not be permitted had the classification been accurate. Employers are now subject to penalties of up to $25,000 per violation. In addition, if an employer is found guilty of willful misclassification by the Labor and Workforce Development Agency or a court, the employer will be required to prominently post information about the violation for two years on its website, and in an area available to both employees and the general public.

The misclassification of individuals as "independent contractors" rather than "employees" can not only lead to liability for back taxes, but can also have workers' compensation implications. "Em-

ployees" who are injured while performing their services are limited to workers' compensation benefits in recovering against the dealer. This will drive up workers' compensation costs, but protect a dealer from being sued for damages in civil court.

If a dealer classifies the person as an "employee," the dealer can usually avoid providing the employee with fringe benefits by using the appropriate written designation--such as temporary or part-time status. These competing costs and considerations must be carefully evaluated.

In the cases of the "drivers" mentioned above, the EDD found that the factors pointed more to employee status than to independent contractor status. Therefore, any dealers who employ various "independent contractors" who are performing services which are often performed by "employees" and who lack some or all of the factors set forth in the IRS guidelines, should review this situation and consult counsel.

Enforcement of Wage and Hour Laws

Wage Theft Prevention Act

In addition to being subject to a civil penalty, any employer who pays or causes to be paid to any employee a wage less than the minimum fixed by an Order of the Commission shall be subject to paying restitution of wages to the employee. It is also a crime (a misdemeanor) if an employer willfully violates specified wage statutes or Orders, or willfully fails to pay a final court judgment or final order of the Labor Commissioner for wages due.

Employers must provide a NOTICE at the time of hiring an employee (on a template to be developed by the Labor Commissioner) in the language the employer normally uses to communicate employment-related information, which must include the following information:

(1) The rate or rates of pay, and whether paid by the hour, shift, day, week, salary, piece, commission, or otherwise, including any applicable overtime rates;

(2) Any allowances claimed as part of the minimum wage, including meal or lodging allowances.;

(3) The regular payday designated by the employer;

(4) The name of the employer, including any "doing business as"' names used;

(5) The physical address of the employer's main office or principal place of business, and a mailing office, if different;

(6) The telephone number of the employer;

(7) The name address, and telephone number of the employer's workers' compensation insurance carrier; and,

(8) Any other information the Labor Commissioner deems material and necessary.

Also, any time any of the information in the Notice changes, the employer must provide an updated notice within 7 days of the change, unless the changes are provided in a timely wage statement, or required by another law within the seven-day period.

The notice requirements do not apply to employees covered under an overtime exemption, or employees covered under a collective bargaining agreement, if the bargaining agreement governs wages, hours of work, and working conditions, provides for premium overtime wages, and has a base rate of pay at least 30% higher than the state minimum wage.

Employees may recover attorney's fees in enforcing a judgment for unpaid wages under Labor Code section 1194.3.

Additionally, civil and criminal penalties are available against employers who willfully fail to pay a final court judgment or final order of Labor Commissioner – this means jail time too – possibly up to a year. See Labor Code section 1197.2.

Employers are also now required to maintain payroll records at least 3 years, and the employer may not prevent an employee from keeping a personal time record of hours worked. (Labor Code section. 1174)

In addition to the crime and employer obligations imposed by this law, the Labor Code provides for other work-related standards and duties that, upon violation, are subject to specified penalties.

Penalties

Section 20 of Wage Order 7-2001 provides that any violation of the Order is a violation of the Labor Code and is punishable by fines and other civil penalties.

Furthermore, Labor Code section 553, imposes criminal sanctions against any person who violates sections 510 through 558 of the Labor Code, holding that person guilty of a misdemeanor. Similarly, additional penalties are codified elsewhere in the Labor Code.

CAUTION

REGARDING PRIVATE ATTORNEYS GENERAL: The Labor Code creates "private attorneys general" by empowering any employee to recover statutory penalties under the Labor Code against their

employer on behalf of all affected current and/or former employees. The Legislature also increased many of the Labor Codes' penalty provisions by enacting AB 276 (Koretz). For example, the penalty for an employer who fails to pay a wage or unlawfully withholds a wage was increased from $50 to $100 for the first violation and from $100 to $200 for a subsequent violation. SB 796 went one step further and established a similar penalty for every section of the Labor Code that previously did not provide one. Under the Private Attorney General Act (PAGA), Labor Code Section 2699 et al., an employee may bring a civil action for violation of the Labor Code and shall be entitled to 25 percent of the penalties recovered plus attorney's fees. Fifty percent of the penalties recovered shall be paid by the employer to the General Fund and another 25 percent will be paid to a fund for employer/employee education about rights and obligations under the new Act. There is no requirement in this new Act that the employee satisfy any "class action" requirements to bring suit. Moreover, it would appear that an employee may bring suit alleging numerous different Labor Code violations although the employee need only have suffered from one of the violations. Recent amendments require the exhaustion of administrative remedies prior to filing a civil action with respect to most violations. Dealers should contact labor and employment counsel immediately upon receiving any notice from an employee, ex-employee, an attorney or the Labor Commissioner claiming a violation of the Labor Code.

Labor Commissioner Enforcement of Wage Claims

(Labor Code sections 98 et seq., and Title 8, Code of Regulations, Sections 13500-13520.)

What complaints can the Labor Commissioner investigate?

The Labor Commissioner has the authority to investigate employee complaints and may provide for a hearing in any action to recover wages, penalties, and other demands for compensation. The Labor Commissioner may also enforce orders of the Industrial Welfare Commission relating to compensation and claims of retaliation for reporting violations of the Labor Code.

How are proceedings for wage claims commenced?

A complaint is initiated by the employee's filing of a complaint in any District Office of the Division of Labor Standards Enforcement of the Department of Industrial Relations of the State of California.

How and when is the employer notified?

Within 30 days of the filing of a complaint, the Labor Commissioner notifies the parties whether a hearing will be held or whether no further action will be taken on the complaint. When a hearing is set, a copy of the complaint, together with a notice of the time and place of the hearing, is served on the parties, either personally or by certified mail. Many claims are also set for an informal conference, which is essentially a settlement conference that takes place prior to a formal hearing. If the claimant is not satisfied, a formal hearing will be set.

How does the employer answer the complaint?

Within 10 days after service of the notice and the complaint on the employer, the employer may file an answer with the Labor Commissioner in such form as the Labor Commissioner may prescribe, setting forth the particulars in which the complaint is inaccurate or incomplete and the facts upon which the employer intends to rely. At the hearing, evidence on matters not set forth in the employer's answer shall be allowed only on such terms and conditions as the Labor Commissioner imposes. Consequently, although an answer is not required in order for the hearing to go forward, it may be advisable for the employer to file an answer with the employer's contentions in order that evidence on those contentions be allowed in the hearing. There may be some times in which a determination will be made not to file a written answer, especially if the complaint fails to indicate the grounds on which the claim is based and the employer has no idea what the employee's contentions are.

Can the employer still appear at the hearing if the employer fails to provide a written answer to the complaint?

Yes. Labor Code section 98(f) provides that if the defendant fails to appear or answer within the time allowed, no default shall be taken against it, but the Labor Commissioner shall hear the evidence offered and shall issue an order, decision, or award in accordance with the evidence.

How are the hearings conducted?

The employer will be given the opportunity at the scheduled hearing to present any relevant evidence, call witnesses and cross-examine witnesses testifying against it. The employer can apply to the Labor Commissioner before the hearing for the issuance of subpoenas to compel the attendance of necessary witnesses and to produce documents.

The employer should bring all documents that support its position. An employer who intends to introduce business records into evidence should have at the hearing a person who can explain how such records were prepared.

The hearing is audio-recorded and need not be conducted according to technical rules relating to

evidence and witnesses. Any relevant evidence is admitted if it is the sort of evidence on which reasonable persons are accustomed to rely in the conduct of their affairs. Oral evidence is taken on oath or affirmation. Each party has the right to call and examine witnesses; to introduce exhibits; to cross-examine opposing witnesses on any matter that is relevant to the issues even though the matter was not covered in the direct examination; to impeach any witnesses regardless of which party first called them to testify; and to rebut the evidence against him or her.

Do I need an attorney for the hearing?

You do not have to be represented by counsel; however, you may use an attorney if you prefer. If you are dealing with a particularly complicated issue, you should consult with employment counsel.

Who is the Hearing Officer?

The Hearing Officer is a Deputy Labor Commissioner who has had experience in the field of labor relations. Deputy Labor Commissioners are generally not attorneys.

When is the decision rendered?

Within 15 days after the hearing is concluded, the Deputy Labor Commissioner hearing the case files the decision, including a summary of the hearing, and the reasons for the decision, and causes a copy to be served on the parties (but it often takes longer).

Is the Hearing Officer's decision subject to review at the administrative level?

Generally no. The usual recourse is to appeal to the courts as set forth below. The Labor Commissioner can stay execution of a judgment for good cause, although such an occurrence is rare.

Can the employer appeal the Labor Commissioner's decision?

Yes. Section 98.2 of the Labor Code allows for an appeal of the decision of the Labor Commissioner. Within 10 days after service of the notice of a decision, either party may appeal the decision to the appropriate Justice, Municipal, or Superior Court, where the entire case will be heard anew. You should normally seek the assistance of your attorney because a corporation cannot appear in a Municipal or Superior Court without counsel. The appeal is accomplished by filing an appeal request with the court and serving a copy on the Labor Commissioner. To calculate the date of service of the decision on the employer, you should count ten days from the date of the decision or the date the decision was mailed to you. A California Supreme Court case entitled *Pressler v. Donald L. Bren Co*. (1982) 187 Cal. Rptr. 449, held that the time limits set forth in section 98.2 of the Labor Code were jurisdictional and that no excuses would be acceptable to allow a late filing. This code section allows for an extra five (5) days if the order, decision, or award is served by mail to an address in California, an extra ten (10) days if the address is outside the state of California, and an extra 20 days if the address is outside the United States. See *Clavell v. North Coast Business Park* (1991) 283 Cal.Rptr. 419. An employer that files an appeal now must also post an "undertaking" or bond for the full amount of the Order, Decision, or Award with the reviewing court.

Once the appeal has been filed with the court, the court will set the hearing for trial of the questions involved. Pending the court hearing, the parties may submit written questions to each other which require answers under oath, may take depositions of parties and witnesses, and may utilize all of the procedures attorneys normally use in preparing for a trial.

While it may be prudent to appeal some Labor Commissioner decisions and try the case before a neutral state court judge, employers should realize that typically the employee will be provided a free attorney from the Labor Commissioner's legal staff. If the decision from the judge is again favorable to the employee, the dealer may be required to pay the attorney's fees of the other side as well as the judgment (and presumably the dealer's own attorney's fees).

In 2002 the California Supreme Court in the case of *Smith v. Rae-Venter Law Group,* 29 Cal.4th 345(2002) set aside a rule that has been in place since 1984, and held that a party appealing a wage claim decision by the State Labor Commissioner must pay the other side's attorneys' fees and costs unless the trial court's decision is "more favorable" than the ruling of the commissioner. However, in another piece of 2003 legislation, former Governor Davis signed AB 223 which reverses this ruling and requires the employer to pay the other side's attorney's fees if the employee still recovers any judgment in his/her favor, even if for less than the Labor Commissioner awarded. (See Labor Code section 98.2.)

What happens if the employer does not appeal the Labor Commissioner's decision?

If the employer does not appeal the Labor Commissioner's decision, the decision becomes final and may be enforced as a judgment by the appropriate Municipal or Superior Court.

Arbitration of Wage and Hour Claims

In the last decade, the current case law in California regarding arbitration of wage claims is favorable for dealers. The California Supreme Court and the United States Supreme Court have both handed

down pro-arbitration decisions. For example, in *Little v. Auto Stiegler, Inc. (2003) 29 Cal. 4th 1064* the Supreme Court of California dealt with an appeal by a terminated employee who refused to abide by the arbitration agreement he executed at his former employer Auto-Stiegler. The Supreme Court ruled that the arbitration agreement was generally legal and enforceable, but added two conditions. First, the court modified the appellate provisions in the agreement. In that regard the arbitration agreement in this case was a rather old version of the CNCDA arbitration agreement. Dealers who are using arbitration agreements in their application forms and handbooks should ensure that they are using the *latest* language. Second, the court extended its earlier ruling in *Armendariz v. Foundation Health Pyschcare Services, Inc.* to require that the employer pay all the costs of the arbitration. In Armendariz, which was a discrimination case, the Court ruled that the employer must pay the arbitration costs so that the employee is in the same position as though he sued in a taxpayer paid in state court.

The Auto Stiegler case involved a Service Manager who claimed that he was terminated in violation of public policy, and in particular that he was terminated for reporting warranty fraud. Because of the importance of this arbitration issue to California dealers, CNCDA filed an amicus brief ("friend of the court brief") urging the court to uphold the dealer's arbitration agreement, which generally was the ruling.

Consequently many California dealerships are utilizing arbitration agreements covering their employees which are contained in a variety of employment documents such as the application form, a separate "At-will and Arbitration Agreement" or in their Employee Handbook. This arbitration procedure is authorized under the Federal Arbitration Act. In such a matter (for example, a claim for overtime pay or additional commissions) it is quite likely that the Labor Commissioner has no jurisdiction to hear and decide such a dispute. This is the holding from the lead California decision on this question, *Baker v. Aubry*, (1989) 216 Cal.App.3d 1259. The Labor Commissioner dislikes this case and often ignores this legal precedent. In such a case, the dealership should consult with their counsel to review the feasibility of a court filing to require the matter to be submitted to binding arbitration.

Many dealers who have filed court papers seeking arbitration of wage and hour claims have successfully obtained court orders requiring arbitration. However, it is critical that if there is an arbitration agreement in place, that the dealership consult counsel promptly and decide whether to assert the arbitration obligation early in the proceedings before the Labor Commissioner. Otherwise, there is a possibility that the dealership might be deemed to have waived its right to have the matter heard in arbitration. In addition, in a number of matters where dealerships have succeeded in having wage and hour matters ordered into arbitration, the claimant simply abandons the claim.

One of the most controversial issues regarding the arbitration of wage and other employment-related claims is whether class action lawsuits may be pursued in arbitration when the employee has signed an arbitration agreement governed by the Federal Arbitration Act (FAA). The arbitration agreement made available by CNCDA, through The Reynolds and Reynolds Company, to members is expressly governed by the FAA.

In 2011, the U.S. Supreme Court in *AT&T Mobility, LLC v. Concepcion* (2011) 131 S. Ct. 1740 held that class-action claims could not be pursued by an employee in binding arbitration where the arbitration agreement was governed by the FAA. However, despite this seemingly clear ruling by the Supreme Court, California courts and plaintiffs' attorneys continue to come with "creative" arguments and results-oriented decisions in an attempt to skirt the *Concepcion* decision and thwart the enforceability of arbitration agreements in certain class-action situations. The law in this area continues to evolve, so any dealer facing an employment-related class-action lawsuit should consult with employment counsel.

WRONGFUL TERMINATION AND DISCRIMINATION

Chapter 16

Contents

WRONGFUL TERMINATION AND DISCRIMINATION

OVERVIEW: This discussion will cover legislative, regulatory, and judicial restrictions on the right of employers to discharge employees. For a discussion of payment to employees who are discharged or who terminate their employment, see Management Guide chapter on Wages and Hours. Generally the law has provided that, absent some agreement to the contrary, an employer can terminate an employee with or without cause at any time. The employer-employee relationship was said to exist "at will" of the employer and employee. This general rule has been codified in California by Labor Code section 2922 which provides as follows: "An employment, having no specified term, may be terminated at the will of either party on notice to the other. Employment for a specified term means an employment for a period greater than one month." There are many exceptions, however, to the right of an employer to discharge an employee "at will." Some of the exceptions are found in legislation and regulations. Others are found in court decisions which in recent years have been gradually eroding away the "at will" doctrine.

Judicial Restrictions on Discharge of Employees

The concept that an employer may discharge an employee, with or without cause, has been eroded by the courts. In addition to the legislative and regulatory exceptions discussed below, the courts have been rapidly expanding the theory of wrongful discharge of employees. Cases of wrongful discharge are an explosive area in the law and there is an ever-expanding number of such cases being brought against employers. These cases are almost always decided by juries who may be sympathetic with the claimant.

General Principles - Wrongful Discharge Cases

There are currently three principal theories under which a terminated employee might sue to challenge a discharge: (1) violation of public policy, (2) breach of some express or implied contract, and (3) breach of the covenant of good faith and fair dealing.

Violation of Public Policy

Many courts have held employers liable for discharging employees in violation of "public policy." Such a finding, moreover, carries exposure to compensatory and punitive damages. The California Supreme Court has made it clear, however, that a discharge must violate a truly **public** policy as set forth in a statute, constitutional provision or administrative regulation. See *Green v. Ralee Engineering Company* (1998) 78 Cal.Rptr.2d 16. It is not enough for an employee to claim that the discharge violated a statute involving purely private interests. If an employee claims that his/her potential termination violates some sort of legal principle, care should be exercised and it would be prudent to consult counsel.

The cases in which California courts have recognized a separate tort cause of action for wrongful termination in violation of public policy generally fall into four categories, where the employee is discharged for: (1) refusal to violate a statute; (2) performing a statutory obligation; (3) exercising (or refusing to waive) a statutory or constitutional right or privilege; or (4) reporting an alleged violation of a statute of public importance. . . ." *Lagatree v. Luce, Forward, Hamilton & Scripps* (1999) 88 Cal.Rptr. 664. It is important to note that where an employee complains of an alleged unlawful act and is later terminated from employment, the employee must only prove that he/she had a good faith dispute that the employer was violating the law; it is not necessary to prove that the employer was actually violating the law at the time of the termination. Thus, even where the employer may not be violating the law, an employer is still at risk for terminating an employee based on the employee's good faith complaints. Dealers should also be aware that claims may also be based on adverse employment actions short of termination, such as demotion, failure to promote, etc.

Express or Implied Contracts

The employment-at-will principle will be overcome by any express or implied agreement that the employee will be employed for a definite period of time or that he or she will not be discharged except

for cause. Such an agreement need not be in writing, and need not be expressly stated. In the latter situation, an "implied-in-fact" contract can arise, which is as enforceable as an express contract.

An oral employment agreement to terminate only for cause might be found where a supervisor makes specific statements to an employee about job security; for example, telling an employee that he or she will remain employed as long as he or she "does a good job."

In addition, the following factors may give rise to a finding that an "implied" agreement to discharge only for cause exists:

- Longevity of employee's service (over six years with the same employer has been held to be significant);
- A steady record of commendations, promotions and pay increases;
- A lack of negative evaluations or warnings of deficiency;
- Company policies and/or practices indicating that employees are discharged only for cause;
- Oral assurances of job security; and
- Industry practices.

In *Lazar v. Superior Court* (1996) 12 Cal.4th 631, the California Supreme Court held for the first time that an employer may be liable for fraudulently inducing an employee to quit his prior job and move his residence to work for the employer. In that case, the employee quit his job in New York and moved to work for the employer in California. The employer allegedly misrepresented material facts regarding the job and later terminated the employee. The Supreme Court held that, even though the employer-employee relationship was at-will, the employee had an independent cause of action against the employer for fraud because the fraudulent acts occurred outside the employment contract itself. Therefore, dealers should be cautious not to make unwarranted promises to prospective employees during the recruitment process and before the employment relationship begins.

The *Lazar* case did not, however, address the situation where a written at-will agreement controlled the nature of the applicant's potential employment. Thus, the issue remained as to whether an applicant covered by a written pre-employment "at will" agreement could maintain a cause of action when the applicant was not hired after relying on the job offer. A more recent case recognized that it was the first to squarely address the issue. *Toscano v. Greene Music* (2004) 21 Cal.Rptr.3d 732. *Toscan*o addresses "Whether a plaintiff who resigns from at will employment in reliance on an unfulfilled promise of other [at will] employment may recover, under a promissory estoppel theory, reliance damages based upon wages lost from his or her prior employment" Id. at 736. The *Toscano* Court held that a plaintiff could recover the difference in what he was making at his former employer and what he made at the new employment as long as the damages are not speculative or remote.

Breach of the Implied Covenant of Good Faith and Fair Dealing

Every contract contains an implied covenant of good faith and fair dealing, and employment contracts are no exception. This covenant requires that neither party to the contract do anything that will deprive the other of the benefits of the agreement.

For a time courts held that plaintiffs prevailing on claims for breach of the implied covenant of good faith and fair dealing were entitled to recover compensatory damages (e.g., mental anguish, embarrassment) and punitive damages. However, the California Supreme Court in *Foley v. Interactive Data Corp.,* (1988) 254 Cal.Rptr. 211, held that such damages could not be recovered for a breach of the implied covenant of good faith and fair dealing in the employment context, and that an "at-will" employee may not use this theory to challenge a discharge as being without cause.

The California Supreme Court in *Guz v. Bechtel Nat'l, Inc.,* 24 Cal.4th 317 (2000) also ruled that in light of specific "at will" language in the employment agreement, a claim for breach of the covenant of good faith and fair dealing would be unavailable except in very limited circumstances, particularly where the employee could claim that his termination was for the purpose of depriving him of earned compensation under the agreement.

While plaintiffs can no longer obtain punitive damage awards for breach of the implied covenant of good faith and fair dealing, plaintiffs may still seek punitive damages related to discharges on other theories, such as intentional or negligent infliction of emotional distress, defamation, or civil rights violations.

NOTE

ON WRITTEN AT-WILL AGREEMENTS: In 1995 a California Court of Appeal issued a decision concerning written at-will agreements. In that case, the employee had signed a written at-will agreement wherein the employee acknowledged that her employment was at-will and could be terminated at any time without cause. The employee was ultimately terminated and thereafter filed a lawsuit against her employer alleging that the employer violated an implied-in-fact contract to terminate her only for good cause. The employee also alleged that the termination violated

the covenant of good faith and fair dealing. The Court of Appeal disagreed with the employee and ruled in favor of the employer, holding that the signing of the express at-will agreement precluded the existence of an implied-in-fact contract. In turn, the absence of an implied-in-fact contract precluded a breach of the covenant of good faith and fair dealing. See Camp v. Jeffer, Mangels, Butler and Marmaro (1995) 41 Cal.Rptr.2d 329.

Several other courts have reached similar conclusions. Therefore a dealer can provide substantial defenses to wrongful discharge claims (stemming from the theories of implied contract and/or breach of the implied covenant of good faith and fair dealing) by having all employees execute detailed at-will agreements. (See discussion of the at-will agreement form developed by CNCDA in the section entitled "At-Will/Arbitration Agreements" in the chapter entitled Other Important Topics.) Note however that an at-will provision is not a bar to claims for wrongful discharge in violation of public policy or to the various discrimination and statutory claims.

Discharges For Cause

Of course, even if employees are not "at will", employees may be discharged for "cause," even under the theories described above, absent some specific agreement or public policy to the contrary. The question then is what constitutes "cause." Ordinarily, an employer will have cause for discharging an employee who engages in misconduct or violates the employer's rules or policies. However, the burden of proving that "cause" existed for a discharge is generally placed on the employer. It is therefore important that work rules and policies be clearly stated and understood by all employees. On the other hand, any set of work rules or policies should allow an employer enough flexibility to account for unusual situations. Moreover, in light of the employer's burden of proving "cause," all facts and circumstances surrounding a discharge should be carefully investigated and documented. This would normally include interviewing witnesses, reviewing the employee's work history and reviewing the history of any similar situations, as well as ensuring that the reasons for a discharge are accurately communicated to the employee and that the employee have some opportunity to provide his/her side of the story.

Importance of Legal Counsel Before Discharge

If an employer has any indication that a wrongful discharge claim may be made, or there is some question whether the discharge is proper, the employer should first consult with its attorney before discharging the employee. This is particularly true for cases when employees have longevity. The area of wrongful discharge is a rapidly evolving area of the law and the employer should take all precautions to avoid exposure to potentially large judgments.

Drug Testing and Discharges for Workplace Drug Use

California state courts have placed some important restrictions upon the extent to which an employer may require employees to submit to drug testing or discharge them for refusing to do so. These restrictions stem from the right to privacy set forth in the California Constitution, which applies to private as well as public employers. As such, with respect to drug testing of current employees, an employer must have a "compelling interest" in testing to justify the intrusion upon an individual's privacy rights caused by drug testing.

Although the California Supreme Court in *Hill v. National Collegiate Athletic Association* (1994) 26 Cal.Rptr.2d 834, has rejected the automatic application of the "compelling interest" standard of testing right to privacy violations in favor of a more fact-oriented general balancing test (the decision evaluated an NCAA drug testing program and did not address permissible drug testing in a nongovernmental employment setting), current law still mandates that private employers demonstrate a compelling interest in performing drug testing on current employees, and it is essential that dealers use caution and consult counsel before implementing a drug testing plan or discharging employees for failing or refusing to take a drug test. Courts are split on whether employers who discharge employees for refusing drug tests have violated the public policy contained in California's constitutional privacy provision.

There are several different forms of drug testing that might be utilized, and different legal standards apply to each.

Pre-Employment Testing

Requiring that **applicants for employment** undergo and pass a drug test has been held not to violate an applicant's right to privacy, where the employer can show a "reasonable" interest in conducting such testing (i.e., to enforce its policy of a drug free workforce) and where procedural safeguards are met so that the dignity of applicants is protected

in the sample collection process, reliable testing methods are utilized, and test results are kept confidential. Recent case law has suggested indirectly, that all pre-employment drug tests must be performed only after all other prerequisites to hire have been satisfied in order to avoid violating the federal and state anti-discrimination laws.

Reasonable Suspicion Testing

Testing of **current employees** is permitted where the employer can show that it has reasonable suspicion that an employee is using drugs or is impaired. Actual observation of employee drug use would obviously satisfy this test, but such is not required. What might constitute "reasonable suspicion" where employee drug use is not actually observed is presently unsettled. Until the California courts issue a definitive ruling in this area, employers are advised to proceed with caution and with advice of counsel.

Random Testing

Requiring that employees submit to random drug testing is not permitted under current California law.

Preventative Measures

There are a number of preventative measures an employer can take to minimize the exposure to wrongful discharge claims.

- The strongest preventative measure is to obtain an agreement in writing from the employee acknowledging that his or her employment is terminable at will and that the employer has the right to terminate the employee at any time for any reason whatsoever, with or without good cause. Any such agreement should state that no implied or oral agreements contradicting the express language of the agreement are valid, that no person is authorized to amend the agreement other than a specifically designated person (e.g., the owner, General Manager, etc.), and that the agreement is the entire agreement of the parties on the subject of at-will employment. This agreement should also state that no written agreements may contradict the language of the agreement unless such an agreement has been signed by a specifically designated person (the owner, General Manager, etc.). Your attorney should approve the language of any written agreement giving you the right to terminate at-will. Such an agreement should be separate from any agreement in an employment application; however, your employment applications should also contain at-will language.
- Avoid any promises of job security in the hiring process.
- Make sure that employment applications, employee handbooks, procedural and policy memoranda, or any other written documents, do not create an express or implied promise of job security.
- Educate managers in this area and make sure they do nothing to create express or implied promises of job security.
- If you have established a formal progressive discipline procedure, ensure that all steps are properly followed and thoroughly documented.
- Prior to the discharge of any employees, top management should review the facts and circumstances of the discharge.
- If the employee is paid extra, non-required compensation upon discharge (i.e., severance pay), obtain from the employee a release from wrongful discharge and discrimination claims approved by your attorney.

Legislative and Regulatory Restrictions

The following are some of the more important statutes and regulations as they affect automobile dealerships. Some of the federal laws below only apply if you have the minimum number of employees required by the particular law. Some of the federal laws below also only apply to employers who are government contractors. Both California and federal law should be reviewed because they sometimes have different requirements in the same area. If you have a question whether a particular law applies to your dealership, you should consult with your attorney.

Unlawful Discharge - Federal Legislation and Regulations

Civil Rights Act of 1964 - Race, Color, Religion, Sex, or National Origin

The Civil Rights Act of 1964 provides that it is an unlawful employment practice for an employer to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his or her compensation, terms, conditions, or privileges or employment, because of such individual's race (including ancestry), color, religion (or sincerely held belief), sex, or national

origin. See 42 U.S.C. section 2000e2(a)(1). This Act also makes it an unlawful employment practice for an employer to discriminate against any of his or her employees or applicants for employment because such an employee has opposed any practice made an unlawful employment practice by the Civil Rights Act relating to equal employment opportunities, or because the employee has filed a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under the Act relating to equal employment opportunities. See 42 U.S.C. section 2000e-3.

Title VII's prohibition against sex discrimination was amended in 1978 to specifically cover pregnancy, childbirth and related medical conditions. As such, women affected by pregnancy, childbirth or related medical conditions must be treated the same for all employment-related purposes as other persons not so affected, but similar in their ability or inability to work. See the separate chapter in this Management Guide on Pregnancy Discrimination.

Title VII of the Civil Rights Act of 1964 applies to employers if they have 15 or more employees.

Age

The Age Discrimination in Employment Act prohibits an employer from failing or refusing to hire, from discharging, or from otherwise discriminating against any individual over the age of 40 with respect to compensation, terms, conditions, or privileges of employment. See 29 U.S.C. section 623 (a)(1). The Act applies to employers who have 20 or more employees, and provides for jury trials and liquidated damage awards.

Civil Rights Act of 1866

The Civil Rights Act of 1866 (42 U.S.C. section 1981) makes it unlawful to discriminate on the basis of race in making and enforcing contracts, including employment contracts. Successful plaintiffs may recover compensatory and punitive damages under this law. A recent ruling by the U.S. Supreme Court has restricted application of this law to hiring.

Civil Rights Act of 1991

The Civil Rights Act of 1991 allows victims of discrimination to recover damages for mental anguish and emotional distress, and in some cases punitive damages. Victims of discrimination also have the right to a jury trial.

Also, if an employer's employment practices cause a "disparate impact" on the basis of color, religion, sex, or national origin, the employer must show the practice is related to the job and consistent with a business necessity.

Under the Act, if race, color, religion, sex, or national origin is a motivating factor for discharge or other adverse action, then the action is unlawful even though the employer had other lawful motives. If the employer can show it would have taken the action anyway, in spite of the unlawful part of the motive, then damages against the employer are limited.

The Act provides for other limitations on damages against the employer.

Exercise of Rights to Collective Bargaining

The National Labor Relations Act provides that it is an unfair labor practice for an employer to interfere with, restrain, or coerce employees in the execution of their rights to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection. See 29 U.S.C. section 158(a)(1). The Act also provides that it is an unfair labor practice for an employer by discrimination in regard to hiring or tenure of employment or any other term or condition of employment to encourage or discourage membership in any labor organization, or to discharge or otherwise discriminate against an employee because he or she has filed charges or given testimony under the Act.

Garnishment for any One Indebtedness

Federal law provides that no employer may discharge any employee by reason of the fact that his or her earnings have been subjected to garnishment for any one indebtedness. See 15 U.S.C. section 1674. California law is similar to federal law as discussed below. A Ninth Circuit Court of Appeals case has examined the question concerning at what point an employee's earnings have actually been subjected to garnishment. The court held that earnings have been subjected to garnishment within the meaning of the federal statute only when they have actually been withheld from the paycheck of the employee. This means that service of the garnishment on the employer is not the point when "earnings have been subjected to a garnishment." The court did not reach the question of which point in the paycheck preparation cycle constitutes the withholding. The case is clear, however, that a garnishment has not occurred until such time as earnings have actually been withheld. It frequently happens that after an employer has received a garnishment notice the employee pays the debt and the garnishment is released. That situation would not be considered to have been a "garnishment" within the meaning of the federal statute. See *Donovan v.*

Southern California Gas Co. (9th Cir.) (1983) 715 F.2d 1405. See also the chapter in this Management Guide entitled Wages and Hours.

Occupational Safety and Health Act

The Occupational Safety and Health Act provides that no person shall discharge or in any manner discriminate against any employee because such employee has filed any complaint or instituted or caused to be instituted any proceeding under or related to the Act or has testified or is about to testify in any such proceeding or because of the exercise by such employee on behalf of himself or herself or others of any right afforded under the Act. See 29 U.S.C. section 660(c)(1).

In addition, the Secretary of Labor has promulgated a regulation that prohibits discrimination against an employee who refuses to work under conditions that the employee "reasonably believes" are unsafe. In order for this regulation to apply, the following factors must be present:

- The employee's refusal to work must be in good faith, and the employee must have no reasonable alternative.
- A reasonable person, under the circumstances then confronting the employee, would conclude that there is a real danger of death or serious injury.
- There is insufficient time, due to the urgency of the situation, to eliminate the danger through resort to regular statutory enforcement channels.
- Where possible, the employee must have sought from his or her employer, and been unable to obtain, a correction of the dangerous condition.

Employee Wage Complaints

Section 15(a)(3) of the Fair Labor Standards Act (29 U.S.C. section 215 (a)(3)) makes it unlawful for any person to discharge or in any manner discriminate against an employee because such employee has filed any complaint or instituted or caused to be instituted any proceeding under or related to the Act or has testified or is about to testify in any such proceeding, or has served or is about to serve on an industry committee.

Exercise of Employee Rights under ERISA

The Employee Retirement Income Security Act of 1974, commonly known as ERISA, provides that it is unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary:

- For exercising any right to which the employer is entitled under an employee benefit plan or under ERISA or related laws.
- For the purpose of interfering with the attainment of any right (i.e., vesting) the employer may become entitled to under a plan or under ERISA or related laws.

The Act further provides that it is unlawful for any person to discharge, fine, suspend, expel or discriminate against any person because he or she has given information or has testified or is about to testify in any inquiry or proceeding relating to ERISA or the Welfare and Pension Plans Disclosure Act. See 29 U.S.C. section 1140.

Service by Employee as Juror

Federal law provides that no employer shall discharge, threaten to discharge, intimidate, or coerce any permanent employee by reason of such employee's jury service, or the attendance or scheduled attendance in connection with any such services, in any court of the United States. Any employer violating this law is liable for the damages the employee suffers, may be required to reinstate the employee, and is also subject to a civil penalty of not more than $1,000 for each violation as to each employee. See 28 U.S.C. section 1875 and also the discussion below concerning California law on this subject.

Employee Involvement in Proceedings under Toxic Substances Control Act

No employer may discharge any employee or otherwise discriminate against any employee with respect to the employee's compensation, terms, conditions, or privileges of employment because the employee (or any person acting pursuant to a request of the employee) has commenced, caused to be commenced, or is about to commence or cause to be commenced a proceeding under the Toxic Substances Control Act, has testified or is about to testify in any such proceeding; or has assisted or participated or is about to assist or participate in any manner in such a proceeding or in any other action to carry out the purposes of the Act. See 15 U.S.C. section 2622(a).

Employee Involvement in Proceedings under Solid Waste Disposal Act

This Act provides that no person shall fire, or in any other way discriminate against, or cause to be fired or discriminated against, any employee or any authorized representative of employees by reason of the fact that such employee or representative has filed, instituted, or caused to be filed or instituted any proceeding under this Act or under any applicable implementation plan, or has testified or is about to testify in any proceeding resulting from the administration or enforcement of the provisions of

the Act or of any applicable implementation plan. See 42 U.S.C. section 6971(a).

Employee Involvement in Proceedings under the Clean Air Act

No employer may discharge any employee or otherwise discriminate against any employee with respect to his or her compensation, terms, conditions, or privileges of employment because the employee (or any person acting pursuant to a request of the employee) has commenced, caused to be commenced, or is about to commence or cause to be commenced a proceeding under the Clean Air Act or a proceeding for the administration or enforcement of any requirement imposed under the Act or under any applicable implementation plan; has testified or is about to testify in any such proceeding; or has assisted or participated or is about to assist or participate in any manner in such a proceeding or in any other action to carry out the purposes of the Act. See 42 U.S.C. section 7622(a).

Worker Adjustment and Retraining Notification Act

The Worker Adjustment and Retraining Notification ("WARN") Act requires employers having 100 or more full-time employees to provide at least 60 days advance notice of:

- A permanent or temporary shutdown of a single site of employment where 50 or more full-time employees suffer an employment loss; or
- Any layoff involving a minimum of 33% of the workforce and at least 50 full-time employees, or at least 500 full-time employees. See 29 U.S.C. section 2101.

Notice must be given to employees individually or to their union, if they are represented, and to state and local governments. Failure to give notice can result in liability for up to 60 days of pay and benefits for each employee who should have received notice, plus a civil penalty of $500 per day for each day notice was not given.

Note that California has its own WARN requirements, patterned after the federal requirements, but with a lower covered-facility threshold (75 employees, instead of 100). California employers should be sure to check both sets of requirements and comply with the most employee-friendly set available.

Employee Polygraph Protection Act

The federal Employee Polygraph Protection Act, which applies to all employers, prohibits an employer from:

- Requiring, requesting, suggesting, or causing, directly or indirectly, any employee or prospective employee to submit to a lie detector test.
- Using, accepting, referring to or inquiring concerning the results of a lie detector test taken by any employee or prospective employee.
- Discharging, disciplining or discriminating against an employee who refuses to take or fails a lie detector test.
- Discharging, disciplining or discriminating against an employee who files a complaint, testifies, or exercises his or her rights under this law.

There is an exception to this law for investigations involving theft or other economic loss or injury to the employer's business, where the employee had access to the stolen property, the employer has reasonable suspicion of the employee's involvement in the loss, the employer executes a written statement to that effect, and numerous protections are afforded the employee during the administration of the test. Even then, the results of the polygraph may not be used as the basis for discharging, disciplining, denying employment or promotion or otherwise discriminating against an employee without **additional supporting evidence**.

Employers violating the Act are subject to civil action for reinstatement and lost wages and a civil fine of up to $10,000. See 29 U.S.C. sections 2001-2009.

Americans With Disabilities Act of 1990

Title I of the Americans With Disabilities Act of 1990 (ADA) prohibits both public and private employers from discriminating in employment against persons with physical and mental disabilities. The ADA requires employers to make reasonable accommodation to the needs of disabled applicants and employees, as long as such accommodation does not result in undue hardship to the employer's operation.

The ADA applies to all employers engaged in an industry affecting commerce who have 15 or more employees.

No entity covered under the Americans With Disabilities Act shall discriminate against a qualified individual with a disability because of the disability of such individual in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment. See 42 U.S.C. section 12112.

The ADA protects individuals who are "disabled" as specifically defined by the Act. An individual is "disabled" under the Act if he or she has (1) a physical or mental impairment that substantially limits one or more major life activities, (2) a record of such an impairment, or (3) he or she is regarded as having such an impairment. Not all impairments effecting work, however, will be protected by the

ADA. Unfortunately, court decisions do not give clear guidance as to (1) who is or is not disabled, and (2) when an employer will be found to have perceived an employee as being an ADA-disabled individual. Therefore, it generally will be necessary to consult with legal counsel for guidance on a case-by-case basis.

The Family and Medical Leave Act of 1993

The Family and Medical Leave Act (FMLA) requires private employers with 50 or more employees to provide eligible employees with up to 12 weeks of unpaid leave each year to care for a new child, a seriously ill relative, or to recover from their own serious health condition, and further provides for additional leave for covered persons related to persons serving in the military. California has a similar law which is discussed below under California Legislation and Regulations. It is unlawful for any employer to discharge or in any other manner discriminate against any individual for exercising rights under this Act. 29 U.S.C. section 2615. The FMLA also requires that employers maintain health benefits in place during a leave and reinstate employees at the end of a leave of absence, subject to certain limited exceptions. Also see the chapter in this Management Guide entitled Pregnancy and Other Leaves for a detailed discussion.

Whistleblowers

A federal law, the Sarbanes-Oxley Act, effective July 1, 2002, creates federal protection for "whistleblowers." 18 U.S.C.A. §1514A. It provides whistleblower protection to employees of public companies when they act lawfully to disclose information about fraudulent activities within their company. The Act specifically protects employees when they take lawful acts to disclose information or otherwise assist criminal investigators, federal regulators, Congress, supervisors (or other appropriate people within a corporation) or parties in a judicial proceeding in detecting and stopping fraud.

The Act requires that the employee reasonably believe that a violation of federal securities law, the rules of the SEC, or "any provision of federal law relating to fraud against shareholders" has occurred or is occurring. The Act protects employees who complain to any person at the company with the authority to "investigate, discover, or terminate misconduct." The whistle blowing protections of the Act apply not only to publicly traded companies, but also to their officers, employees, contractors, subcontractors and agents. This statutory language may allow individual liability of officer and employees.

Unlawful Discharge - California Legislation and Regulations

California Fair Employment and Housing Act

Government Code sections 12940 and 12941(a) prohibit employment discrimination and harassment on the basis of race, religious creed, color, national origin, ancestry, physical and mental disability, medical condition, age, marital status, sex, gender identity, gender expression, transgender status, or sexual orientation of any person. This statute does give the employer the right to discharge a physically disabled employee where the employee, - because of his or her physical or mental disability, is unable to perform the essential functions of the job even with reasonable accommodations, or cannot perform such duties in a manner which would not endanger his or her health or safety or the health and safety of others. The same rule applies to a person who because of a medical condition, is unable to perform his or her duties, or cannot perform such duties in a manner which would not endanger the employee's health or safety or the health or safety of others. However, this health and safety exception has been narrowly construed by the courts. Government Code section 12940(f) makes it an unlawful employment practice for an employer to discharge, expel, or otherwise discriminate against any person because the person has opposed any practices forbidden under the California Fair Employment and Housing Act (FEHA) or because the person has filed a complaint, testified or assisted in any proceeding under the Act. The FEHA also requires a reasonable accommodation for a qualifying disability and for religious beliefs.

Rights of Pregnant Employees

Government Code section 12945 makes it unlawful, unless based upon bona fide occupational qualification, for an employer:

- To discharge, refuse to promote, refuse to select for a training program (provided she can complete the training program at least three months prior to the anticipated start of pregnancy leave), to fail to reasonably accommodate or discriminate in compensation, terms, conditions or privileges of employment against a female employee because of pregnancy, childbirth or related medical condition.
- To refuse to allow a pregnant employee to take either disability, sick leave or other accrued leave made available to other temporarily disabled employees, or a pregnancy leave for a reasonable period of time not exceeding four months (88 work days, for a regular, full-time employee

working five days per week), with the right to return to her same job after such leave.

See the more lengthy discussion of this issue in the separate chapter in this Management Guide entitled Pregnancy and Other Leaves.

Employee Involvement in Workers' Compensation Matters

It is the policy of the State of California that there should not be discrimination against workers who are injured in the course and scope of their employment. Any employer who discharges, or threatens to discharge, or in any manner discriminates against any employee because he or she has filed or made known his or her intention to file a claim for compensation with his or her employer, or an application for adjudication from a Workers' Compensation Judge, or because the employee has received a rating award or settlement, is guilty of a misdemeanor and the employee's compensation shall be increased by one-half, but in no event more than $10,000, together with all costs and expenses not in excess of $250. Also any such employee is entitled to reinstatement and reimbursement for lost wages and work benefits caused by the acts of the employer. See Labor Code section 132a(1).

Any employer who discharges, or threatens to discharge, or in any manner discriminates against any employee because the employee testified or made known his or her intentions to testify in another employee's case before a Workers' Compensation Judge, is guilty of a misdemeanor, and the employee shall be entitled to reinstatement and reimbursement for lost wages and work benefits caused by the acts of the employer. See Labor Code section 132a(3).

Labor Code section 132(a) is commonly used by employees as the basis of claims against the employer when an employee health care benefits are cancelled during a leave of absence occasioned by an on-the-job injury or occupational illness. While there are certain circumstances that would allow an employer to cancel such benefits, employment counsel should be consulted before canceling an employee's benefits while on a Worker's Compensation leave of absence.

Employee Involvement with Employee Safety or Health Laws

An employer may not discharge or in any manner discriminate against any employee because such employee has either (1) made any oral or written complaint to governmental agencies with reference to employee safety or health, or (2) instituted or caused to be instituted any proceeding under or relating to the employee's rights or has testified or is about to testify in any such proceeding or because of the exercise by such employee on behalf of himself or herself or others of any rights afforded under the Act, or (3) participated in an Occupational Health and Safety Committee established pursuant to Labor Code section 6401.7. See Labor Code section 6310.

No employee shall be laid off or discharged for refusing to perform work in the performance of which California law, any occupational safety or health standard or any other safety order of the division or standards board will be violated where such violation would create a real and apparent hazard to the employee or fellow employees. See Labor Code section 6311.

Employee Claims with Labor Commissioner

No person shall discharge, refuse to hire, or in any manner discriminate against any employee because such employee has filed any bona fide complaint or claim or instituted or caused to be instituted any proceeding under or relating to his or her rights, which are under the jurisdiction of the Labor Commissioner, or has testified or is about to testify in any such proceeding or because of the exercise by such employee on behalf of himself or herself or others of any rights afforded him or her. See Labor Code section 98.6. Likewise, an employer may not take adverse action against an employee based on the employee's off-duty, lawful conduct.

Coercion Not To Join Labor Organization

Any person or agent or officer thereof, who coerces or compels any person to enter into an agreement, written or verbal, not to join or become a member of any labor organization, as a condition of securing employment or continuing in the employment of any such person is guilty of a misdemeanor. See Labor Code section 922.

Coercion of Political Activities Of Employees

No employer shall coerce or influence or attempt to coerce or influence employees through or by means of threat of discharge or loss of employment to adopt or follow or refrain from adopting or following any particular course or line of political action or political activity or adopt any rule or policy which would tend to control or direct the political activities or affiliations of its employees. See Labor Code sections 1101 and 1102.

A California Supreme Court decision had held that this section applies to homosexuals who make "an issue of their homosexuality." The employer was not allowed to discriminate against individuals who belong to an organization active in promoting the rights of homosexuals to equal employment op-

portunities. See *Gay Law Students Association v. Pacific Telephone and Telegraph Company* (1979) 24 Cal.3d 458. As noted earlier in the discussion of the California Fair Employment and Housing Act, that Act now expressly protects sexual orientation under Government Code section 12940.

Employee's Refusal To Make Coerced Purchases

No employer, or agent or officer thereof, or any other person, shall compel or coerce any employee, or applicant for employment to patronize the employer, or any other person, in the purchase of anything of value. See Labor Code section 450.

Employer's Language Policy

A law effective in 2002 prohibits an employer from adopting or enforcing a policy which limits or prohibits the use of any language in any workplace unless the policy is justified by a business necessity, there are no lesser alternatives, and the employer notifies its employees of such policy. See Government Code section 12951.

Employee's Refusal To Work Excess Hours

No employer shall discharge or in any other manner discriminate against any employee who refuses to work hours in excess of those permitted by order of the Industrial Welfare Commission. See Labor Code section 1198.3(b).

Employee's Refusal To Sign Medical Information Release Authorization

Employers who receive medical information on employees must establish appropriate procedures to ensure the confidentiality and protection of that information from unauthorized use and disclosure. There are certain provisions prohibiting the employer from using, disclosing, or knowingly permitting its employees or agents to use or disclose such medical information without the patient-employee having first signed an authorization. No employee shall be discriminated against in terms or conditions of employment due to that employee's refusal to sign such an authorization. See Civil Code section 56.20.

Employee's Refusal To Take Polygraph Or Lie Detector Test As Condition Of Employment

No employer shall demand or require of any applicant for employment or prospective employment or any employee to submit to or take a polygraph, lie detector or similar test or examination as a condition of employment or continued employment. Further, no employer shall request any person to take such a test or administer such a test, without first advising the person in writing at the time the test is to be administered of his or her rights. See Labor Code section 432.2. See also the discussion of the federal Employee Polygraph Protection Act discussed earlier in this chapter, which in some ways is stricter than California law. Some advisors discourage the use of polygraph or lie detector tests under any circumstances because of the potential risk and lack of useful information that is obtained.

Employee's Refusal To be Photographed or Fingerprinted

Any person or agent or officer thereof, who requires, as a condition precedent to securing or retaining employment, that an employee or applicant for employment be photographed or fingerprinted by any person who desires photographs or fingerprints for the purpose of furnishing the same or information concerning the employee or applicant for employment to any other employer or third person, and such photographs and fingerprints could be used to the detriment of such employee or applicant for employment, is guilty of a misdemeanor. See Labor Code section 1051. Under this section, an employer may require photographs and fingerprints of an employee for his or her own use and to obtain information regarding such employee, the prohibition of this section in general being against furnishing such information to another employer or third person, including local police departments or other governmental agencies.

Arrest Record or Detention Not Resulting in Conviction or Referral or Participation in Diversion Programs

No employer shall seek from any source whatsoever or utilize, as a factor in determining any condition of employment including hiring, promotion, termination, or any apprenticeship training program or any other training program leading to employment, any record of arrest or detention which did not result in conviction, or any record regarding a referral to and participation in any pre-trial or post-trial diversion programs. This law does not prevent an employer from asking an employee or applicant for employment about an arrest for which the employee or applicant is out on bail or on his or her own recognizance pending trial. See Labor Code section 432.7(a).

Use of Information Concerning Marijuana Offenses

No employer shall seek from any source whatsoever, or utilize, as a factor in determining any condition of employment including hiring, promotion,

termination, or any apprenticeship training program or any other training program leading to employment, any record of arrest or detention resulting in a conviction of certain marijuana violations after two years from the date of such a conviction. See Labor Code section 432.8.

Use of Employee Social Security Numbers

A law effective July, 2002 severely restricts an employer's use of social security numbers unless required by state or federal law. Likewise, the law prohibits the use of social security numbers on payroll checks commencing January 1, 2008. A violation is a misdemeanor.

Garnishment for the Payment of One Judgment

No employer may discharge any employee by reason of the fact that the garnishment of the employee's wages has been threatened. No employer may discharge any employee by reason of the fact that his or her wages have been subjected to garnishment for the payment of one judgment. See Labor Code section 2929(b). See also the chapter on Wages and Hours in this Management Guide and the discussion above concerning the federal statute on this subject.

Employee's Service as Juror or Appearance in Court as Witness

No employer shall discharge or in any manner discriminate against an employee for taking time off to serve as required by law on an inquest trial or jury trial, if such employee, prior to taking such time off, gives reasonable notice to the employer that he or she is required to serve. Similarly, no employer shall discharge or in any manner discriminate against an employee for taking time off to appear in court as a witness as required by law, if such employee, prior to taking such time off, gives reasonable notice to the employer that the employee is required to appear in court. See Labor Code section 230. The employer has no duty to pay an employee for hours of work missed if the employee serves as a juror or is called as a witness.

Taking Time Off for Victims of Domestic Violence

In addition to protecting an employee who has participated as a juror or who has served as a trial witness, Labor Code section 230 prohibits an employer from discharging an employee who is a victim of domestic violence, or from discharging or discriminating against an employee, and who has taken time off to obtain a temporary restraining order or other relief, or who is a family member of a victim of such a crime.

Employee's Acting as Election Officer

No person shall be suspended or discharged from any service or employment because of absence while serving as an election officer on election day. See Elections Code section 12312.

California WARN Act

Effective 2003, California enacted a statute similar to the federal WARN Act. AB 2957 added California Labor Code sections 1400-1408, which preclude employers from ordering a mass layoff, relocation or termination of a covered establishment without first giving 60 days notice to affected employees. A "mass layoff" means a layoff during any 30 day period of 50 or more employees at a covered establishment. A covered establishment means any industrial or commercial facility that employs 75 or more persons (compare this with the 100-employee threshold under the federal WARN) within the preceding twelve months. This statute provides civil penalties for non-compliance and attorneys' fees for successful plaintiffs.

Lawful Conduct Occurring During Non-Working Hours Away From the Employer's Premises

An employer is now prohibited from demoting, suspending, or discharging any employee for lawful conduct occurring during non-working hours away from the employer's premises. See Labor Code section 96(k). Employers should review policies governing employee conduct such as moonlighting, employee conflicts of interest, nepotism, client relations, business conduct, and drug and alcohol policies to assure that company policies will not lead to violations of this law.

Employee Discussion of Wages and Working Conditions

Existing California law states that an employer may not prohibit an employee from disclosing the amount of his or her wages or require an employee to sign a waiver denying him or her the right to disclose the amount of his or her wages. An employer also may not discharge, formally discipline, or otherwise discriminate against an employee who discloses the amount of his or her wages. Labor Code Sections 232 and 232.5 provide that an employer may not prohibit an employee from disclosing information (excluding trade secrets) about wages or the employer's working conditions. In *Grant-Burton v. Covenant Care, Inc.* (2002) 99 Cal. App. 4th 1361, an employee charged her former employer with wrongful termination in violation of public

policy, breach of contract, breach of the covenant of good faith and fair dealing, and a violation of Labor Code § 232. The employee alleged she was discharged for participating in a discussion regarding the fairness of the employer's bonus system. The court held that the employer's conduct violated public policy and that an employee's right to discuss compensation is protected by the National Labor Relations Act and Labor Code section 232.

Employee's Membership in Military or Naval Forces

An employer may not discriminate against any member of the military or naval forces of California or of the United States because of membership therein, nor may such member be denied or disqualified from employment by reason of such membership or service. Further, no employer may discharge any person from employment because of the performance of any ordered military duty or -training or by reason of being an officer, warrant officer, or enlisted man of the military or of the naval forces of California.

Taking Time Off to Appear in School on Behalf of Child

No employer shall discharge or in any manner discriminate against an employee who is the parent or guardian of a pupil for taking time off to appear in the school of a pupil pursuant to a request made under section 48900.1 of the Education Code (dealing with required attendance by parents or guardians of pupils who have been suspended), if the employee, prior to taking the time off, gives reasonable notice to the employer that he or she is requested to appear in the school. See Labor Code section 230.7.

No employer, who employs 25 or more employees working at the same location, shall discharge or in any way discriminate against an employee who is a parent, grandparent or guardian of any child in kindergarten or grades 1 to 12, inclusive, or attending a licensed child day care facility, for taking off up to 40 hours each year, but not exceeding eight hours in any calendar month of the year, in order to participate in activities of the school or licensed day care facility of any of his or her children, if the employee, prior to taking the time off, gives reasonable notice to the employer of the planned absence of the employee. An employee shall utilize existing vacation, personal leave, or compensatory time off for purposes of this planned absence, unless otherwise provided by a collective bargaining agreement. An employee may also utilize time off without pay for this purpose, to the extent made available by his or her employer. The employee, if requested by employer, shall provide documentation from the school as proof that he or she participated in school activities on a specific date and at a particular time. See Labor Code section 230.8.

The provisions of this act, known as the Family School Partnership Act, were substantially expanded in 1997 so as to allow parents greater involvement in their children's education and child-care activities without the fear of being discharged from their employment or facing other discrimination.

Time Off as Volunteer Fire Fighter

No employer may discharge or in any manner discriminate against an employee for taking time off to perform emergency duty as a volunteer fire fighter. There are severe penalties for discrimination against one who acts as such a volunteer. See Labor Code section 230.3.

Sexual Assault Victims Employment Protections

Victims of sexual assault are afforded the same protections as victims of domestic violence with respect to taking time off to attend to issues arising out of the sexual assault. Labor Code Section 230.1.

Leave for Crime Victims

There is a right to an unpaid leave for an employee who is the victim of a crime or who is related to a crime victim in order to attend judicial proceedings related to the crime. Employees may file a complaint with the Labor Commissioner to enforce this right. See Labor Code section 230.2.

California Family Rights Act

It is an unlawful employment practice for an employer to refuse to hire, or to discharge, fine, suspend, expel, or discriminate against, any individual because of the individual's exercise of the right to family care leave provided under California law, or an individual's giving information or testimony as to his or her own family care leave, or another person's family care leave, in any inquiry or proceeding related to rights guaranteed under the Act. See Government Code section 12945.2(l)(1) and (2). See also a full discussion of the California Family Rights Act in the chapter entitled Pregnancy and Other Leaves in this Management Guide.

Discharge Based on an Employee's Illiteracy

An employee who reveals a problem of illiteracy and who satisfactorily performs his or her work shall not be subject to termination of employment because of the disclosure of illiteracy. See Labor Code section 1044.

Whistleblower Legislation

In response to corporate scandals (e.g., Enron, Worldcom) California adopted added protection for so-called "whistleblowers," employees who report suspected or actual misconduct by employers to state or federal authorities. The law requires employers to post a special notice describing the rights and protections of whistleblowers, and how whistleblowers can report misconduct. The CNCDA poster-kit, available from The Reynolds and Reynolds Company, includes this posting, which provides:

Whistleblowers Are Protected

It is the public policy of the State of California to encourage employees to notify an appropriate government or law enforcement agency when they have reason to believe their employer is violating a state or federal statute, or violating or not complying with a state or federal rule or regulation.

Who is Protected?

Pursuant to California Labor Code Section 1102.5, employees are the protected class of individuals. "Employee" means any person employed by an employer, private or public, including, but not limited to, individuals employed by the state or any subdivision thereof, any county, city, city and county, including any charter city or county, and any school district, community college district, municipal or public corporation, political subdivision, or the University of California. (California Labor Code Section 1106).

What is a whistleblower?

A "whistleblower" is an employee who discloses information to a government or law enforcement agency where the employee has reasonable cause to believe that the information discloses:

1. A violation of a state or federal statute,

2. A violation or noncompliance with a state or federal rule or regulation, or

3. With reference to employee safety or health, unsafe working conditions or work practices in the employee's employment or place of employment.

What protections are afforded whistleblowers?

1. An employer may not make, adopt, or enforce any rule, regulation, or policy preventing an employee from being a whistleblower.

2. An employer may not retaliate against an employee who is a whistleblower.

3. An employer may not retaliate against an employee for refusing to participate in an activity that would result in a violation of a state or federal statute, or a violation or noncompliance with a state or federal rule or regulation.

4. An employer may not retaliate against an employee for having exercised his or her rights as a whistleblower in any former employment.

Under California Labor Code Section 98.6, if an employer retaliates against a whistleblower, the employer may be required to reinstate the employee's employment and work benefits, pay lost wages, and take other steps necessary to comply with the law.

How to report improper acts:

If you have information regarding possible violations of state or federal statutes, rules, or regulations, or violations of fiduciary responsibility by a corporation or limited liability company to its shareholders, investors, or employees, call the California State Attorney General's Whistleblower Hotline at 1-800-952-5225. The Attorney General will refer your call to the appropriate government authority for review and possible investigation.

Registered Domestic Partnerships

California Family Code section 297 sets forth the requirements to qualify as a Registered Domestic Partner. California Family Code section 297.5 provides "Registered domestic partners shall have the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law, whether they derive from statutes, administrative regulations, court rules, government policies, common law, or any other provisions or sources of law, as are granted to and imposed upon spouses." This is a sweeping law covering many areas that dealers will face. For example, marital status is protected both by the privacy provisions of the California Constitution, as well the Fair Employment and Housing Act, California Government Code section 12940 et seq. This means that claims alleging wrongful termination in violation of public policy based on registered domestic partnership status, as well as claims alleging discrimination against registered domestic partnerships may be filed against dealers when there are alleged violations of this law. For a further discussion, see the topic, Registered Domestic Partnership Rights, in the Other Important Topics chapter of this Guide.

Sexual and Other Forms of Harassment

Sexual and other forms of harassment are becoming an increasing source of potential liability for employers. Harassment claims frequently involve allegations that the victim was "constructively discharged," i.e., that the harassment made working

conditions so intolerable that the victim had no choice but to resign. Most forms of workplace harassment are actionable under either federal law, state law, or both, regardless of whether termination of employment is involved. By undertaking strong preventative measures, however, employers can reduce their potential liability in this area.

Federal Legislation and Regulations

Harassment on the basis of sex, race, color, national origin and religion is a violation of Title VII. The Equal Employment Opportunity Commission has issued extensive rules and regulations concerning sexual and other types of harassment, which are summarized as follows.

What Constitutes Harassment?

Harassment includes slurs, jokes, and other verbal, graphic, or physical conduct relating to an individual's sex, race, color, national origin or religion.

Sexual harassment also includes unwelcome sexual advances, requests for sexual favors, and other verbal, graphic, or physical conduct of a sexual nature. Suggestive pictures, calendars, and the like have in some cases also been held to be sexual harassment.

There are two types of sexual harassment:

- "Quid Pro Quo" harassment, where the grant or denial of a job benefit is explicitly or implicitly conditional upon acquiescence to or rejection of unwelcome sexual advances, requests for sexual favors or other verbal or physical conduct of a sexual nature.
- "Hostile working environment" harassment, where the conduct is severe or pervasive enough to alter the conditions of employment and create an intimidating, hostile, or offensive working environment.

The United States Supreme Court has held that a woman who claims she was a victim of sexual harassment need not demonstrate that the offensive conduct seriously affected her psychological well-being or led her to suffer injury. *Harris v. Forklift Systems, Inc.* (1993) 126 L.Ed.2d 295. The Harris Court held that such harassment violates Title VII whenever the workplace is permeated with discriminatory behavior that is sufficiently severe or pervasive to cause a reasonable person to find it hostile or abusive. In making the determination, the trier of fact must examine all circumstances, including the frequency and severity of the discriminatory conduct; whether the conduct was physically threatening or humiliating or merely an offensive utterance; and whether it interferes with an employee's work performance.

