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THE TRUTH IN LENDING ACT: PITFALLS FOR CAR DEALERS

While you were sleeping, the Federal Reserve System – the governmental entity charged with interpreting "consumer lending" laws – was running its pen over the Truth In Lending Act. The Reserve's Official Staff Commentary probably wasn't on your summer reading list, but it should have been, especially if you sell cars for a living. By the time you finish this article, some of you will feel the hairs on your necks stand up.

Most auto dealers will immediately recognize the Truth In Lending Act by its acronym, TILA. Virtually every car dealer's blank Installment Sales Contract contains a section entitled "TILA disclosures." These disclosure aren't just for show, federal law requires that dealers make them, and imposes penalties for failure to do so.

When a car dealer offers to extend "closed end" credit (a loan associated with a specific purchase) to a potential buyer, the dealer is required to make a number of "TILA disclosures," including the amount of the finance charge, the number of payments to be made, the amount of each payment, the annual percentage rate for the loan, and the total amount required to repay the debt – basically, the terms of the loan in a nutshell. By requiring consumer lenders to provide the TILA disclosures "in a uniform and straightforward way," consumers are supposed to be able to comparison shop for credit and to make better-informed decisions about borrowing.

Federal Acts like TILA are written in broad strokes. Often, a given Act empowers a federal agency to implement the policies outlined by the Act and to issue "Federal Regulations" consistent with the Act's terms. Perhaps an apt analogy here would be to compare an architect's conceptual drawing of a bridge with an engineer's diagram of the same monument. The conceptual drawing (the Act) is supposed to capture the essence of the bridge, but the diagram (the Regulations) actually explains how the bridge was built and how it functions.

In TILA's case, The Federal Reserve's "Regulation Z" delineates the steps necessary to comply with TILA. In addition to defining the required disclosures, Regulation Z lays out *when and how* the disclosures must be made. One portion of Regulation Z states: "The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, *in a form that the consumer may keep*." The same Regulation later elaborates on the timing requirement, stating, "The creditor shall make disclosures *before consummation* of the transaction" and defining "consummation" as "the time that a consumer becomes contractually obligated on a credit transaction."

It all seems fairly straightforward, though of course that would not make for a very interesting article. In practice, the TILA's disclosure timing requirements have been litigated dozens of times. One phrase in particular has been the subject of repeated litigation. Again and again, in courts all across the country, the question has been asked, "What does it mean to provide the TILA disclosures 'in a form that the consumer may keep'?"

You see (and many of you know), most automobile dealerships don't extend credit; rather, they accept the consumer's down payment and then arrange for a third party – a bank or similar financial institution – to lend the balance. That being so, car purchasers have often been asked to review and sign the contracts for their new cars – including TILA's required disclosures – but haven't taken copies of the contracts home with them. Instead, the original contracts were forwarded to a third-party lender pending final approval. The consumers only received their copies of the disclosures when (and if) their loans were approved by the third-party lenders. The problem was that this receipt arguably occurred *after* "consummation of the transaction."

When consumer advocates became aware of this situation, they argued that the failure to provide an extra copy of the TILA disclosures prior to signing the installment sales contract amounted to a violation of Regulation Z. Specifically, these

advocates felt that the Regulation's "in a form the consumer may keep" requirement dictated that consumers receive separate "disclosures" sheets prior to signing any installment sales contract.

This dispute went beyond idle debate. Regulation Z provided plaintiffs' attorneys with an incentive to settle the matter in court. Specifically, the Regulation permitted plaintiffs to recover actual damages (the amount that the consumer would have saved had he "shopped around"), statutory damages (often measured as a percentage of the dealership's net worth), and attorneys' fees. If, as consumer advocates argued, dealerships were required to provide an extra copy of the disclosures to purchasers prior to execution of the installment sales contract, plaintiffs' attorneys could literally file suit after suit – and win – until every dealership in the country had come into compliance. And, of course, the attorneys could make a pretty penny doing it. That fact probably accounts for the surge in TILA disclosure suits in the past three years.

Many courts have disagreed with the consumer advocates' interpretation of TILA. One prominent decision, *Nigh v. Koons Buick Pontiac GMC*, held that, "[G]iving a buyer the credit terms on [an installment sales contract] that he is to sign complies with the timing requirements of the Act." Another court decided that TILA's notice requirements were met