Employer Liability

The United States Supreme Court in *Faragher v. City of Boca Raton* (1998) 524 U.S. 775 and *Burlington Industries, Inc. v. Ellerth* (1998) 524 U.S. 742, created a new standard of liability for employers whose supervisors sexually harass employees and underscore the importance of an effective policy on sexual harassment. In another decision, *Oncale v. Sundowner Offshore Services, Inc* (1998) 523 U.S. 75, the United States Supreme Court settled an issue which had split the Circuit Courts of Appeals and held that same-sex harassment is actionable under Title VII.

In *Faragher* and *Ellerth*, the Supreme Court created a system of vicarious liability for employers which depends upon what happened to the "victim" and the identity of the "harasser." If the "harasser" is a supervisor, and the victim suffered a "tangible employment action" as a result of the harassment, then the employer will be held strictly liable. In all other cases, an employer has an available affirmative defense to avoid liability if it can demonstrate that:

- the employer took reasonable measures to prevent harassment from occurring – generally through educating its employees and managers of its harassment policy;
- it promptly responds to and corrects any instances of harassment which may occur; and
- the employee unreasonably failed to avail themselves of the employer's written policy and procedures for reporting harassment.

In *State Department of Health Services v. Superior Court* (2003) 31 Cal.4th 1026, the California Supreme Court ruled that the "affirmative defense" noted above by the U.S. Supreme Court is not available in California, but may play a role in limiting damages.

NOTE

THE LEVEL OF SEXUAL HARASSMENT WHICH IS ACTIONABLE: In the case of* Brooks vs. City of San Mateo *(9th Cir.2000) 214 F.3d 1082, the United States Ninth Circuit Court of Appeals held that one episode of conduct did not rise to the level of actionable sexual harassment against the employer. The complaint involved a coworker who allegedly groped the employee's stomach and fondled her bare breast. The employer acted quickly to remedy the harassment when it had knowledge that it occurred. The lesson here is that employers should promptly and effectively respond to any complaint of sexual harassment.

California Legislation and Regulations

The California Fair Employment and Housing Act prohibits harassment based upon sex, sexual orientation, gender identity, race, color, national origin, ancestry, physical and mental disability, medical condition, age, marital status, religious creed, and registered domestic partnership status. See Government Code section 12940(j)(1). For purposes of the Act, "harassment" because of sex includes sexual harassment, gender harassment and harassment based on pregnancy, childbirth or related medical conditions. It is important to recognize that a private cause of action brought under the California Fair Employment and Housing Act may trigger compensatory and punitive damage awards. The California Department of Fair Employment and Housing (DFEH) has issued rules concerning sexual and other forms of harassment. These rules define "harassment" to include:

- Verbal harassment, e.g., epithets, derogatory comments or slurs on a basis enumerated in the Act;
- Physical harassment, e.g., assault, impeding or blocking movement, or any physical interference with normal work or movement when directed at an individual on a basis enumerated in the Act;
- Visual forms of harassment, e.g., derogatory posters, cartoons, or drawings on a basis enumerated in the Act; or
- Sexual favors, e.g., unwanted sexual advances which condition an employment benefit upon an exchange of sexual favors.

The DFEH rules further provide that the rights of free speech and association shall be accommodated consistently with the intent of the above definitions.

The DFEH rules provide that harassment of an employee or applicant by an employer, or its agents or supervisors, is unlawful. Those rules further provide that harassment by non-supervisory employees is unlawful if the employer or its agents or supervisors knew of such conduct and failed to take immediate and appropriate corrective action. If the employer or its agents and supervisors did not know, but should have known of the harassment, knowledge will be imputed to the employer, unless it took reasonable steps to prevent harassment from occurring.

The DFEH rules state that an employee who has been harassed on the job should inform the employer, but the employee's failure to do so is not a defense for the employer.

California law requires employers to take immediate and appropriate corrective action and to take all reasonable steps to prevent sex harassment by a non-employee. This covers persons such as customers, vendors, delivery personnel, factory representatives and the like. See Government Code section 12940.

Preventing Harassment Claims and Required Training

Government Code section 12950 creates obligations for employers in order to ensure a workplace free of sexual harassment. Employers must post a discrimination poster obtained from the Department of Fair Employment and Housing which includes new information relating to the illegality of sexual harassment. Each employer must also provide employees with an information sheet regarding sexual harassment in such a manner that ensures distribution to each employee, such as including the information sheet or information with an employee's paycheck. When new employees are hired, you must also have a system for providing them with the sheet. The sheet is available from the Department of Fair Housing and Employment, and it is recommended that employers have each employee sign a copy of the information sheet, acknowledging receipt of it, and that the signed copy be kept in the employee's personnel file to ensure the dealership's compliance with this law.

Instead of using the state's information sheet, an employer can have its own information sheet if it provides information equivalent to the state information sheet and contains, at a minimum, components on the following:

a. The illegality of sexual harassment.

b. The definition of sexual harassment under applicable state and federal law.

c. A description of sexual harassment, utilizing examples.

d. The internal complaint process of the employer available to the employee.

e. The legal remedies and complaint process available through the Department of Fair Employment and Housing and the Commission.

f. Direction on how to contact the Department and Commission.

g. The protections against retaliation provided by California law.

Just having a written policy is not sufficient, however. The policy must be strictly enforced. All harassment claims must be thoroughly investigated and immediate corrective action must be taken. In addition, proper training of supervisors is critical. All supervisors must:

- Understand what harassment encompasses.
- Be able to identify harassment.
- Understand the importance of taking all complaints seriously.

- Report immediately to upper management all complaints and personal observations of harassment.
- Understand that the company is strictly liable for their "quid pro quo" sexual harassment.
- Understand that they may be personally liable for engaging in harassment.

Under Labor Code section 12950.1, employers with 50 employees or more must now provide all managers with two hours of interactive sexual harassment training within six months of becoming a manager and at least once every two years. The training must include information and practical guidance regarding the federal and state statutory provisions concerning the prohibition against and the prevention and correction of sexual harassment and the remedies available to victims of sexual harassment.

A further requirement is that the training must include practical examples aimed at instructing supervisors in the prevention of harassment, discrimination, and retaliation, and shall be presented by trainers or educators with knowledge and expertise in the prevention of harassment, discrimination, and retaliation.

Remember also that the training must be interactive – a video or a speech won't do. Be sure to record your compliance and frequently audit the training. Without going into more detail on how to comply, be aware that failure to meet this requirement will undoubtedly increase your exposure to sexual discrimination and harassment claims.

Investigating Harassment Claims

Investigating The Complaint

Thoroughly investigate the complaint immediately and interview all witnesses as soon as possible. ***In interviewing the complainant, you should:***

- Remain objective.
- Determine the identity of the accused harasser(s).
- Determine when and where the incident(s) occurred.
- Determine if the incident was isolated or part of a series.
- Get specific details of the incident(s).
- Ask the complainant his/her reaction to the incident(s).
- Determine if there were any witnesses to the incident(s).
- Determine if the complainant has spoken to anyone else about the incident(s).
- Assure the complainant that the complaint will be taken seriously and investigated thoroughly.
- Assure the Complainant that the complaint will be kept as confidential as possible consistent with an appropriate investigation.
- Never agree to forego investigation of a complainant pursuant to the complainant's request for confidentiality.

In interviewing an alleged harasser you should:

- Remain objective.
- Determine if the accused harasser knows of the incident or incidents to which the complainant is referring.

If so:

1. Determine when and where the incident(s) took place;

2. Get specific details of the incident(s);

3. Ask how the complainant reacted;

4. Determine if there were any witnesses to the incident(s)

5. Determine if the accused harasser has spoken to anyone else about the incident(s).

If not:

1. Determine the accused harasser's perception of his/her working relationship with the complainant;

2. Ask whether the complainant and accused harasser socialized together (alone/group);

3. Determine if the accused harasser(s) knows of any reason why the complainant would make the allegation;

4. When the accused harasser is the complainant's supervisor, determine if the complainant was recently granted or denied any job benefits, e.g., raises, promotions.

Assure the accused harasser that the complaint will be kept as confidential as possible consistent with an appropriate investigation.

In interviewing a witness, you should:

1. When the witness is a current or former employee, review his or her personnel file prior to the interview.

2. Inform the witness that the investigation is confidential. Inform current employees that a breach of confidentiality will result in disciplinary action.

3. Be alert to the privacy rights of both the complainant and the accused harasser.

4. Remain objective.

5. Don't give details of the complaint unless it is necessary to obtain relevant information.

6. Phrase questions so as not to give unnecessary information.

7. Do not automatically limit the investigation to witnesses currently in the workforce. Interview

former employees, friends and relatives of both the complainant and the accused harasser as necessary.

CAUTION

A dealership's failure to keep the investigation confidential can lead to defamation or invasion of privacy claims.

Take Corrective Action

- The dealership must promptly take necessary corrective action, up to and including termination. Note that termination is not always required. In fact, dealerships can be liable for wrongful termination when terminating an accused harasser.
- Corrective action must be appropriate to the conduct which occurred.
- All corrective actions taken should be documented. You should include a summary of the investigation explaining the appropriateness of the action.

Follow through

- Inform the complainant that action has been taken.
- Instruct the complainant to immediately report recurring or continuing harassment.
- Obtain a signed memorandum documenting that:
  (1) The complainant has been informed that corrective action has been taken.
  (2) The complainant has been informed to immediately report continuation or recurrence of harassment.

Other Forms of Harassment

While sexual harassment may be the most common type of harassment in the employment context, it is important to note that federal and state law prohibit other types of harassment of employees. See, for example, the various types of harassment in the California Fair Employment and Housing Commission regulations quoted above. Employers should take adequate precautions to avoid claims that the employee was discharged or terminated over harassment problems. Preventative measures similar to those above for sexual harassment may be used.

Response in Administrative Hearings and to Employee Claims

An employer is subject to various claims by employees arising out of the employment relationship. In many instances, these claims are initially heard and determined on an administrative level and not by a court. Claims for unemployment benefits are determined by the California Employment Development Department. Wage claims may be determined by the Division of Labor Standards Enforcement. Workers' Compensation claims are determined by the Workers' Compensation Appeals Board.

When claims are filed against the employer arising out of the employment relationship, it is very important for the employer to make an appropriate response on the administrative level because the information provided and testified to on the administrative level can have a significant impact upon any court action the employee may later bring for wrongful discharge. The employer may be asked for a written response to the employee's claim. The employer may also be contacted by telephone by someone from the administrative agency. In these instances, the employer should be sure to provide the administrative agency with lawful reasons for the discharge. If a possible wrongful discharge lawsuit looms, the employer should have its attorney help formulate a response.

Testimony given by a witness at an administrative hearing can be used against the witness testifying in a later court action for wrongful discharge. The employer's witnesses should be well prepared and the former employee should be carefully cross-examined by the employer. Employers should consider having their attorney present to conduct the hearing on their behalf.

It is very important for the employer to reduce its exposure in the later court action by making sure that the employer is well represented in the administrative hearing and that all relevant testimony is presented on its behalf. Your attorney should be consulted for advice when these types of hearings arise.

In some instances, the employer may decide not to contest a particular claim in order to avoid having factual determinations made on the administrative level which would be binding in a later court action. The question of what on the administrative level binds the employer and the employee in a later court action is an evolving area of the law. Consequently, the employer should consult with its attorney in making a decision whether or not to contest a

claim in view of a potential court action for wrongful discharge or other claims such as sexual or other types of harassment.

It is also critical that any dealer facing a claim by an employee (or former employee) and the claim is being investigated or adjudicated by a state agency, such as the Labor Commissioner, the Fair Employment & Housing Commission, or the Workers Compensation Appeals Board with respect to a Labor Code 132a claim, that the dealer determine whether the employee has executed an arbitration agreement, such as that found on the CNCDA application form, or the at-will agreement, or perhaps some handbook acknowledgement. There have been any number of situations where dealers have successfully argued that these state agencies lack jurisdiction because of the preemptive effect of federal law dealing with arbitration. It is often to the dealer's advantage to have the claim processed under the arbitration procedure rather than with one or more of these state agencies. Any dealer with a claim of this sort before a state agency involving an employee who has executed an arbitration agreement should consult employment counsel for advice.

FAMILY AND PREGNANCY LEAVES

Chapter 17

Contents

FAMILY AND PREGNANCY LEAVES

OVERVIEW: The changing roles of men and women in the work force and the increasing numbers of working mothers have brought about notable federal and state developments in the law aimed at protecting employees who become pregnant or seriously ill or whose spouse, parent or child becomes seriously ill and in temporary need of the employee's care. The purpose of these laws is to promote stability and economic security in working families.

One of the most important and far-reaching developments in this area was the passage under both federal and California law of Family Care and Medical Leave Acts. These Acts govern the rights of employees to take temporary leaves of absence due to a serious illness of the employee or for family care purposes.

California has expanded the rights of employees even further by becoming the first state to authorize paid family care leave for employees. California provides wage replacement benefits to employees who take temporary leaves of absence to care for a family member with a serious illness or to bond with a new child.

Important legislation has also been enacted under both federal and California law for the purpose of protecting pregnant female employees from discriminatory conduct in the workplace and to further provide such employees with the right to take pregnancy leaves of absence and to request temporary job transfers during their pregnancy.

This chapter will summarize the state and federal laws relating to family care and medical leaves and the prohibitions against pregnancy discrimination and an employer's duties and obligations to employees as a result of such legislation.

Family Care and Medical Leaves

Introduction

The California Family Rights Act (“CFRA”), serves to conform California law to the federal Family and Medical Leave Act of 1993 ("FMLA"). Among other changes, CFRA changed the term "family care leave" to "family care and medical leave," because like the FMLA, it now allows leaves for an employee's own serious illness as well as leaves taken because of a serious illness of a parent, spouse or child. However, unlike the FMLA, the CFRA does not cover leaves taken by an employee because of a pregnancy or childbirth disability because pregnancy leaves of absence are specifically covered by the California Pregnancy Discrimination Act ("CAL PDA"), which is discussed later in this chapter.

In enacting the FMLA, codified as 29 U.S.C. section 2601 et. seq., Congress declared that because of the changing roles of men and woman in the workforce and the family (as evidenced by the increasing numbers of working mothers in the workplace) and the need to promote stability and economic security in families, both men and women should have the option of taking leaves for childrearing purposes and to care for family members who have serious health conditions. Additionally, FMLA was designed to provide job security for employees who have serious health conditions that prevent them from working for temporary periods.

The Department of Labor has issued extensive and complicated final regulations detailing the requirements of the FMLA. The Fair Employment and Housing Commission (“FEHC”) has also issued extensive regulations governing the requirements of the CFRA. As summarized below, the CFRA does reconcile many differences between the FMLA and prior California law, although some differences between federal and state law do remain. It is essential that employers become familiar with the requirements of both the federal and state family care and medical leave laws because California employees are to be provided with the most generous provisions of both laws.

California also has enacted a state-mandated paid family leave insurance program. Under the Family Temporary Disability Insurance Act (“FTDI”), an employee who pays into the State Disability Insurance program and suffers a wage loss is eligible to receive up to six weeks of paid family leave benefits, during a 12-month period to (1) care for a seriously ill child, spouse, parent or domestic partner; (2) bond with a new child within the first 12 months after birth; or (3) bond with a minor child in connection with the adoption or foster parenting. An employee who meets one of these three eligibility requirements may receive paid family leave benefits regardless of how long they have worked for an employer or whether they are full or part time.

Under the FTDI, an employee is generally entitled to receive about 55 percent of his or her weekly

earnings, up to the maximum weekly benefit of $1,067 for up to six weeks. The Employment Development Department will not begin to distribute paid family leave benefits until an employee misses seven days of work. These seven days may be missed intermittently throughout a 12 month period, and does not need to be consecutive.

Unlike the current Federal and California Family Care and Medical Leave Acts, this legislation does not apply to employees who take time off from work due to their own serious illness because such workers are already entitled to disability insurance benefits due to their own non-work related injuries and illnesses under existing California law.

Family Care and Medical Leave Requirements

Because the rules governing the FMLA as set forth in the Department of Labor regulations are so extensive, it is not possible to summarize in this article all of the requirements of the FMLA and dealers should seek appropriate legal advice when questions and issues arise with respect to an employer's obligations under the FMLA, the CFRA and the FTDI program. However, set forth below are questions and answers which discuss and compare certain key provisions contained in the FMLA, the CFRA, and the FTDI program, and which highlight important areas for employers to understand with respect to employee requests for family care and medical leaves.

Family Care and Medical Leave Questions and Answers

Who is a covered employer?

Under the FMLA and CFRA, employers engaged in commerce or in any industry or activity affecting commerce who employ 50 or more employees during 20 or more workweeks in the current or preceding calendar year are covered employers (29 U.S.C. section 2611(4); Government Code section 12945.2(c)(2)(A)).

FTDI applies to all employers covered by the California State Disability Insurance Program. As a result, FTDI applies to employers with as little as one employee. Employers not covered by the FMLA and CFRA may continue to provide leaves under any policies they have voluntarily adopted, with FTDI providing wage replacement benefits during those leaves.

With regard to the FMLA and the CFRA, what happens when an employer who in previous years had 50 or more employees drops below the 50 employees threshold mark?

The federal regulations governing the FMLA make it clear that for purposes of being a "covered employer" under the FMLA, once a private employer meets the 50 employee/20 workweeks threshold, the employer remains covered until it reaches a future point where it no longer has employed 50 employees for 20 (nonconsecutive) workweeks in the current and preceding calendar year. For example, if an employer who met the 50 employee/20 workweeks test in the calendar year as of August, 2012, subsequently drops below 50 employees before the end of 2012 and continues to employ fewer than 50 employees in all workweeks throughout calendar year 2013, the employer would still continue to be covered throughout calendar year 2013 because it met the coverage criteria for 20 workweeks of the preceding (i.e. 2012) calendar year.

For what events may a family leave or medical leave be taken?

The FMLA, the CFRA and the FTDI program allow leave to be taken for the birth of a child or in connection with the adoption or foster care of a child. Additionally, leave may be taken in order to care for a parent, child or spouse who has a serious health condition. Both the CFRA and FTDI programs extend this list of qualifying "events" to include caring for a domestic partner, and the FTDI program also includes caring for the child of a spouse or domestic partner, who has a serious health condition.

The FMLA also provides for two important rights related to military service. The first military leave is for a qualifying exigency leave. Eligible employees are entitled to up to 12 weeks of leave because of "any qualifying exigency" arising out of the fact that the spouse, son, daughter, or parent of the employee is on covered active duty in the Armed Forces (including the National Guard or Reserves), or has been notified of an impending call to covered active duty status in a foreign country. (29 U.S.C. section 2612 (a) (1) (E)). The regulations provide for eight types of qualifying exigencies which may qualify for FMLA leave: short notice deployment; military events and related activities; childcare and school activities; financial and legal arrangements; counseling; rest and recuperation; post-deployment activities; and other activities where the employee and employer agree that the leave qualifies as an exigency and further agree on the timing and duration. The second military leave is called the military caregiver leave. Under this provision of the FMLA, an eligible employee who is the spouse, son, daughter, parent, or next of kin of a covered service member who is a member of the Armed Forces (including a member of the National Guard or Reserves) who is recovering from a serious illness or injury sustained in the line of duty on active duty is entitled to up to 26 weeks of unpaid leave in a single 12 month period to care for the service member

(29 U.S.C. section 2612 (a) (3) and (4)). The military caregiver leave has also been expanded to include as a "covered service member" a veteran who is undergoing medical treatment, recuperation, or therapy, for a serious injury or illness and who was a member of the Armed Forces at any time during the period of 5 years preceding the date on which the veteran undergoes the medical treatment, recuperation or therapy. This military caregiver leave is available during "a single 12 month period" which begins on the date the employee first takes leave to care for an injured covered service member and during which 12 month period an eligible employee is entitled to a maximum combined total of 26 weeks of all types of FMLA leave. It should be noted that because the military caregiver leave is required by law to begin on the date the employee takes the military caregiver leave, the employer will need to reconcile the use of the military caregiver leave with other FMLA leaves which may be measured on a calendar year or other specified permitted methods (see discussion of permitted methods for determining FMLA leave under question "What is the maximum duration of a family care or medical leave?") While the FMLA and CFRA apply in cases where the employee takes leave to care for their own serious health condition, the FTDI does not (Unemployment Insurance Code section 3302(b)(1) and (2)). (CFRA does not, however, apply to a disability caused by pregnancy which would be covered by the CAL PDA; see discussion below relating to the interaction of the Family Care and Medical Leave Acts with the CAL PDA). In connection with the birth or adoption of a child, federal and state law requires that the leave must be completed within one year of the birth or adoption. (29 U.S.C. section 2612(a); Unemployment Insurance Code section 3301(a); Government Code section 12945.2(c)(3); 2 C.C.R. section 7297.3(d)).

Who is an eligible employee to take a family care or medical leave?

Under both the FMLA and the CFRA, employees who have been employed for at least 12 months with at least 1,250 hours of service during the previous 12 month period (i.e., an average of at least 25 hours a week) and who work at a worksite or worksites with a minimum of 50 employees within a 75-mile radius are eligible. However, if there is a break in service of seven years of more, the time prior to the break is not counted towards the 12 month requirement, unless the break is due to military service or the employer agrees to count the prior service. (29 C.F.R. section 825.110; 29 U.S.C. section 2611(2); Government Code section 12945.2(a)).

Eligibility under the FTDI program begins immediately upon employment and the need for leave, subject to a waiting period of seven consecutive days during each FTDI period. No benefits are payable during the seven day waiting period. (Unemployment Insurance Code section 3303(b)). As a condition of an employee's initial receipt of FTDI benefits during any 12-month period in which an employee is eligible for these benefits, an employer may require an employee to take up to two weeks of earned but unused vacation leave prior to the employee's initial receipt of these benefits. If an employer does require an employee to take vacation leave, that portion of the vacation leave that does not exceed one week shall be applied to the seven consecutive day waiting period mentioned above (Unemployment Insurance Code section 3303.1(c)).

An individual is not eligible for FTDI benefits with respect to any day that he or she has received unemployment compensation benefits under state or federal law. An individual will also not be eligible for FTDI benefits with respect to any day that he or she is entitled to receive state disability insurance benefits under California law or a disability insurance act of any other state (Unemployment Insurance Code section 3303.1(a)).

CAUTION

REGARDING REGISTERED DOMESTIC PARTNERS: CFRA allows employees to take leave to care for a registered domestic partner; FMLA does not. This means that an employee who takes leave to care for a registered domestic partner is taking CFRA leave only, and this leave cannot be deducted from the employee's FMLA entitlement. As a result, the employee will be entitled to take 12 weeks of FMLA leave to care for himself or herself or a non-domestic partner family member, and CFRA leave taken to care for the domestic partner is additional CFRA leave. In such event, the total leave entitlement could be more than 12 weeks. Please refer to the discussion in the "Other Important Topics" Chapter 22 entitled "Registered Domestic Partner Rights."

What is the maximum duration of a family care or medical leave?

Except for a military caregiver leave as discussed above in the section "For what events may a family leave or medical leave be taken?" leave taken by an employee under the CFRA runs concurrently with leave taken under the FMLA and the aggregate amount of leaves under either or both acts are not to exceed 12 weeks in a 12-month period (29 U.S.C. section 2612(a); Government Code section 12945.2(a) and (s)). However, as is discussed more fully below, leave can be extended for a pregnancy disability.

An individual may not receive more than 6 weeks of FTDI benefits within a 12-month period (Unem-

ployment Insurance Code section 3301(d)). If an individual is entitled to FTDI benefits, as well as leave under the FMLA and the CFRA, he or she must take FTDI leave concurrent with leave taken under the FMLA and CFRA (Unemployment Insurance Code section 3303.1(b)).

Under FMLA, a request for leave and accompanying certification ends in the conclusion of the 12-month leave period. Thus, how an employer measures the 12-month period is critical because an employee's entitlement to more leave and your right to seek a new certification rest on the definition.

FMLA permits four methods for determining the 12-month period:

1. A calendar year;

2. Any fixed 12-month period leave year (such as a fiscal year or an employee's anniversary date); or

3. A 12-month period measured forward from the date an employee's first FMLA leave begins; (most common approach); or

4. A "rolling" 12-month period measured backward from the date the employee starts using FMLA leave.

It is important to notify employees which method you use, either in your employee handbook or in a separate written notice. If you don't specify a method, the leave period will be the one that's most beneficial to the employee requesting leave-even if that results in having different leave periods for different employees.

The 12-month period under the CFRA commences for an employee when the employee first takes leave which qualifies as FMLA leave (in order to prevent employees from "stacking" federal and state leave).

What is a "serious health condition" entitling an employee to FMLA leave?

A "serious health condition" entitling an employee to FMLA leave includes an illness, injury, impairment, or physical or mental condition that involves any of the following: (A) inpatient overnight stay in a hospital, hospice, or residential medical care facility including any period of incapacity, or a subsequent treatment in connection with such inpatient care; or (B) continuing treatment by a health care provider that includes a period of incapacity because of 1.) a health condition lasting more than three consecutive days, 2.) pregnancy or prenatal care, 3.) a chronic serious health condition that continues over an extended period of time, requiring periodic visits to the healthcare provider, and which may involve occasional episodes of incapacity (i.e. asthma or diabetes), 4.) a permanent or long-term condition for which treatment may not be effective (i.e. Alzheimer's disease, severe stroke or terminal cancer), 5.) any absence to receive multiple treatments for restorative surgery or for a condition that would likely result in a period of incapacity of more than three days of not treated (i.e. chemotherapy or radiation.) 29 U.S.C. section 2611(11), 29 C.F.R. section 825.113-115.

The FMLA regulations provide that ordinarily (and unless complications arise) common colds, flu, earaches, upset stomachs, minor ulcers, headaches other than migraines, routine dental or orthodontia problems and periodontal disease will not meet the definition of a "serious health condition" and do not qualify for FMLA leave (29 C.F.R. section 825.114).

Employers should be very careful in denying a serious health condition leave request that has been physician certified, even if it seems not to qualify under the above criteria, because courts have taken a dim view of employers who substitute their own judgment for that of the employee's healthcare provider.

May an employee take intermittent leaves?

For intermittent leave or leave on a reduced leave schedule taken because of one's own serious health condition, to care for a parent, son, or daughter with a serious health condition, or to care for a covered servicemember with a serious injury or illness, there must be a medical need for leave and it must be that such medical need can be best accommodated through an intermittent or reduced leave schedule. The health certification, if required by the employer, must address the need for intermittent leave. 29 C.F.R. section 825.202.

If intermittent FMLA leave is for the birth or care of a newborn or the placement of a child for adoption or foster care, the leave is subject to employer's approval. 29 C.F.R. section 825.120(b). An employee taking intermittent leave for a planned medical treatment must make a "reasonable effort" to schedule the treatment so that it doesn't disrupt the employer's operations, subject to the health provider's approval. In such cases, employers may also transfer the employee temporarily to another position with equivalent pay and benefits that better accommodates recurring periods of leave than the employee's regular job. (29 U.S.C. section 2612(b)).

The CFRA also provides that leave may be taken in one or more periods (Government Code section 12945.2(p)). The California regulations to the CFRA allow interim leave for all purposes, including for the birth or adoption of a child and with no requirement of the employer's consent. The basic minimum duration of a leave taken in connection with a birth or adoption of a child is two weeks, with exceptions providing for a leave of less than two weeks duration on any two occasions. There is

no minimum duration for CFRA leaves taken for the serious health condition of the employee, or his or her parent, child, spouse, or domestic partner except that the employer may limit leave increments to the shortest period of time that the employer's payroll system uses to account for absences or use of leave.

Under what circumstances may an employer designate leave, paid or unpaid, as FMLA leave?

Whenever an employee is absent from work for a reason covered by the FMLA - even if it is a paid vacation - the employer can count it against the employee's entitlement to twelve weeks of FMLA leave. However, the regulations say that employers must do this quickly or they may face liability. Under the regulations, once an employee explains his or her absence with a reason that is covered by the FMLA, the employer has only five business days to notify the employee of the employee's eligibility to take FMLA leave. This is true even if the employee does not mention the FMLA and does not talk to anyone other than his or her supervisor.

Time spent performing light duty does not count against an employee's FMLA entitlement.

An employer that does not provide the required notices may be held liable for lost compensation, benefits, and other consequences if the employee can show that he or she has been personally harmed as a result of not receiving any notice. Although an employer can retroactively designate FMLA leave, if an employee suffers harm because he or she did not receive timely notices, the employer can be liable for any damages incurred by the employee.

Who is a health care provider under the FMLA and CFRA?

A health care provider is defined as a doctor of medicine or osteopathy who is authorized to practice medicine or surgery (as appropriate) by the state in which the doctor practices or any other person determined by the Secretary of Labor to be capable of providing health care services (29 U.S.C. section 2611(6); Government Code section 12945.2(c)(6)). The federal regulations provide that such health care providers include podiatrists, dentists, clinical psychologists, optometrists, physician assistants, chiropractors performing certain specified treatments, nurse practitioners and nurse-midwives authorized to practice under state law.

What kind of medical certification may be required by the employer?

The FMLA and CFRA provide that the medical certification set forth the date when the condition commenced; the probable duration of the condition; if the leave is taken to care for a child, spouse or parent, an estimate of the amount of time needed for the care of the individual; a statement that the health condition warrants participation by a family member; a statement of the name, address, telephone number and fax number of the health care provider, type of medical practice or specialization and whether any intermittent or reduced-schedule leaves are medically necessary. 29 C.F.R. section 825.306. Although federal law requires a medical certification to contain appropriate medical facts regarding the nature of the health condition, California law under the CFRA is less strict than federal law and does not require that the condition be identified on the certification (29 U.S.C. section 2613(b); Government Code section 12945.2(k)(1)) and the employer should not ask for such information. An employer must provide the employee with 7 calendar days to cure any certification deficiency. 29 C.F.R. section 825.303.

California employers should use the sample California Department of Labor FMLA Notices available at: www.edd.ca.gov/Disability/PFL_Forms_and_Publications.htm.

When the employee misses more work days on a monthly basis than those specified in the certification, the employer may require them to submit another FMLA request form and to update the information on their medical certification to reflect the need for additional time off. An employer may request recertification of an ongoing condition every six months in connection with an absence by the employee, and for annual medical certifications when a serious health condition extends beyond a single leave year and may request a certification even when the employee is substituting paid leave for unpaid FMLA leave. An employer may also ask for a new certification where the circumstances described by a previous medical certification have changed significantly (including significant changes in the duration and/or frequency of absences). 29 CFR Section 825.308.

Whereas employers may request medical certification under the FMLA and CFRA, such certification is mandatory under FTDI. The medical certification under the FTDI program must include the date when the condition commenced, the probable duration of the condition, an estimate of the amount of time needed for the care of the individual and a statement that the health condition warrants participation by a family member. The certification must also contain a diagnosis and diagnostic code prescribed in the International Classification of Diseases, or, where no diagnosis has yet been obtained, a detailed statement of symptoms. The Employment Development Department have developed medical certification forms. Refer to the following webpage for more information: www.edd.ca.gov/disability/PFLFormsandPublications.htm (Unemployment Insurance Code section 2708 (b)). The Employment Development Depart-

ment have developed certification forms for an employee taking leave for reason of the birth or placement for adoption or foster care of a child of the employee or the employee's domestic partner. Refer to the following webpage for more information: www.edd.ca.gov/ disability/PFL_Forms_and_Publications.htm (Unemployment Insurance Code section 2708 (c)).

May an employer dispute the certification of a health care provider?

Both the FMLA and CFRA provide that in the case of an employee's own serious illness, an employer, at the employer's expense, may require an examination by a second health care provider not employed on a regular basis by the employer. If the second health care provider opinion differs from the opinion given by the employee's health care provider, then the employer at the employer's expense, may require a third opinion, which third opinion will be binding. Although the FMLA also allows second and third opinions for the serious health condition of a family member other than the employee, the CFRA does not (29 U.S.C. section 2613(c) and (d); Government Code section 12945.2(k)(3)).

May employers restrict leave available to an employee based on the availability of another family member or another family member's use of leave?

Under the FMLA, such leave may be limited to a total of 12 weeks as between a husband and wife provided that they are employed by the same employer and the leave is in connection with the birth, adoption or foster care of a child or to care for a sick parent (29 U.S.C. section 2612(f)). The CFRA conforms to federal law except that the restriction on leaves for a husband and wife or registered domestic partners working for the same employer will be applicable only when the leave is in connection with the birth, adoption or foster care of a child (Government Code section 12945.2(q)). However, California law also prohibits discrimination against workers based on their marital status. Thus, it is best not to limit leave if both parents work for the same employer, regardless of whether or not they are married. Otherwise, the employer could open the door to a marital-status bias lawsuit.

An individual is not eligible for FTDI benefits with respect to any day that another family member is ready, willing, and able and available for the same period of time in a day that the individual is providing the required care (Unemployment Insurance Code section 3303.1(a)).

May paid leave be substituted for unpaid leave?

Employers can usually require an employee to use accrued vacation or other paid time off as part of his or her family leave. All paid time off (PTO) is treated as the same, whether it is offered as paid vacation time, sick leave, or personal leave under the employer's policy. 29 C.F.R. section 825.207. (29 U.S.C. section 2612(d)(2); Government Code section 12945.2(e)).

However, it is the employer's responsibility to designate leave paid or unpaid as FMLA qualifying, and to give notice of the designation to the employee. If the employer requires paid leave to be substituted for unpaid leave, the employer may only designate such leave as FMLA leave from the date of the notification to the employee forward.

What is the maximum amount payable to an individual under the FTDI program?

The FTDI program provides up to six weeks of tax-free wage replacement benefits. A worker's weekly benefit amount will be calculated based on the calendar quarter with the highest earnings during the "base period." (Wages earned approximately 5 to 17 months before the beginning of the FTDI claim are included in the base period.) An employee will receive a weekly benefit amount up to 55% of his or her earnings, up to the "maximum weekly benefit amount." For disability leaves beginning as of January 1, 2013 weekly benefits range from $50 to a maximum of $1,067. To qualify for the maximum weekly benefit amount, an individual must earn at least $25,196.37 in a calendar quarter during the base period. The total amount of benefits payable may not be more than the total wages paid to the individual during his or her base period (Unemployment Insurance Code section 3301(c)).

How is the FTDI program funded?

The FTDI program is a component of California's state unemployment compensation disability insurance program and is funded entirely though employee contributions (Unemployment Insurance Code section 3300(g)). The cost of Paid Family Leave insurance is incorporated into the SDI contribution rate. The SDI contribution rate is 1.0 percent. The taxable wage limit in 2013 is $100,880. Wages above this amount are not taxed for SDI.

Do employers have to continue paying for the employer's share of an employee's health benefits while the employee is on leave?

Under both the CFRA and FMLA, employers are required to maintain health insurance for the employee under group health plans as if the employee were still working during the leave. (29 U.S.C. section 2614(c)(1); Government Code section 12945.2(f)). In addition, an employee is also entitled to additional group health coverage under the CAL PDA, please see discussion in the "Pregnancy Leave Requirements Under California Law" section of this Chapter.

Employers that require their employees to pay a portion of their health insurance coverage premium under normal circumstances may require that employees continue to make those payments during a family care or medical leave. Additionally, neither the federal nor the state statutes require the employer to pay premiums for non-health benefits such as life insurance or long-term disability insurance. Nevertheless, federal and state law do impose significant limitations regarding employee contributions because coverage must be continued by the employer until the employee's contributions are more than 30 days late, and in addition to the 30 day period, an employer must give the employees 15 days written notice that the coverage will lapse if payment is not received. If an employer allows the insurance coverage to lapse without giving this notice, the employer will become the employee's insurer until coverage is reinstated. A further limitation is that should coverage be discontinued, the same coverage must be immediately reinstated upon the employee's return without the requirement of a waiting period or any medical examination.

Employers are liable for any harm the employee suffers if they don't reinstate the lapsed benefits after the employee returns to work. An employer's obligation to maintain health benefits under FMLA will stop when an employee informs the employer that he or she will not be returning to work at the end of the leave period or if the employee does not return to work when leave is over. 29 C.F.R. section 825.212. However, see "What is the effect of the FMLA on COBRA continuation coverage?" below on discussion regarding COBRA continuation coverage.

CAUTION

REGARDING DISCONTINUING EMPLOYEES HEALTH INSURANCE COVERAGE BECAUSE OF NON-PAYMENT OF EMPLOYEE CONTRIBUTIONS: Because of the restrictions placed on an employer respecting employee contributions, employers should exercise extreme caution prior to discontinuing an employee's coverage for health or non-health benefits because of non-payment of his or her share of the premium. Since an employee is entitled to immediate reinstatement to any canceled coverage upon return to work without the requirement of any pre-existing condition waiting period or medical examination, an employer should not discontinue any such coverage unless immediate and non-conditional reinstatement is allowed under the terms of the employer's insurance or employee benefit plan.

May an employer recover health insurance premiums from the employee if the employee fails to return to work from the leave?

An employer may recover the premiums from the employee that the employer has paid in the event the employee fails to return to work after expiration of the leave, and the employee's failure to return is for reasons other than problems caused by the serious health condition which necessitated the leave or other circumstances beyond the control of the employee (29 U.S.C. section 2614(c)(2); Government Code section 12945.2(f)).

The federal regulations give several examples of the kind of circumstances which would be considered "beyond the employee's control" and which would preclude the employer from seeking reimbursement of the health insurance premiums from the employee. These examples include the following: a spouse's unexpected transfer to a job more than 75 miles from the employee's worksite; the onset of an unforeseen serious illness of a family member; or a mother's decision not to return to work in order to stay home with a newborn child. Because of the broad nature as to what may be considered "circumstances beyond the employee's control," it is important for employers to obtain a full explanation from the employee as to why they are not returning to work from the leave before seeking reimbursement for the health care premiums.

May an employer refuse to grant a leave based on business considerations?

Neither the CFRA or FMLA allow a general hardship defense. A "key employee" exception to job reinstatement does exist, but as described below, the exception is only applicable to the highest compensated employees and is to be applied in only very narrow circumstances.

Under what circumstances may a "key employee" be denied reinstatement to his or her job after a leave?

If an employer can demonstrate that job reinstatement would cause substantial and grievous economic injury, an employer may deny reinstatement from a leave to any employee who is among the highest paid 10% of the employees employed by the employer within 75 miles of the facility at which the employee is employed (29 U.S.C. section 2614(b); Government Code section 12945.2(r)).

An employer who believes that reinstatement may be denied to a key employee must give notice to the key employee that he or she qualifies as a key employee or else the employer will not be able to deny reinstatement even if substantial and grievous economic injury would result from reinstatement. Additionally, as soon as an employer makes a good faith determination that it will deny reinstatement to

the key employee, it must so notify the employee in writing of its determination. If an employee is already on leave when such notification by the employer is received, the employee must be given a reasonable opportunity to return to work. If an employee does not return to work after the notification, the employee continues to be entitled to 12 weeks of health benefits ordinarily paid for by the employer.

It is clear from the federal regulations that the "substantial and grievous economic injury" test will be difficult to satisfy and will only rarely be met by an employer.

To what job must an employee be reinstated at the end of his or her leave?

Employees have reinstatement rights under the FMLA and CFRA and therefore employees who take unpaid leave under those Acts must be reinstated to the same or an equivalent job with equivalent employment benefits, pay and other terms and conditions of employment and at the same or similar geographic location as the position held prior to the leave (29 U.S.C. section 2614(a); Government Code section 12945.2(a)).

The FTDI program does not have its own reinstatement provision and therefore businesses with fewer than 50 employees are not required to hold a job open for a worker receiving FTDI benefits unless required by existing company policy.

What rights does an employee have if his or her job is eliminated during the period of the employee's leave?

The FMLA provides that an employee whose position has been eliminated because of legitimate business needs unrelated to the employee's leave, has no greater right to reinstatement than as if the employee had been continuously employed. An employer has the burden of proving, by a preponderance of the evidence, that an employee would not otherwise have been employed at the time reinstatement is requested in order to deny reinstatement.

Is there a requirement that employers advise their employees of the provisions of FMLA?

Employers are required to provide 4 phases of notices regarding FMLA 29 CFR Section 825.300:

(1) General Notices. All covered employers must post and keep posted on its premises in a conspicuous place (such as on an employee bulletin board) a notice no smaller than 8½" x 11" explaining the Act's provisions and its enforcement procedures ("employee notice"), and there is a $100 fine for each violation (29 U.S.C. section 2619(a) and (b)). Furthermore, an employer that fails to post the required notice cannot require an employee to provide advance notice of an FMLA leave. If a significant portion of the employer's workforce are not literate in English, the employer is responsible for translating the notice into the language or languages spoken by such employees.

All employers, regardless of size, are required to post this information. Updated posters and additional information are available on the US Department of Labor web site at www.dol.gov/whd/regs/compliance/posters/fmlaen.pdf

The FMLA also requires that if an employer has an employee handbook, manual or written policy, information regarding FMLA entitlements and employee obligations must be included in the handbook or other documents or document. If an employer does not have any handbook or other written policy, the employer must provide written guidance to an employee regarding all of the employee's rights and obligations under the FMLA when hired.

(2) Eligibility Notice. When an employee requests FMLA leave or the employer has knowledge that a leave may be needed for an FMLA-qualifying reason, the employer must notify the employee within five days whether the employee is eligible to take FMLA leave.

(3) Rights and Responsibilities Notice. Along with the Eligibility Notice, when an employee provides notice of a need for a leave, the FMLA requires that the employer provide the employee with a notice of Rights and Responsibilities detailing the specific expectations and obligations of the employee and explaining any consequences of a failure to meet these obligations. The notice should include: an explanation that leave may be designated and counted against the employee's FMLA entitlement; the employee's rights to substitute employer-sponsored paid leave benefits for FMLA unpaid leave, along with an explanation of the employer's paid leave policy terms and conditions; the employees right to maintain health benefits during FMLA leave and an explanation of how to pay health benefit premiums; an explanation of job restoration rights; and information about medical certification, if the employer requires one, along with a certification form that complies with California law. A sample form "Notice of Eligibility and Rights and Responsibilities" which may be used to satisfy Notice requirement (2) and (3) may be found on the DOL website at www.dol.gov/whd/forms/WH-381.pdf.

(4) Designation Notice. Once the employer has enough information to determine whether the leave is for an FMLA – qualifying reason, the employer must provide a designation notice informing the employee whether the leave will be counted as FMLA leave within five business days unless there are extenuating circumstances. This is very important because if an employer fails to mention an em-

ployee's obligation, it cannot take any action against the employee for failure to meet it. This designation notice may be provided at the same time as the eligibility notice or right after the employee requests leave, if the employer already knows the leave qualifies under FMLA. Retroactive designation notice is permitted if the employer hasn't provided timely notice and the notice delay won't harm the employee. Employers and employees also have the option to agree to retroactively designate FMLA leave. The specific notice should include, as appropriate: any reason that the leave is not designated as FMLA leave, such as insufficient information or a nonqualifying reason; the employer's requirement that paid leave be substituted for unpaid leave; the requirement that the employee present a fitness-for-duty certification before being reinstated along with a list of essential job functions for the employee's position. A sample "Designation Form" which maybe be used to satisfy Notice requirement (4) is available on the DOL website: www.dol.gov/whd/forms/WH-382.pdf.

Employers who do not provide the required notices may be held liable for lost compensation, benefits, and other consequences if the employee can show that he or she has been personally harmed as a result of not receiving any notice. Although an employer can retroactively designate FMLA leave, if an employee suffers harm because he or she did not receive timely notices, the employer can nonetheless be liable for any damages incurred by the employee.

California's family leave law also requires a notice to be posted in a conspicuous place regarding the provisions of the CFRA, as well as requiring the notice be made available to all current and new employees. The CFRA regulations provide a state approved combined notice of an employee's CFRA leave rights and pregnancy disability leave rights. California law also provides that any employer whose workforce contains 10% or more of persons who speak a language other than English as their primary language must translate the notice into the language or languages spoken by these employees.

The California regulations also require that if an employer publishes an employee handbook, the employer must also include a description of the CFRA in the next edition of the handbook which it publishes. Although most provisions of the CFRA have been conformed to the FMLA, an employer should be careful to include in its handbook any differences in California law which are more generous to employees than federal law. In addition, and as described in more detail below, the handbook should include a description of the CFRA provisions which allow an employee to take, in addition to the leaves provided for in the CFRA and FMLA, a pregnancy disability leave under the California Pregnancy Disability Act ("CAL PDA").

The California regulations also encourage the employer to give a copy of the CFRA notice to all current and new employees and otherwise make the notice available to all of its employees.

The Director of Employment Development has provided to each employer of employees a notice informing workers of their disability insurance rights and benefits due to the employee's own sickness, injury, or pregnancy, or the employee's need to provide care for any sick or injured family member or to bond with a new child. The notice must be given to each new employee hired, and to each employee leaving work, due to pregnancy, nonoccupational sickness or injury, or the need to provide care for any sick or injured family member or to bond with a new child. (Unemployment Insurance Code section 2613(c)).

Because the FTDI program is administered by the Employment Development Department and is entirely funded by employee contributions to State Disability Insurance, the program creates very few formal obligations to the employers. Employers are required to deduct paid family leave insurance contributions from employee wages, display a poster providing information on paid family leave benefits and distribute an informational brochure to all new employees and all employees who leave work due to a qualifying event. The required notice are at the Employment Development Department web site, www.edd.ca.gov.

What notice does an employee have to give an employer when the need for FMLA leave is foreseeable?

An employee must provide the employer with at least 30 days advance notice before FMLA leave is to begin if the need for the leave is foreseeable because of an expected birth, or placement for adoption or foster care, or a planned medical treatment for a serious health condition of the employee or a family member. If 30 days notice is not practicable, as when there is a lack of knowledge as to when the leave will be required to begin, a change in circumstances or a medical emergency, notice must be given as soon as practicable. (29 U.S.C. section 2612(e)). As soon as practicable means as soon as both possible and practical, taking into account all of the facts and circumstances in the individual case. 29 C.F.R. section 825.302. Employees may follow "usual and customary" notice requirements for requesting leave, such as a call-in procedure or contacting a specific individual. However, if an employee calls in saying only that he or she is "sick," without more, the notice will not be considered sufficient to trigger FMLA obligations. However, employees are obligated to respond to an employer's

questions about whether a request for unpaid leave is FMLA qualifying.

At a minimum, an employee must provide at least verbal notice sufficient to make the employer aware that the employee needs FMLA-qualifying leave, and the anticipated timing and duration of the leave. The employee need not expressly assert rights under the FMLA or even mention the FMLA, but may state that leave is needed for an expected birth or adoption, for example. The employer should inquire further of the employee if it is necessary to have more information about whether FMLA leave is being sought by the employee, and obtain the necessary details of the leave to be taken. 29 C.F.R. section 825.302(c).

Similarly, under the CFRA, an employee must provide the employer with reasonable advance notice of the need for the leave (Government Code section 12945.2(h)). An employee must provide at least verbal notice sufficient enough to make the employer aware that the employee needs CFRA-qualifying leave, and the anticipated timing and duration of the leave. *Gibbs v. American Airlines, Inc.* (1999) 74 Cal.App.4th 1. The employee need not expressly assert the employee's rights under the CFRA, or even mention the CFRA, to meet the notice requirement, but the employee must at least state the reason the leave is needed. *Id.* Absent unusual circumstances, a common cold or flu is not an incapacitating illness under CFRA, and mere absence from work by an employee is not adequate notice to the employer that the employee requires CFRA-qualifying leave. *Id.*

Must an employee obtain a formal fitness-for-duty certification from his or her healthcare provider, stating that the employee is ready to return to work?

Employees are required to obtain a formal fitness-for-duty certification from his or her healthcare provider, stating that the employee is ready to return to work. Employers may also require the healthcare provider to certify that the employee can perform the essential job functions specified by the employer; a list of essential functions must be given to the employee with the Designation Notice.

Employers can also require an employee to furnish fitness-for-duty certifications once every 30 days if the individual has used intermittent leave and reasonable safety concerns exist.

A representative of the employer, but not the employee's direct supervisor, may contact the employee's health provider directly to authenticate fitness-for-duty certifications. 29 C.F.R. section 825.312.

Does the CFRA and FMLA affect a pregnant employee's rights to take a disability leave under the California Pregnancy Discrimination Act ("CAL PDA")?

The CFRA expressly provides that an employee is entitled to take, in addition to the leave provided for in the CFRA and FMLA, the pregnancy disability leave provided for in the CAL PDA (Government Code section 12945.2(s)). Thus, so long as an employee is qualified to take a pregnancy disability leave, a pregnant employee would be entitled to take a pregnancy disability leave concurrently under the FMLA and CAL PDA for a period of up to 4 months (12 weeks of which would be a combined FMLA and CAL PDA leave, and the remaining time simply a CAL PDA leave) and thereafter an additional 12 week leave under the CFRA in order to care for a newborn child (the first six weeks of which can be paid leave under FTDI). Although a leave of up to 7 months could be taken in these circumstances, the employee would qualify for only 12 weeks of paid health insurance (Government Code section 12945.2(f)(1)).

In connection with a pregnancy disability leave under the FMLA and CAL PDA, federal regulations provide that employees are not required to designate whether the leave they are taking is FMLA leave or leave under state law, and an employer must comply with the appropriate and applicable provisions of both laws. Thus, employees taking a pregnancy disability leave may not be required to use vacation time because although the FMLA allows an employer to require the use of vacation time, the CAL PDA does not.

Note

REGARDING OVERLAPPING WITH OTHER LAWS: In addition to the interplay between the family care and medical leave requirements under the CFRA and FMLA and the pregnancy disability leaves of absence allowed by the CAL PDA as discussed above, the CFRA and FMLA can also overlap with the Americans with Disabilities Act (ADA) and state workers compensation laws which govern work related injuries (workers' comp), and employers need to understand how each applies to given situation. Although FMLA and CFRA leave is limited to a period of twelve weeks, there is no specific time frame for the duration of a workers' comp leave. In order to start the clock for an employer's obligations under the CFRA or FMLA, employers should have a written policy stating that an employee eligible for time off for both workers' comp and the CFRA or FMLA should take them simultaneously and FMLA-CFRA notices should be provided to the injured employee at the same time that it is notified of the workers' comp leave of absence.

An employee's health condition under the FMLA and CFRA may also be a disability as defined under the ADA. For example, one accommodation that may be given to an employee with a disability as defined by the ADA is to provide an employee with periodic time off if it doesn't impose undue hardship on the business (for example, to allow the employee to obtain treatment for cancer). As with the workers' comp leave discussed above, this ADA periodic time off can and should also be counted against FMLA or CFRA leave.

Further,* Sanchez v. Swissport, Inc.*, 2013DJDAR 2400 (Cal. App. 2d Dist., Febr21, 2013), provides that in addition to pregnancy disability leave, women are now allowed to qualify for disability leave, which has no legally specified range, and also still receive 12 weeks of "baby bonding" leave under the CFRA.

An employer should consider an employee's rights under each applicable law separately before determining the employee's leave rights and seek the advice of legal counsel if there is any uncertainty as to how the various laws affect an employee's request for leave.

What is the effect of the FMLA on COBRA continuation coverage?

If an employee takes leave under the FMLA, a qualifying event for purposes of COBRA will occur on the last day of the FMLA leave and the maximum COBRA coverage period is measured from the date that coverage ends for the employee and his or her covered spouse and covered dependents because of the qualifying event. For example, if an employee does not return to work at the end of the 12-week leave, then the qualifying event will occur on the last day of the 12-week leave. If an employee informs his or her employer any time during the period of the 12-week leave that the employee will not be returning to work, the qualifying event will occur on the date the employee notifies the employer that he or she will not be returning to work. The maximum COBRA coverage for which the employee is eligible is measured from the date coverage will end because of the qualifying event.

Therefore, proper COBRA notices should be provided to the employee and the employee's covered spouse and covered dependents immediately following the employee's failure to return to work after a 12-week FMLA leave or upon the employee's notification during the leave that he or she will not be returning to work.

CAUTION

REGARDING EMPLOYEE COBRA RIGHTS: Employers should be aware of their COBRA obligations when an employee is taking both a pregnancy disability leave under the CAL PDA and FMLA and a family care leave under the CFRA. For example, in circumstances where the employee is taking a pregnancy disability leave and family care leave to care for the newborn child, and after 12 weeks has elapsed and the employer is no longer responsible to pay for the employee's health insurance although the employee remains on leave, proper COBRA notices should be sent to the employee and his or her covered spouse and covered dependents. The employee and other covered family members would then be entitled to continue the medical plan during the remaining portion of the leave by paying COBRA premiums.

Domestic Violence Employment Leave

California Labor Code sections 230 and 230.1 make it illegal for employers of 25 or more persons to discharge or discriminate against an employee who is a victim of domestic violence for taking time off from work for any of the following reasons:

- To seek medical attention for domestic violence injuries;
- To obtain services from a domestic violence shelter program or a rape crisis center as a result of domestic violence;
- To obtain psychological counseling relating to domestic violence; or
- To participate in safety planning and take other actions to increase safety from future domestic violence.

Additionally, for all employers, the California law requires victims of domestic violence to provide reasonable advance notice that he or she requires time off for one of the above reasons, unless the advance notice is not feasible. It also prohibits the employer from taking action against an employee for an unscheduled absence if the employee provides certification to the employer. Certification may be sufficiently provided by any of the following:

- A police report indicating that the employee was a victim of domestic violence;
- A court order protecting or separating the employee from the perpetrator of an act of domestic violence, or other evidence from the court or prosecuting attorney that the employee appeared in court;

- Documentation from a medical professional, domestic violence advocate, health care provider, or counselor that the employee was undergoing treatment for physical or mental injuries or abuse resulting in victimization from an act of domestic violence.

To the extent allowed by the law, employers shall maintain the confidentiality of an employee requesting leave under this provision. Finally, it limits the length of unpaid leave an employee may take to 12 weeks.

Federal Pregnancy Discrimination Act

Introduction

The Pregnancy Discrimination Act, codified in 42 U.S.C. section 2000e(k) and which Act constitutes an amendment to Title VII of the Federal Civil Rights Act, applies to virtually all employers with 15 or more employees and essentially provides that a covered employer be aware of the non-discriminatory pregnancy related practices which are mandated by the Act.

The basic principle of the Pregnancy Discrimination Act is that women affected by pregnancy and related medical conditions must be treated the same as other employees and job applicants on the basis of their ability or inability to work. Thus, discrimination on the basis of pregnancy, childbirth or related medical conditions constitutes unlawful sex discrimination under Title VII of the Civil Rights Act.

The provisions of the Pregnancy Discrimination Act protect a woman against such practices as being fired or refused a job or a promotion merely because she is pregnant or has had an abortion. A pregnant woman cannot be forced to leave work as long as she is able to perform the essential duties of her job.

With respect to fringe benefits, such as disability benefits, sick leave, and health insurance, the same principle applies. A woman unable to work for pregnancy related reasons is entitled to disability benefits or sick leave on the same basis as employees unable to work for other medical reasons. Health insurance provided for employees must cover expenses for pregnancy related conditions on the same basis as expenses for other medical conditions.

EEOC Interpretation of Pregnancy Discrimination Act

The Equal Employment and Opportunity Commission ("EEOC"), a federal agency, directs the enforcement of Title VII, including the Pregnancy Discrimination Act. The EEOC has issued detailed questions and answers regarding its interpretation of the Pregnancy Discrimination Act which are reprinted as an appendix to 29 C.F.R. section 1604 (1982). Set forth below are a sample of the questions and answers which contain important guidelines for employers to follow with respect to pregnancy related matters.

EEOC Questions and Answers

What procedures may an employer use to determine whether to place on leave as unable to work a pregnant employee who claims she is able to work or deny leave to a pregnant employee who claims that she is disabled from work?

An employer may not single out pregnancy related conditions for special procedures for determining an employee's ability to work. However, an employer may use any procedure used to determine the ability of all employees to work. For example, if an employer requires its employees to submit a doctor's statement concerning their inability to work before granting leave or paying sick benefits, the employer may require employees affected by pregnancy related conditions to submit such statements. (See also the certification requirements under California Law relating to pregnancy leaves discussed below.) Similarly, if an employer allows its employees to obtain doctor's statements from their personal physicians for absences due to other disabilities or return dates from other disabilities, it must accept doctor's statements from personal physicians for absences and return dates connected with pregnancy related disabilities.

Can an employer have a rule which prohibits an employee from returning to work for a predetermined length of time after childbirth?

No.

If an employee has been absent from work as a result of a pregnancy related condition and recovers, may her employer require her to remain on leave until after her baby is born?

No. An employee must be permitted to work at all times during pregnancy when she is able to perform her job.

May an employer's policy concerning the accrual and crediting of seniority during absences for medical conditions be different for employees af-

fected by pregnancy related conditions than for other employees?

No. An employer's seniority policy must be the same for employees absent for pregnancy related reasons as for those absent for other medical reasons.

For purposes of calculating such matters as vacations and pay increases, may an employer credit time spent on leave for pregnancy related reasons differently than time spent on leave for other reasons?

No. An employer's policy with respect to crediting time for the purpose of calculating such matters as vacations and pay increases cannot treat employees on leave for pregnancy related reasons less favorably than employees on leave for other reasons. For example, if employees on leave for medical reasons are credited with the time spent on leave when computing entitlement to vacation or pay raises, an employee on leave for a pregnancy related disability is entitled to the same kind of time credit.

Must an employer hire a woman who is medically unable, because of a pregnancy related condition, to perform a necessary function of a job?

An employer cannot refuse to hire a woman because of her pregnancy related condition so long as she is able to perform the major functions necessary to the job. Nor can an employer refuse to hire her because of its preferences against pregnant workers or the preferences of co-workers, clients, or customers.

May an employer limit disability benefits for pregnancy related conditions to married employees?

No.

For what length of time must an employer who provides income maintenance benefits for temporary disabilities provide such benefits for pregnancy related disabilities?

Benefits should be provided for as long as the employee is unable to work for medical reasons unless some other limitation is set for all other temporary disabilities, in which case pregnancy related disabilities should be treated the same as other temporary disabilities.

Must an employer who provides benefits for long-term or permanent disabilities provide such benefits for pregnancy related conditions?

Yes. Benefits for long-term or permanent disabilities resulting from pregnancy related conditions must be provided to the same extent that such benefits are provided for other conditions which result in long-term or permanent disability.

If an employer provides benefits to employees on leave, such as installment purchase disability insurance, payment of premiums for health, life or other insurance, continued payments in pension, saving or profit sharing plans, must the same benefits be provided for those on leave for pregnancy related conditions?

Yes. The employer must provide the same benefits for those on leave for pregnancy related conditions as for those on leave for other reasons.

Can an employee who is absent due to a pregnancy related disability be required to exhaust vacation benefits before receiving sick leave pay or disability benefits?

No. The employer cannot impose this requirement on an employee absent for a pregnancy related cause.

Must an employer provide health insurance coverage for the medical expenses of pregnancy related conditions of the spouses of male employees; or for the dependents of all employees?

Where an employer provides no coverage for dependents, the employer is not required to institute such coverage. However, if an employer's insurance program covers the medical expenses of spouses of female employees, then it must equally cover the medical expenses of spouses of male employees, including those arising from pregnancy related conditions.

But the insurance does not have to cover the pregnancy related conditions of other non-spouse dependents as long as it excludes the pregnancy related conditions of the dependents of male and female employees equally.

Must an employer provide the same level of health insurance for the pregnancy related medical conditions of the spouses of male employees as it provides for its female employees?

No. It is not necessary to provide the same level of coverage for the pregnancy related medical conditions of spouses of male employees as for female employees. However, where the employer provides coverage for the medical conditions of the spouses of its employees, then the level of coverage for pregnancy related medical conditions of the spouses of male employees must be the same as the level of coverage for all other medical conditions of the spouses of female employees. For example, if the employer covers employees for 100% of reasonable and customary expenses sustained for a medical condition, but only covers dependent spouses for 50% of reasonable and customary expenses for their medical conditions, the pregnancy related expenses of the male employee's spouse must be covered at the 50% level. 462 U.S. 669.

May an employer offer optional dependent coverage which excludes pregnancy related medical conditions or offers less coverage for pregnancy related conditions where the total premium for the optional coverage is paid by the employee?

No. Pregnancy related medical conditions must be treated the same as other medical conditions under any health or disability insurance or sick leave plan available in connection with employment, regardless of who pays the premiums.

Where an employer provides its employees a choice among several health insurance plans, must coverage for pregnancy related conditions be offered in all of the plans?

Yes. Each of the plans must cover pregnancy related conditions. For example, an employee with a single coverage policy cannot be forced to purchase a more expensive family coverage policy in order to receive coverage for her own pregnancy related condition.

On what basis should an employee be reimbursed for medical expenses arising from pregnancy, childbirth or related conditions?

Pregnancy related expenses should be reimbursed in the same manner as are expenses incurred for other medical conditions. Therefore, whether a plan reimburses the employees on a fixed basis, or a percentage of reasonable and customary charge basis, the same basis should be used for reimbursement of expenses incurred for pregnancy related conditions. Furthermore, if medical costs for pregnancy related conditions increase, reevaluation of the reimbursement level should be conducted in the same manner as are cost reevaluations of increases for other medical conditions.

Coverage provided by a health insurance program for other conditions must be provided for pregnancy related conditions. For example, if a plan provides major medical coverage, pregnancy related conditions must be so covered. Similarly, if a plan covers the cost of a private room for other conditions, the plan must cover the cost of a private room for pregnancy related conditions. Finally, where a health insurance plan covers office visits to physicians, prenatal and post-natal visits must be included in such coverage.

May an employer impose a different deductible for payment of costs for pregnancy related medical conditions than for costs of other medical conditions?

No. Neither an additional deductible, an increase in the usual deductible, nor a larger deductible can be imposed for coverage for pregnancy related medical costs, whether as a condition for inclusion of pregnancy related costs in the policy or for payment of the costs when incurred. Thus, if pregnancy related costs are the first incurred under the policy, the employee is required to pay only the same deductible as would otherwise be required had other medical costs been the first incurred. Once this deductible has been paid, no additional deductible can be required for other medical procedures. If the usual deductible has already been paid for other medical procedures, no additional deductible can be required when pregnancy related costs are later incurred.

Can an employer self-insure benefits for pregnancy related conditions if it does not self-insure benefits for other medical conditions?

Yes, so long as the benefits are the same. In measuring whether benefits are the same, factors other than the dollar coverage paid should be considered. Such factors include the range of choice of physicians and hospitals, and the processing and promptness of payment of claims.

Can an employer discharge, refuse to hire or otherwise discriminate against a woman because she has had an abortion?

No. An employer cannot discriminate in its employment practices against a woman who has had an abortion.

Is an employer required to provide fringe benefits for abortions if fringe benefits are provided for other medical conditions?

All fringe benefits other than health insurance, such as sick leave, which are provided for other medical conditions, must be provided for abortions. Health insurance, however, need be provided for abortions only where the life of the woman would be endangered if the fetus were carried to term or where medical complications arise from an abortion.

If complications arise during the course of an abortion, as for instance excessive hemorrhaging, must an employer's health insurance plan cover the additional cost due to the complications of the abortion?

Yes. The plan is required to pay those additional costs attributable to the complications of the abortion. However, the employer is not required to pay for the abortion itself, except where the life of the mother would be endangered if the fetus were carried to term.

May an employer elect to provide insurance coverage for abortions?

Yes. The Act specifically provides that an employer is not precluded from providing benefits for abortions whether directly or through a collective bargaining agreement, but if an employer decides to cover the cost of abortions, the employer must do so

in the same manner and to the same degree as it covers other medical conditions.

California Law Prohibiting Pregnancy Discrimination

FEPA Restrictions

California law prohibits state employers in the public and private sectors from engaging in unlawful discrimination based on any of eleven characteristics, including pregnancy. Sex discrimination specifically includes discrimination relating to pregnancy, childbirth, or medical conditions relating to pregnancy or childbirth (Government Code section 12926(p); see also Government Code sections 12940(a), 12940(j)(4)(C), and 12945(c)). Employers covered by Title VII are subject to state sanctions for any form of pregnancy discrimination in connection with the hiring or firing of an employee or with respect to the employee's compensation, conditions or privileges of employment. Employers may also not discriminate, harass, or take other adverse actions on the basis of perceived pregnancy. Perceived pregnancy is defined as "being regarded or treated by an employer or other covered entity as being pregnant or having a related medical condition."

Additionally, California law further prohibits pregnancy discrimination relating to employee transfer requests to both Title VII and non-Title VII employers. This change is very significant because as discussed below in the section regarding enforcement of discrimination laws, the remedies available under California law are potentially much greater than those available under Title VII.

The California legislation prohibiting pregnancy discrimination is contained principally in section 12945 of the Government Code ("California Pregnancy Discrimination Act"), which amended the California Fair Employment and Housing Act ("FEHA"). The California Department of Fair Employment and Housing ("DFEH") directs enforcement of the law and the Fair Employment and Housing Commission ("FEHC") promulgates rules and regulations regarding the employer's compliance with California law.

The FEHA defines an employer as a person regularly employing five or more persons. (Government Code section 12926(d)). Pregnancy discrimination has also been held to be sex discrimination under the California Constitution in the court decision of *Badih v. Myers* (1995) 43 Cal.Rptr.2d 229. In *Badih*, the court held that an employee could maintain an action against her former employer for wrongful discharge based on her pregnancy even though her employer was not subject to the FEHA because he employed less than five people.

California law also has enacted strict requirements with respect to the issue of pregnancy leaves of absence (Government Code section 12945) and requests by pregnant employees for temporary job transfers to a less strenuous or hazardous position (Government Code section 12945) and a detailed discussion of these requirements is set forth below.

It is important to note that because Government Code section 12926(c) defines the term "employee" broadly, California pregnancy discrimination provisions appear to apply to all female employees, including probationary, temporary and part-time employees, as well as to regular full-time employees.

Pregnancy Leave Requirements under California Law

California employers with five or more employees are subject to rigid requirements regarding pregnancy leaves of absence, which regulations are set forth in 2 C.C.R. section 7291.2 et seq. The regulations mandate the following employment practices with respect to pregnancy leaves of absence:

a. An employer must allow an employee disabled by pregnancy, childbirth and related conditions to take up to a four month leave of absence, regardless of the employer's policy with respect to other temporary disability leaves. If an employer has a policy of granting temporary disability leave for other medical conditions in excess of four months, then the same disability leave in duration and all other respects must be provided for pregnancy related conditions. The pregnancy leave does not need to be taken in one continuous period of time.

b. An employer may require an employee to use any accrued sick leave during the unpaid portion of her pregnancy disability leave. Additionally, an employee may elect to use any accrued sick leave and any accrued vacation time or other paid leave pursuant to the employer's policy before beginning the remaining unpaid portion of her disability leave.

c. If an employee has taken a pregnancy related disability leave up to four months, and the leave exceeds the employer's temporary disability policy, she cannot be penalized because of the leave and should be treated in the same manner as any other employee who returns from a temporary disability leave.

d. As a condition of granting a pregnancy disability leave or transfer, the employer may request a

medical certification so long as the contents of the certification comply with the requirements of the regulations.

e. An employee on a temporary pregnancy disability leave for a period not exceeding four months has a right to return to her same job, or under very limited conditions, to a substantially similar job, unless to do so would substantially undermine the employer's ability to operate its business safely and efficiently or the failure to do so is for other legitimate business reasons unrelated to the employee's leave of absence. Non-reinstatement of an employee to a comparable position requires the employer to prove either: (a) that the employer would not have offered a comparable position to the employee if she would have been continuously at work during the pregnancy disability leave or transfer period, or (b) that there is no comparable position available.

f. Employers are required to post a notice regarding an employee's right to request pregnancy disability leave or transfer. If an employer has a handbook which describes other types of temporary disability leaves or transfers available to its employees, the employer must include a description of pregnancy disability leave or transfer in the next edition of its handbook. The same notice must also be given to an employee when she actually advises an employer that she is pregnant or inquires about pregnancy disability leaves or transfers. The California regulations now contain a sample combined notice of an employee's rights with respect to pregnancy disability leaves and family care and medical leaves, which notice is suitable for use by all employers with 50 employees or more. The California regulations also contain a sample notice of an employee's rights with respect to pregnancy disability leave which is suitable for employers with less than fifty employees who are not subject to California or federal family care and medical leaves. The notice must be translated into any language spoken by 10% or more of an employer's work force.

g. An employee's entitlement to CAL PDA leave varies based on the number of hours typically worked in a week. A "four-month leave" now considers time off based upon the number of days or hours the employee would normally work within four calendar months. An employee who works 40 hours per week is entitled to 693 hours of leave (based on 17 1/3 weeks). Employees who work more or less than 40 hours a week (including employees with variable work schedules) are entitled to four months of leave on a proportional basis. For example, an employee who works 20 hours per week would be entitled to 346.5 hours of leave, and an employee who works 48 hours per week would be entitled to 832 hours of leave.

h. An employer shall maintain and pay for group health coverage for an eligible female employee who takes pregnancy disability leave for the duration of the leave, not to exceed four months over the course of a 12-month period, beginning on the date the pregnancy disability leave begins, at the same level and under the same conditions that coverage would have been provided if the employee had continued in employment continuously for the duration of the leave. The time the employer maintains and pays for group health coverage during pregnancy disability leave shall not be used to meet an employer's obligations to pay for 12 weeks of group health coverage during leave taken under CFRA. This shall be true even where an employer designates pregnancy disability leave as family and medical leave under FMLA. For example, for employer with 50 or more employees, an employee would be entitled to health coverage for her four months of pregnancy disability leave and an additional 12 weeks for a CFRA "bonding" leave. However for employers with less than 50 and more than 5 employees, the employee would be entitled to the CAL PDA's 4 months of group health coverage.

NOTE

REGARDING PREGNANCY LEAVE: Because the pregnancy leave regulations described above are very detailed and thorough and strictly enforced by the DFEH, employers are strongly advised to consult their legal counsel regarding their legal obligations in circumstances where an employee may be adversely affected by the employer's action when the employee is on leave due to a pregnancy related condition or upon the employee's return from a pregnancy related leave.

PRACTICAL TIP

Employers should remember that an employee is entitled only to Cal PDA leave when she is disabled by pregnancy or a related medical condition, such as abortion, miscarriage or morning sickness. Under current regulations, an employee is disabled when she is unable to perform the essential duties of her job and in the absence of other complications, an employee is often medically ready to return to work 6 to 8 weeks after she has had a child. An employee will also be considered to be "disabled by pregnancy" if she is suffering from severe morning sickness or needs to take time off for prenatal care. If the employer institutes a similar practice

for other temporarily disabled employees, an employer may require written confirmation from the employee's physician certifying the existence of a disability before leave is granted. An employer may also require an employee who plans to take a pregnancy disability leave to give the employer reasonable notice of the date the leave will commence and the estimated duration of the leave. Thirty days advance notice is considered reasonable where practicable under the circumstances. Whatever the employer requires, the employer must give the employee reasonable notice of such requirements and it is recommended that an employer circulate a written policy for an employee to initial, setting forth the employer's temporary disability requirements and the effective date of the same.

Temporary Transfer Rights of Pregnant Employees Under California Law

California law has also enacted two rules relating to temporary transfers of pregnant employees, which rules are contained in Government Code section 12945 and which apply to all employers with 5 or more employees.

The first rule provides that if an employer has a policy or practice requiring or authorizing the transfer of a temporarily disabled employee to a less strenuous or hazardous position for the duration of the disability, a pregnant employee temporarily disabled by pregnancy is entitled to the same right to transfer to a less strenuous or less hazardous position during her pregnancy.

The second rule applies to those employers who do not have a policy or practice that requires or authorizes transfers of temporarily disabled employees. It requires employers to honor the request of a pregnant employee to temporarily transfer to a less strenuous or hazardous position for the duration of her pregnancy if the request is made on the advice of her physician and so long as the temporary transfer can be reasonably accommodated. This obligation exists whether or not the employer has given other disabled employees such a transfer.

There are limitations in the law to an employer's obligation to transfer a pregnant employee. Specifically, employers need not accommodate a pregnant employee by doing any of the following: creating additional employment that would not otherwise be created; discharging any employee; transferring any employee with more seniority than the pregnant employee; or promoting any employee who is not qualified to perform the job.

State Disability Insurance

In the past, California State Disability Insurance (SDI) benefits payable to working women with normal pregnancies were more limited than benefit payments for other disabilities. The limitations that applied in both the public and the private sector have been replaced by legislation that now makes SDI benefits for normal pregnancy related disabilities available on the same terms and conditions as other disabilities. (Unemployment Insurance Code section 2626).

California Unemployment Insurance Code section 2613 requires the Director of Employment Development of the State of California to develop and maintain a program of education concerning disability insurance rights and benefits. The director is required to provide each employer with a notice informing workers of their disability insurance rights and benefits due to sickness, injury, or pregnancy. The notice comes by way of a booklet entitled State Disability Insurance, and may be obtained from the Employment Development Department's website at www.edd.ca.gov/direp/dipub.htm. The notice is required to be given by the employer to each new employee hired and to each employee leaving work due to pregnancy or non-occupational sickness or injury.

This notice was broadened to include notifying workers of their disability insurance rights and benefits due to the need to provide care for any sick or injured family member or to bond with a new child, pursuant to the FTDI program discussed in the "Family Care and Medical Leaves" section of this article. The notice instructs the employee to provide notification of the reason for taking leave in a manner consistent with company policy (Unemployment Insurance Code section 2613).

Enforcement of Discrimination Laws

FEHA Enforcement of California Discrimination Laws

The California Fair Employment and Housing Act ("FEHA") has created two administrative bodies: The Department of Fair Employment and Housing (DFEH) whose function is to investigate, conciliate and seek redress of claimed discrimination, and the Fair Employment and Housing Commission (FEHC) which performs adjudicatory and rule-making functions. An aggrieved person may file a verified complaint with the DFEH within one year from the date of the unlawful practice (Government Code section 12960), and the Department must then

promptly investigate the matter (Government Code section 12963). If the Department deems a claim valid, it seeks to resolve the matter, in confidence, by conference, conciliation and persuasion (Government Code section 12963.7). If the Department fails to resolve the matter this way, it may issue an accusation to be heard by the Fair Employment and Housing Commission (Government Code sections 12965(a) and 12969). The Department acts as prosecutor on the accusation, and argues the complainant's case before the Commission, with all expenses paid by the Department.

If an accusation is not filed within 150 days after the filing of the complaint or if the Department earlier determines not to prosecute the complaint, and the matter is not otherwise resolved, the DFEH must give the complainant a "right to sue" letter. The complainant may then bring a civil suit in Superior Court within one year after receiving the right to sue letter (Government Code section 12965(b)). Because courts have recognized that premature judicial intervention could frustrate the objectives of the FEHA to have such matters resolved in an administrative forum, an employee must first invoke and exhaust the administrative remedies that are available under the FEHA before initiating a civil court action based on alleged discrimination prohibited under California law. However, as a practical matter, any complainant who wishes to sue an employer in civil court will be given a "right to sue" letter by the DFEH, as early as the first day a complaint is filed with the Department.

A Department investigation generally consists of examining the employer's statements given in response to the allegations made, and reviewing the information and data provided to the Department by both the employer and complainant. The Department will interview persons with information relevant to the charges made and can exercise its authority to compel testimony and the production of materials when it deems such action necessary. Occasionally, conferences are held with the complaining employee and employer in order to discuss a resolution of the matter, although a hearing is not held unless a formal accusation is filed against the employer.

Until recently, the DFEH refused to accept complaints against Title VII employers that accused the employers of discriminating against pregnant women by firing them, refusing to hire or promote them, or denying them equal benefits. Instead, the Department would refer such complaints to the federal agency responsible for enforcing Title VII, the EEOC, and the DFEH would only handle complaints against companies with less than 15 employees and complaints against any company for denying pregnancy leave. This was significant for California Title VII employers because as discussed below, federal law provides less extensive damages to a damaged employee than are available to an employee under California law. Because of pressure from state civil rights advocates, the DFEH has changed its policy and now accepts jurisdiction over all types of pregnancy discrimination complaints filed against Title VII employers.

Remedies and Damages available under California Law

For complaints administratively adjudicated by the FEHC, the Commission can issue cease and desist orders, order hiring, reinstatement, promotion or back pay or other action necessary to effectuate the purposes of the Act (Government Code section 12970(a)). Victims of discrimination can also be awarded fringe benefits or their monetary equivalent that were lost due to the unlawful conduct of the employer such as pension, sick leave and dental benefits. Additionally, pursuant to California legislation, the Commission is able to award emotional distress damages and new administrative fines (Government Code section 12970(a)(3)). Upon a finding that the employee sustained an actual injury, the Commission will now be able to award compensatory damages for emotional injuries, pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other "non-pecuniary" losses. Administrative fines may also be assessed against the employer when the Commission determines that the employer is guilty of oppression, fraud or malice.

There is a $150,000 per employee cap for combined "non-pecuniary" damages (such as damages for emotional distress) and administrative fines. Thus in cases tried before the FEHC, the FEHC may award economic damages (such as lost wages and benefits) with no cap, plus a combination of damages for emotional distress with administrative fines of up to $150,000 per employee (Government Code section 12970(a)(3)). The Commission does not have authority to award punitive damages (*Dyna-Med, Inc. v. FEHC* (1987) 241 Cal.Rptr. 67).

For discrimination complaints adjudicated by the courts after the filing of a civil action, the court may in addition to awarding all remedies and damages available to the Commission, also award attorney fees to the prevailing party, and punitive damages in cases where the employer is guilty of oppression, fraud or malice (*Commodore Home System Inc. v. Superior Court* (1982) 185 Cal.Rptr. 270).

The California Supreme Court in *Rojo v. Kliger* (1990) 276 Cal.Rptr. 130, determined that a person alleging sexual discrimination (including pregnancy discrimination) does not have to go to the Fair Employment and Housing Commission before going to court to sue for compensatory and punitive dam-

ages. A claimant, however, must go to the Commission first with regard to statutory claims of such discrimination.

Enforcement of Federal Discrimination Laws

Enforcement of Federal Pregnancy Discrimination Act by the EEOC

The EEOC is required to monitor compliance with and enforce Title VII, the principal federal civil rights law. To administer its responsibilities, it is authorized to accept written charges filed by or on behalf of a person alleging that an employer has engaged in an unlawful employment practice. Unlike the DFEH, enforcement power is not vested in the EEOC, but instead is vested in the federal courts. Thus, the EEOC does not have the power to hold hearings and decide the issues raised. If the administrative remedies fail to resolve the discrimination complaint, either the complainant or the agency itself may bring a suit in federal court.

Title VII has established a special rule for states, such as California, which have enacted their own employment discrimination law. The rules apply to discrimination charges that challenge employment practices prohibited by both Title VII and the FEHA. The rules provide that the DFEH has the exclusive right to process allegations of discrimination over which it has jurisdiction for the first 60 days after a complaint is filed. This is referred to as the "exclusive processing period" (29 C.F.R. section 1601.13). If the charging party has filed a complaint with the DFEH and also desires to file a charge with the EEOC, the charge must be filed with the EEOC within 300 days after the alleged violation occurred or within 30 days after receiving notice from the California DFEH that it has terminated its proceedings, whichever is earlier. If no complaint has been filed with the DFEH, a charge must be filed with the EEOC within 180 days after the alleged unlawful conduct. (42 U.S.C. section 2000e-5(e)). It is necessary for a charge to be filed in a timely fashion in order for a private lawsuit to be filed under Title VII.

The EEOC utilizes similar procedures to the DFEH to investigate charges of unlawful discrimination under Title VII. The EEOC also utilizes a "fact-finding conference" to investigate allegations whereby the employee and employer meet with a representative of the EEOC prior to the EEOC making a determination on the charge.

Title VII authorizes all affirmative action as may be appropriate to remedy unlawful discrimination, including reinstatement or hiring of employees, with or without back pay or other equitable relief as the court deems appropriate (42 U.S.C. section 2000e-5(g)). In addition, compensatory and punitive damages for intentional discrimination are now permitted in civil actions under Title VII as a result of the Civil Rights Act of 1991 (42 U.S.C. section 1981a(a)(1)), although there is a cap on the amount of such damages, which cap will vary depending upon the number of the employees employed by the employer (42 U.S.C. section 1981a(b)(3)). By contrast, the FEHA has no such cap, and compensatory damages in FEHA actions are apparently not limited to cases of intentional discrimination. As under California law, attorney fees may be awarded to the prevailing party.

Enforcement of FMLA by the Department of Labor or Private Lawsuit.

The Department of Labor has been given the authority to promulgate regulations under the FMLA and to monitor compliance with its provisions (29 U.S.C. section 2616).

Eligible employees who are denied the taking of FMLA leave or who are denied reinstatement at the end of the leave in violation of the Act may file a complaint with the Department of Labor or file a private lawsuit against the employer to obtain damages and other relief. Damages available under the law include the following: the amount of wages, salary, employment benefits, or other compensation denied or lost as a result of the violation, or when there are no such losses, any actual monetary losses sustained by the employee as a direct result of the violation (such as the cost of providing care), up to a sum equal to 12 weeks of the employee's wages or up to a sum equal to 26 weeks of wages for the employee in a case involving leave for care of a covered servicemember ("actual damages"); interest on the amount of actual damages; and an additional amount as liquidated damages equal to the amount of actual damages, unless the employer proves to the satisfaction of the court that the unlawful act or omission was in good faith **and** the employer had reasonable grounds to believe it was not unlawful. Where an employee prevails in a civil lawsuit, he or she may recover in addition to monetary damages, costs, reasonable expert witness fees, and reasonable attorney's fees (29 U.S.C. section 2617(a)).

Employees may voluntarily settle or release their FMLA claims without court or DOL approval, but prospective waivers of FMLA rights are still prohibited. In the case of willful violations by an employer, a lawsuit must be filed within 3 years of the employer's last violation of the Act. In all other cases, a lawsuit must be filed within 2 years of the employer's last violation of the Act (29 U.S.C. section 2617(c)).

PRACTICAL TIP

In light of the substantial damages and penalties which an employer can face, it is extremely important that employers investigate complaints of discrimination promptly and thoroughly and take appropriate corrective action immediately.

CAUTION

REGARDING STATE AND FEDERAL AGENCY INVESTIGATIONS: In virtually all cases, it is advisable for employers to consult with legal counsel as soon as possible once an audit is requested or when an employer receives notice that a complaint alleging discrimination has been filed with the DFEH and/or the EEOC or Department of Labor. Employers should be extremely cautious when responding to notifications of state or federal charges, particularly in the investigatory process, and employers should not attend conferences without legal counsel present. If an employer makes inappropriate statements or admissions, or fails to properly address the relevant issues, an employer can seriously prejudice its case.

Conclusion

As apparent from the legislation discussed in this chapter regarding the issues of pregnancy discrimination and family care and medical leaves of absence, both Congress and the California Legislature have shown an increasing willingness in recent years to enact legislation for the purpose of protecting an employee's rights in the workplace and promoting family stability and security, while at the same time limiting the latitude which employers have traditionally had in the past to define their own employment policies. Because liability may be imposed upon even well-meaning employers who unintentionally violate such laws, it is essential that employers keep well informed of such legislation and modify their employment policies when necessary so that such practices conform to state and federal law.

POSTING OF NOTICES BY EMPLOYERS

Chapter 18

Contents

POSTING OF NOTICES BY EMPLOYERS

OVERVIEW: Both the United States Government and the State of California require that employers post various notices in a conspicuous place where notices can be seen by all employees. These notices are set forth below. The notices change from time to time and you should make sure that the ones you have posted are up to date. A comprehensive "All-In-One" employee notices poster is available from The Reynolds and Reynolds Company; except for items each dealership must create on its own, The Reynolds and Reynolds Company poster handles all posting requirements discussed in this chapter.

The Labor Code's Private Attorneys General Act of 2004, sometimes called the "sue your boss law," provides significant motivation to comply fully with all posting requirements. Missed posting requirements might prove a tempting target to a disgruntled employee wishing to file a civil action under that Act to recover 25% of the $100 per pay period per employee per violation penalty.

This discussion does not include notices that must be posted if the dealer contracts with federal, state or local governmental agencies; those required to warn of specific dangerous conditions in the workplace, such as asbestos notices, material safety data sheets, job-by-job cancer-causing substances notices, and the like; notices specific to special programs, such as on the job training programs for the disadvantaged; nor notices required when citations are issued, or those required under municipal or other local ordinance or regulation. For signs required to be displayed by dealers to the public, see the chapter in this Management Guide entitled Public Signs at Dealerships. Posting requirements unique to collective bargaining or union organizing and elections are not covered.

Federal Posting Requirements

Federal Civil Rights Information

All employers who have fifteen or more employees must keep posted in a conspicuous place upon their premises, where notices to employees are customarily posted, a notice which sets forth the essential provisions of the Civil Rights Act of 1986 (prohibiting discrimination based on race, color, religion, national origin or sex) 42 USC section 2000e-10, and the prohibiting of discrimination based on age. 29 USC section 627. The Americans With Disabilities Act requires that employers post a notice describing the provisions of that Act. This notice is now combined in one Federal Civil Rights Information poster that can be obtained from the EEOC. The Americans With Disabilities Act also requires employers to post a notice concerning the provisions of the Americans With Disabilities Act in a place accessible to applicants for employment. The practical way to accomplish this is to post another copy of the same EEOC notice in a place accessible to applicants for employment.

In addition, EEOC regulations under Title II of the Genetic Information Nondiscrimination Act (GINA) require a supplemental poster (the so-called GINA poster) advising employees of the right to be free from discrimination on the basis of genetic information.

These notices, printed in English and Spanish, may be obtained from the Equal Employment Opportunity Commission, 255 East Temple, 4th Floor, Los Angeles, CA 90012. (800) 669-4000. It may also be obtained from their Northern office: Equal Employment Opportunity Commission, Oakland Local Office, 1301 Clay Street, Suite 1170-N, Oakland, CA 94612. (510) 637-6123.

Employee Polygraph Protection

All employers must post and maintain a notice of protection of employees from lie detector exams, in a conspicuous place on their premises, where notices to employees and applicants for employment are customarily posted. 29 USC section 2003. This notice may be obtained from the U.S. Department of Labor, Employment Standards Administration, Wage & Hour Division, 300 S. Glendale Blvd., #250, Glendale, CA 91205. (213) 894-6375 or 894-2685. Northern California: U.S. Department of Labor, Employment Standards Administration, Wage & Hour Division, 2800 Cottage Way, Room W-1836, Sacramento, CA 95825. (916) 978-6123.

Minimum Wage Poster

All employers must post the current federal minimum wage poster, currently providing for a federal

minimum wage of $7.25 per hour. This notice may be obtained from the U.S. Department of Labor, Employment Standards Administration, Wage and Hour Division, 300 South Glendale Boulevard, #400, Glendale, CA 91205. (213) 894-6375 or 894-2685. Northern California: U.S. Department of Labor, Employment Standards Administration, Wage & Hour Division, 2800 Cottage Way, Room W-1836, Sacramento, CA 95825. (916) 978-6123.

Federal Family and Medical Leave Notice

29 USC section 2619 requires employers to post in a conspicuous place (such as on an employee bulletin board) a notice explaining the Act's provisions and its enforcement procedures ("employee notice"). If a significant portion of the employer's workforce are not literate in English, the employer is responsible for translating the notice into the language or languages spoken by such employees. The notice must include the information required by law concerning the rights of military personnel under the FMLA. Be certain that this poster is updated in view of the significant changes included in updated version of the poster released by the Department of Labor in February 2013.

Uniformed Services Employment and Reemployment Rights Act Notice

Employers must give to affected employees notice of their rights under the Uniformed Services Employment and Reemployment Rights Act, also known as USERRA. The notice requirement may be met by placing a poster in an area where employers customarily place notices for employees. USERRA sets out employment reinstatement and benefits rights for service members, and it applies to all employers regardless of size. The poster explains what rights and protections employees have under the Act, including the right to re-employment after uniformed service, freedom from discrimination and retaliation for serving in uniform, and certain health insurance protections. The poster is available from the U.S. Department of Labor at www.dol.gov/vets.

National Labor Relations Board (NLRB) Labor Rights Poster

Under a rule promulgated by the NLRB, most private sector employers would have been required by April 30, 2012, to post a notice advising employees of their rights of collective bargaining under the National Labor Relations Act. Following a lawsuit and injunction to block its implementation, the NLRB indefinitely postponed the effective date of the rule.

California Posting Requirements

Industrial Welfare Commission Orders and Minimum Wage

The Industrial Welfare Commission sets the minimum wage, maximum number of hours, and working conditions for each occupation, trade, or industry. Each dealer must post a copy of Industrial Welfare Commission Wage Order 7-2001 in each building in which employees affected by the order are employed. Order number 7-2001 is the Industrial Welfare Commission Order applicable to automobile dealerships. See Labor Code section 1183. Dealers must also post Minimum Wage Order – MW-2007 to include current minimum wage. Failure to post these orders is a misdemeanor and is punishable by a fine of not less than $100 or by imprisonment of not less than thirty days or both. Copies of this order may be obtained from the Department of Industrial Relations, Division of Labor Standards Enforcement, 107 South Broadway, # 5015, Los Angeles, CA 90012. (213) 620-6330. Northern California: Department of Industrial Relations, Division of Labor Standards Enforcement, Office of State Labor Commissioner, 2424 Arden Way, Suite 360, Sacramento, CA 95825. (916) 323-4920.

Payday Notice

The day, time, and place of the regular payday must be posted. As a convenience, the state provides a small form for this purpose, DLSE 8. However, an employer may post this information in any understandable form. Labor Code section 207. Failure to keep the notice posted is a misdemeanor and is also prima facie evidence of a violation of certain wage payment requirements. This form can be obtained at the Department of Industrial Relations, Labor Standards Enforcement, 107 South Broadway, Room 5027, Los Angeles, CA 90012. (213) 620-6330. Northern California: Department of Industrial Relations, Division of Labor Standards Enforcement, Office of State Labor Commissioner, 2424 Arden Way, Suite 360, Sacramento, CA 95825. (916) 323-4920.

Fair Employment Practices Information

Every employer must post in a conspicuous place on the premises a notice DFEH 162, prepared by the Fair Employment and Housing Commission, setting forth excerpts from the Fair Employment

and Housing Act. Government Code Sections 12900-12996, among other laws. Copies of the current notice in English and Spanish may be obtained from the Fair Employment and Housing Commission at 611 West 6th Street, Suite 1500, Los Angeles, CA 90017-3116. (213) 439-6799. (800) 884-1684. Northern California: Fair Employment and Housing Commission, 2000 "O" Street, Suite 120, Sacramento, CA 95814. (916) 445-5523 or (800) 884-1684 or at http://www.dfeh.ca.gov/ Publications_Publications.htm.

Notice of Workers' Compensation Rights and Identification of Carrier

Employers are required to post Division of Workers Compensation (DWC) form DWC-7, "Notice to Employees – Injuries Caused by Work." This posting is mandated by Insurance Code section 3550, which requires employers to post and the DWC to prepare a notice that contains the following elements: identification of the employer's current workers' compensation carrier (or, if applicable, a notice that the employer is self-insured); a statement of who is responsible for claims adjustment; a statement that all injuries should be reported to the employer; information on how to get emergency medical treatment; the kinds of injuries covered by workers compensation; the right of injured employees to receive medical care; the right of the employee to change the treating physician under applicable law; the right of the employee to benefits (permanent, temporary, vocational, and death benefits); identification of the person to whom injuries should be reported; a statement that time limits exist to notify the employer of occupational injuries; identification of the protections against discrimination for pursuing a workers' compensation claim; the address and telephone number of the nearest information and assistance officer. Labor Code section 3550. The employer must post at least one such notice in a conspicuous location frequented by employees, where they may easily read it during the workday. Copies of a notice satisfying the statute are to be provided by the insurance carrier to its insured employers.

Failure to keep any notice required by this section conspicuously posted shall constitute a misdemeanor, and shall be prima facie evidence of non-insurance, and shall automatically permit the employee to be treated by his or her own personal physician with respect to an injury occurring during that failure. Every employer shall also give every new employee, either at the time the employee is hired or by the end of the first pay period, written notice of the information contained in Labor Code section 3550.

Workers' Compensation Off-Duty Recreational Activities Notice

Every employer subject to the Workers' Compensation laws is required to post a notice promulgated by the Director of the Division of Industrial Accidents advising employees of limitations of workers' compensation benefits for voluntary participation in any off-duty recreational, social or athletic activity not constituting part of the employee's work-related duties. This notice is included in the DWC-7 form described in the preceding section.

Unemployment and Disability Insurance and California Paid Family Leave Notices

Posting Requirements

22 CCR section 1089-1 requires each employer to post and maintain in places readily accessible to all employees the following forms:

1. "Notice To Employees", Form 1857A, which informs employees of their rights to unemployment insurance, disability insurance, and paid family leave.

2. "Notice To Employees", Form DE 1857D, which informs employees of their rights to unemployment insurance for those few employees who may be covered only for unemployment insurance.

2. "Notice to Employees," Form DC 1858, which informs employees of their rights to disability insurance and paid family leave, for those few employees who may be covered only for disability and paid family leave.

Unemployment Benefits Notice Upon Discharge Or Lay Off

When an employer discharges, lays off, or places an employee on leave of absence, 22 CCR section 1089-1 also requires the employer to give the employee the following notices:

1. Written notice entitled "For Your Benefit, California's Program for the Unemployed," Pamphlet DE 2320, which informs employees of the Employment Development Department's unemployment insurance, disability insurance, and paid family leave programs. This notice shall be given no later than the effective date of the discharge, lay off, or leave;

2. Written notice regarding the change in the employment relationship. The notice of change of relationship shall be given no later than the effective date of the action and shall contain at a minimum: (A) The name of the employer; (B) The name of the employee; (C) The social security account number of the employee; (D) Whether the action was a discharge, a layoff, a leave of absence, or other change

in status, such as from employee to independent contractor; and (E) The date of the layoff, discharge, leave, or other change of relationship.

Obtaining Pamphlets

The disability and unemployment insurance forms and pamphlets referred to in this section, mandated by Unemployment Insurance Code sections 1089, 2613 and 2706, may be obtained from your local Employment Development Department Office, or from: Employment Development Department, Form Warehouse, 1733 W Sports Drive, Suite B, Sacramento, CA 95834. Fax (916) 928-5910. www.edd.ca.gov.

California Family Rights Act and Pregnancy Leave Notice

California also requires a notice to be posted in a conspicuous place regarding the provisions of the California Family Rights Act (CFRA), as well as requiring the notice be made available to all current and new employees. The CFRA regulations provide a state approved combined notice of an employee's CFRA leave rights and pregnancy disability leave rights for use by those with fifty or more employees (DFEH-100-21) and of pregnancy disability leave for those with fewer employees (DFEH-100-20). California law also provides that any employer whose workforce contains 10% or more of persons who speak a language other than English as their primary language must translate the notice into the language or languages spoken by these employees.

California "Whistleblower" Notice Under Labor Code Section 1102.5

Labor Code section 1102.5, et seq., provides enhanced penalties and raises the employer's burden of proving that employment action is not retaliation for the employee reporting a violation of law at a current or previous job. This "whistleblower law" requires the display of a specific form of poster and a "hotline" to the state Attorney General's office for reporting violations. A sample form is available at www.dir.ca.gov/dlse/WhistleblowersNotice.pdf.

Safety And Health Protection on the Job Bulletin

Labor Code Sections 6328 and 6408(a) require every California employer to post a Safety And Health Protection On The Job Bulletin. This Bulletin can be obtained from Cal-OSHA Consultation Services, Northern California: 2424 Arden Way, Suite 485, Sacramento, CA 95825. (916) 263-5765. San Francisco Bay Area: 1515 Clay Street, Suite 1103, Oakland, CA 94612. (510) 622-2891. Central Valley: 1901 North Gateway Boulevard, Suite 102, Fresno, CA 93727. (559) 454-1295. San Fernando Valley: 6150 Van Nuys Boulevard, Suite 307, Van Nuys, CA 91401. (818) 901-5754. Los Angeles: 10350 Heritage Park Drive, Suite 201, Santa Fe Springs, CA 90670. (562) 944-9366. San Bernardino, Orange: 464 West 4th Street, Suite 339, San Bernardino, CA 92401. (909) 383-4567. San Diego: 7575 Metropolitan Drive, Suite 204, San Diego, CA 92108. (619) 767-2060.

Cal/OSHA Citations

If Cal/OSHA citations are issued, a copy must be posted at or near the work area involved. Each citation must remain posted until the violation has been corrected, or for three working days, whichever is longer.

Proposition 65 Warning

Clear and reasonable warning must be given to employees of any exposure to a chemical known to the state to cause cancer or reproductive toxicity. Health & Safety Code § 25249.6 et seq. ("Proposition 65"). Since the list of such substances is very long, and includes pervasively existing items such as carbon monoxide, and chemicals used in everyday products, and since Proposition 65 compliance should be based upon a comprehensive approach that takes into account not only the required occupational warnings, but consumer and product warnings as well, it is beyond the scope of this discussion to specify the form and content of the notices required. Dealers who have not already done so should contact the Association to learn about resources available to assist dealers in creating and implementing a compliance program.

Emergency Medical Services Notice

A notice setting forth the telephone numbers for two nearby physicians (a primary and an alternate), and a local hospital, ambulance services, and fire protection services is required to be posted near the telephone switchboard under 8 CCR 1512(e). See www.dir.ca.gov/dosh/dosh_publications/s500pstr.pdf.

Access to Medical Records Notice

All employees are to be given notice of their right to see and copy all medical records on them maintained by their employer. 8 CCR 3204. See www.dir.ca.gov/dosh/dosh_publications/Access_En.pdf.

Smoking Causes Cancer Sign

If an employer permits smoking in a designated break room in compliance with the smoking ban in the workplace of Labor Code section 6404.5, then a sign must be posted that reads: "Warning. This facility permits smoking and smoking is known to the state of California to cause cancer. Smoking is al-

lowed only in designated areas." Health and Safety Code section 25249.6.

Illegality of Sexual Harassment Notice

Government Code section 12950 requires FEHC to cause form DFEH 162 (the state poster advising of the illegality of discrimination and other employment practices referred to previously in this chapter) to include information relating to the illegality of sexual harassment. Each employer is required to obtain a current version of the poster and display it in a prominent and accessible location in the workplace, including hiring offices and employee bulletin boards. See www.dfeh.ca.gov/res/docs/Publications/DFEH-162.pdf.pdf.

In addition, Government Code section 12950 requires each employer to either create its own information sheet on sexual harassment following specific guidelines, or distribute the information sheet on sexual harassment published by FEHC. Employers are required to reproduce the information sheet and distribute it to all employees "in a manner that ensures distribution to each employee, such as including the information sheet or information with an employee's pay." However, the failure to distribute the information sheet shall not "in and of itself" result in employer liability for sexual harassment, nor will proper distribution of the information sheet "insulate the employer from liability." Copies of the information sheet published by FEHC (DFEH 185) are available at www.dfeh.ca.gov/DFEH/Publications/PublicationDocs/DFEH-185.pdf.

It would be prudent to ask each employee to sign a copy of the information sheet to acknowledge its receipt, and to keep that signed copy in the employee's personnel file.

Time Off To Vote

Elections Code section 14001 provides that a notice shall be posted no less than ten days before every statewide election advising employees that if the employee has no time to vote during non-working hours that he or she may take time off work to vote, with pay, in a manner that will reduce work absence, up to two hours. See www.ss.ca.gov/elections/elections_tov.htm.

Recommended Postings

Dealership's Own Policy Against Harassment

In addition to complying with the sexual harassment posting and information sheet requirements referred to previously, it is recommended that the employer post in a conspicuous place the employer's own policy against sexual harassment and other forms of harassment. A discussion of the elements of such a policy is set forth in the chapter in this Management Guide entitled Discharge of Employees, in the section entitled Preventing Harassment Claims. It is recommended that such a policy also be distributed to employees upon their commencement of employment. Legal counsel should review their policy to make sure it contains the necessary elements to be included in a policy intended to prevent sexual and other forms of harassment.

Dealership-Wide Safety Notices

Workplace safety warnings are generally excluded from this discussion because they depend on the unique circumstances of the dealership's parts, service, and body shop departments. Therefore, specific hazard communications requirements are not discussed here and dealers are urged to consult with knowledgeable consultants to ensure full compliance with these and other safety postings and warnings. However, regulatory agencies are now expanding beyond the shop floor. Generic safety programs are now required which apply equally to all employees, including the receptionist, cashier, and other office workers. For this purpose, we include here postings that are applicable to all dealership personnel, and that can be posted in one centralized location.

Emergency Evacuation Routes

Cal-OSHA, pursuant to its order found at 8 CCR 3220, requires employers to maintain a written emergency action plan. To be included in the plan are the emergency evacuation routes to be taken by employees if the facility were to be evacuated on account of fire, earthquake, or other emergency. It is recommended that the operative provisions of this plan be posted for the benefit of all employees.

No Smoking Policy

Labor Code section 6404.5 provides that no employer shall permit smoking in the workplace, except only in special breakrooms that exhaust all air directly to the outside without re-circulation, and

that employees who are not smoking do not have to use.

No smoking signs (discussed in the chapter entitled "Public Signs At Dealerships") and polite requests to refrain from smoking protect the employer from being accused of allowing non-employees to smoke. Employers are apparently required to be more forceful in preventing employees from smoking, however.

It is therefore recommended that there be a notice posted to all employees in a central location stating that smoking in other than designated areas is unlawful, and that employees violating the policy are subject to disciplinary measures.

Injury and Illness Prevention Program

Labor Code section 6401.7 requires employers to prepare and maintain a written injury and illness prevention program (IIPP). The statute also directs workers compensation insurance carriers to conduct reviews of employer IIPP's within the first six months of the insurance policy period if the employer has a workers' compensation experience modification of 2 or more. While posting of the program is not a requirement, an amendment to the statute requires the Division of Occupational Safety and Health to prepare a Model IIPP for Non-High-Hazard Employment and distribute it to employers "for posting" in the workplace. While an employer who posts such a program can still be cited for inadequate implementation of an injury and illness prevention program, the fact that the model is posted will prevent a penalty from attaching for the first such citation. Therefore, obtaining the models from Cal/OSHA and posting them is highly recommended.

PUBLIC SIGNS AT DEALERSHIPS

Chapter 19

Contents

PUBLIC SIGNS AT DEALERSHIPS

OVERVIEW: California and federal statutes and regulations require the placing of various signs, certificates, and licenses at the dealership premises.

An attempt has been made to exhaustively research state and federal law for sign requirements. However, because of the massive volume of state and federal statutes and regulations, it is possible that some requirements for a sign, certificate, or license may not be included in this chapter. If you become aware of any required sign, certificate or license not included here, please bring that to the attention of your Association representative so that it may be included in the next edition of this Management Guide.

Covered Elsewhere

Employment Notices

The chapter does not cover notices that must be posted for the benefit of employees. That subject is covered in this Management Guide in the chapter "Posting Of Notices By Employers."

Ancillary Businesses

This discussion does not attempt to cover the various signs and postings required of activities not directly associated with new vehicle dealerships. Dealers who provide ancillary goods and services should therefore be sure to obtain sign and posting compliance information from all regulatory agencies having jurisdiction over such activities. Some ancillary businesses having posting requirements include car washes, recreational vehicle shows, locksmiths, auctioneers, motor fuel or liquefied petroleum retailers, repackagers of lubricating oil, impound lots, tire and used-oil collection or recycling centers, vending machine or public coin telephone owners, providers of food or beverages, vehicle registration services, launderers of wiping rags, licensed lenders, check cashers, credit union related promotions, property brokers, pawn brokers, and retailers offering trading stamps. Also excluded are notices that must be posted when a dealer's license is suspended or terminated by the DMV.

Hazard and Environmental Warnings

Signs and postings dealing with chemical and hazardous materials or hazardous activities at the dealership, and required business plans respecting emergency release, are excluded from discussion in this chapter since they depend upon the particular substances, equipment, and procedures used at each dealership. Signs or labels required under these excluded topics can include warnings regarding materials and chemicals known or suspected to cause cancer and birth defects, warning signs to be placed during overhead window washing, in elevators and dumbwaiters, warnings related to unreinforced masonry buildings in earthquake zones, and environmental protection notices such as those imposed on temporary household hazardous waste collection facilities licensed, or deemed licensed, by the Department of Health Services.

Consistent with the above, signs and labels required by Proposition 65 dealing with hazardous and toxic materials are excluded from discussion in this chapter. Dealers who have not already done so should contact the Association for information on resources available to assist dealers in implementing a comprehensive Proposition 65 compliance program.

Posting of licenses and permits from local and state fire, health, and building and safety agencies are also excluded from discussion in this chapter.

Contact the applicable regulatory agencies and your environmental and safety consultants for assistance in this area. Your workers' compensation carrier may be able to direct you to a consultant.

Local Ordinances and Regulations

Cities and other local governments generally require business licenses and related notices to be posted, and many maintain posting rules for hazardous substances. You should check with local government officials to see what may apply.

Web and Internet Sites

Notices that must be posted on Web sites are not included in this discussion, including, for example, the privacy notice required under Business and Professions Code section 22575 et seq.

Signs On Vehicles

Warnings, stickers, instructions, and other materials required to be affixed or attached to any motor vehicle are not included; this topic is covered in the chapter entitled "Other Important Topics."

Table of Public Signs

Below is a table of required signs. References to B. & P. are to the California Business and Professions Code; references to CCR are to the California Code of Regulations.

Name of Sign	Law Governing	Where to Post
1. General Repair Shop Sign	B & P Code 9884.17, 16 CCR 3351.3 and 3351.4	In a place conspicuous to all customers at the repair dealer's location or at each location if multiple locations are used or given as a handout when conducting business at other locations.
2. B.A.R. Certificate of Registration	B & P Code 9884.6 and 16 CCR 3351.3(a)	In a place conspicuous to customers.
3. Sign Posting Hours Repair Shop is Open to Public	16 CCR 3340.15	In a place conspicuous to the public.
4. Posting of Labor Rates, Non-Smog (Not Required)	There is no law requiring the posting of non-smog labor rates and posting is not recommended.	If posted, in a place conspicuous to repair shop customers.
5. Display of Lamp and Brake Station Licenses	16 CCR 3307(a)	In the station.
6. Display of Adjusters' Licenses	16 CCR 3307(b)	Prominently displayed in the station.
7. Lamp and Brake Station Signs	16 CCR 3307(c)	In a location clearly visible from outside the station.
8. Lamp and Brake Station Prices	16 CCR 3307(d)	In a conspicuous place.

9. Muffler Station Sign	13 CCR 604(b) and 606	In a location clearly visible from outside the station.
10. Display of Muffler Station License	13 CCR 602 and 604(a)	Prominently in customer area of station.
11. Posting of Muffler Station Prices	13 CCR 604(c)	Conspicuously in customer area.
12. Smog Check Station Sign	Health & Safety 44033(a), 16 CCR 3340.22	In a place conspicuous to the public.
13. Smog Check Station Failed Vehicle Repair Options	Health & Safety 44017.3 and 44017, 16 CCR 3340.22.2	Conspicuously in area frequented by customers.
14. Display of Smog Check Station Licenses and Certificates	16 CCR 3340.15(c)	Prominently in area frequented by customers.
15. Smog Check Station Prices	16 CCR 3340.15(d)	Conspicuously in area frequented by customers.
16. Smog Check Test Only Sign	16 CCR 3340.16(c)	Conspicuously in area frequented by customers.
17. No Cooling Off Period Without Cancellation Option Sign	Vehicle Code section 11709.2	In all cubicles or offices where contracts negotiated or executed.
18. Right to Inspect Used Vehicles Sign	Vehicle Code section 11709.1	In place conspicuous to the public.
19. Spanish/Foreign Translation of Contract Sign	Civil Code section 1632	In a place conspicuous to buyer. (F & I office)
20.Presale Availability of Warranty	15 U.S.C. section 2302	In the new and used sales, F&I, service write-up, and parts counter areas, conspicuous to vehicle, accessory, and parts purchasers.

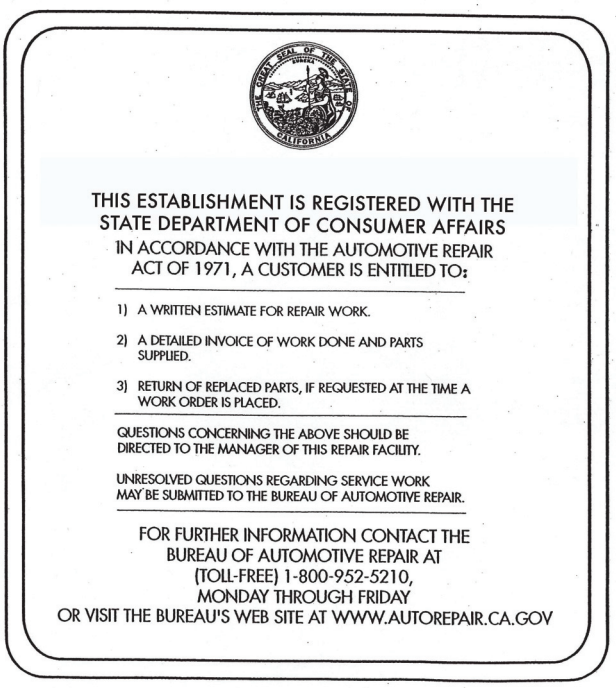
21. Availability of Service Bulletins Sign	Civil Code section 1795.91	In the showroom or other area conspicuous to motor vehicle purchasers.
22. Sign Regarding Credit Card Request for Check Writing	Civil Code section 1725	If required, in conspicuous location where check is written. (see discussion below)
23. Policy Concerning Refunds and Exchanges Sign	Civil Code section 1723(a) and (b)	Either at each cash register and sales counter, at each public entrance, on tags attached to the item, or on seller's order forms, if any.
24. Cellular Telephone Activation Notice	B. & P. Code section 17026.1	Where cellular telephones are displayed and purchased.
25. Grey Market Goods Sign	Civil Code section 1797.8	Conspicuously at product's point of display and affixed to the product.
26. Anti-Graffiti Warning Sign	Penal Code section 594.1	Conspicuous place where paint sold.
27. Child Passenger Restraint Sign	Vehicle Code section 27365	In a place conspicuous to the public.
28. Rental Company Damage Waiver Signs	Civil Code section 1936(g)(1)	At place where renter signs the contract.
29. Display of Sales Tax Permit	Revenue & Taxation Code section 6067	Conspicuously in business office.
30. Posting of Insurance Licenses	Insurance Code section 1725	Prominently displayed in the holder's office.
31. Posting of Dealer License	Vehicle Code section 11709(a)	In place conspicuous to the public.
32. Display of Salesperson Licenses	Vehicle Code section 11812	In place conspicuous to the public where he or she sells.
33. Display of Business License	B & P 16111	In the business office.

34. Contract for Parking or Storage Sign	Civil Code section 1630	Conspicuous place at each entrance of parking lot.
35. Public Parking Prohibited Sign	Vehicle Code section 22658(a)	At all entrances to parking areas.
36. Storage Charges for Towed Vehicles Sign	Civil Code section 3070	If required, in plain view at all cashiers' stations. (see discussion below)
37. Exit Signs	Labor Code section 142.3; Health & Safety Code section 18943(c); 8 CCR 3216	At every exit of intersection of corridors, exits, stairways or ramps, etc.
38. Offsite Display	13 CCR section 270.08	In close proximity to or on vehicles when off site.
39. Lien Sale	Civil Code section 3072(f)	Conspicuous place on the premises of the business office.
40. No Smoking	Labor Code section 6404.5	At each entrance to the dealership.
41. Fuel Economy Guide Booklet	49 USC 32908	Prominently in showroom or sales area
42. Towing Fees and Access Notice	Vehicle Code section 22651.07	In the office area of the storage facility, in plain view of the public

Language and Format of Signs

Sign #1. General Repair Shop Sign

In addition to being required to post this sign, when conducting business from other than the dealer's principal business address, the dealer shall provide to every customer a copy of the automotive repair dealer’s sign, reduced to fit on 8½” x 11” white paper.


THIS ESTABLISHMENT IS REGISTERED WITH THE STATE DEPARTMENT OF CONSUMER AFFAIRS
IN ACCORDANCE WITH THE AUTOMOTIVE REPAIR ACT OF 1971, A CUSTOMER IS ENTITLED TO:

1) A WRITTEN ESTIMATE FOR REPAIR WORK.

2) A DETAILED INVOICE OF WORK DONE AND PARTS SUPPLIED.

3) RETURN OF REPLACED PARTS, IF REQUESTED AT THE TIME A WORK ORDER IS PLACED.

QUESTIONS CONCERNING THE ABOVE SHOULD BE DIRECTED TO THE MANAGER OF THIS REPAIR FACILITY.

UNRESOLVED QUESTIONS REGARDING SERVICE WORK MAY BE SUBMITTED TO THE BUREAU OF AUTOMOTIVE REPAIR.

FOR FURTHER INFORMATION CONTACT THE BUREAU OF AUTOMOTIVE REPAIR AT (TOLL-FREE) 1-800-952-5210, MONDAY THROUGH FRIDAY OR VISIT THE BUREAU'S WEB SITE AT WWW.AUTOREPAIR.CA.GOV

Dealers who, as of June 30, 2006, had the older version of the general repair shop sign may, in lieu of replacing the sign with the new version, post a supplemental sign in proximity to the main sign. The supplemental sign appears as follows:

Figure 1-2

Sign #2. B.A.R. Certificate

Sign 2 refers to the Certificate of Registration or "license" issued by the Bureau of Automotive Repair to the dealer.

Sign #3. Hours Open to Public

THIS SHOP IS OPEN FROM ____ A.M. TO ____ P.M.

Sign #4. Posting of Labor Rates

Neither California of Federal law requires the posting of labor rates in repair shops. It is not recommended that labor rates be posted or be set forth on your repair orders. See, however, the discussion in the Management Guide chapter "Automotive Repair Act" under the topic "Advertising Regulations" if you post labor rates. Various sections of Titles 13 and 16 of the California Code of Regulations, as set forth below, do provide for the posting of prices for lamp, brake, smog inspection and muffler stations.

Sign #5. Lamp, Brake, and Smog Check Station Licenses

The display of these licenses are to be under glass or other transparent cover and prominently displayed in the station.

Sign #6. Adjustors' Licenses

Licenses of Adjustors employed at a licensed station are to be mounted under glass or other transparent cover and prominently displayed in the station.

Sign #7. Lamp and Brake Station Official Signs

Figures 7-2 shows these signs. The exact dimensions are available from the Bureau of Automotive Repair.

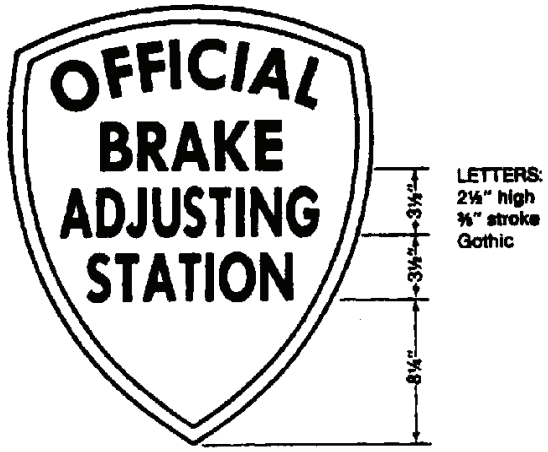


Figure 7-1

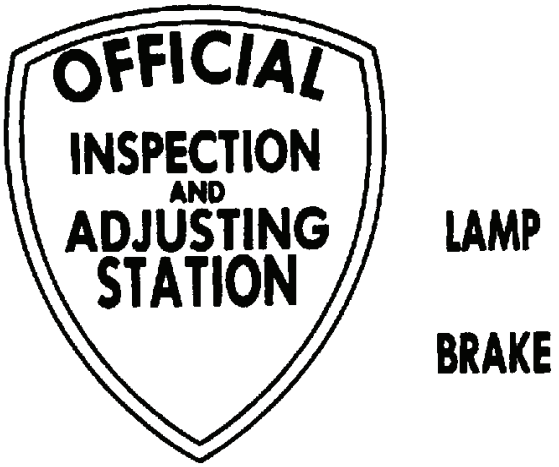


Figure 7-2

Sign #8. Lamp, Brake, and Smog Check Station Prices

A dealer must post conspicuously a list of price ranges for the specific activities for which it is licensed. Prices may be stated either as a fixed fee or an hourly rate on a time-and-material basis. (See discussion below for Smog Check Station Prices.)

Sign #9. Muffler Station Official Sign

Figures 9-1 shows the layout and dimensions of this sign.

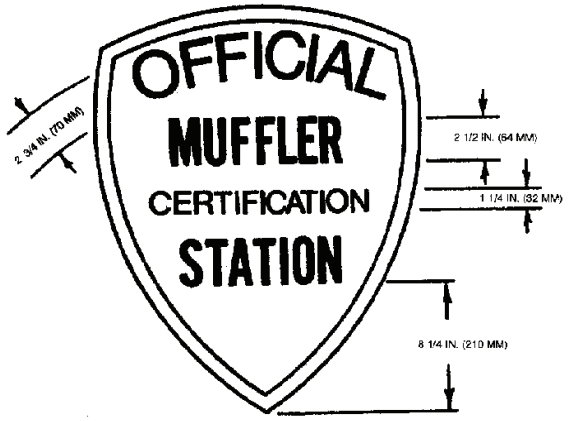


Figure 9-1

Sign #10. Muffler Station License

The license of a muffler certification station shall be prominently displayed under glazing material in the customer area of the station.

Sign #11. Muffler Station Prices

Each muffler certification station must post conspicuously in the customer area the prices for issuing exhaust certifications and for clearing enforcement documents.

Sign #12. Smog Check Station Official Sign

Service signs required to be 24 inches wide and 30 inches high, made of 0.040 aluminum or steel. Camera-ready design and content of required signs are available from the Bureau of Automotive Repair.

Sign #13. Smog Check Station Failed Vehicle Repair Options

Smog Stations must also conspicuously post a sign issued by the Department of Consumer Affairs explaining potential vehicle repair assistance and vehicle retirement options for consumers whose vehicles fail smog check. The dimensions of this sign are set forth in the Statutes and Regulations section of this chapter.

Sign #14. Smog Check Station Licenses and Certificates

The station license, inspector license, and appropriate qualified mechanics' certificate shall be posted prominently under glass or other transparent material in an area frequented by customers.

Sign #15. Dealer's Smog Check Station Prices

The station is to post conspicuously in an area frequented by customers, a list of price ranges for the specific activities for which it is licensed. The posted prices are to include the price charged by the station for inspections, and, if a separate price is charged for reinspections, such reinspection price. The price of issuance of a certificate of compliance or noncompliance charged by the Bureau of Automotive Repair is to be posted separately from the price of the inspection and of the reinspection, if any.

Sign #16. Smog Check Test Only Sign

THIS SMOG CHECK TEST ONLY STATION IS LICENSED TO TEST VEHICLES ONLY, AND CANNOT MAKE ANY REQUIRED REPAIRS TO A VEHICLE WHICH HAS FAILED A SMOG TEST.

Sign #17. No Cooling Off Period Without Cancellation Option Sign

A notice not less than eight inches high and 10 inches wide, in each sales office and sales cubicle of the dealership where written terms of specific sale or lease transactions are discussed with prospective purchasers or lessees, and in each room of a dealer's established place of business where sale and lease contracts are regularly executed, which states the following:

THERE IS NO COOLING-OFF PERIOD UNLESS YOU OBTAIN A CONTRACT CANCELLATION OPTION
California law does not provide for a "cooling-off" or other cancellation period for vehicle lease or purchase contracts. Therefore, you cannot later cancel such a contract simply because you change your mind, decide the vehicle costs too much, or wish you had acquired a different vehicle. After you sign a motor vehicle purchase or lease contract, it may only be canceled with the agreement of the seller or lessor or for legal cause, such as fraud. However, California law does require a seller to offer a 2-day contract cancellation option on used vehicles with a purchase price of less than $40,000, subject to certain statutory conditions. This contract cancellation option requirement does not apply to the sale of a recreational vehicle, a motorcycle, or an off-highway motor vehicle subject to identification under California law. See the vehicle contract cancellation option agreement for details.

Sign #18. Right to Inspect Used Vehicle Sign

This sign must be not less than 8 inches high and 10 inches wide, and posted in a place conspicuous to the public.

THE PROSPECTIVE PURCHASER OF A VEHICLE MAY, AT HIS OR HER OWN EXPENSE AND WITH THE APPROVAL OF THE DEALER, HAVE THE VEHICLE INSPECTED BY ANY INDEPENDENT THIRD PARTY EITHER ON OR OFF THESE PREMISES.

Sign #19. Spanish/Foreign Language Translation Sign

There should be posted in conspicuous locations visible before contracts negotiated in the foreign language are signed (such as in F & I offices) a sign that states, IN THE FOREIGN LANGUAGE, substantially the following :

WE ARE REQUIRED TO PROVIDE A [Language] LANGUAGE CONTRACT OR AGREEMENT IF WE NEGOTIATE (ORALLY OR IN WRITING) A SALE OR LEASE PRIMARILY IN THE [Language] LANGUAGE"

(In the above, [Language] is replaced, in turn by Spanish, Chinese, Tagalog, Vietnamese, or Korean)

Sign #20. Presale Availability of Warranty Sign

A dealer's duty to make warranty terms and conditions available to customers for inspection before sale can be satisfied by posting a signs reasonably calculated to elicit the prospective buyer's attention in prominent locations in the dealership advising prospective buyers of the availability of warranties upon request. The following is an example of such a sign:

WARRANTY TERMS AND CONDITIONS ARE AVAILABLE FOR YOUR REVIEW UPON REQUEST

Sign #21. Availability of Service Bulletins Sign

A dealer's duty to notify prospective purchasers and lessees of manufacturer service bulletin availability is satisfied if a sign is posted in the showroom or other area conspicuous to motor vehicle purchasers and written in the following form:

FEDERAL LAW REQUIRES MANUFACTURERS TO FURNISH THE NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION (N.H.T.S.A.) WITH BULLETINS DESCRIBING ANY DEFECTS IN THEIR VEHICLES.

YOU MAY OBTAIN COPIES OF THESE BULLETINS, FOR A FEE, FROM EITHER OF THE FOLLOWING:

THE MANUFACTURER (ASK YOUR DEALER FOR THE TOLL-FREE NUMBER)

N.H.T.S.A.--TECHNICAL REFERENCE DIVISION
400 SEVENTH STREET, S.W.
ROOM 5110
WASHINGTON, D.C. 20590
202-366-2768

IN ADDITION, CERTAIN CONSUMER PUBLICATIONS PUBLISH THESE BULLETINS AND SOME COMPANIES WILL SEND THEM TO YOU, FOR A FEE.

Sign #22. Credit Card Request for Check Writing Notice

In connection with check writing, if a request for a credit card, is, or might ever be made, you must either train your employees requesting the credit card to inform all check writing customers that they are not required to display a credit card to write a check; or post the following notice in a conspicuous location in the unobstructed view of the public

within the premises where the check is being written, clearly and legibly.

> CHECK WRITING I.D.: CREDIT CARD MAY BE REQUESTED BUT NOT REQUIRED FOR PURCHASES.

Sign #23. Refunds and Exchanges Policy

> Unless otherwise agreed in writing, all sales are final; no refunds or exchanges.

Unless you allow full cash refunds during the first seven days after purchase, your actual refund policy must be conspicuously displayed either on signs posted at each cash register and sales counter, at each public entrance, on tags attached to each item sold under that policy, or on your order forms, if any. The display must state your policy, including, but not limited to, whether cash refund, store credit, or exchanges will be given for the full amount of the purchase price; the applicable time period; the types of merchandise which are governed by the policy; and any other conditions which govern the refund, credit, or exchange of merchandise. No dimensions are given for the sign, but it should be easily read by the public if you choose to use such a sign, rather than putting your policy on your order form.

Sign #24. Cellular Telephone Activation Notice.

Anyone retailing cellular telephones is required by Business and Professions Code section 17026.1 to post a large conspicuous sign, in lettering no smaller than 36-point type. The sign shall be prominently displayed and visible to consumers and located in that area in each retail location where cellular telephones are displayed and purchased:

> Activation of any cellular telephone is not required and the advertised price of any cellular telephone is not contingent upon activation, acceptance, or denial of cellular service by any cellular provider.

Sign #25. Grey Market Goods Sign

Retail sellers of "grey market goods" (see definition below) must, under Civil Code section 1797.8, post a conspicuous sign at the point of display of such goods and affix to the product or the package a conspicuous ticket, label, or tag disclosing:

> As to each item checked below, this product:
> is not covered by a manufacturer's express written warranty valid in the United States (however, any implied warranty provided by law still exists).
> is not compatible with United States electrical currents.
> is not compatible with United States broadcast frequencies.
> has no replacement parts available through the manufacturer's United States distributors.
> has no compatible accessories available through the manufacturer's United States distributors.
> is not accompanied by instructions in English.
> is not eligible for a manufacturer's rebate.
> has other items of incompatibility or nonconformity with relevant domestic standards listed on the tag on the product.

Sign #26. Anti-Graffiti Warning Sign

Any dealer who sells aerosol containers of paint (which could include touch up paint) must post a sign in a conspicuous place in letters at least three-eighths of an inch high stating:

> Any person who maliciously defaces real or personal property with paint is guilty of vandalism which is punishable by a fine, imprisonment, or both.

Sign #27. Child Passenger Restraint Sign

If you lease or rent vehicles to your customers for a period not exceeding four months, then the following sign must be posted in a place conspicuous to the public not smaller than 15 inches by 20 inches. It is uncertain whether a dealer who loans a "courtesy car" to a service customer without charge is required to comply with the signage and availability requirements, but conservative dealers may wish to comply with the requirements in all circumstances.

> CALIFORNIA LAW REQUIRES ALL CHILDREN WHO ARE 8 YEARS OF AGE TO BE TRANSPORTED IN A CHILD RESTRAINT SYSTEM. THIS AGENCY IS REQUIRED TO PROVIDE FOR RENTAL OF A CHILD RESTRAINT SYSTEM IF YOU DO NOT HAVE A CHILD RESTRAINT SYSTEM YOURSELF.

Sign #28. Rental Company Damage Waiver

NOTICE ABOUT YOUR FINANCIAL RESPONSIBILITY AND OPTIONAL DAMAGE WAIVER

You are responsible for all collision damage to the rented vehicle even if someone else caused it or the cause is unknown. You are responsible for the cost of repair up to the value of the vehicle, and towing, storage, and impound fees.

Your own insurance, or the issuer of the credit card you use to pay for the car rental transaction, may cover all or part of your financial responsibility for the rented vehicle. You should check with your insurance company, or credit card issuer, to find out about your coverage and the amount of the deductible, if any, for which you may be liable.

Further, if you use a credit card that provides coverage for your potential liability, you should check with the issuer to determine if you must first exhaust the coverage limits of your own insurance before the credit card coverage applies.

The rental company will not hold you responsible if you buy a damage waiver. But a damage waiver will not protect you if (list exceptions).

"The cost of an optional damage waiver is $___ to $___ for every (day or week), depending upon the vehicle rented.

See the discussion below of California Civil Code section 1936(g)(1) for alternative types of signs.

Sign #29. Sales Tax Permit

Each sales tax permit issued for each place of business within the state shall at all times be conspicuously displayed at the place for which issued.

Sign #30. Insurance Licenses

Every license to act as a fire and casualty broker-agent shall be prominently displayed by the holder in his or her office.

Sign #31. Dealer DMV License

The Dealer license must be posted in a place conspicuous to the public. Dealers must also have erected or posted on the premises signs or devices providing information in relation to the dealer's name and the location and address of the dealer's established place of business to enable every person doing business with the dealer to identify him or her properly. Every such sign erected or posted on an established place of business, shall have an area of not less than 2 square feet per side displayed and shall contain lettering of sufficient size to enable the sign to be read from a distance of least 50 feet.

Sign #32. Salesperson DMV Licenses

Every salesperson's license is to be posted in a place conspicuous to the public on the premises where he or she is actually engaged in the selling of vehicles for the dealer. The license must be displayed continuously during employment.

Sign #33. Business License

You must post or display the receipt or certificate showing evidence of a business' payment of the Business License Tax Receipt.

Sign #34. Contract for Parking or Storage Sign

If you have a contract for parking and storage of vehicles, then see Civil Code section 1630 set forth below.

Sign #35. Public Parking Prohibited Sign

A sign not less than 17 by 22 inches in size, with lettering not less than one inch in height, displayed in plain view at all entrances to the property stating that public parking is prohibited, that vehicles will be removed at the owner's expense, and, optionally, that a citation may be issued. The sign must also contain the telephone number of the local traffic law enforcement agency.

Sign #36. Storage for Towed Vehicles Sign

If a dealership causes a vehicle to be towed or removed in order to create or acquire a lienhold interest in the vehicle, then see the discussion of Civil Code section 3070 below.

Sign #37. Exit Signs

Signs marking exits and giving directions to exits as required under 8 CCR section 3216 are discussed below.

Sign #38. Off Site Vehicle Display

If a dealer engages in off premises display of vehicles at shopping centers, fairs, and the like, as permitted by Vehicle Code section 11709(b), 13 CCR section 270.08 requires the posting of a sign on the vehicle or vehicles or in close proximity thereto, printed in letters of not less than three inches in height, with the name, location and address of the dealer's established place of business and the following statement:

No sales permitted, or deposits accepted at this location.

Sign #39. Notice of Lien Sale

If a dealer conducts a lien sale of a vehicle worth less than $2,500, Civil Code section 3072(f) requires that for a period of at least ten days before the sale, a sign be posted in the business office or at such other site where the lien sale is to take place. The sign is to provide as follows:

Notice of Vehicle Lien Sale
On _____, 20___, at exactly __:__ the vehicle with the following year, make, model, VIN, and California license number will be sold:

Sign #40. No Smoking

Labor Code section 6404.5 completely bans all smoking in the workplace, with the exception of outside exhausted breakrooms. Employers will not be guilty of knowingly permitting smoking by non-employees if there are posted at all entrances to the facility one of the following signs, as applicable to the dealership involved:

NO SMOKING

or

SMOKING IS PROHIBITED EXCEPT IN DESIGNATED AREAS

Sign #41. Fuel Economy Guide Booklet

Federal law requires dealers to display the EPA's Fuel Economy Guide booklet in the same manner it displays vehicle brochures.

Sign #42. Towing Fees and Access Notice

Vehicle Code section 22651.07 requires posting a "Towing Fees and Access Notice" sign whenever the dealer is charging for towing. The sign reads:

Towing Fees and Access Notice
Note: The following information is intended to serve as a general summary of some of the laws that provide vehicle owners certain rights when their vehicle is towed. It is not intended to summarize all of the laws that may be applicable nor is it intended to fully and completely state the entire law in any area listed. Please review the applicable California code for a definitive statement of the law in your particular situation.
How much can a towing company charge?
Rates for public tows and storage are generally established by an agreement between the law enforcement agency requesting the tow and the towing company (to confirm the approved rates, you may contact the law enforcement agency that initiated the tow; additionally, these rates are required to be posted at the storage facility).
Rates for private property tows and storage cannot exceed the approved rates for the law enforcement agency that is primary jurisdiction for the property from which the vehicle was removed or the towing company's approved CHP rate.
Rates for owner's request tows and storage are generally established by mutual agreement between the requestor and the towing company, but may be dictated by agreements established between the requestor's motor club and motor club service provider.
Where can you complain about a towing company?
For public tows: Contact the law enforcement agency initiating the tow.
Your rights if your vehicle is towed:
Generally, prior to paying any towing and storage-related fees you have the right to:
Receive an itemized invoice of actual charges.
Receive your personal property, at no charge, during normal business hours.
Retrieve your vehicle during the first 72 hours of storage and not pay a lien fee.
Request a copy of the Towing Fees and Access Notice.
Pay by cash or valid bank credit card.
Inspect your vehicle or have your insurance carrier inspect your vehicle at the storage facility, at no charge, during normal business hours.
You have the right to have the vehicle released to you upon (1) payment of all towing and storage-related fees, (2) presentation of a valid photo identification, (3) presentation of reliable documentation showing that you are the owner of the vehicle or that the owner has authorized you to take possession of the vehicle, and (4), if applicable, presentation of any required police or law enforcement release documents.
Prior to your vehicle being repaired:
You have the right to choose the repair facility and to have no repairs made to your vehicle unless you authorize them in writing.
Any authorization you sign for towing and any authorization you sign for repair must be on separate forms.
What if I do not pay the towing and storage-related fees or abandon my vehicle at the towing company?
Pursuant to Sections 3068.1 to 3074, inclusive, of the Civil Code, a towing company may sell your vehicle and any moneys received will be applied to towing and storage-related fees that have accumulated against your vehicle.
You are responsible for paying the towing company any outstanding balance due on any of these fees once the sale is complete.
Who is liable if my vehicle was damaged during towing or storage? Generally the owner of a vehicle may recover for any damage to the vehicle resulting from any intentional or negligent act of a person causing the removal of, or removing, the vehicle.
What happens if a towing company violates the law? If a tow company does not satisfactorily meet certain requirements detailed in this notice, you may bring a lawsuit in court, generally in small claims court. The tower maybe civilly liable for damages up to two times the amount charged, not to exceed $500, and up to $4,000 for certain violations.

Discussion of Applicable Statutes and Regulations

The following sets forth in greater detail the statutes and regulations applicable to the signs discussed above. In most situations the exact language of the particular statute or regulation is quoted. The sign numbers below refer to the signs identified both in the chart and the discussion above.

California Requirements

General Repair Shop Signs

General Repair Shop. Sign #1

California Business and Professions Code section 9884.17 states:

The Bureau shall design and approve of a sign which shall be placed in all automobile repair dealer locations in a place and manner conspicuous to the public. Such sign shall give notice that inquiries concerning service may be made to the Bureau and shall contain the telephone number and Internet website address of the Bureau. Such sign shall also give notice that the customer is entitled to a return of replaced parts upon his request therefore at the time the work order is taken.

Title 16 of the California Code of Regulations, section 3351.3, provides as follows:

(a) Except as provided in subsection (b), all automotive repair dealers shall display the following in a place and manner conspicuous to their customers:

(1) A current and valid certificate of registration as an automotive repair dealer issued by the bureau; and

(2) An official automotive repair dealer's sign, which meets the specifications of the Automotive Repair Act and Section 3351.4 of this article. In the event there are multiple facilities, an official automotive repair dealer's sign shall be displayed in a place and in a manner conspicuous to all customers at each location.

(b) When conducting business from other than the principal business address shown in an automotive repair dealer's registration, the dealer shall provide to every customer, with the customer's copy of the work order as provided in paragraph (3) of subdivision (a) of Section 9884.7 of the Business and Professions Code, a copy of an official automotive repair dealer's sign that meets the following specifications:

(1) A copy of the sign shall be reproduced on a white sheet of paper, or similar material, no less than eight and one half inches by eleven inches (8½" x 11") in size.

(2) The sign shall be proportionately reduced in size to fill the page in portrait format with no more than one inch (1") margins outside the right, left and bottom inset border lines.

(3) The current business name, address of record, business telephone number and registration number of the automotive repair dealer, as shown by the bureau's records, shall be printed above the top inset border line of the sign in print no smaller than the smallest print of the reduced sign.

(4) No other information, printing, decoration, border or design shall be placed on the page.

(c) For the purpose of subsection (b), the term "provide" shall mean to give for retention.

Title 16 of the California Code of Regulations, section 3351.4, provides as follows:

(a) Official automotive repair dealer signs shall meet the following specifications:

(1) Content. Until June 30, 2006, signs shall be worded exactly as shown in either Figure 1 or Figure 3. On and after June 30, 2006, signs shall be worded exactly as shown in Figure 3, except that an automotive repair dealer possessing a valid registration on June 30, 2006, may comply with Section 3351.3 and this section by displaying a supplementary sign, containing the bureau's Web site address. The supplementary sign shall be worded exactly as shown in Figure 5, and shall be displayed immediately below any sign that was displayed by the automotive repair dealer in compliance with Section 3351.3 and this section on and before June 30, 2006.

(2) Dimensions. Signs as shown in Figure 1 shall have the dimensions shown in Figure 2, signs as shown in Figure 3 shall have the dimensions shown in Figure 4, and signs as shown in Figure 5 shall have the dimensions shown in that figure.

(3) Sign Material. 24-gauge steel or aluminum or synthetic material of equivalent rigidity may be used. Synthetic material may be acceptable provided it meets all of the requirements herein, including durability.

(4) Color. The background shall be semi-gloss white. All print, border stripe and divider stripes, including the State Seal shall be gloss black in color.

(5) Paint. Paint shall be a premium grade exterior acrylic enamel or equivalent. The silk screen/bake-on process or an acceptable equivalent may be used.

(6) Surface Preparation. All bare metal shall be etched and coated with white primer or equivalent to insure proper paint adhesion and corrosion protection.

(7) Print. Largest lettering shall be 72 pt. Futura Demi "condensed;" medium lettering shall be 48 pt. Futura Bold; and smallest lettering shall be 36 pt. Futura Bold for the signs shown in Figures 1 and 3. The lettering of the supplementary sign shown in Figure 5 shall be 48 pt. Futura Bold for the message and 72 pt. Futura Demi "condensed" for the Web site address.

(8) General. A three and one-half inch diameter State Seal is required for the signs shown in Figures 1 and 3;.

(9) The use of embossed letters or a clear protective finish coat is permitted, but not required; and.

(10) There shall be a one-quarter inch mounting hole in each corner.

(b) Replacement. The bureau may require replacement of any sign which that fails to meet the outlined specifications or which that is no longer readily legible.

B.A.R. Certificate. Sign #2

Title 16 California Code of Regulations section 3351.3, provides as follows:

All dealers shall display the following in a place and manner conspicuous to their customers:

(a) A current and valid certificate of registration issued by the bureau;

(b) An official automotive repair dealer's sign which meets the specifications of the Act and these regulations. In the event there are multiple facilities, an official automotive repair dealer's sign shall be displayed in a place and manner conspicuous to all customers at each location.

Posting of Repair Hours Open To Public. Sign #3

Title 16 California Code of Regulations section 3340.15 provides that a dealer whose facility has been granted smog check program certification shall remain open during business hours, and have certified smog check personnel during those times. Therefore, it is recommended that the hours during which the facility is open to the public should be posted.

Posting of Labor Rates. Sign #4

Neither California nor Federal law requires the posting of non-smog labor rates in repair shops. See, however, the discussion in the chapter in this Management Guide "Automotive Repair Act" under the topic "Advertising Regulations" if you post labor rates. The discussion there is very important to avoid claims of deception when flat rate hours or some similar system is used. Various sections of Title 16 of the California Code of Regulations, as quoted below, do provide for the posting of prices for lamp, brake, and smog inspection stations. Muffler station prices must also be posted as discussed below.

Lamp, Brake, and Muffler Stations

Title 16 of the California Code of Regulations, section 3307 provides that Official lamp and brake stations shall comply with the following provisions governing display of documents, maintenance of equipment, and record keeping.

Display of Station License. Sign #5

Display of Station License. An official station license shall be placed under glass or other transparent cover and prominently displayed in the station.

Display of Adjusters' Licenses. Sign #6

Display of Adjusters' Licenses. Licenses of all official adjusters employed at a licensed station shall be mounted under glass or other transparent cover and prominently displayed in the station.

Display of Station Sign. Sign #7

Display of Station Sign. Each official station except a fleet owner station shall display an official station sign which meets specifications in section 3309, and the sign shall be displayed in location where it is clearly visible from outside the station.

Title 16 of the California Code of Regulations, section 3309, provides as follows:

Official station signs shall meet the specifications illustrated in this section and shall be displayed in accordance with section 3307(c) of this article. A station which performs more than one official function may display a separate sign to designate each function or it may display one multipurpose sign appropriate to the official functions for which the station is licensed.

(a) Single Function Signs. Official station signs displayed separately to designate each function for which the station is licensed shall meet the following specifications:

(1) Dimensions. Single function signs shall have the dimensions shown in Figure 7-1.

(2) Color. Single function signs shall be bordered and lettered in light chrome yellow; and the background shall be royal blue.

(3) Lettering. Single function signs shall have lettering in accordance with Figure 7-1, the exact dimensions of which are available from the Bureau of Automotive Repair.

(b) Multipurpose Signs. Multipurpose station signs displayed to designate the functions for which the station is licensed shall meet the following specifications:

(1) Dimensions. Multipurpose signs shall have the overall dimensions, shield size, placement, and lettering size shown in Figures 7-2.

(2) Color. Multipurpose signs shall have lettering, shield border and station designation(s) in light chrome yellow; and the background shall be royal blue.

(3) Station Type Designation. The space to the right of the official station shield in a multipurpose sign shall be used to designate the official functions of the station, and such designation shall meet the requirements of section 3309(b)(1) of this article.

Posting Of Prices. Sign #8

Title 16 of the California Code of Regulations section 3307(d) provides:

Posting of Prices. Each official station except a fleet owner station may make a reasonable charge for the work performed and shall post conspicuously a list of price ranges for the specific activities for which it is licensed. Prices may be stated either as a fixed fee or an hourly rate on a time-and-material basis. No added charge shall be imposed for the issuance of official lamp adjustment or official brake adjustment certificates, or certifications on enforcement documents or the correction of lamp or brake violations. No charge relating to repair, replacement of parts, or adjustment of lamps or brakes shall be imposed in addition to the posted

price for such adjustment or inspection unless such additional work and added charges are authorized in advance by the vehicle owner or operator.

Muffler Station Sign. Sign #9

Title 13 of the California Code of Regulations, section 604 (b) requires that each muffler certification station, except a fleet owner station that certifies only its own vehicles, shall display a muffler station sign meeting the specifications in section 606 of this title. The sign shall be displayed where it is clearly visible from outside the station.

Section 606 provides: *"Signs for muffler certification stations must meet the following specifications:*

(a) Signs shall have the dimensions shown in Figure 9-1. (Reproduced above.)

(b) The color of the signs shall be bordered and lettered in light chrome yellow. The background shall be royal blue.

(c) Lettering on the sign shall have the dimensions shown in Figure 9-2." (Reproduced above.)

Display of Muffler Station License. Sign #10

Title 13 of the California Code of Regulations, section 601 provides that a "licensed muffler certification station" is an automotive repair facility that meets all requirements of this article of the California Code of Regulations and is licensed and equipped to inspect, repair, replace, and certify vehicular exhaust systems. An "exhaust system" consists of all pipes, converters, and chambers through which the exhaust gas flows from the engine exhaust port to the end of the tailpipe.

Title 13 of the California Code of Regulations, section 604(a) requires that the license of a muffler certification station shall be prominently displayed under glazing material in the customer area of the station.

Posting Of Muffler Station Prices. Sign #11

Title 13 of the California Code of Regulations, section 604(c) requires that each muffler certification station, except a fleet owner station that certifies only its own vehicles, shall post conspicuously in the customer area the prices for issuing exhaust certifications and for clearing enforcement documents.

Smog Check Stations

Smog Check Station Sign. Sign #12

Health & Safety Code section 44033(a) provides that smog check stations meeting the requirements established by the department may be licensed as a smog check station. A licensed smog check station shall display Sign #12 in a manner conspicuous to the public.

Title 16 of the California Code of Regulations, section 3340.22, provides for the following:

Each smog check station shall display an identifying sign that meets the following specifications:

(a) Dimensions. The sign shall be 24 inches wide and 30 inches high.

(b) Sign Material. The sign shall be made of 0.040 aluminum or steel.

(c) Content. Camera-ready design and content of the sign shall be supplied by the bureau.

Title 16 of the California Code of Regulations, section 3340.22.1, provides as follows:

"(a) Separate sign requirements shall apply to the following types of stations which provide smog check program services:

(1) Smog check test only stations.

(2) Smog check stations which only inspect and/or repair heavy-duty vehicle.

(3) Smog check stations which do not inspect and/or repair heavy-duty vehicles.

(b) The service signs required by subdivision (a) shall be made of 0.040 aluminum or steel stock and shall be 24 inches wide and 8 inches high. Camera-ready design and content of required signs are available from the Bureau upon request.

(c) Service signs shall be securely attached to the bottom of or immediately below the smog check station signs required by section 3340.22 of this article. Attachment shall be by ring, hook, bracket, or similar device.

Required Smog Repair Limits Sign. Sign #13

Health & Safety Code section 44017.3 provides as follows:

(a) The department shall provide a licensed smog check station with a sign informing customers about options when their vehicle fails a biennial smog check inspection, including, but not limited to, the option for qualified consumers to retire vehicles, receive repair assistance, or obtain repair cost waivers. The sign shall include the department's means of contact, including, but not limited to, its telephone number and Internet Web site. This sign shall be posted conspicuously in an area frequented by customers. The sign shall be required in all licensed smog check stations.

(b) In stations where licensed smog check technician repairs are not performed, the station shall have posted conspicuously in an area frequented by customers a statement that repair technicians are not available and repairs are not performed.

Title 16 of the California Code of Regulations, section 3340.22.2 reads as follows:

Smog Check Station Repair Cost Limits Sign

(a) The sign required by section 44107.3 of the Health and Safety Code shall be provided by the bureau and shall have the following dimensions and specifications.

(1) Sign shall be 22 inches wide and 16 inches high.

(2) Sign shall be in black typeface on white background.

(3) Sign wording shall and point size shall be as supplied by the bureau.

(4) Typeface shall be bookman.

(b) If a sign no longer meets the outlined specifications or is no longer readily legible, it will be replaced by the bureau.

Display Of Smog Check Licenses and Certificates. Sign #14

Title 16 of the California Code of Regulations, section 3340.15(d) provides: Display of Licenses and Certificates. The station license, inspector license, and appropriate qualified mechanics' certificates shall be posted prominently under glass or other transparent material in an area frequented by customers.

Posting Of Dealer's Smog Check Station Prices. Sign #15

Title 16 of the California Code of Regulations, section 3340.15(e) provides as follows: "Posting of Prices. The station shall post conspicuously in an area frequented by customers a list of price ranges for the specific activities for which it is licensed. Such posted prices shall include the price charged by the station for inspections, and, if a separate price is charged for reinspections, such reinspection price. The station shall also post the inspection prices for vans and/or heavy duty vehicles if such prices differ from the passenger car inspection price. If the station imposes an hourly labor charge for repairs, such hourly labor rate shall be posted. The price of issuance of a certificate of compliance or noncompliance charged by the bureau shall be posted separately from the price of the inspection and of the reinspection, if any." Notice that this regulation does require labor rates to be posted if charges are based thereon; however, this applies only to the smog check operations.

Smog Check Test Only Sign. Sign #16

Title 16 of the California Code of Regulations, section 3340.16(c), provides as follows: A smog check test only station shall post conspicuously, in an area frequented by consumers, a notice to the effect that the station is licensed to test vehicles only, and cannot make any required repairs to a vehicle which has failed a smog check test.

Other Vehicle Sales Related Signs

No Cooling Off Period Without Cancellation Sign. Sign #17

In addition to notices required to be printed in every sales contract and lease, legislation designed to warn consumers that no cooling-off period exists mandates Sign #17. Vehicle Code section 11709.2 provides: "Every dealer shall conspicuously display a notice not less than eight inches high and 10 inches wide, in each sales office and sales cubicle of a dealer's established place of business where written terms of specific sale or lease transactions are discussed with prospective purchasers or lessees, and in each room of a dealer's established place of business where sale and lease contracts are regularly executed, which states the following:

THERE IS NO COOLING-OFF PERIOD UNLESS YOU OBTAIN A CONTRACT CANCELLATION OPTION

California law does not provide for a "cooling-off" or other cancellation period for vehicle lease or purchase contracts. Therefore, you cannot later cancel such a contract simply because you change your mind, decide the vehicle costs too much, or wish you had acquired a different vehicle. After you sign a motor vehicle purchase or lease contract, it may only be canceled with the agreement of the seller or lessor or for legal cause, such as fraud.

However, California law does require a seller to offer a 2-day contract cancellation option on used vehicles with a purchase price of less than $ 40,000, subject to certain statutory conditions. this contract cancellation option requirement does not apply to the sale of a motorcycle or an off-highway motor vehicle subject to identification under California law. see the vehicle contract cancellation option agreement for details."

Right To Inspect Used Vehicles Sign. Sign #18

Vehicle Code section 11709.1 provides as follows:

Every dealer who displays or offers one or more used vehicles for sale at retail shall post a notice not less than 8 inches high and 10 inches wide, in a place conspicuous to the public, which states the following:

“The prospective purchaser of a vehicle may, at his or her own expense and with the approval of the dealer, have the vehicle inspected by an independent third party either on or off these premises.”

Spanish / Foreign Translation Of Contract Sign. Sign #19

California Civil Code section 1632 provides for certain requirements whenever a dealer negotiates a sale or lease covered by Civil Code section 2982 (Conditional sale contracts) or the Vehicle Leasing Act primarily in the Spanish, Chinese, Korean, Vietnamese, or Tagalog languages. See discussion in the chapter in this Management Guide entitled "AUTOMOBILE SALES FINANCE ACT" under the topic "Spanish and Other Foreign Language Contract Requirements." Civil Code section 1632 provides that under these circumstances a Spanish or other foreign language notice shall be conspicuously displayed to the effect that the Seller or Lessor is required to provide a translated contract or agreement in one of the five covered languages. If the Seller or Lessor does business at more than one location or branch, the requirements for the sign shall apply only with respect to the location or branch at which the foreign language is used.

Presale Availability of Warranty Sign. Sign #20

The federal law governing consumer warranties is the Magnuson-Moss Consumer Warranty Act. The Act requires that you make the terms of the any written warranty (including the manufacturer's) available to potential buyers prior to sale (15 U.S.C. section 2302(b) ; 16 C.F.R. section 702.3). The dealer must either conspicuously display the text of the written warranty in close proximity to the product, or post signs in conspicuous places advising that the warranties are available for inspection. Since Magnuson-Moss covers all written warranties, including new and used cars, F&I products (such as alarms) and parts and accessories, dealers should post the sign in several areas: new and used vehicle sales, F&I, the parts counter, and the service write-up area.

Availability of Service Bulletins. Sign #21

Dealers are required under Civil Code section 1795.91 to advice all prospective buyers and lessees of the availability of factory service bulletins. For this purpose, the law recommends and authorizes the posting of Sign #21 in the showroom or other conspicuous place.

If a dealer receives a service bulletin detailing an adjustment program, the law also requires the dealer to disclose the principal terms and conditions of the warranty adjustment program to any service department customer seeking repair of a condition covered by the program. Dealers should implement a system to ensure that such disclosure is always made.

Other State Mandated Signs

Sign Regarding Credit Card Request For Check Writing. Sign #22

When a customer writes a check, California law prohibits any policy which requires the presentation of a credit card (whether or not credit card numbers are recorded) as a condition to acceptance of the check. The law, however, does allow a credit card to be "requested" for purposes of identification, and as an indication of credit worthiness or financial responsibility. Thus "requesting" is permitted, but "requiring" is barred. California Civil Code section 1725 provides that if a request for a credit card, is, or might ever be made, you must either train your employees requesting the credit card to inform all check writing customers that they are not required to display a credit card to write a check; or post the following notice in a conspicuous location in the unobstructed view of the public within the premises where the check is being written, clearly and legibly: "Check writing ID: credit card may be requested but not required for purchases."

Policy Concerning Refunds and Exchanges Sign. Sign #23

California Civil Code section 1723(a) and (b) provide as follows:

(a) Every retail seller which sells goods to the public in this state that has a policy as to any of those goods of not giving full cash or credit refunds, or of not allowing equal exchanges, or any combination thereof, for at least seven days following purchase of the goods if they are returned and proof of their purchase is presented, shall conspicuously display that policy either on signs posted at each cash register and sales counter, at each public entrance, on tags attached to each item sold under that policy, or on the retail seller's order forms, if any. This display shall state the store's policy, including, but not limited to, whether cash refund, store credit, or exchanges will be given for the full amount of the purchase price; the applicable time period; the types of merchandise which are covered by the policy; and any other conditions which govern the refund, credit, or exchange of merchandise.

(b) This section does not apply to food, plants, flowers, perishable goods, marked "as is," "no returns accepted," "all sales final," or with similar language, goods used or damaged after purchase, customized goods received as ordered, goods not returned with their original package, and goods which cannot be resold due to health considerations.

(c)(1) Any retail store which violates this section shall be liable to the buyer for the amount of the purchase if the buyer returns, or attempts to return,

the purchased goods on or before the 30th day after the purchase.

This law does not apply to the sale of vehicles because they are used after purchase.

Cellular Telephone Activation Notice. Sign #24

Anyone retailing cellular telephones is required by Business and Professions Code section 17026.1 to post this sign in the area in each retail location where cellular telephones are displayed and purchased.

Grey Market Goods Signs. Sign #25

California Civil Code sections 1797.8, and following, deal with grey market goods. "Grey Market Goods" are defined in Civil Code section 1797.8 as consumer goods bearing a trademark and normally accompanied by an express written warranty valid in the United States of America which are imported into the United States through channels other than manufacturer's authorized United States distributor which are not accompanied by the manufacturer's express written warranty valid in the United States. The law includes sale of grey market goods or lease of such goods for more than four months. Civil Code section 1797.81 requires retail sellers of grey market goods to post a conspicuous sign at the product's point of display and affixed to the product or the package with a conspicuous ticket, labeled, or tagged disclosing the various matters required by this statute.

Anti-Graffiti Warning. Sign #26

In addition to imposing restrictions on the sale of aerosol containers of paint to minors, Penal Code section 594.1 requires all retailers who sell or offer to sell aerosol containers of paint to post Sign #26.

Child Passenger Restraint Sign. Sign #27

Vehicle Code section 27365 requires every car rental agency in California to post Sign #27 in a place conspicuous to the public in each established place of business.

This law also requires that every such agency shall have available for, and shall, upon request, provide for rental to, adults traveling with children under the age of 6 or weighing less than 60 pounds, child passenger seat restraint systems meeting applicable federal motor vehicle safety standards on the date of the rental transaction, in good and safe condition, with no missing original parts and not older than five years.

Although the term "car rental agency" is not specifically defined in the Vehicle Code section 508 of the code defines a renter as "A person who is engaged in the business of renting, leasing or bailing vehicles for a term not exceeding four months and for a fixed rate or price." It is uncertain whether a dealer who loans a "courtesy car" to a service customer without charge is required to comply with the signage and availability requirements, but conservative dealers may wish to comply with the requirement in all circumstances.

Rental Company Damage Waiver Signs. Sign #28

If your dealership is in the business of renting passenger vehicles to the public, then California Civil Code section 1936, subdivisions (g)(1) and (g)(3) must be complied with. They provide:

(g)(1) A rental company that offers or provides a damage waiver for any consideration in addition to the rental rate shall clearly and conspicuously disclose the following information in the rental contract or holder in which the contract is placed and, also, in signs posted at the place, such as the counter, where the renter signs the rental contract, and, for renters who are enrolled in the rental company's membership program, in a sign that shall be posted in a location clearly visible to those renters as they enter the location where their reserved rental cars are parked or near the exit of the bus or other conveyance that transports the enrollee to a reserved car: (A) the nature of the renter's liability, e.g., liability for all collision damage regardless of cause, (B) the extent of the renter's liability, e.g., liability for damage or loss up to a specified amount, (C) the renter's personal insurance policy or the credit card used to pay for the car rental transaction may provide coverage for all or a portion of the renter's potential liability, (D) the renter should consult with his or her insurer to determine the scope of insurance coverage, including the amount of the deductible, if any, for which the renter is obligated, (E) the renter may purchase an optional damage waiver to cover all liability, subject to whatever exceptions the rental company expressly lists that are permitted under subdivision (f), and (F) the range of charges for the damage waiver.

(2) In addition to the requirements of paragraph (1), a rental company that offers or provides a damage waiver shall orally disclose to all renters, except those who are participants in the rental company's membership program, that the damage waiver may be duplicative of coverage that the customer maintains under his or her own policy of motor vehicle insurance. The renter's receipt of the oral disclosure shall be demonstrated through the renter's acknowledging receipt of the oral disclosure near that part of the contract where the renter indicates, by the renter's own initials, his or her acceptance or declination of the damage waiver. Adjacent to that same part, the contract also shall

state that the damage waiver is optional. Further, the contract for these renters shall include a clear and conspicuous written disclosure that the damage waiver may be duplicative of coverage that the customer maintains under his or her own policy of motor vehicle insurance.

(3) The following is an example, for purposes of illustration and not limitation, of a notice fulfilling the requirements of paragraph (1) for a rental company that imposes liability on the renter for collision damage to the full value of the vehicle:[see sample sign in previous section.]

Display of Sales Tax Permit. Sign #29

Each sales tax permit issued for each place of business within the state shall at all times be conspicuously displayed at the place for which issued. See Revenue & Taxation Code section 6067.

Posting of Insurance Licenses. Sign #30

Insurance Code section 1725 provides: Every license to act as a fire and casualty broker-agent shall be prominently displayed by the holder thereof in his or her office in a manner whereby anyone may readily inspect it and ascertain both its currency and the capacity in which its holder is licensed to act.

Posting of Dealer License. Sign #31

Vehicle Code section 11709(a) provides as follows: A dealer's established place of business and other sites or locations as may be operated and maintained by the dealer in conjunction with his or her established place of business, shall have posted, in a place conspicuous to the public in each and every location, the license issued by the department to the dealer and to each salesperson employed by the dealer and shall have erected or posted thereon signs or devices providing information relating to the dealer's name and the location and address of the dealer's established place of business to enable every person doing business with the dealer to identify him or her properly. Every such sign erected or posted on an established place of business, shall have an area of not less than two square feet per side displayed and shall contain lettering of sufficient size to enable the sign to be read from a distance from at least 50 feet. This section shall not apply to a dealer who is a wholesaler involved for profit only in the sale of vehicles between licensed dealers.

Display of Salesperson License. Sign #32

Vehicle Code section 11812 provides in part as follows:

(a) Every vehicle salesperson licensed under this article shall, at the time of employment, deliver to his or her employing dealer his or her salesperson's license to be posted in a place conspicuous to the public on the premises where he or she is actually engaged in the selling of vehicles for the employing dealer.

(b) The license shall be displayed continuously during the employment. If a vehicle salesperson's employment is terminated, the license shall be returned to the salesperson.

Display of Business License. Sign #33

There is required to be posted or displayed the receipt or certificate showing evidence of a business' payment of the "Business license tax receipt". See California Business & Professions Code section 16111.

Contract for Parking or Storage Sign. Sign #34

If you issue a parking lot gate-ticket or other device meant to be a contract for parking or storage of vehicles, then California Civil Code section 1630 would apply. It provides as follows:

Except as provided in section 1630.5, a printed contract of bailment providing for the parking or storage of a motor vehicle shall not be binding, either in whole or in part, on the vehicle owner or on the person who leaves the vehicle with another unless the contract conforms to the following:

(a) "This contract limits our liability-read it" is printed at the top in capital letters of 10-point type or larger.

(b) All the provisions of the contract are printed legibly in eight-point type or larger.

(c) Acceptance of benefits under a contract included within the provisions of this section shall not be construed a waiver of this section, and it shall be unlawful to issue such a contract on condition that provisions of this section are waived.

A copy of the contract printed in large type, in an area at least 17 x 22 inches, shall be posted in a conspicuous place at each entrance of the parking lot.

Nothing in this section shall be construed to prohibit the enactment of city ordinances on this subject that are not less restrictive, and such enactments are expressly authorized.

Public Parking Prohibited Sign. Sign #35

Vehicle Code section 22658(a) provides a non-exclusive means of being allowed to tow away vehicles improperly parked on private property: "the owner or person in lawful possession of private property… may cause the removal of a vehicle parked on the property to a storage facility that meets the requirements of subdivision (n) under any of the following circumstances: (1) There is dis-

played, in plain view at all entrances to the property, a sign not less than 17 inches by 22 inches in size, with lettering not less than one inch in height, prohibiting public parking and indicating that vehicles will be removed at the owner's expense, and containing the telephone number of the local traffic law enforcement agency and the name and telephone number of each towing company that is a party to a written general towing authorization agreement with the owner or person in lawful possession of the property. The sign may also indicate that a citation may also be issued for the violation. (2) The vehicle has been issued a notice of parking violation, and 96 hours have elapsed since the issuance of that notice. (3) The vehicle is on private property and lacks an engine, transmission, wheels, tires, doors, windshield, or any other major part or equipment necessary to operate safely on the highways, the owner or person in lawful possession of the private property has notified the local traffic law enforcement agency, and 24 hours have elapsed since that notification. (4) The lot or parcel upon which the vehicle is parked is improved with a single-family dwelling.

Storage Charges for Towed Vehicles Sign. Sign #36

California Civil Code section 3070(d)(1) provides that any person who improperly causes a vehicle to be towed or removed in order to create or acquire a lienhold interest enforceable under Chapter 6.5 of the California Civil Code, or who violates any of the provisions of that chapter shall forfeit all claims for towing, removal, or storage, and shall be liable to the owner or lessee of the vehicle for the cost of removal, transportation, and storage, damages resulting from the towing, removal transportation, or storage of the vehicle, attorneys' fees, and court costs.

Civil Code section 3070(d)(2)(E) provides that improperly causing a vehicle to be towed or removed" includes: “Failure by the owner or operator of a facility used for the storage of towed vehicles to display, in plain view at all cashiers' stations, a sign not less than 17 x 22 inches in size with lettering not less than one inch in height, disclosing all storage fees and charges enforced, including the maximum daily storage rate." It appears that this statute, however, only applies if the dealership caused the vehicle to be towed or removed “in order to create or acquire a lienhold interest."

Exit Signs. Sign #37

8 California Code of Regulations section 3216 requires the posting of exit or directional signs, or both, at every exit door, at the intersection of corridors, at exits, stairways or ramps, and at such other locations at intervals as are necessary to provide the occupants with knowledge of the various means of egress available. The signs need not be provided for rooms or buildings having an occupant load of 50 or less and when approved, the main exterior exit doors obviously and clearly identifiable as exits. The Regulation further gives specifications concerning the dimensions of the signs and their luminance.

Off Site Vehicle Display. Sign #38

If a dealer engages in off premises display of vehicles at shopping centers, fairs, and the like, as permitted by Vehicle Code section 11709(b), 13 California Code of Regulations section 270.08 provides for the posting of a sign on the vehicle or vehicles or in close proximity thereto, printed in letters of not less than three inches in height, which shall show the dealer's name, location and address of his or her established place of business and the following statement: “No sales permitted, or deposits accepted at this location.”

Lien Sale in Ten Days. Sign #39

If a dealer conducts a lien sale of a vehicle worth less than $2,500, Civil Code section 3072(f) requires that for a period of at least ten days before the sale, a sign be posted in the business office or at such other site where the lien sale is to take place.

No Smoking. Sign #40

Labor Code section 6404.5 completely bans all smoking in the workplace, with the exception of outside exhausted breakrooms. Employers will not be guilty of knowingly permitting smoking by nonemployees if there are posted at all entrances to the facility one of two alternative "no smoking" signs, as shown above.

Fuel Economy Guide Booklet. Sign #41.

Federal law requires dealers to display the EPA’s Fuel Economy Guide booklet in the same manner it displays vehicle brochures for new vehicles. See 49 USC § 32908.

Towing Fees and Access Notice. Sign #42.

Repair dealers that are involved in charging for towing and/or towing related storage, even in the context of passing through a sublet tow charge for services ordered by the vehicle owner or insurer, must comply with the requirements of California Vehicle Code section 22651.07. These requirements include conspicuously posting a “Towing Fees and Access Notice” sign; providing a copy of the notice to customers upon request; and providing a customer with an itemized invoice containing detailed information related to the towing services involved. Dealers who insist that customers or insurers ar-

range and pay for their own tow charges directly are not subject to the requirements of this law.

PRACTICAL TIP

SIGN VENDORS. The Bureau of Automotive Repair (B.A.R.) no longer maintains a list of sign vendors who sell various B.A.R. signs. The B.A.R. recommends consulting with commercial sign vendors from the telephone directory. Some vendors' signs have a place for hourly labor rates. It is not recommended that you post an hourly rate. See discussion of the dangers of this in the Management Guide chapter, Bureau of Automotive Repair.

DEALERSHIP OPENING, CLOSING, AND LICENSING

Chapter 20

Contents

DEALERSHIP OPENING, CLOSING, AND LICENSING

OVERVIEW: This chapter discusses the licensing and requirements for becoming a vehicle dealer, issues faced in the closing of a dealership, and the requirements for obtaining a salesperson's license. The salesperson licensing provisions contained in Division 5, Chapter 4, Article 2, of the California Vehicle Code (Vehicle Code section 11800 et. seq.), is intended to protect consumers and the dealers who employ vehicle salespersons.

This chapter also describes the requirements for the use of special dealer plates under the "Special Plates" regulation promulgated by the Department of Motor Vehicles ("DMV"). This regulation was adopted as a means of curbing abuses from the improper use of special plates. Those provisions of the Vehicle Code that also specifically regulates the proper and improper use of dealer plates are also reviewed.

Vehicle Dealer's License and Other Permits

Dealer Licensing Requirements

Vehicle Code section 285 defines a dealer as someone who:

(a) For commission, money, or other thing of value, sells, exchanges, buys, or offers for sale, negotiates or attempts to negotiate, a sale or exchange of an interest in, a vehicle subject to registration, a motorcycle, snowmobile or all terrain vehicle subject to identification under this code, or a trailer subject to identification pursuant to section 5014.1, or induces or attempts to induce any person to buy or exchange an interest in a vehicle and, who receives or expects to receive a commission, money, brokerage fees, profit, or any other thing of value, from either the seller or purchaser of the vehicle.

(b) Is engaged wholly or in part in the business of selling vehicles or buying or taking in trade, vehicles for the purpose of resale, selling, or offering for sale, or consigned to be sold, or otherwise dealing in vehicles, whether or not the vehicles are owned by the person.

Three of the types of dealer licenses issued by the DMV are: new, used, and wholesale only. An applicant for a used vehicle dealer license or dealer wholesale only license must attend a dealer education program and pass an examination regarding laws regulating dealers before submitting an original certificate of completion with their DMV application. In addition to these initial licensing requirements, all used car dealers must successfully complete a continuing education program of at least 4 hours, every 2 years, in order to maintain their license. Vehicle Code section 11704.5 provides that a new motor vehicle dealer and "any employee of that dealer" are exempt from these requirements. Additionally, dealers who sell vehicles on a wholesale only basis and who in a one-year period deal with less than 50 vehicles that are subject to registration do not have to complete the continuing education requirements.

To act as an autobroker, you must be licensed as a dealer and obtain from the DMV an endorsement to your license authorizing you to act as an autobroker (please see Chapter 7 for additional information regarding autobrokers).

To obtain a dealer license application, please contact the DMV Occupational License Inspector in your area. Additional information regarding dealer licensing requirements can be obtained from the DMV's Web site at www.dmv.ca.gov.

Application Procedure

The application for a new vehicle dealer license consists of the following Occupational Licensing forms:

- Application for Original Occupational License, Part C (OL 12)
- Original Application for Occupational License Part A (OL 21A)
- One of the following Bonds:
  - Surety Bond of dealer (OL 25); or
  - Surety Bond of Motorcycle Dealer, Motorcycle Lessor-Retail, All-Terrain Vehicle Dealer, or Wholesale-Only Dealer [Less than 25 vehicles per year] (OL 25B); or
  - Cash Bond with OL 65/94; or
  - Passbook or certificate of Deposit with (OL 64/65)

- Application for Occupational License Personal History Questionnaire, Part B (OL 29B) – required for each person listed under ownership on form OL 12.
- Authorization To Release Financial Information (OL 53).
- Certificate of Proposed Franchise (OL 124) – completed by the manufacturer for new automobile, commercial, motorcycle, all-terrain vehicle, motorhome, and recreational trailer dealers only and required for each make.
- Property Use Verification for Vehicle Dealers' License (OL 902) – completed by a city official where the dealership is located.
- Appointment of Director as Agent for Service of Process (ADM 9050) – required for each person listed under OL 12 and which appointment must be either notarized or witnessed.
- Fingerprint Card (ADM 1316) – required for out-of-state applicants only.
- Request for Live Scan Service (DMV 8016) – required for each person completing form OL 29. For out of state applicants, call the Occupational Licensing Unit at (916) 229-3126 to obtain a fingerprint card (ADM 1316).

All of the occupational licensing application forms referred to above, as well as a New Dealer Application Checklist (OL 248A) and Used Dealer, Dealer-Wholesaler Only, and Autobroker Application Checklist (OL 248B), are available on the DMV website at www.dmv.ca.gov/vehindustry/ol/dealer.htm.

Fees

DMV charges the following fees for an application:

- $176 for an original application.
- Fingerprint Livescan fee varies depending on location, plus $32 for Department of Justice record check fee and an additional FBI record check fee.
- $70 for each branch office.
- $100 autobroker endorsement.
- $70 for each dealer plate requested and $72 for each motorcycle plate (these fees may vary by county – please contact a DMV License Inspector to find out exact amount for your location).
- $300 New Motor Vehicle Board Fee.

Site Inspection

Besides completing the application form and submitting the required fees, you must arrange to have an inspection of your dealership conducted by a DMV Occupational License Inspector. You should schedule the inspection well enough in advance to enable you to be ready for opening day. The inspection will cover the following requirements:

Office – The place actually occupied by the dealer where business is conducted. All books and records pertinent to the business must be maintained at the office. (Vehicle Code section 320).

Display Area – Title 13, Cal. Code of Regs. section 270.08 requires that your display area be of sufficient size to physically accommodate vehicles of the type the dealership is licensed to sell. Additional display areas are permitted within a radius of 1,000 feet from the principal place of business and any licensed branch location without being subject to separate licensing.

Sign – Vehicle Code section 11709(a) requires dealers to display signs to enable any person doing business with the dealer to identify him or her properly. Signs must have an area of not less than two square feet per side displayed and must contain lettering of sufficient size to enable the sign to be read from a distance of at least 50 feet.

Other Documents Required to Process Dealer License Application

As a practical matter, DMV requires copies of the following documents to be submitted along with a dealer license application. Further details are discussed below.

- A copy of your State Board of Equalization seller's permit.
- A copy of your city or county business license.
- A copy of your fictitious name statement (issued by the county where you intend to operate).
- If the dealership property is leased, a copy of your lease agreement.
- Corporation, Limited Liability Company or Limited Liability Partnership owned businesses will need to provide a copy of the Articles of Incorporation or Limited Liability Articles of Organization, Corporate Minutes or other document filed with the Secretary of State, which identifies the officers, shareholders, and/or managers with a 10% or more interest in the business.
- Photographs of business location. For information on photograph requirements, see: www.dmv.ca.gov/vehindustry/ol/photoreq.htm.

Live Scan

Fingerprints are currently being requested from Department of Justice to be submitted by Live Scan rather than hard copy fingerprint cards. Typically, results may be obtained within 3 days. If fingerprint

cards are used for out of state applicants, then results may not be available for 10-12 days, and sometimes up to 60 days.

Applicants can visit the DMV website for location of a Live Scan site and further instructions at: http://dmv.ca.gov/vehindustry/ol/livescan.htm

Dealer Bond

The Vehicle Code requires that every dealer applicant procure and file with the DMV a dealer's bond in the amount of $50,000 except that the bond of a dealer who deals exclusively in motorcycles shall be in the amount of $10,000, executed by an admitted surety insurer prior to the issuance or renewal of a dealer's license. (Vehicle Code section 11710(a) and (b)). Liability under the bond is to remain at full value at all times and must be restored to the full $50,000 amount ($10,000 for motorcycle dealers) if liability under the bond is decreased pursuant to a final court judgment or for any other reason. (Vehicle Code section 11710(c)). In addition to persons suffering loss or damage as a result of the fraudulent representations by the dealer or the dealer's salespersons or resulting from other non-compliance by the dealer with the registration and other requirements contained in Division 3 of the Vehicle Code, a dealer who has not paid for a vehicle sold to another dealer may also have a right of action against the purchasing dealer and the surety upon the dealer's bond in an amount not to exceed the value of the vehicle. (Vehicle Code section 11711(a)). However, under a California Attorney General Opinion, "a finance company does not have a statutory right of action against a surety upon a dealer's bond when the dealer defaults on his or her loan from the finance company for the purchase of a vehicle at an auction."

CAUTION

REGARDING A DEALER LETTING SOMEONE ELSE USE THE DEALER'S NAME, BOOKS, OR RECORDS: Dealers should be very cautious about letting non-employees of the dealership use the dealer's DMV supplies, such as report of sale forms. California Vehicle Code section 11713(m) provides that it is unlawful for a dealer to permit the use of the dealer's license, supplies, or books by any other person for the purpose of permitting that person to engage in the purchase or sale of vehicles or permit the use of the dealer's license, supplies, or books to operate a branch location. In the court of appeal case of Valiyee v. California State Department of Motor Vehicles (1999) 88 Cal.Rptr.2d 508, the court upheld the revocation of a dealer's license because the dealer allowed another individual to engage in the buying and selling of vehicles on the dealer's premises, with the dealer receiving a share of the profits from the vehicle sales. In upholding the administrative judge's decision that the dealer's license should be revoked, the court found that the dealer had wholly abandoned his books and allowed this other individual to operate under the dealer's license without any contact, involvement or follow-up on the part of the dealer.

Useful Information on DMV Website

The DMV has the following useful information on its website which can be used in the dealer licensing process and in the operation of a dealer's business:

How to Complete an Application for a Dealer License at www.dmv.ca.gov/vehindustry/ol/olhandbooks/ol40.pdf. This 9 page publication goes through all the steps and forms for obtaining a dealer license.

Guide for Licensed Dealers and Lessor-Retailers at www.dmv.ca.gov/vehindustry/ol/olhandbooks/ol248.pdf. This 11 page publication is a general guide for dealers in operating a dealership.

Vehicle Industry Procedures Manual at www.dmv.ca.gov/pubs/reg_hdbk_pdf/toc.htm which is the DMV's 30 chapter registration procedures manual.

Vehicle Industry News at www.dmv.ca.gov/vehindustry/vin_memos/vin_top.htm. This provides dealer industry news from the DMV. Dealers may also sign up for email alerts.

Occupational License Status Information System at www.dmv.ca.gov/olinq2/ welcome do, where one can check the status of any dealer's license.

Vehicle Registration Procedure at www.dmv.ca.gov/vr/dealer_regservice.htm with links to publications, tables, forms, online services, quick links to the Vehicle Code and other sources of information, and programs.

Occupational Licensing Forms at www.dmv.ca.gov/vehindustry/ol/forms.htm.

Other Dealer License and Permit Requirements

In addition to the requirements specified above, there are numerous other local, state, and federal permits and licenses that you will need to obtain before you can open for business. The following list identifies many of these additional requirements.

For information regarding how to contact the appropriate agencies in your area, log-on to the Cali-

fornia EPA's Internet Web site at www.calgold.ca.gov. Known as CalGold (California Government: On-line to Desktops), this Web site is intended to be a one-stop clearinghouse of permit information.

1. Seller's Permit

You must obtain a seller's permit from the State Board of Equalization authorizing you to collect sales tax. An application can be obtained from the nearest BOE office, or you can register online at the BOE web site at www.boe.ca.gov. There is no fee for a permit.

2. Auto Repair Dealer Registration and Smog Check License

You must obtain an auto repair dealer license from the Bureau of Automotive Repair ($200 fee). In order to perform smog inspections, you must obtain a Smog Check station license ($100 fee). Dealers may receive warnings from the Bureau of Automotive Repair (BAR) for performing smog check repairs without possessing the necessary Smog Check station license. A separate license is also required for lamp and brake stations, brake adjusters, and muffler stations ($10). Applications can be obtained from the Bureau or can be downloaded from the Bureau's Web site at http://www.bar.ca.gov/02IndustryActivities/olGettingLicensed/index.html.

Health and Safety Code section 44032 makes it unlawful for any person to perform a smog check test or related smog check repairs unless the person performing the test or repair is a qualified smog check technician and the test or repair is performed at a licensed smog check station, CA Health and Safety Code 44031.5(a) and 44032. BAR officials have advised that a smog check station license is not required if a dealership is performing emission-related repairs unrelated to a smog test. For example, if a customer visits a dealership because the "check engine light" is illuminated and resulting emission repairs are performed, no smog station license is required. However, if a customer visits the service department and advises the dealer that their vehicle has failed a smog test and requests repairs necessary to pass a re-test, the dealership may not perform the repairs unless licensed as a smog check station-even if the repairs are covered under the manufacturer's warranty.

In the past, there has been some confusion as to whether or not limited liability companies may operate automotive repair shops. A recent published opinion by the California Attorney General has cleared up this issue by stating that limited liability companies may operate automotive repair shops.

3. Insurance License

For information regarding insurance licensing, please see Chapter 4.

4. Employer Identification Number

You must obtain an Employer Identification Number (EIN) from the IRS. For more information, see IRS Form SS-4.

5. U.S. Environmental Protection Agency (ID Number)

A federal EPA number must be obtained by any business that generates, transports, or offers for transport, treats, stores or disposes of hazardous waste. Depending upon the type and amount of hazardous waste generated, a business may qualify as a "conditionally exempt small quantity generator," thus exempting it from the requirement that it obtain a federal EPA number. The business will most likely be required to obtain a California EPA number instead. To find out if your business qualifies as a conditionally exempt small quantity generator, contact the California Department of Toxic Substances Control.

6. California Employment Development Department

You are required to file an employer registration form within 15 days after paying more than $100 in wages to one or more employees. No distinction is made between full-time and part-time or permanent and temporary employees in meeting this requirement.

7. Hazardous Materials Storage Permit

Such a permit is usually required of all facilities that store on-site bulk quantities of hazardous materials, such as motor oil and antifreeze, and is generally issued by the city or county, either of which may be designated as the Certified Unified Program Agency (CUPA) for your area.

8. Hazardous Waste Storage Permit

Such a permit is usually required of all facilities that generate or store hazardous waste, such as waste oil and waste antifreeze, and is generally issued by the city or county's CUPA.

9. Underground Storage Tank Permit

Such a permit is usually required to be obtained by the owner of an underground storage tank, and is generally issued by the city or county's CUPA.

10. Air Quality Management District or Air Pollution Control District Permit

You may need to obtain a permit to construct or permit to operate certain equipment, including paint spray booths, from your local AQMD or APCD.

11. Industrial Wastewater Discharge Permit

Your local sanitary sewer district may require a permit to discharge industrial wastewater into the sanitary sewer system.

12. Certified Oil Recycling Center Certification (Voluntary)

You may voluntarily elect to become certified by the California Integrated Waste Management Board as an oil recycling center. Certification may enable you to receive payment from the State for used oil sent to recycling.

13. Flammable Liquid Storage Permit

Your city or county fire department may require a permit to store or use flammable liquids. Some fire departments may also require a facility inspection.

14. Freon Recycling Permit

Some cities issue permits to perform air conditioning service involving Freon recovery. Permit requirements include the use of Freon recovery units approved by the U.S. EPA and certification of technicians who perform these services.

15. Air Compressor Tank Permit

Air compressor tanks (pressure vessels) must by permitted by Cal-OSHA's Pressure Vessel Unit or an authorized inspector.

16. Land Use Permit/Zoning Clearance

A permit or clearance may be required by your city or county (see California Labor Code 7620 et seq).

17. Public Safety Inspection

City police, county sheriffs or fire departments may offer business crime prevention programs, and may require certain permits, such as burglar or fire alarm permits.

License Denial

Grounds for Denial of New Car Dealer's License

An applicant for a new car dealer's license must submit an application to the DMV on forms prescribed by the DMV providing information as to the applicant's character, honesty, integrity and reputation. The DMV must within one-hundred and twenty (120) days make a thorough investigation of the information contained in the application, and the DMV for reasonable cause shown may refuse to issue a license. (See Vehicle Code section 11704(b)).

Most applicants for a new car dealer's license are corporations and perhaps the most common ground for denial of a license is that the owners, directors, officers and managerial employees of the corporate applicant have held similar positions with a corporate dealership whose license has been revoked for cause and never reissued, or more commonly, has been suspended and the terms of the suspension have not been fulfilled. Under these circumstances, the DMV may refuse to issue a license. (See Vehicle Code section 11703).

It is not uncommon that the owners of a dealership which has, for example, been placed on probation for a one or two year period as the result of an accusation decide that they wish to acquire another dealership and form a new corporation to acquire its assets. Their application for a license to operate the new store will necessarily reflect that they are the owners of a dealership which is presently operating with a probationary license. Depending upon the seriousness of the violations which gave rise to the issuance of the probationary license and the balance of the term of probation, the DMV may refuse to issue the new license, or insist that any new license be issued subject to the same terms of probation as those under which the existing dealership is operating, or the DMV may issue the new license without restrictions.

The filing of incorrect information in the application may result in a refusal to issue a license. (See Vehicle Code section 11703). Where it is apparent that the applicant intentionally filed an application with false information, the likelihood of getting a license is extremely remote. Even where the application reveals that representatives of the applicant have had some prior disciplinary problems with the DMV or have even been convicted of a felony, there is at least an opportunity open to the applicant to demonstrate at a hearing that these problems are in the past and it is still possible that a license will be issued; however, if this type of information is deliberately concealed, there is no chance of getting a license. Needless to say, the prior conviction of a felony or a crime involving moral turpitude on the part of an applicant or one of its representatives is grounds for refusal to issue a license.

If any of the causes specified in Vehicle Code section 11705 as a cause to file an accusation against the license of a dealer exist against the applicant, including its owners, directors, officers and managerial employees, the applicant may be refused a license. (See Vehicle Code section 11703.1. and prior discussion of the causes specified in Vehicle Code section 11705). Finally, if an unsatisfied judgment exists against the applicant and/or its representatives arising out of the purchase, sale or lease of any vehicle, a license may be denied.

If I have been denied a dealer's license how long must I wait to reapply for a license?

This depends upon the reason for the denial. Generally, an applicant must wait one year from the effective date of the decision denying the application. However, if the reason for the denial is something that can be cleared up sooner, the applicant may re-

submit an application at any time accompanied by evidence that the grounds for denial no longer exist. (See Vehicle Code section 11703.3). For example, if the reason for the refusal related to one of the owners, directors, officers or managerial employees of the applicant, a new application may be submitted with evidence that such individual no longer occupies such a position with the applicant or that terms of probation with respect to such individual have now been satisfied. If the reason is an unsatisfied judgment, a new application may be submitted with proof that the judgment has been satisfied.

Right of Applicant to a Hearing upon Refusal to Issue a License

Just as a dealer cannot have his or her license revoked or suspended without a hearing, an applicant for a new car dealer's license must be afforded a hearing if the applicant desires to contest the denial. (See Vehicle Code section 11708).

Once the DMV has made a decision to deny an application for a dealer's license, the applicant is informed in writing of the decision and of a right to demand a hearing. The applicant within sixty (60) days from notice of the denial may make a written demand for a hearing. (See Vehicle Code section 11708.) In response to such a demand, the DMV is required to serve upon the applicant a verified "Statement of Issues," which is similar in form to an accusation, and which specifies the reasons for the denial. The Statement of Issues is accompanied by a Notice of Hearing and either a statement informing the applicant of the right to discovery or copies of the applicable Government Code sections relating to discovery. A Notice of Defense is also served and the applicant must sign and file the Notice of Defense in order to proceed with a hearing. See Government Code sections 11505 and 11506.

From this point forward, the procedures are the same as those relating to accusations, including the right to appeal an unfavorable decision to the New Motor Vehicle Board.

CAUTION

REGARDING CONTESTING LICENSE DENIALS: Careful consideration should be given as to whether to contest a refusal to issue a license since the one year an applicant may be required to wait before reapplying for a license does not begin to run until the effective date of the decision denying the application. If the refusal is unsuccessfully contested, the effective date of the decision will be delayed until the conclusion of the hearing process which may be as long as an additional six to nine months. Also, where a decision not to contest the refusal is made, it is recommended that the DMV be notified that there will be no contest so that there is no chance that the effective date of its decision will be postponed.

Closing a Dealership

There are many issues to consider in closing a dealership. Although this is not an exhaustive discussion, below are some of the issues to consider.

Factory Buy-Back Obligations

Vehicle Code section 11713.13 provides that it is unlawful for the factory to fail to pay to a dealer, within 90 days of termination, cancellation, or nonrenewal of a franchise, all of the following:

Vehicle Inventory. *The dealer cost, plus any charges made by the manufacturer or distributor for vehicle distribution or delivery and the cost of any dealer-installed original equipment accessories, less any amount invoiced to the vehicle and paid by the manufacturer or distributor to the dealer, for all new and undamaged vehicles with less than 500 miles in the dealer's inventory that were acquired by the dealer from the manufacturer, distributor, or another new motor vehicle dealer franchised to sell vehicles of the same line-make, in the ordinary course of business, within 18 months of termination, cancellation, or nonrenewal of the franchise.*

Parts and Accessories. *The dealer cost for all unused and undamaged supplies, parts, and accessories listed in the manufacturer's current parts catalog and in their original packaging, except that sheet metal may be packaged in a comparable substitute for the original package.*

Signs. *The fair market value of each undamaged sign owned by the motor vehicle dealer and bearing a common name, trade name, or trademark of the manufacturer or distributor if acquisition of the sign was required or made a condition of participation in an incentive program by the manufacturer or distributor.*

Special Tools. *The fair market value of all special tools, computer systems, and equipment that were required or made a condition of participation in an incentive program by the manufacturer or distributor that are in usable condition, excluding normal wear and tear.*

Shipping and Handling. *The dealer costs of handling, packing, loading, and transporting any items or inventory for repurchase by the manufacturer or distributor.*

No Application To Sale of Dealership. The factory buyback provisions do not apply to the sale of substantially all of the inventory and fixed assets or stock of a franchised dealership if the dealership continues to operate as a franchisee of the same line-make.

Preserving Rights

Almost all dealer sales and service (franchise) agreements allow the dealer to terminate at will. However, before giving notice of termination, an analysis of preserving certain rights upon termination is recommended. For example, you do not want the termination notice to cancel your rights under the dealer agreement to submit and be paid for warranty and incentive claims right up to the date of termination (be certain you know how and when you receive payments that arrive after you are no longer a franchised dealer). Most franchise agreements have provisions for an immediate termination upon the occurrence of certain events, such as no longer having a DMV license. Further, do not sign a general release for the factory without having your attorney review it.

Vehicle Code section 11713.13(f) gives dealers indemnification rights against the factory and covers dealers whose franchise has terminated. It provides: that it is unlawful for the factory to:

(1) Fail, upon demand, to indemnify any existing or former franchisee and the franchisee's successors and assigns from any and all damages sustained and attorney's fees and other expenses reasonably incurred by the franchisee that result from or relate to any claim made or asserted by a third party against the franchisee to the extent the claim results from any of the following:

(A)The condition, characteristics, manufacture, assembly, or design of any vehicle, parts, accessories, tools, or equipment, or the selection or combination of parts or components manufactured or distributed by the manufacturer or distributor.

(B) Service systems, procedures, or methods the franchisor required or recommended the franchisee to use if the franchisee properly uses the system, procedure, or method.

(C) Improper use or disclosure by a manufacturer or distributor of nonpublic personal information obtained from a franchisee concerning any consumer, customer, or employee of the franchisee.

(D) Any act or omission of the manufacturer or distributor for which the franchisee would have a claim for contribution or indemnity under applicable law or under the franchise, irrespective of and without regard to any prior termination or expiration of the franchise.

Other Agreements with Manufacturer

Even if the franchise agreement can be terminated by the dealer at will, this does not necessarily mean that the dealer or its shareholder(s) can just as easily terminate other agreements with the manufacturer, such as site control agreements, or equipment leases. Before making the final decision to terminate the franchise and close the dealership, review all incidental agreements to be sure they can also be terminated and, if they cannot, seek the factory's agreement to terminate them.

Vendor Contracts

Typically a dealership has a substantial number of vendor contracts, such as computer leases and maintenance agreements, uniform supply contracts, and the like. A dealer closing a dealership should attempt to have the vendors cancel all such contracts upon termination of the franchise. If this is not handled properly, the dealer could be faced with making payments on vendor contracts for a long time. Additionally, the dealer principals may have personally guaranteed some contracts.

Retail Finance Dealer Agreements, Service Contracts, Dealer Warranties

You should plan in advance exactly what will happen when the dealership closes under all of your retail finance agreements and service contract agreements. For example, will a finance company pay you a fixed percentage of your reserve account immediately upon closure, or will you be required to wait until maturity to receive any remaining reserve? Is there a program for "buying out" the right of the lender to pursue any charge-backs against the dealer and/or its principals? If the dealership has obligations to consumers to perform used vehicle "Dealer Warranty" repairs, secure the services of an established dealer or repair shop to provide those services.

DMV and Related Licensing Matters

Whether you close the doors entirely or simply give up a franchise and operate as a used vehicle dealership, you must notify DMV and surrender your new vehicle report of sale documents. The State Board of Equalization must be notified in either case, as well. If you are closing the service department as well, notify the BAR and arrange for surrender of your license. A closure of the entire operation will also have to be noted on your Employment Development Department reports and tax returns.

Records Retention

Closing the dealership does not relieve you of your obligation to retain records and to maintain the safety and security of those records in accordance with applicable law, such as the GLB Safeguards Rule. You may, however, arrange for storage of the records at a new location or contract with a third party to retain and safeguard the records on your behalf. Even if you dissolve the dealership's corporation or other corporate entity, you need to make arrangements for appointment of a dissolution trustee or other person to act for the dissolved corporation for purposes of records retention. See Chapter 21 of this Guide, Records Retention.

Insurance Considerations

Planning for the closure and post-closure insurance coverage available to the dealership and its principals is essential. Ensure that through endorsements for extended reporting periods and other means that termination of the business operations will not prematurely terminate your rights to insurance coverage for claims that may surface in the future alleging wrongdoing by the dealership and/or its principals. Discuss coverage with your broker so that if a vehicle your dealership has repaired burns up seven years after the dealership has closed, and there is a lawsuit for negligent repairs, there will be coverage for the dealership and its owners if the dealership has been dissolved. For business property insurance, be sure to obtain the proper endorsements to avoid having coverage denied based upon your facility being deemed "abandoned" or "unoccupied." Discuss with your insurance company or broker the ending date for various company insurance coverages, such as Workers Compensation, to cut off further premiums.

Business Entity Dissolution

It is beyond the scope of this discussion to detail the business entity dissolution process. If, for example, you are dissolving a corporation, California has very specific statutes on the dissolution process. Liability can be imposed on directors and shareholders for improper distributions of corporate assets, and a dealer should seek an attorney's guidance through the dissolutions process.

Employee Issues and Federal and State WARN ACT Requirements

Under both federal and state law, the WARN requirements are meant to provide employees, the unions (if applicable) and government officials advance notice of an impending loss of employment for mass layoffs or closures. If the requirement of a WARN notice is triggered under federal or California law, then employees must be given 60 days advance notice of the loss of employment. A notice must also be sent to the California Employment Development Department, the Local Workforce Investment Board, and the chief elected official of each city and county government within which the termination occurs. Under federal law, the WARN act applies to employers with 100 or more employees; whereas the California WARN act applies to employers with 75 or more employees. Generally speaking, a WARN notice is triggered if there will be a "mass layoff". A "mass layoff" under federal law means a workforce reduction of at least 500 employees or 33% of the total employees who comprise at least 50 employees at the work site (part-time employees being excluded from these calculations). Under California law, "mass layoff" means a workforce reduction of at least 50 employees during any 30-day period due to lack of work or lack of funds.

The calculations required under the WARN statutes are sometimes complicated, even more so when there are affiliated entities involved. Dealers should have their attorneys guide them through this process. See the "Worker Adjustment And Retraining Notification Act" section of the Wrongful Termination and Discrimination chapter of this Management Guide.

There are a number of other employee liabilities, such as pension funds, payroll taxes, and health insurance matters (including various notices when medical insurance terminates). These issues must be addressed to avoid personal liability of the owners of the business. Discharged employees must receive their final paycheck with all outstanding compensation owed and vacation time accrued. Discharged employees must also be provided with an EDD notice which describes the employee's rights regarding filing for unemployment.

Unfunded Liability if Dealership Pays Contributions to Union Pension Fund

A dealership may have liability for contributions to a pension plan when the plan is underfunded. Some union pension funds have seen dramatic losses contributing to the unfunded liability. When dealerships sell, decrease significantly, or close their operations, they may be liable (in the millions of dollars in pension liability). Because the rules are so complicated and so varying depending upon the dealership, it is recommended that dealerships seek competent legal advice on this subject prior to executing any planned closing of the dealership.

COBRA

In closing a dealership, it is important to consider outstanding COBRA health care continuation coverage liability for existing COBRA participants as

well as for employees terminated as a result of the closing. Although a single point dealership should be able to terminate its health benefit plan entirely, and thus avoid further liability under COBRA, accomplishing such a termination is a complex matter and should be undertaken with the assistance of expert advisers. Additionally, dealer groups that close one of many dealerships will in many cases be unable to terminate the entire health benefit plan and may, under applicable law, be required to provide COBRA coverage to the employees of the closed dealership. Again, the assistance of knowledgeable advisors in this area is essential.

Permits and Taxes

A dealership has various permits and files a number of tax returns. See discussion earlier in this chapter, Other Dealer License and Permit Requirements. The issuer of each permit held by the dealership should be notified of the closing with a request for the issuer's form and procedures for terminating the permit. There can be personal liability of the owner for various taxes and permit fees. For example, for personal liability for unpaid sales taxes, see the Sales Tax chapter 14 of this Guide, Responsible Persons for Sales and Use Tax Liability. Some agencies will have information on their website for the procedures to terminate a permit, such as the Board of Equalization discussion, Buying, Selling, or Discontinuing a Business, at www.boe.ca.gov/sutax/faqbus. htm. The State Board of Equalization, Employment Development Department, and Franchise Tax Board have procedures for obtaining tax clearances to show that no further taxes are owed. Notify the county tax collector that the Company will no longer be paying personal property taxes.

The dealership should obtain advice from its accountant with regard to tax matters, such as the filing of final returns, possible LIFO issues, and planning to take the best advantage of business and carryforward losses.

Utility Companies

Notify utility companies of the date when utilities will no longer be needed, such as water, power, telephone, gas, and the like.

Obtaining a Salesperson's License

Who Needs A Salesperson's License?

Vehicle Code sections 675 and 11800 require persons to be licensed as a vehicle salesperson if they are involved in one or a combination of the following activities:

- Is employed as a salesperson by a dealer, or who, under any form of contract, agreement, or arrangement with a dealer, for commission, money, profit, or other thing of value, sells, exchanges, buys, or offers for sale, negotiates, or attempts to negotiate, a sale, or exchange of an interest in a vehicle required to be registered in this state (Vehicle Code section 675(a)(1)).
- Induces or attempts to induce any person to buy or exchange an interest in a vehicle required to be registered, and who receives or expects to receive a commission, money, brokerage fees, profit, or any other thing of value, from either the seller or purchaser of the vehicle (Vehicle Code section 675(a)(2)).
- Exercises managerial control over the business of a licensed vehicle dealer or supervises vehicle salespersons employed by a licensed dealer, whether compensated by salary or commission, including, but not limited to, any person who is employed by the dealer as a general manager, assistant general manager, or sales manager, or any employee of a licensed vehicle dealer who negotiates with or induces a customer to enter into a security agreement or purchase agreement or purchase order for the sale of a vehicle on behalf of the licensed vehicle dealer (Vehicle Code section 675(a)(3)).

The Vehicle Code does allow certain exemptions from the salesperson's licensing requirement, including persons licensed as a vehicle dealer doing business as a sole proprietorship or member of a partnership or a stockholder and director of a corporation or a member and manager of a limited liability company licensed as a vehicle dealer. However, those persons shall engage in the activities of a salesperson exclusively on behalf of their corresponding entities (Vehicle Code section 675(b)(7)).

Questions often arise relating to the licensing requirements for a finance and insurance manager ("finance manager"). Because a finance manager is also usually involved with the sale of accessories in connection with the vehicle purchase and is thus a participant in the negotiation process with the

buyer, the DMV has taken the position that the finance manager requires a salesperson's license.

Vehicle Code section 11800 specifically provides that "[i]t shall be unlawful for any person to act as a vehicle salesperson without having first procured a license or temporary permit issued by the department or when that license or temporary permit issued by the department has been canceled, suspended, revoked, or invalidated or has expired."

Bird Dog and Referral Fees

Dealers frequently ask about whether they can pay cash or offer other incentives (commonly known as bird dog or referral fees) to the local barber, high school, customers, or other dealers in return for referrals to new customers who visit, purchase, or lease a vehicle from the dealership. While doing so seems innocuous (and is allowed in many other states), California law specifically forbids such payments by various statutes that prohibit the activity.

Vehicle Code section 675 defines a "vehicle salesperson" in part as a person who "[i]nduces or attempts to induce any person to buy or exchange an interest in a vehicle required to be registered, and who receives or expects to receive a commission, money, brokerage fees, profit, or any other thing of value, from either the seller or purchaser of the vehicle." There are some exceptions to the salesperson definition for insurance companies, private party sellers, and automakers, but no exception exists for members of the general public, or other licensed dealers, who refer a customer to a dealer in return for payment. See the full definitions of a Vehicle Salesperson in the "Text of Autobroker and Related Laws" section of the Autobrokers chapter in this Guide. In essence, California law considers that dealers who provide payment in the form of cash, future discounts, or even oil changes to a person who refers a customer are effectively employing a salesperson, and must follow the usual licensing requirements (sending notice of hiring/firing and posting their license at the dealership).

Vehicle Code section 11713(h) bans dealers from employing "any person as a salesperson who has not been licensed . . . ." Because of the broad definition of "salesperson," paying bird dog or referral fees can be considered as employing an unlicensed salesperson. This has been confirmed by senior DMV officials. The Vehicle Code designates this violation as a criminal misdemeanor, which can lead to fines and administrative action up to and including revocation of a dealer's license.

In addition to the potential *dealership* violation, the *person making a referral* can also face serious action. While prosecution of the "bird dog" is unlikely, Vehicle Code 11800 provides that it is "unlawful for any person to act as a vehicle salesperson without having first procured a license or temporary permit issued by the department . . . ." As is the case for the dealer violation, the violation is considered a criminal misdemeanor.

Civil Code section 2982.1 also prohibits dealers from offering a discount or other benefit if the benefit depends upon the purchaser either selling or giving information or assistance for the purpose of leading to the sale of a vehicle to another person under a contract governed by the Automobile Sales Finance Act. Be sure to avoid providing a special price, accessory, or other benefit to customers based on an obligation to send you more business.

Vehicle Code section 232.5 provides as follows: "Brokering is an arrangement under which a dealer, for a fee or other consideration, regardless of the form or time of payment, provides or offers to provide the service of arranging, negotiating, assisting, or effectuating the purchase of a new or used motor vehicle, not owned by the dealer, for another or others." If anyone falls within this definition, including licensed dealers, all of California's autobroker rules apply. See the Autobrokers chapter in this Guide for a full discussion of the autobroker rules.

Application Forms

An application for a vehicle salesperson license consists of:

- An Application for Occupational License Form OL 16S available through the DMV website at www.dmv.ca.gov.
- DMV 8016, Request for Live Scan Clearance (receipt).
- If applicable, to expedite the application, a copy of the arresting agency report for a prior criminal conviction and a certified copy of the court documents should be submitted along with the OL 16.
- A $51 non-refundable application fee.

Temporary Permit

Upon filing an application, payment of the required fees and if the applicant has had no convictions within the past 10 years, a temporary permit will be issued which will allow the applicant to work as a vehicle salesperson for up to 120 days while the DMV is completing its investigation of the applicant. The temporary permit shall become invalid when canceled or when the DMV issues, or refuses to issue, a permanent license. If the DMV determines to its satisfaction that the temporary permit was issued upon a fraudulent application or determines or has reasonable cause to believe that the application is incorrect or incomplete or the temporary permit was issued in error, the DMV

may immediately cancel the temporary permit (Vehicle Code section 11803).

For those applicants who have any convictions(s) during the past 10 years, no temporary permit will be issued. Instead, the application will be forwarded to DMV headquarters in Sacramento for review. Such applications will be given priority review and the applicant notified by mail whether a license will or will not be issued.

NOTE

ON FAILURE TO DISCLOSE: The failure of an applicant to disclose in the application any conviction, felony or misdemeanor, but excluding traffic offenses, which occurred within the last 10 years will result in the cancellation of any temporary permit which may be issued and generally results in the refusal of a vehicle salesperson license.

Term of License, Renewal and Duplicate

Every original vehicle salesperson license issued, and every such license renewed, is valid for a period of 3 years from the date of issuance unless cancelled, suspended, or revoked by the DMV. Renewal of a license must be made prior to the expiration date and may be renewed by mail if the license was not renewed by mail for the immediately preceding 3 year period. A salesperson must obtain a duplicate license when the original is lost, stolen or mutilated. (Vehicle Code section 11814). Whenever the DMV cancels, suspends, or revokes a license, the licensee or person in possession of it must immediately return the license to the DMV. (Vehicle Code section 11819(c)).

Display of License and/or Temporary Permit

Every vehicle salesperson must, at the time of his or her employment, deliver to his or her employing dealer his or her salesperson's license or temporary permit to be posted in a place conspicuous to the public on the premises where he or she is actually engaged in the selling of vehicles for the employing dealer (Vehicle Code section 11812(a)). It is the dealership's duty to display the license or a true and exact copy of the license conspicuously and continuously during the employment and if a vehicle salesperson's employment is terminated (Vehicle Code section 11812(b)), the original license must be returned to the salesperson. It is the responsibility of each licensed salesperson to report in writing to the DMV every change of residence address within 5 days of the change. (Vehicle Code section 11812(c)).

Loss of License Privileges

Grounds for the Refusal to Issue, or to Suspend or Revoke a License

Section 11806 of the Vehicle Code sets forth several grounds upon which the DMV may refuse to issue or may suspend or revoke a vehicle salesperson license. These grounds include the following:

1. Failure to satisfy an outstanding court judgment rendered in connection with a licensed activity (Vehicle Code section 11806(a)).

2. Failure by an applicant or a licensee to pay funds or turn over property received in the course of employment, or surrender possession of any vehicle upon termination of employment, to a dealer entitled thereto (Vehicle Code section 11806(b) and (c)).

3. Acting as a dealer by purchasing or selling any vehicle using the license, report of sale books, or other supplies of the dealer when not acting on behalf of a dealer (Vehicle Code section 11806(j)).

4. Acting as a dealer by purchasing or selling vehicles while employed by a licensed dealer without reporting that fact to the dealer or without utilizing the dealer's report of sale documents (Vehicle Code section 11806(f)).

5. Acting as a salesperson without having obtained a license (Vehicle Code section 11806(h)).

6. Improper oversight as a dealer's managerial employee, of a person whose wrongful acts resulted in the suspension or revocation of the dealer's license (Vehicle Code section 11806(i)).

7. Acting as a vehicle salesperson for more than one licensed dealer where the businesses do not have common controlling ownership. However, a vehicle salesperson may work at more than one location of a licensed dealer if the business of that dealer has common controlling ownership. Dealers have common controlling ownership when more than 50 percent of the ownership interest in each dealer are held by the same person or persons, either directly or through one or more wholly owned subsidiary entities (Vehicle Code section 11806(g)).

Criminal Conduct

A further ground under Vehicle Code section 11806(d) is if a cause for refusal, suspension or revocation of a license exists under any of the provisions of Vehicle Code sections 11302 to 11909, inclusive. This provides the basis for the denial, suspension or revocation of a vehicle salesperson li-

cense if the applicant or licensee has been convicted of a crime or committed any act or engaged in any conduct involving moral turpitude which is substantially related to the qualifications, functions or duties of the licensed activity (see Vehicle Code section 11703(d)). Moral turpitude has been defined by the courts as "an act of baseness, vileness, or depravity in the private and social duties which a man owes to his fellowmen, or to society in general, contrary to the accepted and customary rule of right and duty between man and man" (*In re Craig* (1938) 82 P.2d 442), and has also been described as any crime or misconduct committed without excuse, or any "dishonest or immoral" act not necessarily a crime (*In re Higbie* (1972) 99 Cal.Rptr. 865).

A crucial element for the courts has been determining if the "crime of moral turpitude" in question was substantially related to the functions and duties of automobile salespersons. For example, one court decision held that there was no evidence of any connection between the business of selling cars and the salesperson's conviction for child molestation and therefore the salesperson's license was improperly revoked (*Brewer v. Department of Motor Vehicles* (1979) 155 Cal.Rptr. 643). However, another court subsequently held that an applicant's conviction, less than one year earlier, for possession of cocaine with intent to sell, was a crime of moral turpitude substantially related to his performance and duties as a vehicle salesperson and provided sufficient grounds for denial of his application (*Clerici v. Department of Motor Vehicles* (1990) 274 Cal.Rptr. 230).

The DMV's "Occupational Licensing and Disciplinary Guidelines" are intended to provide the DMV with a detailed framework within which to decide whether a dealer's or salesperson's crime, act, or conduct is of sufficient moral turpitude and is sufficiently related to the functions and duties of a dealer or salesperson to warrant suspending, revoking, or refusing to issue an occupational license. The guidelines contain a list of some common crimes which have been divided into three different classes (Type A, Type B and Type C) for the purpose of determining the severity of proposed disciplinary action. For example, according to the guidelines, a Type A offense, which is deemed the most serious, is considered to be a crime involving moral turpitude which has a substantial connection or relationship to the duties of an occupational licensee. Accordingly, the guidelines indicate that the commission of a Type A offense within the previous five years will almost always result in the outright denial of a license. Less serious crimes involving moral turpitude which have a substantial connection or relationship to the licensee's duties will not automatically result in the denial of an occupational license. A Type C offense, deemed the least serious, is not considered to involve moral turpitude, and therefore requires close review of the underlying facts and circumstances leading up to the offense before a determination can be made.

The full test of these guidelines, together with the DMV's list of Type A, Type B and Type C crimes is set out under the section Test of Occupational Licensing and Disciplinary Guidelines later in this chapter. In any licensing situation, these guidelines should be reviewed carefully. Any questions regarding the application of these guidelines to a specific set of circumstances should be addressed to one's legal counsel.

Unlawful Use of Salesperson's License

It is unlawful pursuant to Vehicle Code section 11819 for any person:

- To lend a salesperson's license to any other person or knowingly permit its use by another (Vehicle Code section 11819(a)).
- To display or represent any salesperson's license not issued to the person as being his or her license (Vehicle Code section 11819(b)).
- To fail or refuse to surrender to the DMV, upon its lawful demand, any salesperson's license which has been suspended, revoked or cancelled (Vehicle Code section 11819(c)).
- To permit any unlawful use of a salesperson's license issued to him or her (Vehicle Code section 11819(d)).
- To photograph, photostat, duplicate, or in any other way reproduce any salesperson's license or facsimile thereof in such a manner that it could be mistaken for a valid license, or to display or have in possession any such photograph, photostat, duplicate, reproduction, or facsimile unless for display by a dealer, or as authorized by the vehicle code (Vehicle Code section 11819(e)).

Salesperson's Licensing Issues and Rules

Dealerships and salespersons should be aware of various licensing matters. Failure to comply with the rules can lead to serious DMV problems for dealerships and salespersons, including criminal misdemeanor charges and administrative action against a dealer's or salesperson's license. Some of the matters discussed below have recently been brought to the Association's attention.

All of the Occupation Licensing forms described below, except the postcard form, OL 16A, Salesperson Change of Employment, are on the Forms section of the DMV's website at www.dmv.ca.gov/vehindustry/ol/forms.htm. They can be completed online and printed out. In submit-

ting documents to the DMV it is suggested that you enclose an extra copy and ask that date-stamped copies be returned to you along with confirmation of the change.

Salesperson Employment Commencement and Termination

Various salesperson licensing issues were recently brought to the attention of some dealers in Southern California. It was determined by the DMV that certain personnel working in dealerships were required to be licensed as salespersons, but did not have salesperson licenses. Vehicle Code section 11713 (h) provides that no dealer shall: *Employ any person as a salesperson who has not been licensed pursuant to Article II (commencing with Section 11800), and whose license is not displayed on the premises of the dealer as required by section 11812, or willfully fails to notify the department by mail within 10 days of the employment or termination of employment of a salesperson***.**

It is important to note that under Vehicle Code section 11713(h), it is the dealer's duty to display the salesperson license and to notify the DMV by mail within 10 days of the employment or termination of employment of a salesperson. The termination of employment must be reported to the DMV on DMV Form OL 16A, Salesperson Change of Employment. This form can be obtained from the DMV or online at http://dmv.ca.gov/forms/ol/ol16

a.htm

After a routine inspection conducted in Southern California, the DMV determined that a General Manager of a dealership corporation did not both own stock and have a director position in the corporation, and was thus required to have a salesperson license. Failure to have such a license resulted in an arrest and charging of the General Manager with a misdemeanor. The exemption provisions of section 675(b)(7) must consequently be carefully reviewed by dealers and a determination made whether salesperson licensing is required in particular instances.

Salesperson Change of Address and Responsibilities

Vehicle Code section 11800 provides: *It shall be unlawful for any person to act as a vehicle salesperson without having first procured a license or temporary permit issued by the department or when that license or temporary permit issued by the department has been cancelled, suspended, revoked, or invalidated or has expired.*

Vehicle Code section 11812 provides in part as follows:

(a) *Every vehicle salesperson licensed under this Article shall, at the time of employment, deliver to his or her employing dealer his or her salesperson's license to be posted in a place conspicuous to the public on the premises where he or she is actually engaged in the selling of vehicles for the employing dealer.*

(b) *The license shall be displayed continuously during the employment. If a vehicle salesperson's employment is terminated, the license shall be returned to the salesperson.*

(c) *Every vehicle salesperson licensed pursuant to this Article shall report in writing to the department every change of residence address within 5 days of the change.*

The form for a salesperson to report an address change, as required by Vehicle Code Section 11812(c), is DMV Form OL 18. A salesperson should use page 2 of that form which is entitled Report of Change of Address of a Vehicle Salesperson. According to the DMV's Vehicle Salesperson License Handbook, there is a $15 fee for a salesperson address change. It is the salesperson's duty to report the change; this is not the dealer's responsibility. The form gives the following as the address to use for a salesperson to report the change:

Department of Motor Vehicles
Licensing Operations Division
Mail Station L224
P.O. Box 932342
Sacramento, California 94232-3420

Misdemeanor and Licensing Actions

Vehicle Code section 40000.11 makes a violation of any of the statutes described above a misdemeanor and not an infraction. This applies to the statues regulating both dealers and salespersons. Additionally, for violating any of the rules above, the dealer's or salesperson's license is subject to an administrative accusation to revoke or suspend the particular license.

Audit and Processes Recommended

It would be prudent and beneficial for dealerships to conduct an audit to see if they are in compliance with the rules stated above. It is easy to overlook rules in these areas, and dealerships should have processes in place to insure that they remain in compliance. It would also be a good idea to have some way of reminding salespersons of their obligation to notify the DMV of address changes. A reminder in the employee handbook would help.

Deadbeat Parent Laws

Vehicle salespersons are among those affected by two important laws aimed at the state's general policy to clamp down on individuals delinquent in their obligations to make child or family support payments.

Under the first law, if an individual fails to make child support payments, a district attorney will notify the Department of Social Services. That department then compiles a list of those individuals, and provides the list to a number of different agencies which regulate or license persons engaged in various businesses or professions. One agency which receives the list is the DMV. Prior to issuing or renewing a vehicle salesperson's license, the DMV is required to review the list and if the applicant or licensee is named on the list, the DMV would not be able to issue or renew the applicant's permanent license until a release order has been provided by the Department of Social Services (Family Code section 17520(e)).

The second law requires auto dealers, among other enumerated employers, to report new hires or rehires to the California Employment Development Department ("EDD") within 20 days of the hire or rehire. If the dealer files such reports magnetically or electronically, then the reports must be submitted by two monthly transmissions not less than 12 days nor more than 16 days apart. The reporting requirement extends to all employees of the dealership, including salespersons, and is designed to help locate parents who have failed to meet their child support obligations. The information received by the EDD will then be provided to county district attorneys who are then able to locate the individual's employer and garnish the wages of the delinquent employee. Failure to submit this information, absent good cause, may subject a dealer to a penalty of $24, or $490 if the failure is the result of conspiracy between the dealer and the employee. (Unemployment Insurance Code section 1088.5).

Occupational Licensing and Disciplinary Guidelines

The DMV publishes its Occupational and Disciplinary Guidelines on its website at: http://www.dmv.ca.gov/about/lad/pdfs/ol_disc_guidelines/oldg_handbook.pdf.

The Guidelines provide the following in considering whether certain acts and crimes are substantially related to the licensed activity:

(1) When considering whether a license should be issued with a warning letter, on a restricted (probationary) basis, denied, suspended or revoked, on the basis of a criminal conviction, or on the basis of commission of an act or engagement in any conduct involving moral turpitude, the crime, act or conduct shall be deemed to be substantially related to the qualifications, functions, or duties of the licensed activity if it involves:

(a) The fraudulent taking, obtaining, appropriating or retaining of funds, property, services or labor belonging to another person.

(b) Counterfeiting, forging or altering of money, any instrument, or any receipt, or the uttering of any materially false statement.

(c) Willfully attempting to derive a personal financial benefit through the nonpayment or underpayment of any fees, duties, taxes, assessments or levies duly imposed upon the licensee or applicant by federal, state or local government.

(d) The use of bribery, fraud, deceit, falsehood, extortion, or misrepresentation to achieve an end.

(e) Sexually related conduct causing physical harm or emotional distress to a person who is a witness or nonconsenting participant in the conduct or convictions which require registration pursuant to the provisions of Section 290 of the Penal Code.

(f) Importation, transportation, or possession for sale or distribution of any controlled substances, illegal weapons, goods for which duties have not been paid, or other contraband in violation of any laws, rules or ordinances imposed upon the licensee or applicant by federal, state or local government.

(g) Willfully violating or failing to comply with any licensing, registration, tax, or regulatory provision of Divisions 3, 3.5, 3.6, 4, or 5 of the Vehicle Code, which has resulted in damage, loss, or harm to any individual, the public, or to the State of California.

(h) Willfully violating or failing to comply with a statutory requirement that a license, permit or other entitlement be obtained from a duly constituted public authority before engaging in a business or course of conduct.

(i) Doing of any unlawful act with the intent of conferring a financial or economic benefit upon the perpetrator or with the intent or threat of doing substantial injury to the person or property of another.

(j) Doing any unlawful act of physical harm or violence which resulted in substantial loss or injury to the person or property of another.

(2) The conviction of a crime, act or conduct constituting an attempt, solicitation or conspiracy to commit any of the above enumerated acts or omissions is also deemed to be substantially related to the qualifications, functions, or duties of a licensee of the department.

(3) If the crime, act or conduct is substantially related to the qualifications, functions, or duties of a licensee of the department, the context in which the crime, act or conduct were committed shall go only to the questions of the weight to be accorded to the

crime, act or conduct, in considering the action to be taken with respect to the applicant or licensee.

The following are guidelines for rehabilitation, denial, suspension, revocation, reinstatement or reduction of penalty:

(1) When considering a license denial, suspension, revocation, reinstatement or reduction of penalty, the department will consider the following criteria:

(a) Nature and severity of the criminal conviction(s), act(s), or conduct.

(b) Any criminal record and evidence of any act(s) or conduct committed subsequent to the criminal conviction(s), act(s) or conduct under consideration which also could be considered as grounds for denial, suspension or revocation.

(c) The time that has elapsed since the criminal conviction(s), act(s) or conduct referred to in subdivision (1) or (2), excluding any time spent incarcerated on such conviction(s)

(d) The extent to which the applicant or licensee has complied with any terms of parole, probation, restitution or any other sanctions lawfully imposed against the applicant or licensee.

(e) If applicable, evidence of expungement proceedings pursuant to section 1203.4 of the Penal Code.

(f) Evidence, if any, of rehabilitation submitted by the applicant or licensee.

These occupational licensing guidelines are intended for use in determining whether to issue or refuse to issue an occupational license on the basis of criminal convictions and prior department actions. For purposes of analysis, criminal convictions are divided into three categories, which are identified as Class A crimes, Class B crimes and Class

Attachment 1 of the Guidelines is a list of the more common Class A, B and C crimes. Based on the classifications, an unlisted crime will require analysis to determine if it fits a particular Class. Class A crimes are serious crimes involving moral turpitude which have a substantial connection or relationship to the duties of an occupational licensee. Instead of attempting a lay definition of the complex legal term "crime involving moral turpitude", a list of such crimes which are serious and have a substantial connection or relationship to the duties of an occupational licensee are listed in Attachment 1 of the Guidelines as Class A Crimes. Less serious crimes involving moral turpitude which have a substantial connection or relationship are listed in Attachment 1 as Class B Crimes. Crimes which have a less substantial connection or relationship to the duties of the licensed activity, or which have a connection only if facts not part of the conviction can be independently proven are listed in Attachment 1 as Class C Crimes. The use of criminal convictions to deny an occupational license, whether Class A, Class B, or Class C, depends to a large degree on when the convictions occurred in relationship to the date of the license application.

Use of Dealer Special Plates

Requirements For Use of Dealer Plates under Special Plates Regulation

The issuance and use of special plates by dealers, manufacturers, remanufacturers and distributors is authorized in Vehicle Code sections 11714, 11715, and 11716. However, those statutes are general in nature and give little guidance on the permissible use of such plates in particular circumstances

In response to this problem, the Office of Administrative Law approved a "Special Plates" regulation promulgated by the Department of Motor Vehicles. This regulation (13 C.C.R. 201.00),governs the uses of special plates issued to automobile dealers, manufacturers, remanufacturers and distributors.

The regulation provides that special plates may only be used on vehicles that a dealer, manufacturer, remanufacturer or distributor owns or lawfully possesses. (13 C.C.R. 201.00 (a)). Further, only the following individuals may operate a vehicle with special plates for any purpose: (1) an individual who is the sole owner, a general partner, a manager of a limited liability company, or a corporate officer or director of a dealer, manufacturer, remanufacturer, or distributor, provided the individual is actively engaged in the management and control of the business operations of the dealer, manufacturer, remanufacturer, or distributor; (2) a general manager, business manager or sales manager who is actively engaged in the management and control of the business operations of the dealer, manufacturer, remanufacturer, or distributor when no other individual meets the criteria in (1) above; or (3) an individual employed by a manufacturer or distributor and licensed as a representative. (13 C.C.R. 201.00 (b) (1-3)).

Thus, in order to qualify for unlimited use of a special plate, the individual must meet the following two-prong test: (1) the individual must be a sole owner of a dealership that is a sole proprietorship, a general partner of a dealership that is a partnership, a manager of a dealership that is a limited liability company, or a corporate officer or director of a dealership that is a corporation; and (2) the individual must be actively engaged in the management

and control of the business operations of the dealership. If no individual at a dealership qualifies under this test, a general manager, business manager or sales manager that is directly engaged in the management and control of the business operations of the dealership can qualify.

It is important for dealers to understand that under this law, a general manager, business manager or office manager that is not also a general partner, manager of a limited liability company or corporate officer or director of the dealership does not qualify for special plate use unless no one else at the dealership can qualify. The limited exception for the use by managerial employees of dealer plates described above was intended to accommodate publicly traded dealership groups that may not have an officer or director employed at the dealership. Similarly, a family member or other person that is an officer or director of the dealership, but who is not actively engaged in the management and control of the business operations of the dealership, also does not qualify for special plates.

The following are some examples of the **improper** use of special plates:

- The son of a dealer principal driving himself to and from high school.
- The wife of a dealer principal making shopping trips unrelated to her husband's use of the vehicle.
- A dealership office manager, who is neither a licensed salesperson nor an officer or director of the corporation, is assigned a demonstrator vehicle for unlimited use.

Any licensed driver may operate a vehicle with special plates for any purpose if a qualified individual identified above is also in the vehicle. An unaccompanied licensed driver, who regularly resides in the immediate household of an individual identified above, may operate a vehicle with special plates solely to pick up or drop off that individual. (13 C.C.R. 201.00(c)).

The following are some examples of **proper** uses under this subdivision:

- The daughter of a dealer principal driving on a trip with her parents as long as the dealer principal is also in the vehicle.
- The wife of a dealer principal, which wife is not employed at the dealership, picks up her husband at the airport.
- A licensed driver who is an employee of a dealer, manufacturer, remanufacturer or distributor may drive a vehicle with special plates when that employee is acting within the course and scope of his or her employment. (13 C.C.R. section 201.00(d)).

The following are some examples of **proper** uses of dealer plates by employees of the dealership acting within the scope of his or her employment:

- A secretary of the dealership driving to the bank to make a deposit for the dealership.
- A salesperson or other employee driving a vehicle for demonstration or testing purposes.
- An employee of the dealership transferring vehicles between dealership facilities, but not for non-employees of the dealership (such as an employee of a vendor or subcontractor).

Any licensed driver may operate a vehicle with dealer, manufacturer, remanufacturer, or distributor special plates for special event purposes if the operator carries a letter of authorization from the licensee identifying the vehicle, duration, and location of operation, and person(s) authorized to operate the vehicle. (13 C.C.R. 201.00 (e)). This provision is not intended by the Department of Motor Vehicles to be as broad as it may first appear. It is not within the discretion of a dealer to unilaterally designate a "special event" and issue a "special event letter" to a non-employee of the dealership. Special events must be approved by the Department of Motor Vehicles.

The following are some examples of **proper** uses of dealer plates for "special events":

- Department of Motor Vehicles issues a letter to Chrysler authorizing the use of 100 Chrysler minivans for the Rose Bowl Parade.
- Department of Motor Vehicles issues a letter to a dealer approving the use of 10 Cadillacs at a PGA golf tournament.

Any licensed driver, who is a prospective buyer or lessee, may test drive a vehicle with special plates for up to seven (7) days. (13 C.C.R. 201.00(f)). A salesperson is not required to be present, but if a salesperson is not present, the operator must carry a letter of authorization from the licensee identifying the vehicle, duration, and person(s) authorized to operate the vehicle. (13 C.C.R. 201.00(f)(1 and 2)). Notwithstanding the foregoing, be sure to keep in mind that, according to the DMV, a prospective purchaser becomes a purchaser after he or she has either paid the full purchase price or signed a purchase contract, after which time the purchased vehicle must be registered.

The following is an example of a **proper** use by a prospective purchaser of a vehicle with dealer plates:

- A dealer permits a customer that has not signed a contract to purchase the vehicle to take a new vehicle home for the weekend for a test drive, as long as the customer has a letter from the licensee identifying the vehicle, du-

ration and the person(s) authorized to operate the vehicle.

The following are examples of **improper** uses under the prospective purchaser subdivision:

- A service customer borrowing an unregistered dealer vehicle while her vehicle is being repaired.
- A customer driving a new car to Nevada to register it in that state after already paying the dealer the purchase price.

Employees of a commercial vehicle dealer, manufacturer, remanufacturer, or distributor who must operate a commercial vehicle in the course of their employment may take a commercial drive test in a commercial vehicle displaying dealer, manufacturer, remanufacturer, or distributor special plates. (13 C.C.R. 201.00(g)). A trailer, displaying special plates, may be towed by a vehicle with Vehicle Code authority to operate on the highways. (13 C.C.R. 201.00(h)).

The following is an example of an **improper** use under this subdivision:

- A dealer principal driving a dealer plated vehicle that is towing a dealer plated boat trailer that is not part of the dealer's inventory (the boat trailer cannot be operated on the special plate).

Any use of special plates issued to a dealer, manufacturer, remanufacturer, or distributor except as specified above (or otherwise authorized in the Vehicle Code; see discussion below on Vehicle Code provisions dealing with special plates) is prohibited. (13 CCR 201.00(i)).

Vehicle Code Provisions on the Use of Special Plates

As noted above, the use of special plates is specifically authorized in Vehicle Code sections 11714, 11715, and 11716. Every owner, upon receipt of a registration card issued for special plates, shall maintain the same or a facsimile copy thereof in the vehicle bearing the special plates. (Vehicle Code section 11715(f)). Special plates are valid for a period of one year from midnight of the last day of the month of issuance. (Vehicle Code section 11717(a)). If application for renewal of the special plates is not made by midnight of the expiration date, application for renewal may be made within 30 days after expiration although a penalty will be assessed in addition to the regular fee. (Vehicle Code section 11717(c)). In no event may special plates be renewed after expiration of the 30-day period. (Vehicle Code section 11717(d)). Although not reflected in the new special plate regulation, there are also two Vehicle Code provisions that deal with the proper and improper use of dealer plates that dealers should be aware of and which are discussed below.

Salespersons

Subdivision (d) of Vehicle Code section 11715 specifically authorizes special plates to be used on "vehicles rented or leased to vehicle salesmen in the course of their employment for purposes of display or demonstration." If a dealer has a demonstrator assigned full time to a particular salesperson, the dealer must make sure that the salesperson has a copy of the written rental or lease agreement with him or her in the vehicle at all times. The rental or lease agreement, should reflect that the salesperson is expected to display or demonstrate the vehicle at all times it is operated and that the vehicle is not to be used for personal, family, or household purposes. A demonstrator lease agreement also should provide, among other things, that the salesperson will:

- Keep the vehicle in public view at all reasonable times and whenever reasonably feasible, offer the vehicle for test drives to potential buyers or lessees.
- Keep the vehicle well maintained, washed and polished.
- Indemnify dealer from any and all claims arising out of salesperson's use, operation or maintenance of the vehicle.

Work Vehicles

Vehicle Code section 11715(d) also specifically excludes "work or service vehicles" owned by a dealer from being operated with special plates. As such, the following types of vehicles are examples of some of those that cannot be operated on special plates: (i) parts delivery and pickup vehicles, (ii) tow vehicles, (iii) vehicles loaned to service customers, and (iv) vehicles rented or leased to any individual(s) other than a vehicle salesperson in the course of their employment for the purposes of display or demonstration.

RECORDS RETENTION

Chapter 21

Contents

RECORDS RETENTION

OVERVIEW: The subject of records retention transforms from regretful bore to priority number one when a dealership gets into a dispute with the IRS, Board of Equalization, factory, DMV, BAR, lenders, vendors, landlords, or private attorneys for customers and others. This chapter covers the rationale of records retention schedules, and also discusses requirements for computer storage of records and data.

Records Retention Schedules

DMV Regulations Regarding Records Retention

DMV regulations (13 C.C.R. sections 272.00-272.02) define those records subject to DMV's jurisdiction as well as specify minimum retention periods, plus requirements for the location of original paper records, and imaging for archived records.

Records Subject to DMV Regulation

Pertinent records under the regulations are all records maintained by the dealer in the regular course of business insofar as those records are directly concerned with the purchase, sale, rental or lease of a vehicle.

Three Year Minimum Retention Period Required by Regulations for All Records

All business records shall be retained by the dealership for a period of not less than three years. The regulations clearly provide that this minimum requirement does not relieve a dealer from maintaining records as required by any other state or federal law or regulation for any longer period.

Special Rules For Initial 18 Months of the Three Year Retention Period

For a period of at least 18 months, a dealer shall maintain all original business records at its principal place of business after the purchase, sale, rental, or lease of a vehicle. Thereafter (for the balance of the 3 year minimum), the optional storage rules discussed below apply.

If a dealer has a branch location, business records relating to transactions that take place at that branch location may be maintained either at the branch location or at the principal place of business.

Offsite Storage or Electronic Imaging Permitted After Initial 18 Months

After the initial 18-month record retention period, a dealer may maintain the original business records at an offsite storage location within California, provided that the original business records are retrievable upon three business days notice and the business records are stored in a manner that meets any applicable safeguard requirements pursuant to the GLB Safeguards Rule.

Also, while a dealer may create an electronic copy of an original business record at any time, after the initial 18-month record retention period, an electronic copy of an original business record shall satisfy the record retention requirements for the remainder of the three-year record retention period provided all of the following requirements are satisfied:

(A) The electronic copy is created in a non-alterable format; (B) the electronic copy is retained in a format that permits the document to be readily accessible and retrievable; (C) the electronic copy is a legible, complete and accurate reproduction of the original business record; (D) a back-up of the electronic copy is retained at an on-site or off-site location in a manner that permits the business record to be retrieved upon three business days notice; and (E) any access device, server, network device, or any internal or external storage medium used for storing the electronic copy or back-up copy has access controls and physical security measures to protect the records from unauthorized access, viewing or alteration. If these requirements are met, the dealer may dispose of the original business record in a manner that meets the requirements of Civil Code section 1798.81, the personal information disposal shredding law.

Finally, although third party vendors may be used to assist with storage (and, after the initial 18 month period, to physically or electronically store business records), the use of a third party does not reduce a dealer's responsibility to produce a business record when required.

No Bright-Line Test for When Records Can Be Destroyed

Tax rules dominate most records retention discussions, sometimes leaving the incorrect impression

that satisfying tax rules automatically satisfies all other records retention concerns. In reality, no dealer can safely expect to win a dispute of any kind without written proof of all important events and transactions. Records are therefore needed until all disputes for which the records are relevant become time-barred by the applicable statutes of limitation (or longer under some special laws that precisely spell out the retention period.)

It impossible to give an accurate statement as to some date or timetable after which the dealership will never have a need for a particular document or for all documents of a particular class. This is true because most records are relevant not only to one or two legal theories or claims, but to a range of issues and claims, each with a different statute of limitations length, and a different statute of limitations start-date. Furthermore, many statute of limitations start-dates are "floating" - time only begins to run upon discovery of wrongdoing by the alleged victim.

Since identifying all of the possible legal theories that may require reference to a particular document is virtually impossible, and start-dates are not always known, records retention schedules take into account only the most likely theories and most likely start-dates.

Permanent Retention May be the Best Approach

The conservative approach would therefore be to retain all records permanently, "just in case." As computer imaging and other options for "archiving" records expand, this option may become more feasible. A discussion of legal requirements for such system appears later in this chapter,

NOTE

ON E-MAIL, VOICE MAIL, AND INFORMAL INTERNAL COMMUNICATIONS: Even if you adopt the conservative approach of retaining all of your documents permanently, you may want to consider a deletion schedule for E-Mail, voice mail, and other highly informal communications within your dealership. Communications of this type are more akin to telephone calls than to written correspondence. As such, they should not be retained beyond the normal times needed to complete transmission. Any particular message that is especially important should be saved as a separate file or printed out (or transcribed) at the time of its use. But once a dispute arises, or is clearly on the way, the "stop" button must be pressed on the deletion of any relevant material, including E-Mail, voice mail, and other computer records. Otherwise, civil claims of spoliation of evidence and criminal charges of obstruction of justice may be the unintended result.

Illustrative Records Retention Schedule

For purposes of illustration only, published materials on records retention have been reviewed, correlated, and expanded upon to provide the following list of minimum record retention times for California motor vehicle dealers. Remember, the safest approach is to retain all records permanently. Also bear in mind that some records may fall into two or more categories. The longest retention period of any of the applicable categories will apply to those records.

(Schedule appears on next page.)

Description of Record	Retention Period	Commences As Of ...
Accident reports	6 years	Later of (a) final resolution of claims / investigations, if any, or (b) filing date of last tax return for years where company books were affected by accident.
Accounts payable ledgers and schedules	6 years	Filing date of last tax return for current year.
Audit, review, or compilation reports of accountants	Permanently	N/A
Bank reconciliation worksheets	1 year	End of year in which reconciliation performed.
Bills of lading	10 years	After date goods received and sold.
Cash books, cash receipts	6 years	End of year in which books closed.
Charts of accounts	Permanently	N/A
Checks, canceled	10 years	End of year in which check clears; except that copies of checks for important payments should be retained permanently.
Claims register, or other record system that proves whether a claim was received or not.	10 years	After last year covered by particular register or group of records.
Construction contracts, blueprints, plans, occupancy permits, environmental remediation papers	Permanently	N/A
Credit applications and all related documents where no sale made.	5 years (recommended) 25 months (mandatory)	After year in which credit application completed.

Credit applications and all related documents where sale is made.	10 years (recommended) 7 years (mandatory)	See below under "customer files."
Credit card, merchant transaction records	6 years (Check merchant agreement and issuer security rules for other requirements)	Date of transaction
Corporate, LLC, or partnership stock or ownership records: stock ledgers, transfer registers, stubs showing stock issues, records of options, etc.	Permanently	N/A
Correspondence, general	4 years	After the later of the year in which correspondence was written, or in which any issues relating to the correspondence are resolved.
Credit memos	6 years	After year issued.
Customer files, deal jackets, vehicle contracts and leases, service contracts.	10 years (recommended) 7 years (mandatory)	After year of maturity of customer's lease, contract, or extended warranty, whichever comes last.
Daily operating control	Permanently	N/A
Deeds, mortgages, bills of sale	Permanently	N/A
Demo agreement and records	6 years	After end of year in which vehicle disposed of
DMV, BAR, and other business licenses and related correspondence	Permanently	N/A
Duplicate deposit slips	10 years	After end of year in which deposit reconciled.

Employment applications, personnel files	10 years	After end of year in which employment terminated, permanently if any dispute involved.
Environmental testing, compliance, or remediation paperwork	Permanently	N/A
Expense analysis, expense distribution schedules	6 years	After year in which reports created.
Facilities tests and resulting documents for health, safety, disability, or other laws	Permanently	N/A
Flooring agreements	Permanently	N/A
Flooring statements	6 years	After statement closing date
Unsolicited fax compliance materials (written consent to fax)	Permanently	Shorter time possible if consents expire or dealership treats consents as expiring
Financial statements	Permanently	N/A
Fixed asset contracts and equipment leases and correspondence	6 years	After later of year in which contract (or warranty) expires or year final tax return filed taking depreciation or expense deduction.
Fixed asset records and depreciation schedules	Permanently	N/A
Form 8300 filings	Permanently	N/A
Franchise agreements, dealer agreements	Permanently	N/A
Garnishment records	6 years	After year in which garnishment is completed.
General ledgers	Permanently	N/A
Government contracts	Permanently	N/A

Insurance policies, general liability, garage keepers, E&O, D&O, and correspondence	Permanently	N/A
Insurance policies, single vehicle	6 years	After disposition of vehicle.
Internal audit reports	6 years	After completion of internal audit (copies should be included in accountant's audit, review, or compilation report file).
Inventory records	6 years	After end of year in which inventory completed.
Invoices, from vendors other than for vehicles	10 years	After end of year in which paid or resolved.
Invoices, for vehicles	6 years	N/A
Journals, original	Permanently	N/A
Lawsuit files	Permanently	N/A
Minute books	Permanently	N/A
Notes receivable schedules	8 years	After year in which all notes on schedule are paid in full.
Odometer disclosures (including copy of odometer disclosures on title).	Permanently (recommended) 5 years (mandatory)	After disclosure given or received.
Parts sales slips, parts invoices	6 years	After year in which sold.
Payroll records, withholding tax records and worksheets	10 years	After year in which prepared.
Petty cash vouchers	3 years	After year in which prepared.
Purchase orders	10 years	After year in which issued; one copy is sufficient.

Receiving sheets	4 years	After year in which items received.
Rental agreements	7 years	After vehicle returned.
Repair order check sheets	4 years	After year work completed.
Repair orders, office copy and hard copy	6 years	After repairs completed.
Report of sales books	8 years	After year in which book closed.
Retirement and pension records	Permanently	N/A
Safety reports, Cal/OSHA and otherwise	10 years	After date of incident or inspection.
Sales commission reports	Permanently	N/A
Scrap and salvage, records of disposition, non-toxic	4 years	After year in which disposed.
Service contracts, extended warranties	10 years	See above under "customer files."
Stenographers' or typists' notebooks or raw notes	1 year	After current year.
Tax elections (such as LIFO or S Corporation status)	Permanently	N/A
Tax returns	Permanently	N/A
Telemarketing compliance materials (internal do-not-call records, national do-not-call downloads, etc.)	9 years	After year in which prepared or obtained.
Timebooks, cards, flagsheets.	10 years	After year in which prepared.
Toxic materials, waste oil, record of proper disposition.	Permanently	N/A
Tradename, trademark, or patent registrations	Permanently	N/A

Training manuals	4 years	After year in which manual completely discontinued or replaced (retain permanently if a copy is not available from other sources).
Trial balances and schedules	6 years	After year in which final return filed for period covered by trial balance.
Union agreements	Permanently	N/A
Vehicle registration correspondence	6 years	After current year
Vouchers for payments to vendors, employees (e.g., expense, T & E)	6 years	After year in which final return filed taking such items as expenses.
Data collected when originating motor vehicle ignition keys	2 years	After key is made.

Retention Schedule Litigation "Hold"

When litigation, a government investigation, or other legal proceedings are is anticipated, dealers must suspend their routine document retention/ destruction policy and put in place a litigation "hold" to preserve all information and documents known *or even suspected* of being relevant. In effect, once a litigation hold is triggered, the dealership must identify, isolate, and preserve all documents (paper or electronic) that could have any reasonable relation to the matter.

"Anticipation of litigation," and thus the need for a litigation hold, would certainly be present if the dealership were served with a lawsuit. However, a demand letter or other notice that litigation was a real possibility could also trigger the conclusion that there is an anticipation of litigation. Legal counsel should be involved in making any determination concerning the presence or absence of anticipated litigation.

Retention of Documents Using Computer Technology

Computer systems vendors are offering dealerships ways to store fax-like images of dealership paper records on disk, CD-ROM, or computer tape. Once "imaged," the vendors say, the original paper can be thrown out. Unfortunately, dealers could face substantial legal risk in implementing such a system unless they first navigate a number of legal issues in deciding which papers must stay, and which may go.

Proof of Reliability Essential

A basic issue applies to all types of archived documents, be they contracts, phone messages, accounting records, or anything else: will the computer-based record be considered so clearly an authentic copy of the original that the original need not be available?

Two branches of California evidence law apply. The first branch recognizes that microfilm, photocopies, and other exact reproductions made in the ordinary course of business can be used in lieu of the original. The second branch recognizes that information can be stored in a computer accounting system or other database even if the original paper records, if any, look nothing like the computer screens and reports.

While either branch could conceivably be used to admit imaged documents in court, the first branch deals most directly with the subject by specifically mentioning A nonerasable optical image reproduction or any other reproduction of a public record by a trusted system, as defined in Section 12168.7 of the Government Code, if additions, deletions, or changes to the original document are not permitted by the technology." (Evidence Code section 1550). The second branch has generally been used for data that has been keyed into computer programs.

But in the case of either branch of computer-evidence law, having proof of the system's reliability, as implemented by your dealership, is essential.

Proving reliability of the hardware and software is only part of the problem, which can be handled by having a dealership employee with long term exposure to the system testify that the machines have consistently worked as expected (computer experts are not required).

Most difficulties actually arise in another area: proving that your employees faithfully follow reliable procedures for preparing, storing, and retrieving computer-based records.

Furthermore, the perception that documents are easier to alter on the computer than on paper has given rise to the "non-erasable" limitation mentioned above, and to suggestions that courts require even more evidence of reliability for imaged documents than are required for paper copies, such as security or audit capabilities, or at least limitations on physical access to the computer system.

While it is up to the individual judge to decide the issue of reliability, and to reconcile the two branches of evidence law mentioned here, at a minimum, dealers seeking to discard any original documents after imaging them should use a system that stores the data on read-only optical discs which the vendor will certify comply with Evidence Code section 1550. A reasonable amount of in-house planning and on-going training geared to enhance reliability must also be implemented and documented.

Retaining Original Documents Having Special Legal Significance

Other imaging issues focus more narrowly on documents having special legal significance. For example, a 300 year old law called the statute of frauds requires many contracts to be in writing and signed. Even though an image of a contract could be admitted into evidence under the rules previously

discussed, you would be at a serious disadvantage without the original if the other party denied the genuineness of his or her signature because document examiners, and judges and juries, are more comfortable working with the original when signatures are denied. Moreover, procedural rules exist that require the submission of the original contract documents in court cases (to "cancel" once a judgment is obtained) unless an acceptable explanation of why the original is unavailable is offered. As a consequence, dealers may want to ensure that original paper contracts, promissory notes, leases, repair orders, and other signed documents be retained until no further obligations or claims exist or can be made under the document.

Some documents absolutely may not be substituted by a computer image or photocopy: certain government documents such as certain certificates, licenses, and permits must be kept in their original paper based format, as must stock certificates, wills, and any notarized documents.

CAUTION

Observe IRS Revenue Procedure 98-25. A 2005 "Automotive Alert" issued by the IRS reminds dealers that Revenue Procedure 98-25, Electronic Records Retention Requirements, applies to all taxpayers, including dealers, with at least $10 million in assets. The procedure is designed to require large taxpayers to maintain their records in an electronic format that is capable of being retrieved, manipulated and printed for audit purposes, and contains sufficient transaction level detail. The procedure also requires the taxpayer to provide the IRS the necessary resources to process the records. This includes the hardware, software, terminal access, computer time, and personnel. IRS computer audit specialists have been working with the major DMS vendors to make them aware of the requirements. The 2005 alert includes a Generic List of Computer Files Necessary for Most IRS Examinations. The IRS suggests that dealers check with software vendors to determine if they have updated their software sufficiently to be in compliance with Revenue Procedure 98-25.

NOTE

REGARDING IRS REGULATIONS ON IMAGED DOCUMENTS: Revenue Procedure 97-22 covers the use of imaging systems to satisfy IRS recordkeeping requirements. The procedure is very detailed, but its highlights include the following. The system must create accurate, highly legible and readable indexed images of hardcopy documents, able to be retrieved and printed at the time of any IRS examination by IRS personnel working on equipment provided by the taxpayer at the taxpayer's location. The workings of the system must be documented and include reasonable written controls and testing to ensure integrity, accuracy, and reliability (one control could be the use of a non-erasable and non-rewritable media). A record of where, when, by whom, and on what equipment the image was produced must be created. The system must be able to reproduce a legible and readable hardcopy. All imaged documents that support entries on company books and financials must be readily retrievable via cross references. The IRS must be given access to the system to test it, even on a random basis, and even if there are absolutely no tax liability problems.

Confidentiality Considerations

Just as an imaging system makes it quick and easy for your staff to find and look through tens of thousands of pages, it also makes it easy for someone suing your dealership to go on a fishing expedition through all of those files: courts are now routinely ordering parties to turn over computer based information during the discovery phase of lawsuits. While relevant evidence, good or bad, should be out in the open, the sheer volume of data on imaging disks makes inadvertent disclosure of irrelevant or confidential material much more likely. Consider adopting a rule that confidential materials, like communications with your attorney, be kept off the system, or at least be specially coded to prevent unauthorized access.

Computer document imaging has barely made a dent in the estimated 1.3 trillion paper documents stored in file folders across the U.S. While advances in technology may increase the size of this dent, the law currently seems to be reserving filing space for original contracts and other legally significant documents.

Shredding Law

Dealerships maintain mountains of consumer records that include "personal information" of consumers. When those records are thrown out, dealers are required by Civil Code section 1798.81 to destroy the records by shredding, erasing, or otherwise modifying the personal information in those records to make it unreadable or undecipherable through any means. It is important to remember this law whenever paper documents with any personal information are thrown out. It must also not be over-

looked when computer hard drives are replaced or upgraded.

For purposes of this law, "personal information" means any information that identifies, relates to, describes, or is capable of being associated with, a particular individual, including, but not limited to, his or her name, signature, social security number, physical characteristics or description, address, telephone number, passport number, driver's license or state identification card number, insurance policy number, education, employment, employment history, bank account number, credit card number, debit card number, or any other financial information.

OTHER IMPORTANT TOPICS

Chapter 22

Contents

OTHER IMPORTANT TOPICS

At Will/Arbitration Agreements

CNCDA has available a combined At Will Employment and Mandatory Arbitration Agreement form. One side is written in English, the reverse is in Spanish. The At Will Employment Agreement allows you to terminate an employee with or without cause. Although the Association Employment Application contains an At Will Agreement, some court decisions in California question whether the At Will Agreement in an employment application would be upheld. In a California case the Court rejected the At Will Agreement in the employment application. One of the reasons behind this decision was that the employment application did not cover a number of key aspects of the employment relationship such as salary, position, job duties, etc. Therefore, it is recommended that you have your employees (new and present) sign a separate At Will Employment Agreement.

The Arbitration Agreement requires that you and your employees submit employment related claims to mandatory arbitration, rather than have such claims go through the court system. This means that claims of discrimination and the like would be heard by a private arbitrator who is required to be a retired California Superior Court Judge, rather than by a sitting judge or jury. Moreover, arbitration is generally less expensive and quicker than the court process.

In using the combined form, you can have your employees sign both the At Will and Arbitration Agreements, or either Agreement can be signed separately. To place an order for the forms, call the Association office for a referral to a Reynolds and Reynolds Company representative.

Buy-Here-Pay-Here Dealer Laws

Unlike traditional new vehicle dealers who sign conditional sale and lease agreements as initial creditors and then assign substantially all such contracts to third party finance sources, Buy-Here-Pay-Here (BHPH) Dealers operate under a business model where they hold their sales and lease agreements and collect payments directly from their customers. A series of major newspaper articles highlighting abuses in the BHPH sector sparked enactment of legislation prohibiting abusive practices. Most of the legislative proposals initially sought to cover *all* dealers, but were narrowed in scope to cover only BHPH dealers in the face of strong CNCDA opposition.

Buy-Here-Pay-Here Definition*:* The most important provision of the BHPH law is the definition of a Buy-Here-Pay-Here Dealer—which establishes the types of dealers that must comply with the onerous new requirements. The BHPH provisions apply only to dealers who assign ***less than*** 90% of non-cash, unrescinded, conditional sale and lease agreements to unaffiliated third-party finance or leasing sources within 45 days of consummation (Vehicle Code section 241). The laws specify that they do not apply to leasing companies who primarily lease vehicles two model years old or newer, or to dealers who certify 100% of their vehicles, are registered with BAR, and employ at least 5 ASE-certified master technicians (Vehicle Code section 241.1). This definition effectively exempts almost all new vehicle dealers, leasing companies, and "big box" used car dealers such as Car Max.

Used Vehicle Written Warranty Requirement: Civil Code section 1795.51 prohibits BHPH dealers from selling or leasing vehicles without providing a written warranty meeting the following requirements (which must be accurately reflected on the used car buyer's guide):

- Duration: the earlier of 30 days from date of delivery, or 1,000 miles from the odometer reading disclosed on the contract.
- Covered Components:
  - (1) Engine, including all internally lubricated parts;
  - (2) Transmission and transaxle;
  - (3) Front and rear wheel drive components;
  - (4) Engine cooling system;
  - (5) Alternator, generator, starter, and ignition system, not including the battery;
  - (6) Braking system;
  - (7) Front and rear suspension systems;
  - (8) Steering system and components;
  - (9) Seatbelts;

(10) Inflatable restraint systems installed on the vehicle as originally manufactured;

(11) Catalytic converter and other emissions components necessary for the vehicle to pass a smog test;

(12) Heater;

(13) Seals and gaskets on components described in this subdivision;

(14) Electrical, electronic, and computer components, to the extent that those components substantially affect the functionality of the components listed above.

- The warranty shall provide that the BHPH dealer shall pay 100% of the cost of labor and parts for any repairs pursuant to the warranty and may not charge the buyer or lessee for the cost of repairs or for inspecting the vehicle, tearing down the engine or transmission or other part, or for any deductible.
- The warranty shall provide that if the buyer or lessee notifies the BHPH dealer that the vehicle does not conform to the warranty, the BHPH dealer shall either repair the vehicle to conform to the warranty, reimburse the buyer or lessee for the reasonable cost of repairs, or cancel the sale or lease contract and provide the buyer or lessee with a full refund, plus a reasonable amount for any damage sustained by the vehicle after the sale or lease, excepting damage caused by any non-conformity with the warranty.
- The BHPH dealer or its agent may elect to provide the buyer or lessee with a full refund, plus a reasonable amount for any damage sustained by the vehicle after the sale or lease, excepting damage caused by any non-conformity with the warranty, rather than performing the repair. In the event the BHPH dealer cancels the sale or lease, all of the following shall apply:

  (1) The BHPH dealer shall give written notice to the buyer or lessee of the election to cancel the sale or lease by personal delivery or first-class mail.

  (2) The buyer or lessee shall return the vehicle in substantially the same condition as when it was delivered, reasonable wear and tear and any non-conformity with the warranty excepted.

  (3) The BHPH dealer shall provide the buyer or lessee with a receipt stating (i) the date the vehicle was returned to the BHPH dealer, (ii) the vehicle identification number, (iii) the make, year and model of the vehicle, (iv) the odometer reading at the time the vehicle was returned to the BHPH dealer, (v) a statement that the BHPH dealer has cancelled the sale or lease, and (vi) the amount of the buyer's or lessee's refund.

  (4) The BHPH dealer shall not treat the return of the vehicle as a repossession.

  (5) The buyer or lessee shall execute documents necessary to transfer any interest in the vehicle to the BHPH dealer or to remove the buyer or lessee from any registration or title documents.

  (6) The BHPH dealer shall refund to the buyer or lessee all amounts paid under the sale or lease agreement plus a reasonable amount for property damage sustained by the vehicle after the sale or lease, excepting damage caused by any non-conformity with the warranty. The refund must be paid not later than the day after the date on which the buyer or lessee returns the vehicle and the notice of election to cancel is given to the buyer or lessee.

- Any Used Car Buyer's Guide displayed on a vehicle offered for sale or lease by a BHPH dealer shall list each of the systems and components covered under the warranty and shall specify that the BHPH dealer will pay 100% of the cost of parts and labor for repairs covered by the warranty.

Payment Collection Prohibitions: Civil Code section 2983.37 strictly limits a BHPH dealer's use of electronic tracking and starter-interruption devices to enforce payment obligations, and prohibits BHPH dealers from requiring that payments be made in person (aside from the downpayment). BHPH dealers may not repossess a vehicle or impose any charges on the grounds that the deferred downpayment was not made in person.

Used Vehicle "Fair Market Price" Posting Requirement: Vehicle Code section 11950 requires BHPH dealers to affix a label on any used vehicles offered for retail sale disclosing the vehicle's "Reasonable Market Value"—defined as the "average retail value of a used vehicle based on the condition, mileage, year, make, and model of the vehicle, as determined within the last 60 days by a nationally recognized pricing guide that provides used vehicle retail values or pricing reports to vehicle dealers or the public." The BHPH dealer must also provide a prospective purchaser with a copy of any information obtained from the pricing guide that was used to establish the "Reasonable Market Value."

California Emission Standards and "The 7,500 Mile Rule"

Under California law, no California business or resident may import, deliver, purchase, rent, lease, acquire or receive a new motor vehicle that is not certified as compliant with California emissions standards. Health and Safety Code sections 43150 et seq. For purposes of the prohibition, a vehicle is considered new if it has an odometer reading of less than 7,500 miles—hence the name: "7,500 Mile Rule." Health & Safety Code section 43156(a). The prohibition also extends to the importation or sale of new vehicle engines that are not certified to California emission standards.

Any person who violates any of these provisions is liable for a civil penalty of up to $5,000 per vehicle. and California courts interpret this law as meaning that liability attaches not only to the dealership, *but also to the dealer principal individually*. Health & Safety Code section 43154(a). A California court of appeal case has held that a dealership and its principal can both be found liable and individually fined for a violation of this law. *State Air Resources Board v. Wilmshurst* (1999) 68 Cal.App.4th 1332, 81 Cal.Rptr.2d 221. Vehicles Furthermore, vehicles that are the subject of a violation will be denied California DMV registration and will be required to be removed from the state. Vehicle Code section 4750.

The exceptions to the 7,500 Mile Rule are very limited in scope, but include when a California resident: (1) obtains the vehicle as part of an inheritance or divorce settlement; or (2) purchases the vehicle out of state to replace a California registered vehicle that was stolen while out of state, or purchases the vehicle out of state to replace a California registered vehicle that was destroyed or became inoperative beyond reasonable repair while out-of state, provided that such replacement vehicle is acquired out of state at the time the previously owned vehicle was either damaged or became inoperative or was stolen. Health & Safety Code section 43151(b). Also, a person moving to California from another state may register a new federally certified vehicle if it was first registered by the owner in his or her home state and that person provides satisfactory evidence to the DMV of the previous residence and registration. Health and Safety Code section 43151(c).

1971 and newer vehicles are required to have an emission control label indicating whether they were manufactured to meet California or U.S. standards. To find out whether a car or truck is California certified, check the emission control label that should be affixed in the engine compartment or under the hood. At the top of the label are the words "VEHICLE EMISSION CONTROL INFORMATION" and the corporate name or trademark of the manufacturer. If the vehicle is California certified, the label will state that the vehicle conforms to California regulations or that it is legal for sale in California. If a vehicle is federally certified, the label will state that the vehicle conforms to U.S. EPA regulations, but no mention will be made of meeting California requirements.

Enforcement. Enforcement of the 7,500 Mile Rule by the Air Resources Board (ARB) is directly linked to the Smog Check Program and DMV's electronic database of odometer readings. Each time a vehicle is smog tested (including smog tests performed in connection with the transfer of a vehicle) a licensed smog technician is required to record the vehicle's current mileage and scan the vehicle's emission bar code. The bar code identifies whether the vehicle is California certified. Non-California certified vehicles are electronically "red flagged" by BAR and DMV and cross-referenced against odometer information obtained either through the Smog Check Program or registration paperwork submitted to DMV. Suspicious transactions are referred to ARB for enforcement action. DMV will not register a "red flagged" vehicle until its emission status is resolved.

Warning Signs. Dealers should be cautious of the following transactions:

Purchasing or taking in on trade a non-California certified low-mileage, late-model vehicle that is registered in another state. Once such a vehicle has been denied California registration, the owner might try to trade it in rather than remove it from the state.

Courtesy deliveries to California residents on behalf of an out-of-state dealer. A good rule of thumb is to never accept a drop-shipped new car that is not California certified.

Even if these vehicles have more than 7,500 miles, it could be the subject of a violation if the owner improperly imported it and attempted to register it with DMV before it reached the threshold

NOTE

AVOID THE RISK: RUN A KSR INQUIRY: To eliminate the risk of acquiring a vehicle that may be "red flagged," dealers are advised to run KSR inquiries on suspicious vehicles through DMV prior to purchase. Once a VIN has been "red flagged" it is next to impossible to get the vehicle regis-

tered. We are aware of one instance where a California dealer purchased a non-certified car at auction with close to 20,000 miles on the odometer, only to find that the vehicle had been "red flagged" due to an earlier attempt to register the vehicle in state when it was under the 7,500 mile threshold. The dealer was unable to remove the flag, and forced to sell the vehicle out of state. If the dealer had run a KSR inquiry on the vehicle prior to purchase, the red-flag status would have been made clear.

It cannot be overemphasized that violation of the 7,500 Mile Rule is a strict liability offense. This means that inadvertence, mistake or negligence on the part of a dealer will not negate or mitigate the fact that a non-California certified vehicle was received, imported or sold before its odometer read 7,500 miles. Moreover, purchasing a non-California certified vehicle with less than 7,500 miles and then driving it until it passes the threshold prior to resale or registration is also prohibited (dealers usually get caught because the seller's odometer statement reflecting the under 7,500 mile odometer reading must be submitted to DMV as part of the registration process). Consequently, if such a vehicle is imported or obtained by a dealer, a fine from ARB can be expected. In order to lessen the damage, evidence that the dealership has unwound the purchase and removed the vehicle from the state will likely be seen by the ARB as evidence of good faith and may result in a reduction of the $5,000 fine.

In one case, a dealer purchased two non-California certified vehicles with less than 7,500 miles at an out-of-state factory auction without checking the emission labels. After smog testing the two units, the dealer discovered their certification status and was able to unwind the auction deals before the vehicles were retailed. Despite the dealer's good faith efforts, ARB cited the dealer for a violation and offered to settle for a $2,500 per vehicle fine. The dealer countered at $2,000 per vehicle. The ARB responded by filing a Superior Court complaint seeking a separate $5,000 per vehicle penalty against the dealership and each of its principals. The case ultimately settled for $10,000. Inspection of the emission label *prior to purchase* should be a standard procedure anytime a vehicle is to be purchased with less than 7,500 miles.

California Tire Fee

California Public Resources Code section 42885 provides as follows:

(a) For purposes of this section, "California tire fee" means the fee imposed pursuant to this section.

(b)(1) A person who purchases a new tire, as defined in subdivision (g), shall pay a California tire fee of $1.75 per tire. [Beginning January 1, 2015, the California tire fee **is set to decrease** to $0.75 per tire, **but legislation has been introduced to default to a higher rate**].

(2) The retail seller shall charge the retail purchaser the amount of the California tire fee as a charge that is separate from, and not included in, any other fee, charge, or other amount paid by the retail purchaser.

(3) The retail seller shall collect the California tire fee from the retail purchaser at the time of sale and may retain 1 1/2percent of the fee as reimbursement for any costs associated with the collection of the fee. The retail seller shall remit the remainder to the state on a quarterly schedule for deposit in the California Tire Recycling Management Fund, which is hereby created in the State Treasury.

(c) The board, or its agent authorized pursuant to Section 42882, shall be reimbursed for its costs of collection, auditing, and making refunds associated with the California Tire Recycling Management Fund, but not to exceed 3 percent of the total annual revenue deposited in the fund.

(d) The California tire fee imposed pursuant to subdivision (a) shall be separately stated by the retail seller on the invoice given to the customer at the time of sale. Any other disposal or transaction fee charged by the retail seller related to the tire purchase shall be identified separately from the California tire fee.

(e) Any person or business who knowingly, or with reckless disregard, makes any false statement or representation in any document used to comply with this section is liable for a civil penalty for each violation or, for continuing violations, for each day that the violation continues. Liability under this section may be imposed in a civil action and shall not exceed twenty-five thousand dollars ($25,000) for each violation.

(f) In addition to the civil penalty that may be imposed pursuant to subdivision (e), the board may impose an administrative penalty in an amount not to exceed five thousand dollars ($5,000) for each violation of a separate provision or, for continuing violations, for each day that the violation continues, on any person who intentionally or negligently violates any permit, rule, regulation, standard, or requirement issued or adopted pursuant to this chapter. The board shall adopt regulations that specify the amount of the administrative penalty and the

procedure for imposing an administrative penalty pursuant to this subdivision.

(g) For purposes of this section, "new tire" means a pneumatic or solid tire intended for use with on-road or off-road motor vehicles, motorized equipment, construction equipment, or farm equipment that is sold separately from the motorized equipment, or a new tire sold with a new or used motor vehicle, including the spare tire, construction equipment, or farm equipment. "New tire" does not include retreaded, reused, or recycled tires.

(h) The California tire fee may not be imposed on any tire sold with, or sold separately for use on, any of the following:

(1) Any self-propelled wheelchair.

(2) Any motorized tricycle or motorized quadricycle, as defined in Section 407 of the Vehicle Code.

(3) Any vehicle that is similar to a motorized tricycle or motorized quadricycle and is designed to be operated by a person who, by reason of the person's physical disability, is otherwise unable to move about as a pedestrian.

(i) This section shall remain operative only until January 1, 2015, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2015, deletes or extends that date.

The Board of Equalization takes the position that the dealer must collect the California Tire Fee from the retail purchaser or lessee at the time of sale or lease. For rental vehicles, the fee must be either collected by the dealer when sold to the rental company, or self-reported and remitted by the rental company. In correspondence between the California New Car Dealers Association and the Board of Equalization, the Board of Equalization stated the following:

Lease Vehicles

The general rule under California's Sales and Use Tax law has long been that a lease is a continuing sale and purchase. Accordingly, the first lease of a new tire on a new or used motor vehicle, construction equipment or farm equipment should be treated as a retail sale subject to tire fees.

Spare Tires It is clear that the Legislature did not intend to collect the fee twice on any tire. Therefore, although a spare tire may never be put to use, it can only be new once for purposes of the fee. Accordingly, the first retail sale (including a lease) of a new tire should be treated as subject to the fee and no additional fee on that tire is due, even if the tire is never actually put to use.

Demonstrator Vehicles

Section 42885(b)(1) of the Public Resources Code states that *"A person who purchases a new tire, as defined in subdivision (g), shall pay a California tire fee of $1.75 per tire."* Further, section 42885(b)(3) states that *"the retail Seller shall collect the California tire fee from the retail purchaser.*

Under a written opinion issued by the Board of Equalization, once a dealer puts a vehicle into demonstrator service, the dealer is required to self-report and remit the tire fee to the Board of Equalization for the four demonstrator tires on the ground, but cannot charge a tire fee for those four tires when the demonstrator is later sold to a retail customer. The dealer should, however, charge a tire fee to that customer for the unused spare tire. These rules for demonstrators are summarized as follows:

Tires on the ground. Dealers must self-report and pay the tire fee on all tires on the ground, but may not recoup the fee from a subsequent retail purchaser of that vehicle.

Unused Spare Tire. The dealer should charge a tire fee to the customer for the unused spare tire at the time the demonstrator vehicle is sold to the customer.

Vehicles Sold to Rental Car Companies

The Public Resources Code states in section 42885(b)(3) *"The retail Seller shall collect the California tire fee from the retail purchaser at the time of sale…"* The Board of Equalization issued an opinion letter clarifying this section as it applies to rental car companies (such as Hertz, Avis, Enterprise, etc.) which purchase motor vehicles from vehicle dealers as wholesale fleet transactions. The Board's letter states that the tire fee for new rental vehicles can be paid in one of two ways:

Dealer Collection: When a dealer sells a vehicle to a rental company, the dealer may collect the applicable tire fees from the company in the same manner as with a retail customer.

Rental Company Self-Reports and Remits: If a dealer does not collect tire fees from the rental company, the rental company must self-report and remit the tire fees to the BOE, much like dealers do when putting a new vehicle into demonstration service.

While dealers may collect the tire fee from a rental company purchasing a vehicle, the BOE letter clearly states that dealers will not face liability if they fail to collect the fees:

"Since the dealer likely will not know, at the time the short-term rental company purchases the motor vehicle, how a particular vehicle will be used, if the dealer timely takes a valid resale certificate in good faith from the rental company, the dealer from whom the rental company purchases the vehicle

(inclusive of the "new tires") is relieved from liability for collecting and remitting the Fee on those tires to the Board."

In such circumstances, the burden will be placed on the rental company to report and remit the appropriate fees to BOE.

Vehicles Sold at Wholesale

Section 42885(b)(3) of the Public Resources Code states that the retail seller shall collect a fee from the retail purchaser at the time of the sale. The BOE has concluded that no such requirement exists for the collection of the fee at the time of a wholesale transaction. (This was in response to a question whether the fee would be due for dealer trades or for new motor vehicles sold to a leasing company or converter.)

Vehicles Sold to Government Entities

There is no provision for exemption of the fee on tires sold to government entities. Accordingly, the fee is due for all new tires sold to such entities.

Courtesy Deliveries for Out-of-State Dealers

The Board recognizes a courtesy delivery as a transaction whereby an out-of-state dealer contracts to sell a vehicle to a customer in California and directs the manufacturer to make delivery to the customer at a specified location in California. The manufacturer may then deliver the vehicle to a dealer in California, who will deliver it to the customer in California. If the out-of-state dealer is not engaged in business in California, or does not have a California seller's permit and dealer's license from the California Department of Motor Vehicles, the fee and the applicable sales tax must be reported by the California dealer. In this instance, the California dealer is considered to have made the retail sale of the tires. Therefore, the tire fee is due from the California dealer.

Sublet Work

CNCDA solicited guidance from the Board of Equalization relative to the following scenario: *A licensed new motor vehicle dealer takes a used vehicle in trade in conjunction with the sale of a new motor vehicle. The dealer is desirous of retailing the trade-in vehicle on its used car lot but the vehicle has two tires that fail to meet the tire tread requirements of Division 12 of the Vehicle Code. As part of reconditioning the vehicle for resale by this dealer, the dealer sublets the replacement of two worn-out tires with a local tire dealer who charges the dealer $1.75 per new tire for the California tire fee.*

We are advised that most tire dealers do not differentiate between retail and wholesale transactions for purposes of charging the California tire fee. We assume that the tire fee should only be collected and remitted one time for each new tire sold and that the new motor vehicle dealer in the above factual situation would not be required to charge the purchaser of the used vehicle an additional $1.75 per new tire for the California tire fee. If you agree with our assumption, what type of documentation, if any, will your auditors require our dealer members to maintain in order to demonstrate that the fee was collected by the tire dealer?

The Board of Equalization responded as follows: *If the local tire dealer sold the two new tires to the automobile dealer in a retail transaction, the tire dealer is responsible for collecting the fee from the automobile dealer. The automobile dealer is not subsequently required to collect the fee upon the sale of the used vehicle. However, if the local tire dealer sold the tires to the automobile dealer in a wholesale transaction (i.e., accompanied by a resale certificate) then the automobile dealer is responsible for the collection of the fee when the vehicle with new tires is subsequently sold at retail. If the local tire dealer collects the $1.75 per tire from the automobile dealer in a wholesale transaction (i.e., accompanied by a resale certificate), it would be considered excess fee reimbursement and the local tire dealer would be required to either refund the $1.75 per tire directly to the person who purchased the tire or remit it to the Board of Equalization. The automobile dealer is required to collect and remit the fee on the retail sale of the new tires on a new or used car.*

NOTE

NUMBER OF TIRES. Be sure that dealership service personnel properly communicate with sales/F&I personnel about the number of new tires installed on used vehicles prior to sale, and that the tire fee is collected for the correct number of tires. Dealers should also be sure that the correct fee is collected for new vehicles that do not include spare tires—many automakers no longer provide spare tires for certain new vehicle models. Dealers should ensure that their DMS software is not automatically programmed to collect $8.75 on all new and used vehicles.

Cancellation of Contracts by Minors

Every now and then a question comes up concerning whether a minor (a person under the age of 18) can enter into a binding contract to purchase a vehicle. California law provides that contracts entered into by a minor for a purchase of a vehicle can be cancelled by the minor before the minor reaches 18 or within a reasonable period afterwards. There are certain contracts minors are not allowed to cancel. Such contracts must be for the purchase of things necessary for the support of the minor or the minor's family and the contract is entered into by the minor when the minor is not under the care of a parent or guardian who is able to provide for the minor or the minor's family. If a minor enters into a contract for the purchase of a vehicle with a cosigner who is not a minor, then the contract is enforceable against the cosigner, but the minor's liability under the contract can be cancelled by the minor. See California Family Code sections 6700-6713.

Computer Access Issues

Under relevant provisions of the California Vehicle Code, no manufacturer or computer vendor can access or extract confidential dealer records containing personal information without prior written consent of the dealer. Computer vendors are further prohibited from requiring express consent from a dealer as a condition of doing business. However, express consent may be required to protect against fraud, to comply with federal, state, or local laws, to permit investigations or to make other use of customer information authorized by the customer. This law also prohibits computer vendors and manufacturers from interfering with lawful efforts of dealers to comply with the federal and state data security and privacy laws:

Extracting Information from Dealer Computer Records by Manufacturer. California Vehicle Code section 11713.3(v) makes it unlawful for a manufacturer:

(1) To access, modify, or extract information from a confidential dealer computer record, as defined in Section 11713.25, without obtaining the prior written consent of the dealer and without maintaining administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of the information. (2) Paragraph (1) does not limit a duty that a dealer may have to safeguard the security and privacy of records maintained by the dealer.

Factory Interference with Dealer's Computer Rights and Obligations. California Vehicle Code section 11713.3(w) makes it unlawful for a manufacturer:

(1) To use electronic, contractual, or other means to prevent or interfere with any of the following: (A) The lawful efforts of a dealer to comply with federal and state data security and privacy laws. (B) The ability of a dealer to do either of the following: (i) Ensure that specific data accessed from the dealer's computer system is within the scope of consent specified in subdivision (v). (ii) Monitor specific data accessed from or written to the dealer's computer system. (2) Paragraph (1) does not limit a duty that a dealer may have to safeguard the security and privacy of records maintained by the dealer.

Extracting Information from Dealer Computer Records by Vendor. California Vehicle Code section 11713.25 provides:

(a) A computer vendor shall not do any of the following:

(1) Access, modify, or extract information from a confidential dealer computer record or personally identifiable consumer data from a dealer without first obtaining express written consent from the dealer and without maintaining administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of the information.

(2)

(A) Except as provided in subparagraph (B), require a dealer as a condition of doing or continuing to do business, to give express consent to perform the activities specified in paragraph (1).

(B) Express consent may be required as a condition of doing or continuing to do business if the consent is limited to permitting access to personally identifiable consumer data to the extent necessary to do any of the following:

(i) To protect against, or prevent actual or potential fraud, unauthorized transactions, claims, or other liability, or to protect against breaches of confidentiality or security of consumer records.

(ii) To comply with institutional risk control or to resolve consumer disputes or inquiries.

(iii) To comply with federal, state, or local laws, rules, and other applicable legal requirements, including lawful requirements of a law enforcement or governmental agency.

(iv) To comply with lawful requirements of a self-regulatory organization or as necessary to per-

form an investigation on a matter related to public safety.

(v) To comply with a properly authorized civil, criminal, or regulatory investigation, or subpoena or summons by federal, state, or local authorities.

(vi) To make other use of personally identifiable consumer data with the express written consent of the consumer that has not been revoked by the consumer.

(3) Use electronic, contractual, or other means to prevent or interfere with the lawful efforts of a dealer to comply with federal and state data security and privacy laws and to maintain the security, integrity, and confidentiality of confidential dealer computer records, including, but not limited to, the ability of a dealer to monitor specific data accessed from or written to the dealer computer system. Waiver of this subdivision or purported consents authorizing the activities proscribed by the subdivision is void.

(b) A dealer shall have the right to prospectively revoke an express consent by providing a 10-day written notice to the computer vendor to whom the consent was provided or on any shorter period of notice agreed to by the computer vendor and the dealer. An agreement that requires a dealer to waive its right to prospectively revoke an express consent is void.

(c) For the purposes of this section, the following terms mean as follows:

(1) "Confidential dealer computer record" means a computer record residing on the dealer's computer system that contains, in whole or in part, any personally identifiable consumer data, or the dealer's financial or other proprietary data.

(2) "Computer vendor" means a person, other than a manufacturer, manufacturer branch, distributor, or distributor branch, who in the ordinary course of that person's business configured, sold, leased, licensed, maintained, or otherwise made available to a dealer, a dealer computer system.

(3) "Dealer computer system" means a computer system or computerized application primarily designed for use by and sold to a motor vehicle dealer that, by ownership, lease, license, or otherwise, is used by and in the ordinary course of business of a dealer.

(4) "Express consent" means the unrevoked written consent signed by a dealer that specifically describes the data that may be accessed, the means by which it may be accessed, the purpose for which it may be used, and the person or class of persons to whom it may be disclosed.

(5) "Personally identifiable consumer data" means information that is any of the following:

(A) Information of the type specified in subparagraph (A) of paragraph (6) of subdivision (e) of section 1798.83 of the Civil Code.

(B) Information that is nonpublic personal information as defined in section 313.3(n)(1) of Title 16 of the Code of Federal Regulations.

(C) Information that is nonpublic personal information as defined in subdivision (a) of section 4052 of the Financial Code.

(d) This section does not limit a duty that a dealer may have to safeguard the security and privacy of records maintained by the dealer.

Consignment Sales

Vehicle Code section 266 defines a consignment as follows: A "consignment" is an arrangement under which a dealer agrees to accept possession of a vehicle of a type required to be registered under this Code from an owner for the purpose of selling the vehicle and to pay the owner or the owner's designee from the proceeds of the sale.

Vehicle Code section 11729 requires that any dealer engaging in a consignment as defined above must execute a consignment agreement, the form of which is prescribed by Vehicle Code section 11730. If a dealer fails to complete and comply with the terms of the consignment agreement for any vehicle which the dealer agrees to accept on consignment, or if the dealer fails to pay the agreed amount to the consignor or his or her designee within 20 days after the date of the sale of the vehicle, there is cause for suspending or revoking the license of the dealer.

Vehicle Code section 11730 requires that the consignment agreement be in the following form, and the form must contain the date the agreement is executed:

(1) I (We), the undersigned consignor(s), hereby consign and deliver possession of my (our) vehicle, which is a

(Year) _____
(Make)_____
(ID#) _____
(License)_____
(State) _____
(Mileage)_____,
to
(Consignee)_____
(Dealer #)_____

for the sole purpose of selling the vehicle and paying, to the consignor or his or her designee from

the proceeds of the sale of the vehicle, the amount agreed upon under terms of this agreement. This agreement is effective and valid only for a period of _____ days from this date.

(2) At the termination of this agreement, the consignee shall return the vehicle to the consignor, or, at the option of both the consignor and consignee, enter into a new agreement.

(3) If the vehicle is sold by the consignee during the term of this agreement, the money due the consignor shall be disbursed within 20 days after the date of sale in accordance with the terms of this agreement. As used in this agreement, a "sale" occurs when the consignee either (A) receives the purchase price or its equivalent or executes a conditional sale contract for the vehicle, or (B) when the purchaser takes delivery of the vehicle, whichever occurs first.

(4) The following information shall be completed prior to the signing of this agreement:

Current market value: $____

Source:_____.

Outstanding liens: $_____

Lienholder:_____.

(Any difference between the outstanding amount shown and the actual payoff to the lien holder will be credited to the consignor.)

Repairs to be made: $___Work Order # _____. Moneys to the consignor:_____ percent of sale price, flat fee of $_____, or the following specific formula:_____.

(5) Within 20 days after sale, the consignee shall make an accounting to the consignor of all of the following: date of sale, repairs authorized by consignor (supported by work records), exact amount of any liens payable to lienholders, evidence of payment of any liens, and the total sales price.

(6) The consigned vehicle is delivered to the consignee in trust for the exact terms set forth in this agreement. The consignee agrees to receive this vehicle in trust and not to permit its use for any other purpose other than contained in this agreement without the express written consent of the consignor.

(7) Upon payment of the moneys due the consignor, the consignor agrees to furnish the consignee those documents necessary to transfer the ownership of the vehicle to the purchaser.

Signatures:

_____

Consignor Date

_____

Address

_____

Consignee Date

_____

Address

(8) NOTICE TO CONSIGNOR: Failure of the consignee to comply with the terms of this agreement may be a violation of statute which could result in criminal or administrative sanctions, or both. If you feel the consignee has not complied with the terms of this agreement, please contact an investigator of the Department of Motor Vehicles.

A dealer is not required to use the Consignment Agreement form if the consignment is with another dealer, or with a manufacturer, manufacturer branch, distributor or a distributor branch licensed under the Vehicle Code, and the consignment is not otherwise prohibited by the Vehicle Code. Additionally, a dealer conducting retail auction sales on behalf of a fleet owner (a person who is the registered or legal owner of 24 or more vehicles registered in the state or a bankruptcy trustee who owns or has legal control of the vehicles) must use the Consignment Agreement form. The form used in that situation need not include (i) a description of any specific vehicle by year, make, VIN, license, state or mileage; or (ii) the current market value, outstanding lien amount, and lienholder for any specific vehicle.

Consignor's Rights Can Trump Those of Flooring Lender

When a dealership goes out of business and is holding both floored vehicles and consigned vehicles, disputes often arise between the flooring lender and the consignor as to which one has superior rights to the consigned vehicles. If the flooring lender has filed a UCC-1 financing statement but the consignor has not, the flooring lender may have a superior claim to the consigned vehicles, even though the flooring lender did not originally floor them. A California case has clarified when a consignor, who has not filed a UCC-1, may nevertheless claim superior rights to its consigned vehicles. In that case, a wholesaler consigned cars to a dealership for sale, but did not file a UCC-1 financing statement covering the consigned vehicles. The dealership's inventory at that time also included ve-

hicles financed by its flooring lender. The flooring lender was actually aware of the consignment, even though the wholesaler had not filed its own UCC-1 financing statement. Later, the dealership went out of business, and when the wholesaler sought to recover his consigned vehicles, he learned that they had been earlier repossessed by the flooring lender on the strength of the flooring lender's UCC-1 financing statement. The wholesaler brought suit against the flooring lender to recover the consigned vehicles and prevailed at trial. The case went on appeal, and the California Court of Appeal agreed with the trial court, holding that a consignor has superior rights to its consigned vehicles when the flooring lender has actual knowledge of such consignment, even thought the consignor had not filed its own UCC-1 statement (*Fariba v. Dealer Services Corp*., (2009) 178 Cal.App.4th 156, 100 Cal.Rptr.3d 219).

The significance of this case to consignors and consignees is clear. Dealers and wholesalers who consign vehicles to others for sale should either file a UCC-1 financing statement or take other steps to ensure that the consignees's secured creditor (usually the floorplan lender) is on notice of the consignment. Conversely, if the dealer acts as a consignee for a wholesaler or another dealer with whom he has a continuing business relationship, the consignee-dealer may want to consider notifying his floorplan lender of the consignment to protect the rights of his consignor and avoid confusion. Of course, a dealer who has any questions concerning any particular consignment situation should always consult with legal counsel.

Consumer Recovery Fund

Overview

During the economic downturn in the late 2000s, the legislature enacted new laws to address the failure by defunct dealers to pay off liens or lease balances on trade-in vehicles, remit proceeds of consignment sales, or pay registration fees to the Department of Motor Vehicles.

The These laws require the DMV to collect a $1.00 fee from dealers for each new and used vehicle sold and reported to DMV. The collected funds are transmitted (after paying the DMV's expenses) to the state Consumer Recovery Fund ("Fund"), which is managed by the Consumer Motor Vehicle Recovery Corporation ("Corporation"). Consumers may file a claim with the Corporation, seeking reimbursement for economic losses related to eligible claims (see "Consumer Application" discussion, below). Vehicle Codes sections 4456.3 and 12200-12217.

Dealer Fee

The statute requires the DMV to charge dealers and lessor-retailers a $1.00 fee for each vehicle sold and reported to the DMV. The statute expressly prohibits dealers from passing on the fee to customers. DMV may not charge a single dealer more than $2,500 in such fees in a single calendar year (Vehicle Code section 4456.3).

Timeline

The law requires the DMV to collect the fee until the balance of the fund reaches $5,000,000. DMV must then stop collecting the fee within 90 days. Once the balance of the fund is depleted to $2,000,000, DMV will once again collect the fee until the fund's balance reaches $5,000,000. The cycle continues, ensuring that the fund is maintained at a level sufficient to pay incoming claims, but does not reach an unnecessarily high balance (Vehicle Code section 4456.3).

Fee Collection

DMV developed a billing practice of sending invoices at the end of each calendar quarter for vehicles sold during the previous quarter, according to the following schedule:

Month Invoice Sent	Months Collected
April	January-March
July	April-June
October	July-September
January	October-December

The DMV has been extremely aggressive in collecting these fees, and has filed claims against several dealer bonds for fees past due—requiring swift replenishment of the bond to prevent automatic cancellation of the dealer license. DMV may also take action to suspend or revoke the occupational license issued to a dealer for failing to pay the invoiced amount.

Consumer Application

The statute is designed to assist consumers who have suffered certain economic losses caused by a dealer that is either subject to a bankruptcy petition or is no longer in business. Injured consumers may apply to the Fund for reimbursement of damages if a dealer fails to:

- Remit to the DMV amounts paid by consumers for license or registration fees;

- Pay to the legal owner of a trade-in vehicle the amount the dealer or is contractually obligated to pay in connection with the purchase of a vehicle by a consumer; or
- Pay the proceeds of a consignment sale to a consumer consignor.

Claim forms and more information are available on the Corporation's website at: http://www.cmvrc.org/.

Consumers suffering such losses are eligible to submit an application for proceeds from the Fund. The statute of limitations for a consumer to file a claims is limited to 12 months after the dealer ceased selling or leasing motor vehicles to the general public or became subject to a petition in bankruptcy (Vehicle Code section 12204). The amount a consumer may receive from the Fund is limited to $35,000 per transaction (Vehicle Code section 12208).

Once the Corporation receives a completed claim application, it is required to notify the consumer and subject dealer of that fact. The Corporation then has 60 days to decide whether to grant the claim. In the meantime, the subject dealer may contest payment of the claim by filing a written response to the application. The Board of Directors of the Corporation, composed of one consumer representative, two dealers, two public members, and one non-voting representative from the Attorney General's office, must affirmatively vote to deny a claim within the 60-day period, or the claim is deemed approved. If the claim is affirmatively denied by a vote of the Board, the consumer may seek to contest the denial by seeking a superior court review. If the claim is approved, the Corporation is subrogated to all consumer rights against the dealer to the extent of the payment amount. The Corporation may then bring an action to recover the amount of the payment plus 10 percent interest annually, in addition to costs and attorney's fees. The consumer may still bring an action against the dealer for other violations of law (Vehicle Code sections 12206-12210).

Dealer Penalties

If a consumer is paid on a claim concerning the activity of a former or current dealer, the DMV may refuse to issue a license in the future until that dealer reimburses the Fund for the amount of that claim, plus 10% per year. The DMV may also suspend or revoke a dealer license for failure to repay the Fund for a claim that was paid to a consumer. The DMV, if notified of a claim application, may choose to investigate the dealer for the alleged underlying action (Vehicle Code section 12207).

Corporate Minutes

Corporate minutes have only one purpose: to record meetings of either the shareholders or the directors of a corporation. Technically, shareholder and director meetings, and thus minutes, are required only at pre-determined times set by the bylaws, the legal minimum being once per year, called "regular meetings." Other meetings are called "special meetings," and are made necessary by proposed corporate action requiring shareholder or board approval. By asking yourself "is it necessary, or desirable, to have the directors or shareholders approve this decision" you get the answer to the question "are minutes needed?"

Unanimous written consents signed by all of the directors for director action, and all of the shareholders for shareholder action, can substitute for meetings. These consents are usually filed in the Minute Book just as if they were minutes of a meeting.

When is shareholder approval required? Only for a limited number of corporate actions, some of which include election or removal of directors, articles of incorporation amendments and certain amendments to the bylaws, sale of substantially all of the corporation's assets, and approval of loans by the corporation for the benefit of any officer or director.

Board approval is required more often than is shareholder approval. Some of the matters generally requiring board approval include election or removal of officers; adoption or amendment of bylaws; authorization of issuance of stock; borrowing and lending of money, except in the ordinary course of business (for example, approval of a capital loan would be required, but approval of the regular purchase of inventory or supplies on credit would not); transactions between the corporation and any of its officers, directors or shareholders; entering into employment agreements or fixing employee benefit plans for profit sharing arrangements; indemnification of officers, directors or employees in any litigation; and declaration of dividends or redemption or repurchase of shares. Also, most of the actions that require shareholder approval also require board approval.

Outside of unanimous written consent, duly conducted board or shareholder meetings are the exclusive means of obtaining the necessary approval. Simply polling the directors and/or shareholders is not enough. Without the required approval, corporate officers or employees carrying out a proposed transaction may be acting outside of their authority.

Minutes serve as evidence that the required meetings were held and approvals obtained.

Another consequence of failing to conduct necessary meetings and document them by way of minutes is that this laxity in observing "corporate formalities" can be considered a factor in support of a "piercing the corporate veil," a legal doctrine used to hold the shareholders of a corporation directly liable for the corporation's debts. Although many other factors are also reviewed before such liability is imposed, unless the exemption for close corporations discussed below is available, diligent observance of director and shareholder meetings and minutes is highly recommended.

Shareholders of California corporations known as "statutory close corporations" can obtain protection against personal liability based upon failure to observe corporate formalities concerning meetings and minutes. California Corporations Code section 300(e) provides that if such failure is pursuant to a close corporation's shareholders agreement, then it shall not be considered a factor tending to establish that shareholders have personal liability for corporate obligations. To take advantage of this exemption, a corporation must be or become a statutory close corporation (which requires a statement in the articles of incorporation), and all shareholders must enter into an appropriate shareholders agreement.

Credit Card Processing Fees

Dealers sometimes have questions about the use of credit cards for purchases or for down payments. Specifically, dealers have asked whether the bank processing fee, which can generally range from 1% - 3%, may be added to the price of the goods or vehicle being purchased, or somehow passed on to the customer. Some customers are motivated to use their credit card because of various bonuses and incentives available from the card issuer for use of the card.

There are laws on both the state and federal level that deal with this subject. Under Section 1666f of the federal Truth-In-Lending Act, a dealer may offer a customer a discount from the regular price offered by the dealer for the purpose of inducing payment by cash, check, or other means not involving the use of an open-end credit plan or a credit card, and this discount would not constitute a finance charge under Truth-In-Lending laws. Under federal law, the availability of the discount must be disclosed "clearly and conspicuously" such that all customers will know that payment other than by credit card entitles them to a discount.

California Civil Code section 1748.1 provides that: "No retailer in any sales, service, or lease transaction with a consumer may impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means. A retailer may, however, offer discounts for the purpose of inducing payment by cash, by check, or other means not involving the use of a credit card, provided that the discount is offered to all prospective buyers." Any retailer who violates this section and who fails to pay to the cardholder the amount of the surcharge within 30 days of a written demand by the cardholder by certified mail, is liable to the cardholder for three times the amount of actual damages and the cardholder's reasonable attorneys' fees and costs.

Although at one time federal law prohibited a surcharge for credit card fees, that law was later repealed. California, however, enacted the surcharge prohibition mentioned above. Even if one were to argue that federal law controls over California law, then under the Truth-In-Lending Act, a dealer would be required to disclose a surcharge for use of the credit card as an additional finance charge which could affect the APR and dollar amount of credit.

As long as there is nothing prohibitive in your merchant agreement with the credit card issuer, dealers can refuse to take credit cards, or limit the use of credit cards to a certain dollar amount. In those cases one might want to consider simply absorbing the card issuer fee. You can also ask the customer to use his or her credit card to transfer cash to a checking account and then use a check for the purchase.

It is certainly permissible to have a policy of cash discounts for purchases by other than credit card, as many merchants do. Other than a cash discount policy, any arrangement to recoup the credit card fees runs the risk of being an illegal surcharge under California law and an undisclosed finance charge under federal law. There are penalties for illegal surcharges, as noted above, and also for the failure to disclose all finance charges under federal law. Additionally, undisclosed finance charges could lead to a customer's right to rescind the sales contract because under California's Automobile Sales Finance Act, every conditional sale contract must contain the disclosures required by federal law and Regulation Z under Truth-In-Lending.

Any policies that a dealership establishes with respect to the use of credit cards should be carefully reviewed by your legal counsel.

Customer Bankruptcy

What are the risks for a dealer when a customer files bankruptcy shortly after the sale of a vehicle? The primary risks arise from (i) the bankruptcy preference law and (ii) the bankruptcy trustee's lien on the customer's property.

Preference Law

Under the bankruptcy preference law, if the customer has transferred property, including a security interest, in the ninety days before the filing of his bankruptcy, the bankruptcy trustee may be able to have the transfer set aside as a "preference" which should come back into the bankruptcy estate for the benefit of all creditors. This means that the security interest in a vehicle given by the customer at the time of sale could theoretically be set aside by the bankruptcy trustee if the customer files bankruptcy within ninety days of the sale. However, the Bankruptcy Code provides that the trustee will not be able to set aside the security interest if the dealer/finance company perfects the security interest within 30 days from the date the customer receives possession of the vehicle. In California, a security interest in a vehicle is perfected when a properly endorsed certificate of ownership has been deposited with the DMV or an application for registration showing the secured party as legal owner has been deposited with the DMV. Accordingly, if the dealer deposits the endorsed certificate of ownership or the application for registration within 30 days of delivering possession of the vehicle to the customer, a bankruptcy trustee will not be able to later set aside the security interest as a preference.

Trustee's Lien

The bankruptcy trustee acquires a lien on all of the customer's assets as of the date of the filing of the bankruptcy. This lien is superior to and will defeat security interests which are unperfected at the time of the bankruptcy filing. Therefore, if the customer files his bankruptcy case before the time the dealer deposits the properly endorsed certificate of ownership or the application for registration with the DMV, the bankruptcy trustee can defeat the security interest. In order to be protected from the bankruptcy trustee's claims in this regard, the security interest in the vehicle should be perfected before the customer files bankruptcy.

Bankrupt Customers Lose "Ride-through" Option

In bankruptcy, a debtor is required to provide notice of how he or she intends to handle the payment of a vehicle subject to a lien. In a 9th Circuit decision, the Circuit Court of Appeal effectively ended the "ride-through option", under which the debtor could keep the car so long as he or she continued to make payments, but would not be responsible for any deficiency balance. The Court ruled that under a 2005 amendment to the Bankruptcy Code, a debtor could no longer select the ride-through option, but instead was required to either surrender the vehicle, redeem the vehicle by paying off its fair market value, or sign a reaffirmation agreement to remain obligated for payment of all installments due under the contract, including any deficiency balance (*Dumont v. Ford Motor Credit Company* (In re Dumont) (2009) 581 F.3d 1004).

Dealer Involvement in Criminal Prosecutions

Dealers can be the victims of criminal conduct, and sometimes customers, vendors, or even employees are the perpetrators. It is natural to want the offenders brought to justice, but how does one go about seeking criminal prosecution, and what dangers are in store for the dealer who does so?

Filing False Police Report

It is initially important to point out that any person who knowingly gives a false report of a crime to any law enforcement officer or district attorney is guilty of a criminal misdemeanor. (Penal Code section 148.5.)

Cooperating with District Attorney

Only the offices of the district attorney, city attorney, Attorney General, and grand jury control the ultimate decision of whether criminal charges should be filed in court. But a criminal investigation does not begin until the crime is reported to a law enforcement agency. Each police department and sheriff's office has its own procedures for citizen reports of crime. Some departments require forms to be signed by the "complaining party" or "victim," but law enforcement has the power to conduct investigations and recommend prosecution even if such forms are not signed.

District and city attorneys generally do not like to accept criminal complaints directly from citizens,

although they might discuss unusual situations, such as where the law enforcement agency fails to take appropriate action. However, after law enforcement refers the case to the prosecutor's office for charges to be filed, the prosecuting attorney assigned to the matter will generally assume more day-to-day control. At this point, the prosecutor often wants as much assistance as the victim can offer to help prove the case.

Court decisions in this area have made it more risky for prosecutors to work closely with the victim. An entire district attorney's office can be disqualified from prosecuting a case if the prosecutor's ability to deal objectively with the defendants is compromised by the victim's participation. For example, the California Supreme Court upheld the disqualification of the entire Santa Cruz District Attorney's office when it was discovered that software pioneer Borland paid for expert witnesses used by the D.A. in a trade secrets embezzlement case against a former Borland employee. *People v. Eubanks* (1997) 14 Cal.4th 580, 59 Cal.Rptr.2d 200. This forced the state Attorney General's office to take over from the D.A., a fairly expensive and time consuming proposition. Some prosecutors now question whether they can accept technical assistance from the victim's own employees or accountants, as is common in cases of embezzlement.

Immunity from Civil Law Suits

In two cases, the California Supreme Court has ruled that people cannot be sued for reporting suspicious or criminal activity to the police, regardless of their motivation. In *Hagberg v. California Federal Bank(2004) 32 Cal.4th 350, 7 Cal.Rptr.3d 803*, a bank customer was detained and handcuffed by the police after a teller mistakenly reported her to police for passing a bad check. In *Mulder v. Pilot Air Freight*(2004) 32 Cal.4th 384, 7 Cal.Rptr.3d 828, a man was arrested after a business rival enlisted the police to set up a stolen merchandise sting. The charges were later dropped.

In both cases, the California Supreme Court held that one who reports suspicious or criminal activity to the police is absolutely immune from a damages lawsuit brought by the arrestee. The Court relied upon California Civil Code section 47(b), which bars lawsuits against those who make communications in connection with legislative, judicial, or other proceedings. The Court explained that absolute immunity was necessary to "assure utmost freedom of communication between citizens and public authorities whose responsibility is to investigate and remedy wrongdoing." The Court noted, however, that this immunity from a damages lawsuit did not apply to circumstances where the arrestee could establish the elements of the tort of malicious prosecution (See below).

Malicious Prosecution

Criminal proceedings against a suspect at a dealer's urging which do not result in a conviction can later expose the dealer to a lawsuit for malicious prosecution by the suspect. If malicious prosecution is established against the dealer, the dealer can be held liable for all damages suffered by the plaintiff during the arrest, jailing, and prosecution associated with the criminal case, as well as for punitive damages. To sue for malicious prosecution, the plaintiff must prove certain elements, including that the criminal proceedings did not result in a conviction. "Malice" and lack of "probable cause" on the dealer's part must also be proved against the dealer.

"Malice" does not require a showing of hatred or ill-will; it merely refers to some motive for instituting criminal proceedings other than an honest desire to bring a guilty person to justice. For example, a dealer's long standing dislike of the suspect could be a basis for a finding of malice, as could the filing of a crime report mainly in hopes of recovering money or property from the wrongdoer.

Even with malice, no liability can attach for malicious prosecution if the dealer had "probable cause." Probable cause exists where the person reporting the crime has a sincere belief that the suspect is guilty **and** has a reasonable basis to support that belief. Advice of legal counsel can sometimes help establish probable cause, so long as all known facts were disclosed when the lawyer's advice was sought.

Remember, probable cause for the particular crime for which the suspect is charged is required, not simply probable cause that some crime or illegality was afoot. Recommending that the authorities pursue the suspect under a particular crime or statute should be avoided - leave that to law enforcement and prosecuting attorneys. Also avoid any exaggeration or embellishment on the perceived wrongful conduct of the suspect - this could indirectly bring about the filing of more serious charges for which probable cause may be hard to prove.

Do the risk and cost of defending even a baseless malicious prosecution suit make it unwise for dealers to seek criminal prosecution? A law designed to require dismissal of a certain class of meritless suits early in the lawsuit process may help reverse the chilling effect created by the prospect of being sued for malicious prosecution. Code of Civil Procedure section 425.16 is a law enacted to curb so-called SLAPP (Strategic Litigation Against Public Participation) suits. Traditionally these were suits by a land developer charging neighborhood opposition

groups with libel and slander of the developer, with the hidden purpose of forcing the opposition groups to expend time and money on defending themselves in court, thereby discouraging their exercise of the rights of free speech and petition for the redress of grievances.

The anti-SLAPP law was drafted in very broad language that goes well beyond the original developer/opposition group setting. Indeed, an amendment to the anti-SLAPP law specifically states that it "shall be construed broadly." The language is so sweeping that some believe that it can be used to defend against baseless malicious prosecution claims. The California Supreme Court has ruled that malicious prosecution lawsuits are subject to dismissal under the anti-SLAPP law. *Jarrow Formulas, Inc. v. LaMarche* (2003) 31 Cal.4th 728, 3 Cal.Rptr. 3d. 636.

The best advice for dealers is to exercise caution and consult with legal counsel. If there has been a verifiable, voluntary confession, or the evidence of guilt is otherwise strong, being sued for seeking appropriate criminal prosecution is not likely. If suspicion is high, but there is little evidence to prove guilt, dealers should consider adopting a "mere witness" approach, where just the facts as known to the dealer are reported, and all dealership personnel refrain from demanding, requesting or even recommending that any particular action be taken by law enforcement. This can reduce the chance that the suspect will later be able to prove that the dealer's conduct was actively instrumental in causing the prosecution, or was so aggressive that it could be taken as evidence of malice.

Dealer Liability For Damage Caused by Vehicle Thief

A California Court of Appeal ruling has raised the specter of potential dealer liability for damage or injury caused by a thief who steals a vehicle from a dealer's premises.

In that case, a prison parolee who had just been released from prison spent his release date becoming intoxicated and then wandered into a repair facility operated by the dealer. The parolee had wandered onto the premises just prior to the facility's closing time but during daylight, and got into a tow truck with keys left in the ignition. The parolee smashed the vehicles parked in front of and behind the tow truck and then tore through a canopy on top of the unlocked gate of the facility. After entering the nearby streets, he smashed into several vehicles and then approximately one mile from the facility, swerved onto a sidewalk and plowed into 11 people waiting at a bus stop. The accident left three people dead and eight people injured. The parolee was convicted of murder and sentenced to a lengthy prison term.

The injured parties and the survivors of the deceased parties brought a lawsuit against the dealership, claiming that the dealership was negligent in not taking adequate steps to protect its vehicle from theft – especially by leaving the keys in the ignition. The trial court ruled in favor of the dealer based on a longstanding California legal principle holding that, absent special circumstances, the owner or bailee of a vehicle is not responsible for damages to third parties caused by the theft of that vehicle. However, the Court of Appeal reversed the trial court's ruling, holding that, with regard to a "special circumstance vehicle" (meaning one that is not within the ordinary person's driving experience), the dealership could be liable for the damages and injuries caused by the parolee because it should not have left the keys in the ignition and also should have better guarded its facility from the theft. (*Carrera v. Maurice J. Sopp & Son*, (2009) 177 Cal.App.4th 366, 99 Cal.Rptr.3d 268).

This case is citable as current California law on the subject, which means that dealers should make sure to take all reasonable and necessary measures to adequately secure its facilities from theft after the facilities are closed to the public. It is recommended that dealers not leave ignition keys in vehicles that are located in their facilities.

A Dealer's Right To Refuse Business

A dealer generally has the right to refuse to do business with any individual, provided the refusal to do business does not violate any anti-discrimination laws. For example, California Military and Veterans Code section 394 prohibits discrimination against a member of the military because of that membership. More generally, California Civil Code section 51, also known as the Unruh Civil Rights Act, provides that "All persons within any jurisdiction of this state are free and equal, and no matter what their sex, race, color, religion, ancestry, national origin, disability, medical condition, genetic information, marital status or sexual orientation are entitled to the full and equal accommodations, advantages, facilities, privileges, or services in all business establishments of every kind whatsoever."

A dealer is thus prohibited from refusing to conduct business with an individual because of that person's sex, race, color, religion, ancestry, national origin, disability, medical condition, genetic information, marital status or sexual orientation. Because other personal traits, beliefs or characteristics which are not specifically identified in this statute can be legally protected against discrimination, a dealer must carefully consider a decision to refuse business and should base such a decision on legitimate business purposes. Legitimate business purposes have been recognized by California Courts to include such things as maintaining order, complying with legal requirements and protecting a business reputation or investment. Subject to the types of legal concerns discussed above, a dealer has no obligation to do business with a potential customer whom the dealer thinks will be more trouble than it is worth.

No Gender Discrimination When Rendering Services. California Civil Code section 51.6, known as the Gender Tax Repeal Act of 1995, provides that no business establishment of any kind whatsoever may discriminate, with respect to the price charged for services of similar or like kind, against a person because of the person's gender. The penalty for the violation of the statute is the amount of the actual damages suffered by the person discriminated against, plus an amount equal to a maximum of three times the amount of the actual damages, but in no case less than $4,000, and any attorney fees incurred by the person bringing the action (Civil Code section 52.).

Disclosing Identities of Financial Institutions Receiving Credit Applications

Although federal and state law does not require dealers to disclose to their customers the names and addresses of the financial institutions to which their credit applications will be submitted, dealers should be aware that such a disclosure may be required by individual financial institutions. Specifically, a financial institution may provide in its dealer agreement that its name and address must be disclosed by the dealer to a customer submitting a credit application. By requiring this disclosure, a financial institution can avoid being deemed a "credit reporting agency" for purposes of the Federal Fair Credit Reporting Act which might otherwise apply and place significant legal duties on the financial institution regarding communications between it and the dealer relating to a customer's credit application. If a dealer agreement requires this disclosure, the specific terms of the agreement should be followed, but usually the disclosure is given in writing and either included on the credit application form itself, or on a separate written statement given to the customer, or even on a sign posted on the dealership premises.

Dishonored Checks

The law regarding dishonored checks is contained in California Civil Code section 1719. Here is a summary of that law:

- As used in the statute, the words "pass a check on insufficient funds" means writing a check for money where the check is dishonored for any of the following reasons:

  (1) Lack of funds or credit in the account to pay the check.

  (2) The person who wrote the check does not have an account with the drawee.

  (3) The person who wrote the check instructed the drawee to stop payment on the check.

- A person who passes a check on insufficient funds shall be liable to the payee for the amount of the check and a service charge payable for an amount not to exceed $25 for the first check passed on insufficient funds and an amount not to exceed $35 on each subsequent check to that payee passed on insufficient funds.

- If a written demand for payment is mailed by certified mail to the person who passed the check on insufficient funds and the written demand informs this person of (A) the provisions of this code section, (B) the amount of the check, and (C) the amount of the service charge payable to the payee, and the person does not, within 30 days from the date the written demand was mailed, pay the amount of the check, the amount of the service charge, and the cost to mail the written demand, then that person shall then be liable instead for (1) the amount of the check, minus any partial payments made toward the amount of the check or the service charge within 30 days of the written demand, and (2) damages equal to treble that amount, which shall be not less than $100 nor more than $1,500.

- A person is not liable for the above damages if he or she stops payment in order to resolve a good faith dispute with the payee. The exis-

tence of a "good faith dispute" is determined by the court and is one in which the court finds the maker had a reasonable belief of his or her legal entitlement to withhold payment. Grounds for the entitlement include, but are not limited to, the following: services were not rendered, goods were not delivered, goods or services purchased are faulty, not as promised, or otherwise unsatisfactory, or there was an overcharge.

- A person is not liable for the service charge if, at any time, he or she presents the payee with written confirmation by his or her financial institution that the check was returned to the payee by the financial institution due to an error on the part of the financial institution.
- A person is not liable for the service charge if the person presents the payee with written confirmation that his or her account had insufficient funds as a result of a delay in the regularly scheduled transfer of or the posting of a direct deposit of a social security or government benefit assistance payment.

- In the case of a stop payment, damages or costs cannot be awarded unless you provide the court with a copy of the written demand and a signed certified mail receipt showing delivery, or attempted delivery if refused.
- You can sue in the small claims court if the claim does not exceed $5,000. This is subject, however, to a limitation that only two claims per calendar year may be filed which ask for more than $2,500 in damages (C.C.P. section 116.231).
- A lawsuit against the payee brought by someone to whom you have assigned your claim, (for example, a collection agency) is a limited civil case. If the agency is doing the collection for a flat fee or percentage fee, the agency may not charge you a greater flat fee or percentage fee for that portion of the amount collected that represents treble damages than you are charged for collecting the face amount of the check. This rule, however, does not apply to actions brought in small claims court.

In the case of a stop payment, the notice to the drawer must be in substantially the following form:

NOTICE

To: _____
(name of drawer)

_____ is the payee of a check
(name of payee)

you wrote for $_____.
(amount)

The check was not paid because you stopped payment, and the payee demands payment. You may have a good faith dispute as to whether you owe the full amount. If you do not have a good faith dispute with the payee and fail to pay the payee the full amount of the check in cash, a service charge in an amount not to exceed twenty-five dollars ($25) for the first check passed on insufficient funds and an amount not to exceed thirty-five dollars ($35) for each subsequent check passed on insufficient funds, and the cost to mail this notice, within 30 days after this notice was mailed, you could be sued and held responsible to pay at least all of the following:

(1) The amount of the check.

(2) Damages of at least one hundred dollars ($100) or, if higher, three times the amount of the check up to one thousand-five hundred dollars ($1,500).

If the court determines that you do have a good faith dispute with the payee, you will not have to pay the service charge, treble damages or mailing cost. If you stopped payment because you have a good faith dispute with the payee, you should try to work out your dispute with the payee. You can contact the payee at:

_____
(name of payee)

_____
(street address)

_____
(telephone number)

You may wish to contact a lawyer to discuss your legal rights and responsibilities.

_____
(name of sender)

In case of a demand because of lack of funds or credit in the account, or the non-existence of an account, the notice can be in the following form:

NOTICE

To :_____
(name of drawer)

_____ is the payee of a check you
(name of payee)

wrote for $_____.
(amount)

The check was not paid because of a lack of funds or credit in the account to pay the check (or if applicable, you do not have an account with the drawee). If you do not pay the full amount of the check, the service charge of $_____, ($25 if first bad check, $35 for subsequent bad check) and the cost of mailing this notice of $_____ to the payee within 30 days after this notice was mailed, you could be sued and held responsible to pay at least all of the following:

1. The amount of the check, minus any partial payments made toward the amount of the check or the service charge within 30 days of this written demand, and

2. Damages equal to treble (three times) the above amount, which shall not be less than $100 nor more than $1,500.

_____
(name of payee)

_____
(street address)

_____
(telephone number)

You may wish to contact a lawyer to discuss your legal rights and responsibilities.

_____
(name of sender)

CAUTION

POSSIBLE LIMITATION ON DAMAGES FOR DISHONORED CHECK UNDER CONDITIONAL SALE CONTRACT: Although Civil Code section 1719 permits recovery of damages of up to $1,500.00 for a dishonored check, Civil Code section 2982(p) [contained in the Automobile Sales Finance Act] limits the dealer's recovery to $15.00 for a check dishonored in connection with a payment made under a conditional sale contract – if the contract so provides or if it contains a generalized statement that the buyer may be liable for collection costs. This $15.00 limitation on dishonored checks under section 2982(p) is in conflict with section 1719, and raises a question as to which statute applies. Under general rules of statutory interpretation, if two statutes are in conflict, the statute having specific application to a situation controls over a statute having only general application. A different approach is used by some courts, who resolve conflicts of this type by applying the later enacted statute. Both of these approaches favor section 2982(p) because it applies specifically to transactions under a conditional sale contract and was enacted later then section 1719. Additionally, most conditional sale contract forms – including the Law 553 form – specifically state that damages for a dishonored check under a conditional sale contract are limited to $15.00. Accordingly, the $15.00 damage limitation contained in section 2982(p) would apply to checks dishonored under a conditional sale contract. A dishonored check received in connection with any other type of transaction – including a lease – should still be governed by section 1719.

Environmental Fee

Businesses that employ 50 employees who work more than 500 hours each in California in a calendar year must register with the Board of Equalization and file environmental fee returns. This annual fee is due to the Board on or before the last day of February and covers the previous calendar year. The fee is based on the number of employees who each worked more than 500 hours in California during the year. Businesses with fewer than 50 qualifying employees are not required to register and pay the fee.

The fee is used for programs that oversee the treatment, storage, and disposal of hazardous waste in California and is administered by the Board of Equalization on behalf of the Department of Toxic Substances Control.

For more information and to register a corporation call the Environmental Fee Division at (916) 323-9555 or write to:

Environmental Fee Division MIC:57
State Board of Equalization
P.O. Box 942879
Sacramento, California 94279-0057
[See Health and Safety Code section 25205.6]

Factory Payment of Warranty and Incentive Claims

California law furnishes certain protections to dealers in the area of manufacturer warranty/incentive audits and chargebacks:

Vehicle Code section 3065(d) provides: "All claims made by franchisees pursuant to this section shall be either approved or disapproved within 30 days after their receipt by the franchisor. Any claim not specifically disapproved in writing within 30 days from receipt by the franchisor shall be deemed approved on the 30th day. When any claim is disapproved, the franchisee who submits it shall be notified in writing of its disapproval within the required period, and each notice shall state the specific grounds upon which the disapproval is based. All claims made by franchisees under this section and section 3064 for labor and parts shall be paid within 30 days following approval. Failure to approve or pay within the above specified time limits, in individual instances for reasons beyond the reasonable control of the franchisor, shall not constitute a violation of this article.

"(e) Audits of franchisee warranty records may be conducted by the franchisor on a reasonable basis, and for a period of 12 months after a claim is paid or credit issued. Franchisee claims for warranty compensation shall not be disapproved except for good cause, such as performance of nonwarranty repairs, lack of material documentation, or fraud. Any chargeback to a franchisee for warranty parts or service compensation shall be made within 90 days of the completion of the audit. If a false claim was submitted by a franchisee with intent to defraud the franchisor, a longer period for audit and any resulting chargeback may be permitted if the franchisor obtains an order from the board."

Vehicle Code section 3065.1 reads as follows: "(a) All claims made by a franchisee for payment under the terms of a franchisor incentive program shall be either approved or disapproved within 30 days after receipt by the franchisor. When any claim is disapproved, the franchisee who submits it shall be notified in writing of its disapproval within the required period, and each notice shall state the specific grounds upon which the disapproval is based. Any claim not specifically disapproved in writing within 30 days from receipt shall be deemed approved on the 30th day. Following the disapproval of a claim, a franchisee shall have one year from receipt of the notice of disapproval in which to appeal the disapproval to the franchisor and file a protest with the board. All claims made by franchisees under this section shall be paid within 30 days following approval. Failure to approve or pay within the above specified time limits, in individual instances for reasons beyond the reasonable control for the franchisor, do not constitute a violation of this article.

"(b) Audits of franchisee incentive records may be conducted by the franchisor on a reasonable basis, and for a period of 18 months after a claim is paid or credit issued. Franchisee claims for incentive program compensation shall not be disapproved except for good cause, such as ineligibility under the terms of the incentive program, lack of material documentation, or fraud. Any chargeback to a franchisee for incentive program compensation shall be made within 90 days of the completion of the audit. If a false claim was submitted by a franchisee with the intent to defraud the franchisor, a longer period for audit and any resulting chargeback may be permitted if the franchisor obtains an order from the board."

Fair Debt Collection Practices Act Is Applicable to Dealers

Dealers who have their employees engage in consumer oriented debt collection activities on a regular basis in the ordinary course of business should be aware of the California Fair Debt Collection Practices Act (Civil Code sections 1788-1788.33). This group of statutes prohibits certain types of conduct in connection with the collection of a debt owed by a natural person relating to property or services acquired primarily for personal, family or household purposes (identified as "consumer debt"). By statute the following conduct of a threatening nature is prohibited:

1. The threat or use of physical force or violence;

2. The threat that the failure to pay such a debt will result in an accusation (which is false) that the person owing the debt (identified as the "debtor") has committed a crime;

3. The threat of or a communication to any person of any facts (except the fact that the debtor has failed to pay a consumer debt) which would defame the debtor;

4. The threat to sell or assign to another person the obligation involved, combined with a false representation that such an assignment will cause the

debtor to lose any defense to the consumer debt; and

5. The threat that non-payment of a consumer debt will result in the arrest of the debtor or the seizure, garnishment, attachment or sale of any property or the attachment of wages of the debtor unless that action is in fact contemplated by the debt collector and permitted by law.

With respect to communications (including telephone communications) with debtors, persons involved in collecting a consumer debt are prohibited from:

1. Using obscene or profane language;

2. Placing telephone calls without disclosing the caller's identity;

3. Causing expenses to any person for long distance telephone calls, telegram fees or other charges by misrepresenting the purpose of such telephone call, telegram or similar communication;

4. Causing a telephone to ring repeatedly or continuously to annoy the person called; and

5. Communicating, by telephone or in person, with the debtor with such frequency as to be unreasonable and to constitute harassment.

In the context of collection of a consumer debt, the California Fair Debt Collection Practices Act also prohibits certain types of communications to employers and family members of the debtor. Specifically prohibited are communications as follows:

1. Communications with the debtor's employer unless the communication is necessary to collect the debt or unless the debtor or his or her attorney has consented in writing to such a communication. A communication of that type is deemed necessary to collect the debt only if it is made for the purposes of verifying the debtor's employment, locating the debtor or effecting garnishment, after judgment, of the debtor's wages;

2. Communicating information regarding a consumer debt to any member of the debtor's family, other than the debtor's spouse or the parents of a debtor who is a minor or who resides at the same household, prior to obtaining a judgment against the debtor, except where the purpose of the communication is to locate the debtor or where the debtor or his or her attorney has consented in writing to such a communication;

3. Communicating to any person any list of debtors which discloses the nature or existence of a consumer debt commonly known as a "deadbeat list" or advertising any consumer debt for sale, by naming the debtor; and

4. Communicating with the debtor by written communication in such a manner as to display information (such as the name address and telephone number of the debtor) in such a way as to embarrass the debtor. It is however recognized that the disclosure, publication or communication by a debt collector of information relating to a consumer debt or the debtor to a consumer reporting agency or a person reasonably believed to have a legitimate business need for the information is not in violation of this particular statute.

False representations by dealership employees involved in consumer debt collection activities should also be avoided, including any of the following:

1. Written communications which give the false impression that the communication is from an attorney or has been approved or authorized by an attorney;

2. Any false representation that a debt collector is vouched for or affiliated with a government agency;

3. Any false representation that a debtor's debt will be increased by the addition of attorney's fees and other investigations costs unless there is a legal basis for that to occur; and

4. Any false representation that a debtor's failure to pay a consumer debt has been reported to a consumer reporting agency or that legal proceedings will be commenced or that the debt involved will be assigned to another debt collector.

Communications with debtors involving consumer debts may also be prohibited when the debtor is represented by an attorney and there has been a written notification to the debt collector that all communications regarding the consumer debt are to be addressed to that attorney. This prohibition does not apply if the attorney fails to answer correspondence, return telephone calls, or discuss the obligation in question.

A waiver of any of the provisions of the Fair Debt Collection Practices Act is contrary to public policy, and is void and unenforceable. California Civil Code section 1788.33.

A violation of the California Fair Debt Collection Practices Act can subject a dealer to suit and liability for actual damages sustained by the debtor. Dealers who willfully violate these statutes can also be liable for a statutory penalty of $1,000. It is possible this penalty amount could be assessed per violation. This approach would be consistent with a recent federal case applying a similar penalty provision of the Federal Fair Debt Collection Practices Act (as a general rule this act does not apply to "in-house" collections). Dealers having specific questions concerning collections activities engaged in by their employees should consult legal counsel.

Federal Restrictions on Selling 15-Passenger Vans

Federal law imposes restrictions on the sale of certain motor vehicles which do not comply with relevant safety and equipment standards.

In particular, federal law prohibits the sale of "school buses" that do not meet applicable school bus safety standards and requirements, including, for example, protective seats, emergency exits, special mirrors, stop-arms and four-way/eight-way alternating flashing lights. 49 U.S.C. section 30112. A "school bus" is defined under federal law to include any passenger motor vehicle designed to carry a driver and more than 10 passengers, which is likely to be used significantly to transport preprimary, primary and secondary school students to or from school or an event related to school. 49 U.S.C. section 30125(a).

Many before and after school childcare facilities use 15-passenger vans to transport children between school and the care facility several times a week. A 15-passenger van that will be used in that way is regarded under federal law as a "school bus" and must therefore meet the school bus equipment and safety standards. Generally, 15-passenger vans do not meet these standards. Accordingly, a dealership's sale of a 15-passenger van (which does not meet these standards) to a school, school district, or any entity which the dealership is aware will use the vehicle significantly to transport school students to or from school or a school-related event, will violate federal law.

A dealership which violates these strictures is liable to the United States government for a civil penalty of up to $5,000 for each violation. A separate violation occurs for each motor vehicle or item of motor vehicle equipment. Indeed, the National Highway Traffic Safety Administration has been active in assessing civil penalties against dealerships nationwide for selling 15-passenger vans to schools or school districts in violation of federal law.

Fuel Economy Guides

Dealers are required to prominently display, at each location where new automobiles are offered for sale, the EPA/DOE Fuel Economy Guide booklets, and to make them available to the public at no charge. 40 C.F.R. section 600. 405-88. The booklets must include each model year vehicle offered for sale at the dealership. In lieu of booklets, the dealer can post a notice stating where the customer may access an electronic version of the booklet at the dealership, but the notice must include the link www.fueleconomy.gov, and the customer must be allowed to access and print the booklet at no cost. If a regional edition of the booklet is prepared for California automobiles, then dealers must display the California Regional edition of the booklet. These booklets must be available in sufficient quantities for retention by each prospective purchaser upon his request. The manufacturer's name and logo or the dealer's name and address, or both, may appear on the back cover of the booklet.

The dealer must display these booklets in the same manner and in each location used to display brochures describing the automobiles offered for sale by the dealer. The display should also include information that similar booklets containing the EPA Fuel Economy information are also available through mail by writing to Fuel Economy, Pueblo, Colorado 81009.

For copies of the booklets or information concerning these requirements, dealers can either contact the DOE's EERE Information Center by calling 1-877-337-3463 between the hours of 9:00am and 7:00pm Eastern Time, or by accessing www.fueleconomy.gov/feg/contacts.shtml.

Lienholders Have 15 Days After Payoff To Deliver Title

California law requires lienholders to deliver title within 15 days after the lien has been paid off. The law also requires that lessors must, within 15 days after payment, deliver title to lessees who purchased the vehicle under an option to purchase.

If the lienholder or lessor fails to comply with the 15 day time requirements, it must pay the transferee of the vehicle $25 a day for each day that the time requirements remain unsatisfied, up to a maximum of $2,500. If the lienholder or lessor fails to pay the penalty amount within 60 days following a written demand by the transferee, the amount is tripled, not to exceed $7,500.

Below is a notice which dealers can include with the payoff check, reminding the lienholder about these time periods. The notice includes a copy of

Vehicle Code section 5753 where these rules are found.

NOTICE TO FINANCE COMPANY

California law requires that you release your security interest in the vehicle which this check pays off within 15 days of your receipt of this payment and mail, transmit, or deliver the vehicle's certificate of ownership to the transferee as designated in the enclosed documents. If you fail to do so within the 15 days, you will be subject to a payment to the transferee of $25 a day for every day beyond the 15 days to a maximum of $2,500. The following is a copy of California Vehicle Code section 5753:

(a) *It is unlawful for any person to fail or neglect properly to endorse, date, and deliver the certificate of ownership and, when having possession, to deliver the registration card to a transferee who is lawfully entitled to a transfer of registration.*

(b) *Except when the certificate of ownership is demanded in writing by a purchaser, a vehicle dealer licensed under this code shall satisfy the delivery requirement of this section by submitting appropriate documents and fees to the department for transfer of registration in accordance with Sections 5906 and 4456 of this code and rules and regulations promulgated thereunder.*

(c)

(1) Within 15 business days after receiving payment in full for the satisfaction of a security interest and a written instrument signed by the grantor of the security interest designating the transferee and authorizing release of the legal owner's interest, the legal owner shall release its security interest and mail, transmit, or deliver the vehicle's certificate of ownership to the transferee who, due to satisfaction of the security interest, is lawfully entitled to the transfer of legal ownership.

(2) If a lease provides a lessee with the option to purchase the leased vehicle, within 15 business days after receiving payment in full for the purchase, and all documents necessary to effect the transfer, the lessor shall mail, transmit, or deliver the vehicle's certificate of ownership to the transferee, who, due to purchase of the vehicle, is lawfully entitled to the transfer of legal ownership

(d) *The certificate of ownership delivered pursuant to subdivision (c) shall be signed by the legal owner or lessor to reflect release of the legal owner's interest or transfer of the lessor's interest in the vehicle or accompanied by a form provided by the department to accomplish the same result and signed by the legal owner or lessor. If the legal owner or lessor is not in possession or control of the certificate of ownership, the legal owner or lessor shall, within the time provided in subdivision (c) for the mailing, transmittal, or delivery of the certificate of ownership, take any action required by the department to release the legal owner's security interest or transfer the lessor's interest in the vehicle and within that time shall mail, transmit, or deliver written notice of its taking that action to the transferee.*

(e) A legal owner or lessor that fails to satisfy the requirements of subdivisions (c) and (d), shall, without offset or reduction, pay the transferee twenty-five dollars ($25) per day for each day that the requirements of subdivisions (c) and (d) remain unsatisfied, not to exceed a maximum payment of two thousand five hundred dollars ($2,500). If the legal owner or lessor fails to pay this amount within 60 days following written demand by the transferee, the amount shall be trebled, not to exceed a maximum payment of seven thousand five hundred dollars ($7,500), and the transferee shall be entitled to costs and reasonable attorneys fees incurred in any court action brought to collect the payment. The right to recover these payments is cumulative with and is not in substitution or derogation of any remedy otherwise available at law or equity.

Money Judgment versus Right to Possession

When the owner of a motor vehicle retail contract (creditor) files suit against his or her customer who is in default, the creditor has the right to pursue a judgment for possession of the car (or its fair market value) or, in the alternative, may obtain a judgment for the balance owing under the contract. Although the judgment for the balance of the contract is usually a larger amount than the alternative judgment for fair market value of the vehicle, in the past there was a substantial risk when the creditor chose to obtain a money judgment.

In that regard, a number of courts have taken the position that if a creditor obtains a money judgment, the creditor has waived its security interest (and title) to the vehicle, and its rights to possession, and may have become an unsecured creditor. This interpretation stems in part from old Commercial Code cases and the Unruh Act which deals with installment contracts for non-motor vehicle consumer goods such as refrigerators. See Civil Code sections 1801, et seq. The net effect of this position could be very troublesome for the creditor, especially if the customer were to subsequently file bankruptcy and have the money judgment discharged (while retaining free and clear title to the vehicle).

There have been a few cases which have dealt with this "election of remedies" issue. Based upon a review of these cases, it now appears that although this area of the law is still somewhat unsettled, the more acceptable view by the courts is that regardless of whether the judgment is for possession of the vehicle (or its fair market value), or, in the alternative, for money on the contract, the creditor does not waive its security interest in the vehicle.

The United States Bankruptcy Appellate Panel in California ruled on an election of remedies issued in a motor vehicle case. In Merchants Recovery v. Egbe, 107 B.R. 711 (1989), the creditor obtained a money judgment against its customer, then the customer filed a Chapter 13 bankruptcy proceeding and argued that because the creditor had obtained a money judgment, the creditor had waived its security interest in the vehicle. The customer further argued that in light of this "election of remedies", the creditor was merely an unsecured creditor, having lost its security interest in the car. However, the court held that the creditor had not in fact "waived its collateral" and was still entitled to its security interest in the subject vehicle.

Although there are no recent California cases which have ruled on the "election of remedies" issue in a motor vehicle case, a persuasive argument can be made that this doctrine does not apply to vehicles which are subject to the California Automobile Sales Finance Act. Actual execution on a judgment, however, would probably result in an "election of remedies". Dealers should consult their own counsel for specific advice if this issue arises.

Notice Required When You Repossess a Vehicle

Under Vehicle Code section 28, whenever a vehicle is repossessed under the terms of a Security Agreement or Lease Agreement, the person taking possession shall notify, within one hour after taking possession of the vehicle, and by the most expeditious means available, the city police department where the repossession occurred, if it occurred within an incorporated city, or the sheriff's department of the county where the repossession occurred, if it occurred outside an incorporated city, or the police department of a campus of the University of California or the California State University if the repossession occurred there. The notice to the police department, sheriff's department or campus police should be by the telephone, telegram, or in person, and within twenty four hours a written notice must also be forwarded to the police, sheriff's or campus police department.

If the repossession involves two or more vehicles, each vehicle must be reported as a separate event.

Any person failing to notify the city police department, sheriff's department, or campus police as required by this Vehicle Code section is guilty of an infraction, and shall be fined a minimum of three-hundred dollars ($300), and up to five-hundred dollars ($500). A district attorney, city attorney, or city prosecutor must promptly notify the Bureau of Security and Investigative Services of any conviction resulting from a violation of this law.

One of the purposes of this statute is to alert law enforcement authorities that the vehicle has not been stolen. It is also suggested that you keep a record of your oral and written notifications in the event questions arise as to whether or not proper notification was given. Government Code Sections 26751 and 41612 provide that after possession is taken of any vehicle by or on behalf of any legal owner under the terms of a security agreement or a lease agreement, the debtor shall pay the sheriff or chief of police or a parking authority operated by a city and county a fee of $15 for the receipt and filing of the report of repossession pursuant to section 28 of the Vehicle Code before the vehicle may be redeemed by the debtor. Except as provided by statute, any person in possession of the vehicle shall not release it to the debtor without first obtaining proof of payment of the fee to the sheriff or chief of police or parking authority operated by a city and county. At the request of the debtor, a person in possession of the vehicle, or the legal owner, may also release the vehicle to the debtor provided the debtor pays the $15 fee, plus the administrative fee not to exceed $5, to the person in possession or the legal owner who shall then transmit the $15 fee to the sheriff or chief of police or parking authority operated by a city and county within 3 business days. Failure to transmit the fee within 3 business days shall subject the responsible party to a fine of $50. The statute further provides that proof of payment, or a copy thereof, shall be retained by the party releasing possession to the debtor for the period required by law, and an additional copy must be given to the debtor upon the debtor's request.

Office of Foreign Assets Control ("OFAC") Compliance

Dealers should be aware that they are prohibited by federal law from engaging in business of any

kind with persons or entities designated as terrorists or their associates. Because of this prohibition, dealers must check a potential customer's name against a list of "specially designated nations" and several other OFAC-maintained lists (collectively, the "SDN list"). This list is available for downloading at www.treas.gov/ofac and contains thousands of business names, names and aliases. A dealer conducting business transactions with persons on the SDN list, even unknowingly, may be subject to asset freezes, potential forfeitures of the property involved in the transaction and administrative fines per transaction. Criminal penalties may also apply in the case of a knowing violation. A dealer should maintain an OFAC compliance policy which instructs dealership personnel involved in vehicle lease or sales transactions, both cash and credit, to always check a customer's name against the SDN list. Unlike credit reports, a check of the SDN list does not require a customer's permission or knowledge, and can be done at any time prior to the signing of the binding agreements or the exchange of money or property.

Dealership personnel may perform the SDN list check utilizing various approaches, including using "find" features of software products against the full list downloaded from the OFAC website or the integrated SDN searching offered by all three national credit bureaus for an extra fee with each credit print out certificates to be used to prove that the search was conducted.

The SDN list contains only names (without Social Security numbers) and addresses, and so a "false hit" may occur from time to time if a customer has the same name as someone on the list. To confirm that a false hit has occurred, dealership personnel should contact OFAC directly at 800-540-6322 or 202-622-2490. If a true match does exist and has been verified, dealership personnel should end the transaction and file a report with OFAC using the form for blocked transactions found at the website. Although the dealership personnel may advise the customer of the reason for the transaction being blocked, that information should be treated as an item of highly sensitive customer information under the dealership's privacy policy. Certainly dealership personnel should not engage in discriminatory conduct against a customer because his or her name is similar to one found on the SDN list.

Offsite Sales

Vehicle Code section 11713 makes it unlawful for a dealer to:

(r) Display a vehicle for sale at a location other than an established place of business authorized by the department for that dealer or display a new motor vehicle at the business premises of another dealer registered as an autobroker. This subdivision does not apply to the display of a vehicle pursuant to subdivision (b) of section 11709 or the demonstration of the qualities of a motor vehicle by way of a test drive.

For your reference, Vehicle Code section 11709(b) provides that:

...a dealer may display vehicles at a fair, exposition, or similar exhibit without securing a branch license, if no actual sales are made at those events and the display does not exceed 30 days.

Moreover, Title 13, California Code of Regulations, section 270.08(b) provides that:

The provisions of Vehicle Code section 11709(b), which permits a dealer to display vehicles at a fair, exposition, or similar exhibit without securing a branch license extends to public shopping areas, public shopping centers, autoramas and other similar locations or events open to the public and intended to merely bring the dealer's identity and product to the public attention, provided that:

(1) No sales are offered, attempted, solicited, negotiated or otherwise transacted from such locations or at such public event, including the acceptance of cash deposits, trade-in vehicles or any other considerations from persons for the purpose of inducing or binding a sale.

(2) Such locations are available to all dealers licensed in this state without discrimination as to type of manufacture, make or year of vehicle displayed.

(3) Every dealer participating at such locations or events shall post a sign on the vehicle or vehicles or in close proximity thereto, printed in letters of not less than three (3) inches in height, which shall show the dealer's name, location and address of his established place of business and the following statement: "No sales permitted, or deposits accepted at this location."

Vehicle Code section 11728 provides for penalties which may be assessed against the dealer for violating the prohibition against displaying a vehicle for sale at a location other than an established place of business authorized by the DMV. The code provides for up to a $2500 fine per violation and imposition of a license suspension of not more than 30 days per violation as part of a compromise settlement agreement. Moreover, if no compromise settlement agreement is entered into, the DMV, through an administrative proceeding, may bring an accusation for permanent license revocation.

Because of this prohibition and accompanying stiff monetary and licensing penalties, dealers should thoroughly review their policies and practices relative to the display of vehicles at any offsite location or the sale of a vehicle at a location not authorized by the DMV for that dealer. Vehicles that are displayed at auto shows, shopping centers, or other such expositions must comply with the provisions of C.C.R. 270.08 (no sales solicitations must take place and the three inch lettered sign "No sales permitted, or deposits accepted at this location" must be either on the vehicles or in close proximity thereto). Vehicles should not be offered for sale or sold at any location for which the dealer who owns the vehicle does not have a branch license issued by the DMV.

Finally, dealers are reminded that Vehicle Code section 11713(q) specifically makes it unlawful for a dealer to consign for sale to another dealer a new vehicle. Any new car dealer who allows another dealer (either another new car dealer or a used car dealer) to take possession of a new car which has not been sold and reported to the DMV as transferred, runs the risk of facing license revocation or suspension for violation of either the consignment prohibition or the display for sale at an unauthorized location prohibition, or both.

See also discussion in Autobroker chapter in this Guide entitled "Offsite Sales and Deliveries".

Originating and Duplicating Motor Vehicle Ignition Keys

Dealers Exempt From Licensing Requirements

A locksmith license is generally required for any person engaged in the business of originating keys for locks. However, automobile dealers are specifically exempt from this licensing requirement and may therefore originate ignition keys without having a locksmith license. Duplication of existing ignition keys is also exempt from this licensing law. California Business and Professions Code section 6980, 6980.10, and 6980.12.

Record-Keeping Requirements

The California Penal Code contains record-keeping requirements for persons who originate (not duplicate) keys for the ignition of motor vehicles. Penal Code section 466.6 provides as follows:

(a) Any person who makes a key capable of operating the ignition of a motor vehicle or personal property registered under the Vehicle Code for another by any method other than by the duplication of an existing key, whether or not for compensation, shall obtain the name, address, telephone number, if any, date of birth, and driver's license number or identification number of the person requesting or purchasing the key; and the registration or identification number, license number, year, make, model, color, and vehicle identification number of the vehicle or personal property registered under the Vehicle Code for which the key is to be made. Such information, together with the date the key was made and the signature of the person for whom the key was made, shall be set forth on a work order. A copy of each such work order shall be retained for two years, shall include the name and permit number of the locksmith performing the service, and shall be open to inspection by any peace officer or by the Bureau of Collection and Investigative Services during business hours or submitted to the bureau upon request. Any person who violates any provision of this subdivision is guilty of a misdemeanor.

(b) The provisions of this section shall include, but are not limited to, the making of a key from key codes or impressions.

(c) Nothing contained in this section shall be construed to prohibit the duplication of any key for a motor vehicle from another such key.

The Bureau of Collection and Investigative Services – the state agency which audits persons for compliance with this law – does not audit automobile dealers for compliance with this law. Indeed, one official of that agency has stated that the agency believes that this law does not even apply to automobile dealers. This position is buttressed by the fact that the work order to be prepared and maintained requires the locksmith license number of the person originating the ignition key – and automobile dealers are specifically exempt from the locksmith licensing law.

Despite the position of the Bureau, the letter of this law would nevertheless appear to apply to automobile dealers, and, until a specific exemption for dealers is approved by the legislature, dealers should follow the record-keeping requirements of this law when originating motor vehicle ignition keys.

"Pay Or I'll File Charges" is Illegal

When a dealer has been defrauded by a criminal act, there may be a temptation to say to the criminal, "Pay, or I'll file charges." However, under California law this could constitute the crime of attempted extortion, and if payment is made under such a threat, the crime of extortion has probably been committed. These types of threats, or similar implied threats, are prohibited by California Penal Code section 518.

Some courts in other parts of the country have criticized this rule. The West Virginia Supreme Court considered a statute similar to the one in California, and commented that making such a threat a crime "utterly defies both human nature and common sense." This court thus stated that it was "quite reasonable to approach the man who embezzled the money that we have set aside for our children's education and offer not to prosecute him if he will return the money to us." However, the law in California remains as stated above, and you cannot rely on legal developments in other states as an indicator of what a California court might do.

There is no problem, however, in actually filing criminal charges in a good faith belief you are a crime victim.

Payment by Check and Credit Card, and Copying Drivers' Licenses

Apparently some DMV investigators have advised dealers that it is unlawful to copy drivers' licenses. This is not correct. There are a number of legitimate business reasons for a dealer to request a customer to allow his or her driver's license to be photocopied and a copy retained in the dealer's business records. Some Wholesale Finance Plans give dealers protection against theft of floorplanned vehicles while out on a test drive and require that in order to obtain this coverage the dealer, among other things, make a photocopy of the prospective buyer's driver's license and a photocopy of a nationally recognized credit card. This practice does not violate any provisions of California or federal law.

There is no prohibition against a prospective customer allowing his or her driver's license to be copied. Vehicle Code section 14610(a)(7) prohibits copying of a valid license only if the copy could be mistaken for an original license. With normal black and white photocopying on 8 1/2" x 11" paper, the copy would not be mistaken for an original license. However, a high resolution color photocopying might be on the borderline of being able to be mistaken for a valid license. The DMV's Legal Department has confirmed that there is no violation in copying a driver's license for legitimate business reasons such as a test drive and as otherwise allowed by law. However, as discussed below, you may not copy a driver's license when a credit card is used for full or partial payment.

The law absolutely does prohibit the practice of recording credit card numbers anywhere, for any purpose, when accepting a check from a customer. While the law never requires you to accept a check, it prohibits any policy which requires the presentation of a credit card (whether or not credit card numbers are recorded) as a condition to acceptance of a check. Because of this, if the customer uses a check in the purchase of a vehicle, any copy of a credit card taken in connection with a test drive should be destroyed.

The law, however, allows a credit card to be requested for purposes of identification, and as an indication of creditworthiness or financial responsibility. Thus "requesting" is permitted, but "requiring" is barred. But, if a request for a card is, or might ever be made, you must post a sign which reads **"CHECK WRITING ID: CREDIT CARD MAY BE REQUESTED BUT NOT REQUIRED FOR PURCHASES"** or by training and requiring your employees to tell customers that they do not have to display a credit card to write a check.

If the request is refused, do you immediately have to accept the check without any further inquiry? The law does not spell out exactly what you are allowed to do if the request is denied, except to prohibit your turning the customer away at that point. Because it is not prohibited by the law, you should be able to request a check guaranty card, driver's license, or other evidence of identity and financial responsibility when a request for a credit card is refused. The rules do not apply when the merchant is "solely" giving cash back for the check, or using the card in lieu of a deposit for the protection of, or to guarantee the return of, property (as in a test drive, rental car, or other "deposit imprint" situation).

When you do accept a credit card for payment in full or in part, not only are you prohibited from requiring the customer to give you a telephone number or address, but you are even prohibited from **requesting this information**, or utilizing a form which contains preprinted spaces designed for the filling in of such information. Although you are

permitted to request reasonable forms of identification, including a driver's license, you may not record any of the information contained on the license when a credit card is used for full or partial payment. This obviously prohibits photocopying of a driver's license whenever a credit card is used for payment. However, you may record the customer's driver's license number or identification card number on the credit card transaction form or otherwise, if the customer pays with a credit card number and does not make the credit card available upon request to verify the credit card number.

These rules regarding payment by check and credit card do not apply in cash advance transactions, or when a credit card is being used in lieu of a deposit to secure return or protection of goods (such as a test drive), or for purposes other than accepting the credit card, such as warranty registration, shipping, delivery, etc. The rules also do not apply if you are "contractually obligated" (presumably under your merchant's agreement) to provide the personal identification information in order to complete the credit card transaction, or if you are obligated to collect and record the personal identification information by federal law or regulation. California Civil Code sections 1725 and 1747.08.

"Payment In Full" Checks

What happens when a debtor tenders a check to you in full satisfaction of a debt with the words "Payment In Full" or other similar words noted on the back of the check? If you deposit the check, does this mean that you have settled your claim with the debtor? In California there are two conflicting Code sections which apply to this situation– California Civil Code section 1526, California Commercial Code section 3311.

Civil Code Section 1526

In accordance with California Civil Code section 1526, enacted in 1987, where a claim is disputed and any check or draft is tendered by the debtor to settle the claim, and the words "Payment In Full" or other similar words are noted on the check or draft, the acceptance of the check or draft does not constitute a release of your claims against the debtor if you protest by striking out or otherwise deleting that notation on the back of the check. This means that you should cross out the restrictive language on the back of the check and deposit it, after which you can then proceed with your further claim against the debtor. Even if you do not physically strike out or obliterate the words "Payment In Full" on the check but communicate to the debtor that you are not accepting the check as full payment, you may still be protected according to this law. A recent bankruptcy case held that where the creditor did not physically mark out or obliterate the "Payment In Full" language on the check, but instead sent a letter to the debtor stating that the check was not being accepted as full payment between the parties, the letter was deemed to be a deletion of the "Payment In Full" language under this California law (*In re Van Buren Plaza, LLC* (Bkrtcy. C.D. Cal. 1996) 200 B.R. 384).

Civil Code section 1526 additionally provides that a check tendered with the words "Payment In Full" or similar words will not necessarily constitute full payment of a claim if acceptance of the check by the creditor was inadvertent or without knowledge of the notation. In a 1995 federal case involving this California law, the federal court of appeal held that where a manufacturer received a dealer's partial payment in a lockbox and automatically cashed it, but thereafter promptly notified the dealer that it did not consent to the terms upon which the check was offered, the acceptance and cashing of the check did not constitute a full satisfaction of the claim. (*Red Alarm, Inc. v. Waycrosse* (9th Cir. 1995) 47 F.3d 999).

Please be aware, however, that Civil Code section 1526 specifically states that a creditor shall be conclusively presumed to have knowledge of the "Payment In Full" language on a check if it either (i) accepts the check pursuant to the terms of a previously executed written agreement, or (ii) has been given, not less than 15 days nor more than 90 days prior to the receipt of the check, a written notice from the debtor that a check will be tendered with a restrictive endorsement ("Payment In Full") and that the acceptance and cashing of the check will constitute full payment of the claim.

Commercial Code Section 3311

California Commercial Code section 3311 can lead to a different result. Commercial Code section 3311, enacted in 1992, generally provides that if a creditor accepts a partial payment containing or including a notation to the effect that the partial payment is being tendered in full satisfaction of the claim, the creditor will be deemed to have accepted the partial payment in full satisfaction of the claim, even if the creditor deletes or crosses out the notation.

Which Statute Controls?

These two statutes are in conflict and cannot be harmonized. Creditors are therefore left with a dilemma: which statute should they follow in this

situation? Two relatively recent cases have provided guidance, holding that Commercial Code section 3311 controls and should be followed.

In the federal court case of *Directors Guild v. Harmony Pictures, Inc.* (C.D. California 1998) 32 Fed.Supp.2d 1184, a federal trial court found that Commercial Code section 3311 was the controlling law because it was enacted more recently than Civil Code section 1526. The federal trial court therefore ruled that a creditor was deemed to have accepted a debtor's partial payment as full satisfaction of a debt, even though the creditor had crossed out the "paid in full" notation on the check. In the case of *Woolridge v. J.F.L. Electric, Inc.* (2002) 96 Cal.App.4th Supp. 52, 117 Cal.Rptr.2d 771, the Appellate Division of the San Bernardino County Superior Court reached the same conclusion, holding that Commercial Code section 3311 was the controlling law because it had been enacted more recently than Civil Code section 1526.

The federal trial court decision in *Directors Guild* is not binding on California trial courts. Likewise, the decision of the Appellate Division of the San Bernardino Superior Court in *Woolridge* is probably not binding on California trial courts outside of San Bernardino County. Until the conflict between Civil Code section 1526 and Commercial Code section 3311 is reconciled or clarified by the legislature in Sacramento, or by a definitive opinion of the California Court of Appeal or the California Supreme Court, dealers are well-advised not to accept partial payments containing "paid in full" notations without first seeking guidance from their legal counsel.

Protecting Customer Lists

A common assumption is that when a salesperson moves from one organization to another, the salesperson may keep and use a list of the salesperson's "own" customers so long as the list was compiled personally by the salesperson. The legal reality, however, is more complicated. Not only is the assumption incorrect where the customer information is considered a protected trade secret, but it may also be inconsistent with the Gramm-Leach-Bliley Act and other laws concerned with consumer privacy. Although, it has been legally recognized that a former salesperson may use general knowledge, skill, and experience acquired in his or her former employment in competition with a former employer, this does not permit appropriation or use of the former employer's trade secrets. Customer lists can be among the trade secrets afforded protection under the law.

California is one of many states that have adopted the Uniform Trade Secret Act ("UTSA"). Not all customer information generated during the course of a business enterprise is entitled to protection, and the UTSA limits the scope of statutory protection to information that is not generally known (i.e., is secret), derives value from its secrecy, and is kept secret by reasonable means (Civil Code section 3426.1(d)). The requirement that a customer list must have value based on its secrecy has been interpreted to mean that the limited access to the information provides a business with a substantial business advantage. In this respect, a customer list can be found to have such value because its disclosure would allow a competitor to direct its sales efforts to those customers who have already shown a willingness to purchase as opposed to a list of people who only might be interested.

If the dealer's customer list and other customer information satisfies the trade secret elements, then a departing employee may not take or use any part of the list or information. This is true even if the employee worked closely with the customers and even if the employee gathered the information personally. In fact, the customer information does not even have to be on a physical list to be protected. Courts have prohibited former employees from using customer lists and other information in the former employee's memory or in a collection of business cards (*Greenly v. Cooper*, 77 Cal. App. 3d 392; *Stampede Tool Warehouse, Inc. v. May*, 651 N.E.2d 209; *Marline, Inc., v. Lloyd Perry*, 56 Cal. App. 4th 1514).

In the *Morlife* case, the former employees being sued for using their former employer's trade secrets argued that they had a right to compete with their former employer and that their own compilation of business cards over six years of employment did not constitute misappropriated trade secrets. The court found that the employer's customer list satisfied the UTSA trades secret requirements, especially in light of the employer's efforts to maintain the secrecy of its customers' identity by advising its employees through an employment agreement and an employee handbook that customer information is considered valuable and confidential. The court enjoined the salesperson from doing business with any of the entities that switched their business and further granted a monetary award to the employer for unjust enrichment.

In order for courts to afford the kind of protection of valuable customer lists as did in *Morlife*, dealers should implement reasonable efforts to safeguard customer information. These safeguards should include notices in employee handbooks and computer

log-on screens, and agreements signed by employees concerning the confidentiality of customer lists, customer information, and other dealership information, and training. Many of these safeguards now overlap other steps put into place to comply with privacy laws.

Title V of the Gramm-Leach-Bliley Act (15 U.S.C. sections 6801 et seq.) ("GLBA") imposes limits on the use and disclosure of nonpublic personal information of the customers of every dealer. Under the GLBA regulations respecting consumer financial privacy (the "Privacy Rule"), dealers are prohibited from disclosing or using customer information except as specified in their notices of privacy policy or as otherwise permitted by law. These permitted uses do not include allowing departing employees to take customer information with them to their new employer. In addition, an employee may be directly prohibited by GLBA from using or disclosing customer information for any purpose other than as requested by the original employer (See 16 C.F.R. section 313.11(c)).

Moreover, under the "Safeguards Rule" regulations of the GLBA, every dealership must have formal safeguards in place to protect customer information from inadvertent or improper use or disclosure. A major part of every safeguards program is employee training and other administrative safeguards to ensure that employees having access to customer information undertake to keep that information confidential and secure. Even the most basic form of safeguards policies would prohibit an employee from keeping information concerning dealership customers on scraps of paper in a desk drawer or on his or her personal laptop. A former employee can expect little sympathy from a judge being asked to stop the employee from using customer information obtained by the employee in violation of a GLBA safeguards program.

Customer lists are valuable assets to all dealers. Each salesperson should be made aware of a dealer's proprietary rights to their customer list as well as trained on how to deal with maintaining the confidentiality of the customers.

Protections When Selling to Another Dealer

When a dealer ("first dealer") delivers possession of a vehicle to anyone in the business of selling or leasing vehicles ("second dealer") for sale or lease, the first dealer is always in jeopardy of losing any ownership or security interest in the vehicle. Rather than the clear cut victory the first dealer should expect against the second dealer who does not pay for the car, turmoil begins with the appearance of third parties such as the second dealer's flooring lender, other secured creditors of the second dealer, and possibly a bankruptcy trustee. Without satisfying the requirements discussed below, those third parties may take priority over the first dealer.

To prevent the vehicle from being subject to the security interest of these creditors, certain requirements apply, including giving such lenders actual written notice of the first dealer's UCC-1 filing before it is filed, and filing the UCC-1 before delivery of the vehicle. The names and addresses of the secured creditors can generally be obtained through a search request to the California Secretary of State. Of course, legal counsel should be consulted over the form and content of these notices and other requirements. If vehicles are expected to be delivered to the same dealer in the future, counsel may be able to prepare a blanket filing to cover multiple future transactions. In fact, some dealers require the obligations to be personally guaranteed by the principals of the second dealer, or secured by a letter of credit or other security. Dealers are cautioned that Vehicle Code section 11713(q) flatly prohibits the consignment of new vehicles to another dealer.

In the California Court of Appeals case of *Minor v. Stevenson* (1991) 227 Cal.App.3d 1613, 278 Cal.Rptr. 558, the court addressed the rights of yet another third party against the first dealer: an unsecured trade creditor of the second dealer. The court ruled that by levying a money judgment against a vehicle sold and delivered by the first dealer to the second dealer, but unpaid for, the trade creditor cut off the first dealer's rights in the vehicle. Delivering the vehicle under a written contract of consignment, or under a contract of sale, with title being held and registered in the first dealer's name would make no difference, said the court. While there are innumerable ways attorneys may be able to distinguish the facts of this case to help dealers facing situations like that of the first dealer, such as showing the creditor knew or should have known that the first dealer claimed title to the vehicle, this case was unusual in stating that the structure of the deal (such as sale versus consignment) and most mitigating circumstances (such as bounced checks), make no difference. The court's decision makes clear that only by filing an appropriate UCC-1 financing statement with the California Secretary of State can the first dealer ensure priority over such unsecured creditors of the second dealer.

Even if all of these filing and notice requirements are met, the second dealer's sale to a bona fide retail purchaser is generally regarded as cutting off the first dealer's interest in the vehicle, so cash on or before delivery is really the only way to prevent the

possibility of the first dealer becoming a mere unsecured creditor of the second dealer.

Punitive Damages Against a Corporation

There are few things which create more uncertainty or potential fear for a business than a lawsuit for punitive damages. The reason, of course, is that in California punitive damages cannot be covered by insurance. Additionally, juries sometimes get carried away in awarding large amounts of punitive damages.

The awarding of punitive damages is governed by California Civil Code section 3294(a), which states that in non-contract cases, a plaintiff can recover punitive damages against the defendant when he can show by "clear and convincing evidence" that the defendant "has been guilty of oppression, fraud, or malice."

Section 3294(b) contains a special qualification for employer liability for punitive damages. Subdivision (b) states, in relevant part, that an employer shall not be liable for punitive damages based on an employee's acts unless "the employer had advance knowledge of the unfitness of the employee and employed him or her with a conscious disregard of the rights or safety of others or authorized or ratified the wrongful conduct for which the damages are awarded or was personally guilty of oppression, fraud, or malice." The statute includes an additional qualification for corporate employers, who may not be liable for punitive damages unless the "advance knowledge and conscious disregard, authorization, ratification or act of oppression, fraud, or malice is on the part of an officer, director, or managing agent of the corporation."

Although the question of who an officer or director of a corporation is for purposes of punitive damages is relatively straightforward, the question of who a managing agent of the corporation is can be more difficult to determine. The California Supreme Court has clarified who can be considered a managing agent of a corporation for the purpose of punitive damages. In the case of *White vs. Ultramar* (1999) 21 Cal. 4th 563, 88 Cal. Rptr. 2d 19, the issue to be decided was whether a particular "zone manager" for the defendant was a managing agent who could subject the corporation to punitive damages because of her own actions. The court concluded that the legislature intended the term "managing agent" to include only those corporate employees who exercise substantial independent authority and judgment in their corporate decision making and whose decisions ultimately determine corporate policy. The scope of a corporate employee's discretion and authority under this test is a question of fact on a case-by-case basis. The mere fact that a manager or supervisor can hire and fire employees does not itself necessarily mean that that person is a managing agent. A managing agent must be someone who exercises substantial discretionary authority over a decision that ultimately will determine corporate policy.

The court concluded that: "the Legislature intended that principal liability for punitive damages not depend on employees' managerial level, but on the extent to which they exercise substantial discretionary authority over decisions that ultimately determine corporate policy. Thus, supervisors who have broad discretionary powers and exercise substantial discretionary authority in the corporation could be managing agents. Conversely, supervisors who have no discretionary authority over decisions that ultimately determine corporate policy would not be considered managing agents even though they may have the ability to hire or fire other employees. In order to demonstrate that an employee is a true managing agent under section 3294, subdivision (b), a plaintiff seeking punitive damages would have to show that the employee exercised substantial discretionary authority over significant aspects of a corporation's business."

Rear Seatbelt Disclosure

Dealers are required to make certain disclosures concerning the use of rear seat shoulder harnesses for 1972 to 1990 model year vehicles.

Vehicle Code section 27314.5 provides that no dealer shall sell or offer for sale any used passenger vehicle of a model year of 1972 to 1990 inclusive, unless there is affixed to the window of the left front door or, if there is no window, to another suitable location so that it may be seen and read by a person standing outside the vehicle at that location, a notice, printed in 14-point type, which reads as follows:

"WARNING: While use of all seat belts reduces the chance of ejection, failure to install and use shoulder harnesses with lap belts can result in serious or fatal injuries in some crashes. Lap-only belts increase the chance of head and neck injury by allowing the upper torso to move unrestrained in a crash and increase the chance of spinal column and abdominal injuries by concentrating excessive force on the lower torso. Because children carry a disproportionate amount of body weight above the waist, they are more likely to sustain those injuries. Shoul-

der harnesses may be available that can be retrofitted in this vehicle. For more information call the Department of Transportation Vehicle Safety Hotline at 1-800-424-9393."

The window notice must remain affixed to the vehicle at all times that the vehicle is for sale and the only exception to the window sticker requirement pertains to 1972 to 1990 model year vehicles that are "equipped with both a lap belt and a shoulder harness for the driver and one passenger in the front seat of the vehicle and for at least two passengers in the rear seat of the vehicle."

In addition to the window sticker requirement, if a nonprofit entity has furnished a dealer with a supply of belt buckle notices free of charge, the dealer must also affix to one rear seat lap belt buckle of every used passenger vehicle (unless the vehicle is either equipped with both lap belt and a shoulder harness for at least two passengers in the rear seat or having no rear seat lap belts) of a model year of 1972 to 1990, inclusive, that has a rear seat, a notice, printed in 10-point type, that reads as follows:

"WARNING: While use of all seat belts reduces the chance of ejection, failure to install and use shoulder harnesses with lap belts can result in serious or fatal injuries in some crashes. Shoulder harnesses may be available that can be retrofitted in this vehicle. For more information, call the Department of Transportation Vehicle Safety Hotline at 1-800-424-9393."

Registered Domestic Partnership Rights

Registered domestic partners are entitled to the same rights and privileges of marriage as a legally married couple. See California Family Code sections 297-299.6.

Who qualifies as domestic partners These are the criteria:

1) The domestic partners must live together.

2) Neither person can be married to another, even if in the midst of divorce proceedings.

3) They may not be related by blood.

4) They must be 18 years of age.

5) They must be either one of the following (pay attention to this!):

A. the same sex, or

B. if the opposite sex, one must be over 62 years of age (or qualify for Social Security benefits).

6) Both parties are able to give consent.

Note that under this new law same sex couples receive better treatment than couples of the opposite sex. Same sex couples qualify to be registered domestic partners at age 18; whereas opposite sex couples have to wait until one member is 62 years old or, in other words, qualifies for Social Security benefits.

Consider how broad this statute is and just some of the many implications it could have in your business. For instance, consider sick leave. The law now says that you must allow an employee to take up to one-half of the yearly paid sick leave allotment to care for a parent, child or spouse. That rule will now apply to registered domestic partners.

If the law provides a benefit to spouses you must provide that benefit now to registered domestic partners. Likewise, if you voluntarily provide a benefit to spouses, you must provide it to registered domestic partners. If you are having a company retreat, and spouses are going to be paid for, registered domestic partners had better be paid for as well.

Calculation of leave eligibility is extremely complicated now under these changes because the California Family Rights Act and the federal Family Medical Leave Act now differ in their coverage of spouses and now registered domestic partners (only in California) where they did not before. The FMLA would not provide leave eligibility for a registered domestic partner to care for the other person; whereas the California leave laws now would. If a registered domestic partner contemplates taking family or medical leave, you should call your attorney immediately.

Health Insurance

Do these new domestic partner rules apply to health coverage governed by ERISA? The real answer is that nobody knows for sure quite yet. This uncertainty is created by ERISA, the federal law which is supposed to preempt the field of employer-sponsored benefit plans. This rule of preemption is supposed to mean that any state law pertaining to health care benefits is irrelevant. The federal law is controlling, and the federal law does not recognize domestic partners. If the analysis ends there, it would appear that the federal law would prevent the extension of coverage for spouses to the registered domestic partners. However, there may be a loophole.

ERISA contains language that says, in effect, that although the Act is controlling, States will still be allowed to regulate insurance benefits. The question then becomes whether or not a state's extension of coverage to a domestic partner is a form of regulating insurance benefits, or is it simply a direct contradiction of the federal law? The problem is that the courts might not provide a definitive answer to

that question until years from now. Does your dealership want to be the test case? Imagine discovering you owe an employee's registered domestic partner eight years of medical treatment for cancer because you wrongly decided to not extend benefits to that individual where other employees' spouses would have been covered. It might be safer to err on the side of extending coverage.

An increasing number of cities and counties in California are also taking the position that they will not do business with employers that do not extend these benefits to registered domestic partners. This would mean those counties or cities will not buy from you or service vehicles with you. If doing business with those entities matters to your dealership, your hand may be forced on this. Most signs point to the reality that registered domestic partners will likely be entitled to health care coverage if spouses are entitled to such coverage under the employer's health plan.

Reporting Lost or Stolen Dealer Plates

What do you do if one or more of your dealer plates is lost or stolen? California Vehicle Code section 4458 requires that when "..license plates have been lost or stolen, the registered owner shall immediately notify a law enforcement agency, and shall immediately apply to the [DMV] for new plates…." The handbook for Dealers and Registration Services, section 15.025, advises dealers to use form OL-22 when ordering plates, registration cards or stickers and that a fee is required to replace a lost or stolen dealer plate. Moreover, the OL-22 contains a notice that lost or stolen dealer plates should be reported to the police department or sheriff's office.

The lesson here is to always make sure the security interest in the vehicle is perfected as soon as possible after a sale, and in no event later than 30 days after the sale, so that the security interest cannot be set aside by or lost to the bankruptcy trustee.

Repossession Law

California law, like the law of almost every other state in the country, provides that a party with a security interest in a motor vehicle may use self-help to take possession of it if there has been a default in the security agreement. But, the repossession must be accomplished "without breach of the peace." If it is impossible to repossess the property without a breach of peace, the creditor must resort to legal action through a legal proceeding known in California as a Claim and Delivery or Replevin action.

A Mississippi court ruling regarding a statute substantially similar to California's interpreted the meaning of "breach of the peace". In taking possession of a van, two repossessors drove a quarter of a mile up a driveway past the customer's house, and when they could not start the van with the key they had for it, they hooked it up to a tow truck and began towing it back down the driveway. At the end of the driveway, the repossessors noticed that the owner of the van was running toward them. However they ignored him and continued out into the state highway. The owner gave chase in a pickup, and the tow truck and the pickup were involved in a slight accident. After the owner collected his personal belongings from the van, the repossessors continued on their way with the vehicle.

The court reasoned that a situation that was "fraught with the likelihood of violence," or actual violence constitutes a breach of peace, invalidating the repossession. In this case, the auto accident was a breach of peace, with the repossessor's actions of ignoring the owner aggravating the situation. The customer was awarded $5,000 in damages, but punitive damages of $100,000 awarded by the jury were overturned by the Mississippi Supreme Court on the grounds that the action of the repossessors did not rise to the willful, wanton, or reckless level necessary for an award of punitive damages. *Ivy v. General Motors Acceptance Corporation* (Miss. 1992) 612 So.2d 1108.

Business & Professions Code section 7507.13 clears up the issue of who may be liable for wrongful repossession. This law states that so long as the repossessing party hires a properly licensed California repossession agent, the repossessing party cannot be held responsible for the acts or omissions of the repossession agent in carrying out the repossession assignment. However, to be free from liability, a dealer assigning the repossession to the repossession agency may not, by any means, direct or indirect, express or implied, instruct or attempt to coerce the repossession agency to violate any law, regulation or rule regarding the recovery of the vehicle, including laws which prohibit a breach of the peace (Bus. Prof. Code section 7500.3 (b)).

If dealers have questions about whether the repossession might be questionable, legal counsel should be consulted. If a wrongful repossession occurs, the damages assessed by a judge or a jury against the repossessing party can be quite large. Also see discussion below regarding Notice Required When You Repossess Vehicle.

CAUTION

PICKING UP AN EXPIRED LEASE VEHICLE MAY BE CONSIDERED A REPOSSESSION: The California Attorney General has issued a legal opinion providing that when a dealer, at the request of a lessor, picks up a vehicle from a lessee on an expired lease, the dealer is deemed to be "repossessing" the vehicle and therefore needs to hold a license as a repossession agency. In the case at issue, the lessor called the dealer and asked the dealer to retrieve a leased vehicle from the lessee's residence because the lease had expired. The lessee allowed the dealer to take the vehicle, and the dealer later sold it at action on behalf of the lessor. In his written opinion, the California Attorney General stated that "repossession" occurs when a party having the right to possess a vehicle (the lessor) recovers it from a party who has actual possession of the vehicle (the lessee). The dealer performing this repossession for a lessor therefore needs to be licensed as a repossession agent (Opinion of the California Attorney General, No. 07-204). Although opinion letters from the California Attorney General do not constitute California law or carry the force of law, they nevertheless can carry great weight in a court of law or before administrative agencies, including the DMV and BAR. Accordingly, dealers should exercise caution whenever picking up a vehicle they do not own. The recommended and safe practice is to always hire a licensed repossession agency to pick up any vehicle.

CAUTION

REQUIREMENT TO GIVE NOTICE OF VIOLENT ACT: Under California law, whenever a violent act has occurred or been threatened involving a licensed repossession agency in the course of a repossession or attempted repossession, that results in either a police report or bodily harm or injury, the repossession agency is required to send a notice of the violent act or threatened violent act to the person or company who gave the repossession assignment to the repossession agency, and (if the repossession assignor is not the legal owner) to the legal owner of the vehicle. The notice must be in a form provided by the Bureau of Security and Investigative Services and must be sent by the repossession agency within seven days after the violent act or threatened violent act. If a dealer receives such a notice and subsequently gives a repossession or skip trace assignment to a repossession agency on the same vehicle, the dealer is required to advise the repossession agency of the information contained in that notice at the time the subsequent repossession or skip trace assignment is given. Accordingly, a dealer should keep a copy of any such notice in the applicable deal jacket – or in some other accessible location – so that the notice will be readily available to dealership personnel if a subsequent repossession or skip trace assignment is given on the same vehicle. Busi. Prof. Code section 7507.6; Vehicle Code section 11724; Civil Code sections 2984.6 and 2993

Responding to a Summons and Complaint

A dealership which is served with a lawsuit (summons and complaint) should always act promptly to protect its rights:

A. Respond Within 30 Days.

A party served with a summons and complaint is required to file a response with the court within 30 days of service. It is therefore important that a dealership act quickly to notify its legal counsel and also provide its attorney with the precise date of service so that the attorney will know when the 30-day deadline runs. A dealership is well advised to establish an appropriate intake procedure to ensure that any summons and complaint delivered to the dealership is brought to the attention of management as soon as possible.

B. Avoid Entry of Default.

The failure of a dealership to file a response with the court within 30 days of service will expose the dealership to having its default entered by the plaintiff. The effect of a default is serious – it bars the dealership from appearing in the case or asserting any defenses. The entry of a default against the dealership can also jeopardize its insurance coverage (see below). Although a default can be set aside by agreement with the plaintiff or through a motion filed with the court, a dealership should not rely on this. Many plaintiffs refuse to agree to set aside a default, and courts have the discretion to deny such motions.

C. Tender to Insurance Carrier.

In addition to alerting legal counsel, the dealership should promptly tender a lawsuit to this liability insurance carrier regardless of the nature of the lawsuit. Indeed, most liability policies require the dealership to promptly notify the insurance carrier of any lawsuit. Depending upon the nature of the lawsuit, the liability policy may provide coverage for damages or attorney's fees, or both. By law, however, insurance coverage for punitive damages is not permitted.

Sales and Rentals to Unlicensed, Risky, and Uninsured Drivers

Should a dealer have any concern about whether a vehicle buyer holds a valid driver's license? Does a dealer have a duty to inquire as to whether a customer has a license? What about delivery of a vehicle to an incompetent driver?

Courts around the country have struggled with these issues, and other related issues, for many years. A California court decision that discusses some of these issues is the case of *Dodge Center v. Superior Court* (Anderson) (1988) 199 Cal.App.3d 332 and 244 Cal.Rptr. 789. The court decided that the theory of "negligent entrustment" applied in California under both a vehicle code section and under common law (judge-made law). Vehicle Code section 14606 provides that a person shall not employ or hire any person to drive a motor vehicle or knowingly permit or authorize the driving of a motor vehicle owned by him or her or under his or her control, upon the highways by any person unless that person is then licensed for the appropriate class of vehicle to be driven. Vehicle Code section 14604(a) provides that no owner of a motor vehicle may knowingly allow another person to drive the vehicle upon a highway unless the owner determines that the person possesses a valid driver's license that authorizes the person to operate the vehicle. For purposes of this Vehicle Code section, an owner is required only to make a reasonable effort or inquiry to determine whether the prospective driver possesses a valid driver's license before allowing him or her to operate the owner's vehicle. An owner is not required to inquire with the Department of Motor Vehicles whether the prospective driver possesses a valid driver's license. These statutes have great significance in the test-drive or loaner situation, but do not apply to a dealer once the vehicle has been sold. The common law theory of negligent entrustment, however, remains available to anyone injured by the driver regardless of the fact that the dealer no longer owns the vehicle.

What are the dealer's duties to be free from liability for negligent entrustment to an unlicensed driver? The court in the *Dodge Center* case ruled that a dealer cannot be held liable for negligent entrustment for failure to inquire as to whether or not the buyer is licensed. The court noted that no statute makes it unlawful for a motor vehicle retailer to sell to an unlicensed driver, and no statute imposes on a retailer a duty to inquire as to the purchaser's license status. In contrast Vehicle Code section 14608 imposes a duty on one who rents a motor vehicle, requiring inspection of the driver's license. The court stated: "It follows that a retail seller of motor vehicles may normally assume that a purchaser is either legally entitled to drive the vehicle, or alternatively, if not himself qualified to drive, will not do so, but rather will arrange for a legally qualified driver's service."

With regard to rental vehicles Vehicle Code section 14608(a) provides: "A person shall not rent a motor vehicle to another person unless both of the following requirements have been met:

1. The person to whom the vehicle is rented is licensed in California or is a nonresident who is licensed under the laws of the state or country of his or her residence.
2. The person renting to another person has inspected the driver's license of the person to whom the vehicle is to be rented and compared either the signature thereon with that of the person to whom the vehicle is to be rented or the photograph thereon with the person to whom the vehicle is to be rented.

Section 14608(b) states that this does not prohibit a blind or disabled person who is a non-driver from renting a motor vehicle, if both of the following conditions exist at the time of rental:

(1) The blind or disabled person either holds an identification card issued under California law or is not a resident of California.

(2) The blind or disabled person has a driver present who is either licensed to drive a vehicle in California or is a nonresident licensed to drive a vehicle pursuant to the laws of the state or country of the driver's residence.

Vehicle Code section 14609 contains further provisions regarding records that must be kept with regard to the rental of vehicles. A record of the registration number of the vehicle, the name and address of the person to whom the vehicle is rented, his or her driver's license, and the jurisdiction that issued the driver's license and expiration date, must be kept. If the person renting is a nondriver, the same information must be kept for the nondriver substituting the identification card for the driver's license. You must also keep the name and address of the licensed driver, his or her driver's license number, and the expiration date of his or her driver's license.

There is no prohibition against copying a driver's license for your recordkeeping purposes, provided it is not copied in such a manner that it could be mistaken for a valid license. Vehicle Code section 14610(a)(7)

Subsequent court decisions have applied the theory of the *Dodge Center* case to situations involving

potential hazardous driving by a buyer resulting from incapacities other than lack of a driver's license, such as driver inexperience with a certain type of vehicle. These courts support the view that without actual knowledge of the incapacitating condition, or of circumstances which should indicate that the driver is incompetent, a seller cannot be liable for negligent entrustment. A buyer's obvious intoxication at the time of delivery would be an example of the type of knowledge required for liability. But a sale to a chronic drunk driver would not subject the dealership to liability if unknown; moreover, there would be no duty to inquire as to whether the buyer had any such driving history.

Although some comfort can be taken from the *Dodge Center* case, the case assumes throughout that the dealership personnel had never asked for the driver's license in the first place. The question therefore remains open as to what the dealer must do when the driver's license is requested, but not produced. One way to be extra careful in that situation would be for the customer to be asked to sign a statement that the customer will have a licensed driver arrange for transportation of the vehicle from the dealership, and that the customer will not use the vehicle on the public highways until the customer obtains a valid driver's license.

What about vehicle leases? Vehicle Code section 14606, discussed above, provides in part: "No person shall ... knowingly permit or authorize the driving of a motor vehicle, owned by him or under his control, upon the highways by any person unless the person is then licensed for the appropriate class of vehicle to be driven." The lessor of a vehicle is the owner of the vehicle and consequently no vehicle should be leased to an unlicensed driver.

It appears, based upon a recent court decision, that, unless the customer has an obvious impairment or incapacity which may render him an unsafe driver, a lessor or rent a car company need only make sure that its customer has a valid driver's license in order to protect itself from liability. In the case of *Lindstrom vs. Hertz Corporation* (2000) 81 Cal. 4th 644, 96 Cal.Rptr.2d 74, a foreign citizen with a valid driver's license from his own country rented a car from the rental agency in California. Shortly thereafter, the foreign citizen, not being familiar with the roads in the area, caused an accident, injuring the plaintiff. The plaintiff brought suit against the rental agency for negligent entrustment, asserting that the rental agency had a legal duty to provide a copy of California's rules of the road before allowing the foreign citizen to rent the vehicle. The court of appeal disagreed. The court held that the rental agency's only duty was to make sure that the foreign citizen possessed a valid driver's license from the country where he resided, and had no duty to provide the foreign driver with a copy of the rules of the road. The court stated that absent any evidence that the foreign driver was mentally or physically impaired, it was legally sufficient for the rental agency to ask only for his driver's license.

A question which has frequently arisen is whether it would be a problem for a dealer to sell a motor vehicle to a customer known to have no liability insurance. The concern stems from California's Financial Responsibility Law, which requires each driver to carry liability insurance coverage in specified amounts to protect others against personal injury and property damage caused by the driver.

Relevant court decisions have held that the doctrine of negligent entrustment does not apply where the vehicle is entrusted to an uninsured motorist who otherwise appears to be a competent driver. The reasoning of the decisions is that even though the Financial Responsibility Law requires all drivers to carry liability insurance, the lack of such insurance does not make a person an incompetent driver. Accordingly, the sale of a motor vehicle to a buyer known not to have liability insurance should not expose a dealer to legal liability.

The lack of collision insurance on the part of the buyer raises a different concern. Many retail lenders require that vehicles described in contracts assigned to them be covered by physical damage insurance. Your flooring agreement may also require coverage for physical damage insurance before the vehicle is delivered to the customer. The dealer should therefore review its dealer wholesale and retail agreements before delivering a vehicle to a buyer who does not have physical damage insurance coverage.

Subpoena of Employment Records

California Code of Civil Procedure section 1985.6 applies whenever employment records are sought by way of a subpoena. The law defines "employment records" as the original or any copy of books, documents, other writings or electronically stored information pertaining to the employment of any employee maintained by the current or former employer of the employee. When someone subpoenas your employee's employment records, you must be given at least 15 days' notice. Ten days prior to the date for production of the records, the party who has subpoenaed the records must serve on the employee whose records are being sought a copy of the subpoena and documents filed in support of the subpoena. The service must be made on the employee personally, or if the employee is a party to

the action, service can be made on the employee's attorney. Service on the employee has to be made not less than 10 days prior to the date for production of the records and also at least five days prior to service on the employer.

Once the employee has been notified that the employee's employment records are being sought, the employee can bring a motion to the court to cancel the subpoena. If the employee files such a motion, the employer is relieved of his duty to produce the employment records until the court rules on the motion. As part of this law, the subpoenaing party can also furnish the employer with a written authorization to release the records signed by the employee or by his or her attorney of record.

Employment records are often sought in family law cases and personal injury cases. There has always been some concern on the part of employers about producing records and then being subject to a claim of violating the employee or former employee's privacy rights. This statute gives a detailed statutory scheme that must be followed whenever employment records are sought. Because the time period and procedures that must be followed are somewhat intricate, an employer would be well advised to consult with his or her attorney before producing employee records to make sure that the statute has been complied with.

Teenage Driving by Employees of the Dealership

Under the Drive for Teen Employment Act [29 U.S.C. section 213(c)(6)], 16 and 17 year old employees have on-the-job driving privileges, subject to certain limitations.

Under this law, employees who are under 17 years of age are not permitted to drive automobiles or trucks on public roadways at any time, but may drive vehicles on the dealership property. Employees who are 17 years of age may drive automobiles or trucks on public roadways only if:

A. Such driving is restricted to daylight hours;

B. The employee holds a California license valid for the type of driving involved in the job performed and has no record of any moving violation at the time of hire;

C. The employee has successfully completed a state approved driver education course;

D. The automobile or truck is equipped with a seatbelt for the driver and any passengers, and the employee's employer has instructed the employee that the seatbelts must be used when driving the automobile or truck;

E. The automobile or truck does not exceed 6,000 pounds of gross vehicle weight;

F. Such driving does not involve –

- the towing of vehicles;
- route delivery or route sales;
- the transportation for hire of property, goods, or passengers;
- urgent, time-sensitive deliveries;
- more than two trips away from the primary place of employment in any single day for the purpose of delivering goods of the employee's employer to a customer (other than urgent, time – sensitive deliveries);
- more than two trips away from the primary place of employment in any single day for the purpose of transporting passengers (other than employees of the employer);
- transporting more than three passengers (including employees of the employer); or
- driving beyond a 30 mile radius from the employee's place of employment; and

G. Such driving is only occasional and incidental to the employee's employment. For purposes of this section G, the term "occasional and incidental" is no more than one-third of an employee's work time in any workday and no more than 20% of an employee's work time in any workweek. [29 U.S.C. section 213(c)(6)].

At the time of application, prospective driver/employees should sign a waiver authorizing background checks for driving record and driver's education verification. While the law does not require that dealers conduct motor vehicle record checks, insurance requirements and liability concerns make this a good idea. Prospective driver/employees should be told at the time they are making an application for employment, that if hired, they will be required to provide a written signed certification that they meet the criteria above. This certification should include a statement that any falsification or omission of information may result in the employee's termination. Once completed, the certification should be kept with the employee's personnel file. Since the law requires that teenage drivers be instructed to wear safety belts, the certification should also include a statement from teenage employees that they have been so instructed.

Tire Chain Disclosure

Vehicle Code section 9953 provides that every **manufacturer** of a new motor vehicle sold in this state which, as equipped, may not be operated with tire chains shall do both of the following:

a. Indicate that fact in the owner's manual for the vehicle or other written material provided by the manufacturer regarding the vehicle.

b. Provide each of its franchised new motor vehicle dealers in this state with a list of the affected vehicle models on an annual basis and prior to the manufacturer's introduction of its new model year vehicle. The list shall include sufficient information, including information regarding tire sizes where necessary, to allow the selling dealers to determine when disclosure is required pursuant to Vehicle Code section 11713.6.

Vehicle Code section 11713.6 makes it unlawful for any dealer to fail to disclose in writing to the buyer or lessee of a new motor vehicle that the vehicle, as equipped, may not be operated on a highway signed for the requirement of tire chains if the owner's manual or other material provided by the manufacturer states that the vehicle, as equipped, may not be operated with tire chains. The required disclosure must meet both of the following requirements:

1. The disclosure shall be printed in not less than 14-point boldface type on a single sheet of paper that contains no information other than the disclosure.

2. The disclosure shall include the following language in capital letters: "AS EQUIPPED, THIS VEHICLE MAY NOT BE OPERATED WITH TIRE CHAINS BUT MAY ACCOMMODATE SOME OTHER TYPE OF TIRE TRACTION DEVICE. SEE THE OWNER'S MANUAL FOR DETAILS."

Prior to the sale or lease, the dealer must present the disclosure statement for the buyer's or lessee's signature and then must provide the buyer or lessee with a copy of the signed disclosure.

Dealers should be careful in situations where dealer-added equipment, such as oversized wheels or tires, may render a vehicle which is otherwise able to accommodate tire chains, unable to do so. In these situations dealers should follow the disclosure rules noted above. Because in these types of cases, the owner's manual will not give any details, the disclosure should be modified to delete the reference to the owner's manual.

The signed disclosure document should be retained in the deal file.

Trade-In Payoffs: 21-Day Deadline and Other Rules

Under Vehicle Code section 11709.4, when a dealer purchases or obtains a vehicle in trade in a retail sale (even an all-cash sale) or lease transaction and the trade-in is subject to a prior credit or lease balance, all of the following apply:

- *If the sale or lease contract specifies an amount of the credit or lease balance to be paid on the trade-in and the agreement of the dealer to pay that specified amount is contained in a written agreement documenting the transaction, the dealer must tender the specified amount to the lessor or legal owner of the trade-in or their designee no later than 21 calendar days after acquiring the trade-in (unless a shorter period is specified in writing).*
- *If the sale or lease agreement does not contain an agreement regarding payment of the prior credit or lease balance of the trade-in vehicle or does not specify the amount to be paid, the dealer must discharge the entire amount owing on the trade-in no later than 21 calendar days after acquiring the trade-in (unless a shorter period is specified in writing).*
- *For any vehicle purchased or obtained in trade, the dealer cannot sell, consign or transfer an ownership interest in that vehicle until the prior credit or lease amount is tendered to the lessor or legal owner or their designee.*

A dealer does not violate the 21-day payoff rule if the dealer reasonably and in good faith gives notice of rescission of the contract promptly, but no later than 21 days after the date on which the vehicle was purchased or obtained in trade, and the contract is thereafter rescinded on any of the grounds in section 1689 of the Civil Code (which include mutual consent, mistake, fraud, duress, the material failure of consideration, etc.).

Suggested Procedures To Comply with Payoff Requirements

- *Monitor all trade-in vehicles to ensure that the agreed payoff amount is either tendered within 21 days of taking the vehicle in trade or that a notice of rescission is given to the customer within the 21 day period and the transaction is thereafter properly rescinded.*

- *Maintain evidence of compliance by having written proof that the agreed payoff amount was tendered within 21 days or that a timely rescission notice was given to the customer and the transaction was in fact rescinded.*

This law does not "extend" the 10-day "Seller's Right To Cancel" clause contained in most conditional sale contract forms. If you are unable to finance a contract within the prescribed 10 day period, a notice of rescission must be given with in the 10 day period (see Inability to Assign Contract or Lease, below).

To document compliance, dealers should retain evidence of a tender of the lien payoff amount to the lien holder or proof that a notice of rescission was given. That evidence could be in the form of an electronic funds transmittal receipt or a copy of the printed check. If regular mail is used to send a payoff check, a photocopy of the outside of the envelope (in which the check is contained) reflecting the lien holder's name and correct address and the correct date stamped by the dealer's postage machine should also be retained. If a rescission notice is given to the customer, a copy of the rescission notice should be retained. If rescission is sent by regular mail, a photocopy of the outside of the envelope (in which the rescission notice is contained) reflecting the customer's name and correct address and the correct date stamped by the dealer's postage machine should be retained.

Finally, conditional sale contract forms are available that include agreement language requiring the seller to pay off a specific lien amount (otherwise the entire lien amount must be paid). A violation of Vehicle Code section 11709.4 is grounds for dealer license suspension or revocation and is also a criminal misdemeanor.

Unclaimed Property Law

OVERVIEW: California's Unclaimed Property Law requires holders of property that belongs to others to attempt to track down the owners to make them aware that the property is being held. If the owner does not respond, the law requires property holders to annually report that property to the State Controller's Office (SCO) after a specified period. The SCO will then attempt to locate the owner, but if the property is not claimed within a certain timeframe, the holder is required to remit the property to the SCO. Although businesses may be tempted to keep unclaimed property and record it as income, doing so may lead to significant liability.

This often-ignored requirement has particular bearing upon dealers which hold unclaimed property such as refunded DMV fees, forgotten customer deposits, customer rebates, uncashed checks to vendors, and unclaimed wages and commissions. Since dealers are regularly targeted for audits by the SCO, we urge dealers to pay particularly close attention to these requirements, and to consult competent advisors to ensure compliance.

This section discusses requirements of California's Unclaimed Property Law (Code of Civil Procedure section 1500 *et seq*.), as well as the policies of the SCO, which enforces the law.

State Controller's Office

The (SCO) is responsible for enforcing California's Unclaimed Property Law and offers a very helpful resources for unclaimed property holders on its website at www.sco.ca.gov/updrp tg.html.

Changing Landscape

The entire Unclaimed Property program has been under scrutiny from both the judicial and legislative branches recently. In 2007, major revisions were passed as part of the state budget to meet the demands of a federal judge who issued an injunction prohibiting the SCO from accepting or collecting any unclaimed property until the Unclaimed Property program was amended to meet due process standards under the United States Constitution. Although this revision addressed one major concern, other litigation has arisen that challenges the manner in which the SCO handles interest earned on unclaimed property. Further changes were implemented in the 2009 and 2011 legislative sessions. Legislative changes have been introduced in early 2013 to further amend the Unclaimed Property program. Be sure to check the monthly CNCDA Bulletin for future updates on changes to the Unclaimed Property Law.

General Requirements

Property Reportability. The Unclaimed Property Law requires that holders of unclaimed property report funds or other assets belonging to another party after a specified period of abandonment subsequent to the property becoming due and payable. For dealers, the most common properties reported are uncashed DMV refund checks, uncashed paychecks, and uncashed checks to vendors. Dealers should work with their accountants to determine whether other kinds of property they hold may be subject to the Unclaimed Property Law.

The amount of time a business holds property before it is considered abandoned varies by property type. For example, a business must report uncashed salaries, wages and commissions that remain un-

claimed one year after becoming payable, while most other property, such as uncashed payments to vendors and uncashed DMV refunds checks, becomes reportable if unclaimed three years after becoming payable.

Notifying the Property Owner—"Due Diligence Letter". A business must attempt to contact the owner of an account of more than $50 by mail (or electronically, if the property owner has given consent beforehand) at their last known address six to twelve months before the property becomes reportable warning the owner that their property may escheat to the state.

The "due diligence" letter must contain a heading centered at the top with the following wording "THE STATE OF CALIFORNIA REQUIRES US TO NOTIFY YOU THAT YOUR UNCLAIMED PROPERTY MAY BE TRANSFERRED TO THE STATE IF YOU DO NOT CONTACT US." The letter must also contain a notice, either in bold or in a font at least two points larger than the rest of the letter (aside from the heading), which:

1. Specifies that since the date of last activity, or for the last two years, there has been no owner activity concerning the property;
2. Identifies the property by number or other identifier (which need not exceed four digits);
3. Indicates that the property is in danger of escheating to the estate; and
4. Specifies that the California Unclaimed Property Law requires banks, banking organizations, and financial organizations to transfer funds of a deposit, account, shares, or other interest if it has been inactive for three years.

The notice must also contain a form allowing the owner to confirm the current address (which, if filled out, signed by the owner, and returned by the holder, is deemed active and begins the escheatment period again). In lieu of returning the form, the dealer may provide a telephone or fax number, or email address with which the owner may contact the dealer. This contact, as long as memorialized and kept by the dealer, serves as confirmation that the account is active and recommences the escheatment period.

The SCO has created a sample due diligence letter, which is available online at: http://www.sco.ca.gov/FilesUPD/outreach_rptg_notice_duediligencesample.pdf.

The law also allows property holders to impose a "due diligence" service charge on the account in an amount not to exceed the administrative cost of mailing or electronically sending the letter, which in no case can exceed $2.00.

Notice Report. If the owner does not claim the property or reinstate the account, the holder must report such funds and property to the SCO prior to November 1st. The report must contain all known owner and property information, including the owner's name, Social Security Number, last known address, property type, property amount, and the last date of contact with the owner. While most property must be reported with the name of the property owner, with the exception of traveler's checks and money orders, all accounts of less than $50 may be aggregated into a single file and reported to the state without itemizing separate accounts. The report must also contain certain information concerning the property holder, including contact information. If your dealership wishes to give different contact information for the SCO than for the owner of the property, it may do so on the latest forms. Businesses are required to annually report unclaimed property to the SCO by filing Form UDS-1 (for reports filed on paper, which are only allowed if fewer than 10 properties are reported) or UFS-1 (for reports filed on electronic media) and any applicable schedules. The SCO strongly recommends that the report be filed electronically in all circumstances. Electronic filings must be made in the newest National Association of Unclaimed Property Administrators (NAUPA) format, known as NAUPA II. If reporting more than ten items of unclaimed property, electronic reporting is mandatory. The NAUPA II software is available for free download online at: http://www.wagers.net/hrs/downloads.php.

NOTE

ORIGINAL SIGNATURE FOR ELECTRONIC FILING: Although the SCO strongly encourages electronic filing, property holders are still required to provide a "wet" signature to prove that the filing was verified by an individual, a partner, an officer, or an employee authorized by the holder. For reports to be properly verified, the SCO requires an original signature on all Universal Holder Face Sheets (UFS-1). Reporting Agents submitting multiple reports at one time will be allowed to submit a transmittal letter with an original signature that lists all reports being submitted. Reports with UFS-1 forms that do not contain an original signature may be subject to interest at a rate of 12% per annum from the date the property should have been reported or remitted with the signature. Failure to comply with this very technical requirement could end up costing a substantial amount of money!

Once the SCO receives this report, it will attempt to locate and contact the property owner (if the

amount unclaimed is at least $50), and provide the holder's contact information and instructions for claiming the property. If the property remains unclaimed, the holder must remit the property, along with a similar Remit Report, to the SCO.

Remit Report. If property remains unclaimed after submittal of the Notice Report, the holder must remit the property to the SCO between June 1 and June 15 of the following year, along with a Remit Report detailing the property being sent. The report should be submitted in the same format as the Notice report, and include a hard copy of the UFS-1 form. Payment of unclaimed cash in the amount of $20,000 or more must be paid by electronic funds transfer, or the holder will face a 2% penalty. If property reported on the Notice Report has subsequently been claimed by the owner, the holder may either exclude those claims from the remit report, or may include the claims on the report, showing a $0 remittance amount.

If new accounts are identified that were not included on the Notice Report, the holder **must not** include such accounts on the Remit report. Instead, these new accounts should be reported on a Supplemental Holder Notice Report, with another Holder Remit Report sent between 7 and 7 ½ months after the date the Notice Report was filed.

The following table provides guidance concerning the different reporting and remitting deadlines:

Date Property Escheats to State (1-3 Years of Inactivity)	Due Diligence Letter to Owner	Notice Report Due Date to SCO	Remit Report Due Date to SCO
July 1, 2011-June 30, 2012	October 31 2012-April 30, 2013	October 31, 2013	Jun 1-15, 2014
July 1, 2012-June 30, 2013	October 31 2013-April 30, 2014	October 31, 2014	Jun 1-15, 2015

NOTE

ALTERNATIVE REPORTABILITY CALENDAR: The SCO allows businesses to calculate whether property is reportable "as of" either June 30th or their own fiscal year-end preceding this date. If the "as of" date falls between January 1 and June 30, the Holder Notice Report is due before November 1 of the same year. If the "as of" date falls between July 1 and December 31, the Holder Notice Report is due before November 1 of the following year.

Time Limits. Records of unclaimed property must be maintained for at least seven years after being reported to the SCO. While the SCO's internal policy is to audit a business for the past ten years of unclaimed property activity, they deviate from this policy as the situation warrants—at times looking into records well-beyond ten years. There is no statute of limitations regarding escheatment of property, meaning businesses may be liable from the time the statute was first implemented—1960.

Penalties for Non-Compliance

The fine for willfully failing to file the annual report is $100 per day, capped at $10,000. For willfully failing to remit the property to the state, a business can be fined in an amount ranging from $5,000 to $50,000. These failures to act can only be considered willful, however, if the business has failed to respond to a written notice from the SCO. ***Even if no warning is provided and the failure to act is not considered willful, businesses are liable for interest at a rate of 12% per year of the amount not reported or remitted, starting from the date the property should have been remitted***. If the holder pays or delivers unclaimed property in a timely manner, but files a noncompliant report, the 12% interest still applies, but is capped at $10,000.

Professional Assistance

The Unclaimed Property laws are complicated and confusing. Dealers should check with their accountants to determine appropriate procedures and to assist in compliance with the Unclaimed Property laws. Be sure to ask your accountant about establishing an "Unclaimed Property Liability Account," into which unclaimed property can be deposited and recorded. Such accounts allow a dealership to keep track of their unclaimed property accounts in a single location for simpler recording and remittance when appropriate.

For more information, consult the SCO's website: http://www.sco.ca.gov, or call the SCO directly at (916) 464-6088 for compliance information, or (916) 464-6284 for reporting assistance.

Underground Storage Tank Fee

If you own an underground storage tank in California, you may be required to pay a fee for petroleum products placed into the tank. The underground storage tank maintenance fee provides revenues for cleanup programs. Effective January 1, 2010, the fee per gallon is 20 mills ($0.020). On

January 1, 2012, the fee will revert back to 14 mills ($0.014) per gallon. Petroleum products that are subject to the fee, include, but are not limited to, gasoline and additives, aviation gasoline and additives, jet fuel and additives, diesel fuel and additives, lubrication oils, heating and lighting oils, and solvents.

For further information, you can call the State Board of Equalization Fuel Taxes Division at (800) 400-7115. The Board of Equalization also has a Publication 88 entitled Underground Storage Tank Fee, available online at www.boe.ca.gov/pdf/pub 88.pdf.

Owners of underground storage tanks must register with the State Board of Equalization. After registration, the Board of Equalization will let you know how often you will be required to file returns.

(See Health & Safety Code sections 25299.41 and 25299.43.)

Unlawful Subleasing of Motor Vehicles

California Penal Code sections 570-574 make it a crime for a person to engage in an act of unlawful subleasing of a motor vehicle when the person receives compensation or some other consideration for the transfer or assignment of a vehicle subject to a lease contract, conditional sale contract, or security agreement which prohibit such a transfer. These criminal statutes are directed toward agents and middlepersons who attempt to profit from these transactions. California Civil Code section 3343.5 provides for civil damages, including punitive damages, for persons damaged by unlawful transfers of motor vehicles subject to lease or sale contracts. Although these Code sections are not directed at a lessee or purchaser who violates the terms of a lease or sale contract, such an act by the lessee or purchaser can be grounds for civil damages under breach of contract rules.

In *People v. Carter* (1994) 30 Cal.App.4th 775, 37 Cal.Rptr.2d 59, the appellate court upheld the conviction of Thomas C. Carter, the part owner of U.S. Financial Company, a company involved in soliciting lessees for the purpose of having them sublease their vehicle to persons without sufficient credit to purchase or lease vehicles elsewhere. As part of its services, U.S. Financial provided an agreement which committed the sublessee to make the lessee's monthly payments to the financial institution actually holding the original lease. U.S. Financial was not a party to this agreement. Also, as part of the solicitation, a sublessee was told that if he or she made six months of payments on behalf of the lessee, U.S. Financial would arrange for the vehicle to be financed in the name of the sublessee. U.S. Financial charged a fee for its services which ranged from $1,500 to $5,000. Evidence presented at trial indicated that these subleasing transactions were arranged without the knowledge of the financial institutions holding the original leases and furthermore indicated that the vehicles involved were not refinanced in the name of the sublessees.

In upholding the conviction, the appellate court confirmed that Mr. Carter had violated California Penal Code section 571(b) which provides "a person engages in an act of unlawful subleasing of a motor vehicle when the person is not a party to the lease contract, conditional sale contract, or security agreement, and assists, causes, or arranges an actual or purported transfer or assignment, as described in subdivision (a)". An unlawful transaction or assignment as described in California Penal Code section 571(a) involves a person who is not a party to a lease transferring or assigning an interest in the subject motor vehicle to a person who is also not a party to the lease without the consent of the lessor and this person receives compensation or some other consideration for the transfer or assignment.

The appellate court was not persuaded by Carter's argument that he did not violate section 571(a) because he merely supplied a sublease agreement and personally did not transfer or assign any interest in a leased vehicle. Despite the ambiguity of the statutory language, the appellate court construed Section 571 in a manner consistent with its perception of the legislature's intent which the court believed was to hold culpable those persons who promote a transfer or assignment of an interest in a motor vehicle without the approval of the lessor. The appellate court further was not convinced of Carter's argument that section 571 violated his constitutional rights of equal protection since the lessee of a motor vehicle could engage in this type of conduct without the permission of the lessor and not be subject to criminal prosecution. The appellate court dispensed with this argument by determining that the legislature had a rational basis for distinguishing between the conduct of non-parties and parties to a lease in this context.

Use of Credit Cards by Retail Customers

The use of credit cards has expanded significantly in the past several years. Credit cards are now being used not only for traditional retail purchases, but

also in other, less traditional places, such as supermarkets and traffic court. The expanded use of credit cards has spilled over into sales of new and used vehicles – although most typically for the purpose of paying a part or all of a down payment. The use of credit cards by retail customers raises a variety of issues which do not arise when the payment is made in the more traditional forms of cash or check.

Acceptance of Card not Prohibited

The law does not prohibit acceptance of credit cards for vehicle purchases or down payments. However, retail finance source agreements usually contain warranties by the dealer that the down payment has been paid in cash or that the down payment was made in the manner described in the contract. A dealer could be charged with breach of such a warranty unless the contract actually discloses that the payment was made by credit card or there is written proof that the lender otherwise knew about the credit card payment before it funded the deal. Another wrinkle: if the dealer knows the use of the credit card will increase the outstanding balance on an open account listed on the credit application, the finance source might charge the dealer with concealment or misrepresentation concerning the credit application.

No Requirement that Dealer Accept Card

No law requires dealers to accept credit cards in lieu of other payment methods. Merchant agreements with credit card issuers often require acceptance of the card as to "all goods and services offered by Merchant." Many card issuers are now aware, however, of the problems uniquely faced by dealers and are allowing dealers to accept credit cards in the service and parts departments only. Some card issuers allow the dealers to refuse credit cards when the payment would exceed $1,000, or some cap set by the dealer. On the other hand, other card issuers, through their merchant agreements, require the dealer to either accept credit cards for any portion or all of the purchase price (with no cap), or not accept credit cards at all in the sales department, in which event the dealer would have to remove all credit card emblems and logos from the showroom and sales areas.

Prohibition Against Surcharges for Use of Card

See the previous discussion in the section titled “Credit Card Processing Fees”. Basically, dealers cannot raise credit card prices over cash prices, not even to pass the credit card transaction fee on to the customer.

Credit Card "Stop Payment" Rights Against Dealers

Legally, any complaint the customer has against the dealer may also be asserted against the credit card issuer, and the customer does not have to pay the charges on his or her credit card bill until the dispute is resolved. The card issuer can immediately charge back the disputed amounts against the dealer. The customer must first try to work out the problem directly with the dealer, and may then be required to raise the dispute with the card issuer – but must do so within 60 days of receiving the credit card bill showing the charge. The credit card issuer then has 60 additional days or more to charge back and investigate. The customer loses all of these rights if he or she pays the credit card bill in full without deducting the disputed charges. See Fair Credit Billing Act 15 U.S.C. 1666-1666j; California Civil Code 1747.01 et seq.

Escalation of Complaint Process

Card issuers have customer service staffs to handle billing disputes. These staffs may not handle a billing dispute simply by accepting the dealer's version of the dispute; the staffs are required to obtain and independently assess the customer's position. Because of their legal and contractual rights of charge back and dislike of open billing items, these staffs can put pressure on dealers to settle, or advise the customer to seek regulatory agency intervention. Since these staffs are versed in the heavily regulated area of mail order charges, where customers have many more legal rights, there may be a tendency to overstate customer rights in all "big ticket" charge situations even if the mail order rules don't apply.

Additional Warranty or Unwind Rights

Customer disputes, even bogus ones, can initially result in charge backs as discussed above, but the underlying merits of any dispute are still governed by applicable non-credit card law. See *Izraelewitz v. Manufacturers Hanover* (1983) 465 N.Y.S.2d 486. But by the time a dispute is resolved in the dealer's favor, the customer may have no cash or credit left. Also, merchant agreements often incorporate extensive rules and regulations drafted by card issuers that sometimes give the customer additional rights. Some of these rules require that merchants have a "fair policy" concerning refunds. Whether the written vehicle sales contract will override these rules is unknown, but the risk remains. Although a legal long shot, dealers should also be aware that a cus-

tomer who signs a binding purchase contract and uses a credit card for the deposit can try to get out of the deal prior to taking physical delivery based on other provisions of the credit card law relating to charges for unaccepted goods.

Vehicle Safety and Equipment Requirements

California Vehicle Code section 11713(i) provides that no holder of any license issued under Article 1 of Chapter 4 of Division 5 of the Vehicle Code shall deliver, following the sale, a vehicle for operation on California highways if the vehicle does not meet all of the equipment requirements of Division 12 (commencing with section 24000). This law, however, does not apply to the sale of leased vehicles to the lessee if the lessee is in possession of the vehicle immediately prior to the time of the sale and the vehicle is registered in California. Further Vehicle Code section 24007(a) states that a dealer may not sell a new or used vehicle which is not in compliance with these safety and equipment requirements (unless the vehicle is sold to another dealer, sold to be wrecked or dismantled, or sold exclusively for off-highway use).

The safety and equipment requirements are set forth in Division 12 of the Vehicle Code (Sections 24000 through 28114) entitled "Equipment of Vehicles." Division 12 is subdivided into five separate chapters: (1) general; (2) lighting; (3) brakes; (4) windshield and mirrors; and (5) other equipment. Selected highlights from each of these chapters are listed below.

Chapter 1. General Provisions.

- Each vehicle must be in a safe condition to operate and contain all of the equipment specified in Division 12 (section 24004-28114).
- Each vehicle must be properly smogged (Section 24007(b)).
- Each vehicle may not be equipped with any lamp or illuminating device not required or permitted under Division 12 (See Chapter 2 below) (section 24003).
- Each vehicle may not be modified so that any portion of it (other than the wheels) has less clearance from the roadway than the clearance between the lowermost portion of any rim of any wheel and the roadway (section 24008). The frame height or body floor height cannot be greater than 23 inches from the ground and the lowest portion of the body floor shall not be more than 5 inches above the top of the frame (section 24008.5).
- For each new vehicle, no dealer shall sell or offer for sale such new vehicle unless (1) it contains a certification by the manufacturer that the vehicle is in compliance with all applicable Federal standards, and that the vehicle actually does conform to these applicable Federal standards (section 24011); (2) that it bear the manufacturer's name and gross weight rating of the vehicle (section 24009); (3) that it bear the trademark of the manufacturer or name and type or model designation and owner's manual at least regarding light source to be used with lamps (Section 24006); and (4) that it has a manufacturer's notice affixed to the vehicle confirming that the vehicle has bumpers that can withstand an impact of 2.5 miles per hour with no damage to the vehicle's body and safety systems (Section 24011.3). It is the manufacturer's duty in the first instance to comply with these statutes.

Chapter 2. Lighting.

- For each vehicle, all lamps and other lighting equipment must be maintained in good working order and equipped with the required voltage (section 24252(a)).
- Each vehicle must have tail lamps capable of remaining lighted for a period of at least 15 minutes with the engine not operating (section 24253).
- Each vehicle must have at least two headlamps, one on each side of the front of the vehicle, located no more than 54 inches nor less than 22 inches above the road (section 24400).
- Auxiliary driving lamps (if on the vehicle) must be mounted on front of car at a height of no less than 16 inches nor more than 42 inches. Optional passing lamps must be mounted on the front at height of not less than 24 nor more than 42 inches (section 24402).
- Fog lamps (if on a vehicle) must be limited to no more than two (2) and shall be mounted on the front of a vehicle at height not less than 12 nor more than 30 inches. Aiming and intensity of the lamps are also regulated. On a motorcycle, the fog lamps must be at a height not less than 12 nor more than 40 inches (section 24403).
- Spotlamps also have mounting and intensity requirements (section 24404).
- In total, no more than 4 lamps to the front of the vehicle may be lighted at any one time (section 24405).
- Each vehicle must have operational high/low beam indicator (section 24408).

- Each vehicle should be equipped with at least two taillamps, one on each side of the vehicle at the same level, at height of at least 15 and no more than 72 inches (section 24600). The taillamps must be red in color and plainly visible from all distances within 1000 feet (section 24600(e)).
- For each vehicle, the taillamp or a separate lamp must be placed so as to illuminate with white light the rear license plate and render it legible from a distance of 50 feet (section 24601).
- Red fog taillamps (if on a vehicle) must be limited to no more than 2, and shall be mounted on both sides of rear not lower than 12 inches nor higher than 60 inches (if one only, it must be mounted as far to left as practical, but not closer than 4 inches from edge of stop lamp. Controls must be independent from headlamps, and need an indicator light as well. (See section 24602)).
- Each vehicle shall be equipped with at least two red light stoplamps mounted at the rear at the same level (section 24603(b)), not lower than 15 inches nor higher than 72 inches above the roadway (section 24603(c)), which are plainly visible from a distance of 300 feet in sunlight and at nighttime (section 24603(e)).
- A supplemental stop lamp may be mounted inside the rear window so long as it is in compliance with Fed. Motor Vehicle Safety Standard No. 108 (section 24603(h)).
- Each vehicle shall be equipped with one or more backup lamps (section 24606(a)), directed so as to project a white light to the rear of the vehicle for a distance not to exceed 75 feet (section 24606(b)). They should only work when in reverse or backing up (24606(c)).
- Each vehicle must have at least two red reflectors on the rear of the vehicle plainly visible at night from distances within 350 to 100 feet from the rear of the vehicle, and mounted not lower than 15 inches and not higher than 60 inches (section 24607(a) and (d)).
- Each vehicle must be equipped with turn signal lamps in the front and rear of the vehicle (section 24951(a), visible in normal sunlight and at nighttime from a distance of at least 300 feet from the front and rear of the vehicle (section 24952). Mounted not lower than 15 inches (section 24951(c)).
- Each vehicle shall have white or amber turn signal lights flashing up front, and red or amber at rear (section 24953(a)).
- There are additional requirements for optional lighting such as courtesy lamps (section 25105), side, cowl or fender lamps (section 25106), cornering lamps (section 25107), running lamps (see section 25109), utility flood and loading lamps (section 25110), deceleration warning lights (section 25251.5) and for acetylene lamps (section 25450), lamps using diffused non-glaring light (section 25400), and reflectorizing material (section 25500).
- The specifications for color and mounting of certain lamps or reflectors are set forth in section 25950.

Chapter 3. Brakes.

- Each motor vehicle must be equipped with a parking brake system, separately operated from the service brake system, which is capable of holding the vehicle stationary on any grade on a surface free from snow, ice or loose material (section 26451(a)). The parking brake shall be held in the applied position solely by mechanical means (see section 26451(c)).
- Each vehicle must be equipped with an emergency brake system so that rupture or leakage-type failure of any pressure component of the service brake system will not result in complete loss of function (section 26301.5). Every vehicle must be able to permit application of brakes at least once for purposes of bringing vehicle to stop after engine failure (section 26452).
- Each vehicle must be equipped with service brake system on all wheels (section 26311(a)), and a parking brake system, which system shall operate separately (section 26450).
- For each vehicle, all brakes and component parts thereof must be maintained in good condition and working order (section 26453).
- Each vehicle offered for sale must be tested to ensure a stopping distance on dry, smooth, hard-surfaced road, with a grade not to exceed 1%, at a speed of approximately 20 m.p.h. (section 26456). The vehicle must be able to stop within 25 feet (section 26454(b)(1) and 26456).
- Additional requirements are set out for air brakes (sections 26502-26508) and vacuum brakes (sections 26520-26522).

Chapter 4. Windshields and Mirrors.

- Each vehicle must be equipped with an adequate windshield (section 26700(a)).
- Each vehicle must be equipped with safety glazing material wherever glazing materials are used including doors, windows, windshields and openings in the roof (section 26701(a)).
- Each vehicle must have one or two self-operating windshield wipers which meet the requirements set forth in the Federal Regulations, maintained in good operating condition, and which provide

clear vision through the windshield (section 26706(b)).

- For each vehicle, no object or material can be displayed or affixed to the windshield or side or rear windows (section 26708(a)(1) and (2)), except for 7 inch square signs or stickers in the lower corner of the windshield or rear window farthest removed from the driver; 5-inch square signs or stickers in the lower corner of the windshield nearest the driver (section 26708(b)(3)); side windows to the rear of driver (section 26708(b)(4)); electronic device in center of uppermost portion of interior of windshield within area no greater than 5 inches square (section 26708(b)(11)); rear window wiper (section 26708(b)(6)); sun visors (sections 26708(b)(2), 26708(b)(10), and 26708.2); rear view mirror (section 26708(b)(1)); and a GPS if mounted in a 7-inch square in lower corner of windshield farthest removed from driver or in 5-inch square in lower corner of windshield nearest to driver, if GPS is used only for door-to-door navigation outside of airbag deployment zone (section 26708(b)(12)).
- A video event recorder may also be mounted upon the windshield subject to the following conditions. It must be mounted in a seven-inch square in the lower corner of the windshield farthest removed from the driver, in a five-inch square in the lower corner of the windshield nearest to the driver and outside of an airbag deployment zone, or in a five-inch square mounted to the center uppermost portion of the interior of the windshield. The vehicle must have a notice posted in a visible location which states that a passenger's conversation may be recorded. The video event recorder shall store no more than 30 seconds before and after a triggering event. A registered owner or lessee of the vehicle must be able to disable the device, and the data recorded to the device must be the property of the registered owner or lessee. section 26708 (b)(13).
- California has enacted legislation adopting the policy of a forthcoming federal regulation to also exempt video event recorders installed in commercial motor vehicles that can monitor driver performance to improve driver safety. The device must be mounted no more than two inches below the upper edge of the area swept by the windshield wipers, and outside the driver's sight lines to the road and highway signs and signals. The installation and use of video event recorders in commercial motor vehicles will not be effective until the date the California Highway Patrol determines that the federal regulation on the subject has become effective and provides that the exception will become inoperative if the federal regulation is repealed. section 26708 (b)(14).
- Optional tinted safety glass may be installed if (1) safety glazing materials are used; and (2) only in location permitted by standards for the particular type of glass used (section 26708.5(b)).
- Each motor vehicle must have at least two mirrors reflecting to the driver a view of the road to the rear for a distance of at least 200 feet, with one such mirror affixed to the left-hand side (section 26709(a)).

Chapter 5. "Other Equipment."

In addition to the foregoing safety and equipment requirements, every vehicle must also be equipped with the following:

- Each vehicle must have a horn in good working order and capable of emitting sound audible under normal conditions for a distance of not less than 200 feet (section 27000).
- Each vehicle is required to have a fuel tank cap made of non-combustible material (section 27155).
- Each vehicle is required to have safety belts for each seating position (section 27314). The safety belts must be in good working order for the use of the driver and all occupants of the vehicle, and must conform to motor vehicle safety standards established by the United States Department of Transportation. Certain notices regarding risk of lap belts, only, may have to be provided by dealer when selling a used vehicle of model year 1972-1990 (section 27314.5(a)(1)(2) and (3)and 27314.5(b)).
- If a vehicle equipped with solid tires, (a) the tires must have minimum thickness of resilient rubber of at least 1 inch, if width of tire between 3-6 inches; of 1.25 inches in width between 6-9 inches; and 1.5 inches if width is more than 9 inches thick (section 27450).
- Rubber shall be measured between road surface and nearest metal part to which tire is attached (section 27451);
- Condition of rubber shall be such that it extends evenly around the tire, without flat spots or bumps (section 27452).
- No vehicle shall be sold which is equipped with any recut or regrooved tires (section 27461).
- The tread depth requirements for pneumatic tires are specified in section 27465, including the requirement that each vehicle sold with pneumatic tires shall have tire tread depth of at least 1/32nd of an inch tread deep in any two adjacent grooves at any location of the tire.

- Each vehicle sold shall have fenders, covers, or other devices, including flaps or splash aprons, to effectively minimize the spray or splash of water or mud to the rear of the vehicle, which shall be at least as wide as the tire tread (section 27600).
- Each vehicle must contain a functioning odometer which has not been disconnected or altered, subject to exceptions for authorized repair (sections 28050, 28050.5, 28051 and 28051.5). If the odometer does not register the true mileage of the vehicle, the odometer should be adjusted to zero, and that should be disclosed in writing, and should be posted on the vehicle (section 28053).
- Each vehicle must have a front and rear bumper or any other device designed and intended to prevent the front or rear of the vehicle from coming into contact with any other vehicle (section 28071).
- Optional equipment of alarm system may flash lights and sound audible signal, but not a siren (section 28085).
- Optional equipment of child restraint system, if on a vehicle, must conform to federal motor vehicle safety standards (section 27362).

As stated above, Vehicle Code section 24011 states that a dealer may not sell a vehicle unless it also complies with the National Traffic and Motor Vehicle Safety Act (49 U.S.C. sections 30101 et. seq.) and bears the manufacturer's certification that the vehicle complies with such standards. Although these federal requirements are imposed on the manufacturer of new motor vehicles, the selling dealer is also held accountable if the manufacturer fails to comply with the federal safety requirements.

Dealers should be aware that a violation of any of the sections of Division 12 of the Vehicle Code constitutes a violation of Vehicle Code section 11713, and therefore could expose a dealership to suspension or revocation of its dealer license together with other civil, administrative or criminal penalties.

Dealers should refer to the cited provisions of the Vehicle Code or consult their legal counsel if they have any specific questions or problems in this area.

Chapter 6. "License Plate Brackets."

A dealer may not deliver a motor vehicle for which the DMV issues two license plates unless either of the following occurs:

1. The motor vehicle is equipped with a bracket or other means of securing a front license plate.

2. The dealer obtains a signed written acknowledgment from the person taking delivery of the motor vehicle acknowledging both of the following:

A. The person expressly refused installation of a bracket or other means of securing the front license plate.

B. The person understands that California law requires a license plate to be displayed from and securely fastened to the front of the motor vehicle and that the hardware necessary to securely fasten the front plate is available from the dealer. (Section 11713.17.)

Window Stickers on Vehicles

Federal Monroney Window Sticker (MSRP Sticker)

Federal law requires that each manufacturer affix a window sticker (commonly known as the Monroney Sticker) to the windshield or side window of each new automobile. A "new automobile" includes any passenger car or station wagon; but, as seen below, California also requires a similar sticker for new light duty trucks.

15 U.S.C. 1232 provides as follows:

Every manufacturer of new automobiles distributed in commerce shall, prior to the delivery of any new automobile to any dealer, or at or prior to the introduction date of new models delivered to a dealer prior to such introduction date, securely affix to the windshield, or side window of such automobile a label on which such manufacturer shall endorse clearly, distinctly and legibly true and correct entries disclosing the following information concerning such automobile-

(a) the make, model, and serial or identification number or numbers;

(b) the final assembly point;

(c) the name, and the location of the place of business, of the dealer to whom it is to be delivered;

(d) the name of the city or town at which it is to be delivered to such dealer;

(e) the method of transportation used in making delivery of such automobile, if driven or towed from final assembly point to place of delivery;

(f) the following information:

(1) the retail price of such automobile suggested by the manufacturer;

(2) the retail delivered price suggested by the manufacturer for each accessory or item of optional equipment, physically attached to such automobile at the time of its delivery to such dealer, which is not included within the price of

such automobile as stated pursuant to paragraph (1);

(3) the amount charged, if any, to such dealer for the transportation of such automobile to the location at which it is delivered to such dealer; and

(4) the total of the amounts specified pursuant to paragraphs (1), (2), and (3);

(g) if one or more safety ratings for such automobile have been assigned and formally published or released by the National Highway Traffic Safety Administration under the New Car Assessment Program, information about safety ratings that—

(1) includes a graphic depiction of the number of stars, or other applicable rating, that corresponds to each such assigned safety rating displayed in a clearly differentiated fashion indicating the maximum possible safety rating;

(2) refers to frontal impact crash tests, side impact crash tests, and rollover resistance tests (whether or not such automobile has been assigned a safety rating for such tests);

(3) contains information describing the nature and meaning of the crash test data presented and a reference to additional vehicle safety resources, including http://www.safercar.gov; and

(4) is presented in a legible, visible, and prominent fashion and covers at least—

(A) 8 percent of the total area of the label; or

(B) an area with a minimum length of 4 ½ inches and a minimum height of 3 ½ inches; and

(h) if an automobile has not been tested by the National Highway Traffic Safety Administration under the New Car Assessment Program, or safety ratings for such automobile have not been assigned in one or more rating categories, a statement to that effect.

A manufacturer who willfully fails to affix and endorse the required label can be fined up to $1000 for each offense. 15 U.S.C. section1233(c) provides the following with regard to alteration or removal of the sticker:

Any person who willfully removes, alters, or renders illegible any label affixed to a new automobile pursuant to section 1232 of this title, or any endorsement thereon, prior to the time that such automobile is delivered to the actual custody and possession of the ultimate purchaser of such new automobile, except where the manufacturer relabels the automobile in the event the same is rerouted, repurchased, or reacquired by the manufacturer of such automobile, shall be fined not more than $1,000, or imprisoned not more than one year, or both. Such removal, alteration, or rendering illegible with respect to each automobile shall constitute a separate offense.

Removal of the label prior to sale and delivery is prohibited and is punishable by fines and/or imprisonment. The U.S. Department of Justice (DOJ) enforces the law and in correspondence responding to questions about the law has communicated its position on label removal. DOJ takes the position that the label cannot be removed until after delivery of the new vehicle to the actual custody and possession of the ultimate purchaser (defined as the first person, other than a dealer purchasing in his capacity as a dealer, who in good faith purchases the vehicle for purposes other than resale). Delivery occurs when a vehicle's keys have been given to the customer, and he or she is free to drive the vehicle from the dealer's premises without returning.

As a result of the MSRP label having to be affixed to the vehicle at the time of delivery, the label itself becomes the property and responsibility of the purchaser. No provision permits a dealer to place these labels in glove compartments, beneath the floor mats or seats, inside a car's trunk, or elsewhere. A dealer is not automatically authorized to remove these labels while detailing or cleaning a car. Accordingly, unless new owners expressly indicate they would like this label removed and given to them as a part of a car's final preparation, the label should remain on the window.

California Requirements for Light Duty Trucks

California law requires a window sticker for new light duty trucks with a manufacturer's gross vehicle weight rating of 8,500 pounds or less. Vehicle Code section 24013.5 provides as follows:

(a) No dealer shall sell, offer for sale, or display for sale any new light duty truck with a manufacturer's gross vehicle weight rating of 8,500 pounds or less unless there is securely affixed to the windshield or side window of the light duty truck a label on which the manufacturer has endorsed clearly, distinctly, and legibly, true and correct entries disclosing the following information concerning the light duty truck:

(1) The make, model, and serial or identification number or numbers.

(2) The retail price of the light duty truck as suggested by the manufacturer.

(3) The retail delivered price, as suggested by the manufacturer, for each accessory or item of optional equipment which is physically attached to the light duty truck at the time of its delivery to the dealer and which is not included within the price of the light duty truck as stated pursuant to paragraph (2).

(4) The amount charged, if any, to the dealer for the transportation of the light duty truck to the location at which it is delivered to the dealer.

(5) The total of the amounts specified pursuant to paragraphs (2), (3), and (4).

(b) Subdivision (a) applies to every light duty truck sold, offered for sale, or displayed in California which is manufactured on or after September 1, 1988.

California Bumper Strength Notice

Vehicle Code section 24011.3 imposes a requirement on manufacturers or importers of new passenger vehicles for sale or lease to affix to a window or windshield of a vehicle a notice regarding bumper strength.

Fuel Economy Notice

49 U.S.C. section 32908 is a federal law requiring a window sticker regarding fuel economy. The information may be contained in the Monroney MSRP sticker. The requirement of this notice applies to "automobiles" which are defined as "Any four-wheeled vehicle propelled by fuel which is manufactured primarily for use on public streets" and which has a gross vehicle weight rating of 8,500 pounds or less.

Noncompliance Sticker-Emissions

California Health and Safety Code section 43012(d) provides that if a representative of the California Air Resources Board or the Department of Consumer Affairs finds that a used motor vehicle fails to comply with applicable emissions standards or equipment, the Board or a representative of the Department of Consumer Affairs shall issue a notice to correct. Pending the corrections, the motor vehicle shall prominently display the following disclosure affixed to the windshield in at least 18-point type:

NOT FOR SALE
THIS VEHICLE IS PRESENTLY NOT IN COMPLIANCE WITH THE CALIFORNIA VEHICLE POLLUTION CONTROL LAWS AND MAY NOT BE SOLD UNTIL A VALID CERTIFICATE OF COMPLIANCE HAS BEEN ISSUED.

Foreign Content Labeling

Federal law requires that each manufacturer of a new motor vehicle manufactured after September 30, 1994, and distributed in commerce for sale in the United States, shall establish each year for each model year and cause to be attached in a prominent place on each of those vehicles, at least one label. The label shall contain the following information:

(A) The percentage (by value) of passenger motor vehicle equipment of United States/Canadian origin installed on vehicles in the carline to which that vehicle belongs, identified by the words "U.S./Canadian content".

(B) The final assembly place for that vehicle by city, state (where appropriate), and country.

(C) If at least 15 percent (by value) of equipment installed on passenger motor vehicles in a carline originated in any country other than the United States and Canada, the names of at least the 2 countries in which the greatest amount (by value) of that equipment originated and the percentage (by value) of the equipment originating in each country.

(D) The country of origin of the engine and transmission for each vehicle.

Dealers are required to maintain the label on each vehicle to which the label is required to be attached.

The information required may be disclosed on the Monroney sticker (MSRP sticker), on the fuel economy sticker, or on a separate label that is readily visible. 49 U.S.C. section 32304.

Other Stickers

Discussed elsewhere in this Guide are Supplemental or Addendum Price Stickers, FTC Used Car Buyers' Guides, Rear Seat Belt Notices, and Proposition 65 warnings. Check the Index for reference to these discussions.

What To Do If the Dealership is a Criminal Defendant

There are occasions when a DMV investigator will refer a consumer complaint to the local City or District Attorney for criminal prosecution. This can arise out of complaints of advertising violations, failure to sell at the advertised price, or some other violation of statutes governing the activities of automobile dealers. These are generally misdemeanor cases, but are serious matters because misdemeanor convictions can affect a dealer's licensing and his ability to obtain another license. A criminal conviction can also be used in a civil action against the dealership, making the civil case a "slam dunk" with regard to liability of the dealership for civil damages. DMV licensing accusations may also follow criminal complaints or convictions. Conse-

quently, criminal complaints should be taken very seriously by dealers.

A little known procedure in the Penal Code can sometimes be utilized to have the criminal complaint dismissed. Penal Code sections 1377 and 1378 provide: "If the person injured appears before the court in which the action is pending at any time before trial, and acknowledges that he has received satisfaction for the injury, the court may, in its discretion, on payment of the costs incurred, order all proceedings to be stayed upon the prosecution, and the defendant to be discharged therefrom… . The order is a bar to another prosecution for the same offense."

If a dealership ever finds itself as a criminal defendant, use of these Penal Code statutes should be considered.

What's in a Dealer File?

A file on each new motor vehicle dealer licensed in California is maintained in Sacramento. The Sacramento dealer file typically contains records of all documents a dealer files to obtain a license, all dealer changes (such as change of address, officers, directors, and shareholders), and complaints against dealers leading to disciplinary action. In the Sacramento dealer file there will also be bonding information, information regarding dealer plates, records of disciplinary action, and other miscellaneous pieces of information. Any member of the public can obtain a copy of a dealer file; however, the DMV will delete from any material provided to a member of the public any confidential information such as residence addresses and any other information deemed to be confidential. A dealer, however, can obtain a copy of the dealer's entire file without any deletions for confidentiality. If a dealer wanted to obtain a copy of the file, a check for the required fee made payable to the DMV should be sent to DMV Occupational Licensing, P.O. Box 932342, Mail Station L224, Sacramento, California 94232-3450. Telephone (916) 229-3151. Call in advance to confirm the amount of the required fee. A dealer requesting a copy of his or her entire dealer file must submit a copy of the dealer's drivers license with the request in order to obtain the unedited version of the file. Processing of the request may take 3 to 4 weeks.

Sometimes a dealer would like to find out who made a complaint to the DMV about that dealer. If there were any complaints that resulted in disciplinary action, those complaints would be in the Sacramento dealer file. If a complaint was made against a dealer and no action taken by the DMV, that complaint apparently does not go into the dealer's permanent file. A dealer, however, might be able to obtain a copy of such a complaint from the Investigative Review Unit of the DMV. A letter requesting this information should be addressed as follows: Investigations, 8259 Demetre Avenue, Sacramento, California 95828. Telephone (916) 229-0167. Because Field Offices sometimes apparently keep those complaints for 3-4 years, a similar request can be made to a dealer's local Field Office.

If there is an ongoing investigation against a dealer, a field office file will be maintained in the local DMV field office. The DMV field office might allow a dealer to have copies of some, but maybe not all, of documents pertaining to an ongoing investigation which are maintained in the field office file.

California has a Freedom of Information Act which is found in the Government Code. Under the Freedom of Information Act many public records are open to inspection at all times and copies of public records can be obtained by paying photocopy expenses. Certain records, however, are exempt from inspection and one of the exemptions concerns records of complaints to or investigations by a state agency for law enforcement or licensing purposes. Because of this, pending complaints and investigatory materials pertaining to ongoing investigations may be withheld from any request you might make for copies of documents in your file. In any letter you write requesting records, you can simply state the following: "We are making this Public Records Request pursuant to California Government Code sections 6250, and following. Please advise us of the fee that will be required for duplication of records and we will promptly remit the same. Further, pursuant to Government Code section 6253, we will anticipate your response to this request within the ten (10) days provided." Then describe the records you are requesting.

Who Can You Sue On Odometer Rollback?

Odometer Law

You get stuck with a car with a rolled back odometer. How far up the chain of ownership can you go in pursuing an odometer lawsuit, and do former owners have to be guilty of wrongdoing before incurring liability? A look at an example may shed light on the subject.

Owner 1 rolled back the odometer on a car in otherwise very good shape and sold to Owner 2.

Owner 2 had no way of knowing of the rollback; after several thousand miles, Owner 2 sold to Owner 3. Owner 3, an expert appraiser, noticed some excessive wear and tear on the steering wheel and brake pedal indicative of excess mileage, but had these things cosmetically restored. Shrugging off any suspicions, Owner 3 soon forgot about these things and sold the vehicle in the ordinary course to Owner 4. Owner 4 had absolutely no way to know of the odometer inaccuracy. Owner 4 sells the car to you. Which of these owners can you pursue? The answer depends on how you can fit each owner into one or more of the three primary legal theories at your disposal: contract, fraud, and statute.

Contract Action Against Owner 4. You usually have a legitimate claim against the person selling the car to you. Even if that person is completely innocent of wrongdoing and had no way to know of the mileage inaccuracy, under the law of contracts (governed as to personal property sales by Division 2 of the California Uniform Commercial Code), and absent an "as-is" clause, within the four year statute of limitations you can claim the right to unwind, or seek damages, on the theory of breach of express or implied warranty that the odometer was accurate.

Even if there is an "as-is" clause, if you act promptly, you can claim a right to unwind under various legal theories such as "failure of consideration," "totally nonconforming goods," or "mutual mistake" - all devices used to prevent buyers from being stuck with something so far different from what was supposed to be delivered that it would be beyond all fairness to let the transaction stand. These methods require giving a rescission notice immediately after the problem was, or should have been, discovered.

There are no contractual relationships between any of the other members of the chain and you. Without that relationship - called "privity of contract" - you may not pursue any of the other parties for breach of contract, including breach of warranty. As with some of the other theories discussed here, you can sometimes stretch the privity rule to include those working closely with the person from whom you purchased, such as that person's regular supplier of cars.

Fraud Action Against Owner 1. Fraud claims require a good deal of guilt: proof is required that the person knew he or she was passing on false information, and that the person did so to induce the buyer to act. Anyone who rolled back the odometer, or knowingly lied on the disclosure, can be sued for fraud within the statute of limitations, which runs three years after the problem was, or should have been, discovered.

If Owner 1 was the culprit, can you sue him or her for fraud even though you are several owners away in the chain of title? Yes: Owner 1's fraud can be considered a continuing representation by Owner 1, and anytime someone down the chain of title repeated or made use of the false information supplied by Owner 1, Owner 1 would be charged with that statement. (See *Varwig v. Anderson-Behel Porsche/Audi, Inc.* (1977) 74 Cal.App.3d 578, 141 Cal.Rptr.539). This is called fraud by indirect communication. This area of law is changing, however. The California Supreme Court's rejection of the "fraud on the market" theory, for example, means that you must still prove that you reasonably relied on the false information passed down the chain before Owner 1 would be liable (*Mirkin v. Wasserman* (1993) 5 Cal.4th 1082, 23 Cal.Rptr.2d 101.).

Statutory Action Against Owner 1. Both California and federal statutes prohibit odometer rollbacks, and both allow buyers to jump past their own sellers, back up the chain of title to sue the culprit. In the case of California law, the suit can seek punitive damages; in the case of federal law, damages can be trebled - multiplied by three - and attorneys fees may be awarded. (See Vehicle Code sections 28050 et. seq.; *Laczko v. Jules Meyers, Inc.* (1969) 276 Cal.App.2d 293, 80 Cal.Rptr. 798.) The statute of limitations for the federal law is two years from discovery of the problem (one court saying from the first date the problem should have been discovered by any party in the chain of title. *Byrne v. Autohaus on Edens* (1989, ND Ill) 488 F.Supp. 276).

Fraud Action Against Owner 3. Owner 3 was not guilty of an actual rollback, nor of fraud, but was negligent in not investigating further. Suing Owner 3 for negligent misrepresentation would be much harder than in the case of Owner 1 since there is little authority as to whether the indirect communication rule applies to mistakes, however careless, as opposed to true fraud. In fact, one case suggests the rule is limited to cases of intentional fraud. (See *Haberman v. Public Power Supply System* (1987) 109 Wash.2d 107, 744 P.2d 1032). Without the indirect communication rule, you could not win a common law claim for negligent misrepresentation.

Statutory Action Against Owner 3. California's anti-tampering law relates only to mechanical issues like rollback, disconnect, and repair, whereas the federal law covers those issues plus inaccurate disclosures as well. Can you sue Owner 3 under federal law for providing a false odometer statement? Federal law allows you to pursue any culpable party in the chain of title, regardless of any lack of privity with, or even prior knowledge of, that person. A

loophole here can be where a second fraud starts up down the chain of title, which arguably wipes out the first fraud, and the first culprit's liability, as to sales taking place thereafter.

The federal odometer statute does, in name at least, require proof of an "intent to defraud." Cases have chipped away at this requirement, however, and a violation of the statute can now be found from any conduct that can be called either reckless or grossly negligent. Some cases have found violations on the basis of "constructive knowledge" of the odometer inaccuracy - a standard very similar to ordinary negligence. As a result, there is a good chance that you could pursue Owner 3 under the federal odometer statute. (See *Auto Sport Motors, Inc. v Bruno Auto Dealers, Inc.* (1989, SD NY) 721 F.Supp. 63.)

No Claim Against Owner 2. You may not pursue Owner 2, the innocent victim of Owner 1. Although just as innocent as Owner 2, Owner 4 was pursued under a contract theory; Owner 2 safely avoids this due to a lack of privity. Even though Owner 2 could have discovered the inaccuracy if he or she had done a title history, or taken the vehicle to a top mechanic, Owner 2's failure to do so does not amount to an "intent to defraud" under the statute, and does not even approach intentional fraud. If you pursue Owner 4, Owner 4 can pursue Owner 3, Owner 3 can pursue Owner 2, and Owner 2 can pursue Owner 1. Each Owner is liable to the purchaser to whom he or she sold the vehicle on a contract theory, and also on any of the other series discussed above when they apply.

A common perception hampers dealers in court: that their expertise should alert them to odometer problems. This hurts the dealer not only when he or she is being sued, but also when the dealer is pursuing others for odometer cheating. In the above example, if a consumer were to sue Owner 2, and Owner 2 were a dealer, the dealer might have a tough time convincing the court of the dealer's innocence. On the other hand, if Owner 2 were a consumer, and you as a dealer decided to sue him or her, your chances of success would be negligible, and if you lost the suit, you might then face liability for malicious prosecution.

As shown above, the placement in the chain and behavior of all previous owners must be carefully reviewed in evaluating odometer problems.

INDEX

—B—

—C—

—D—

—E—

—F—

—M—

—P—

—R—

—T—

—U—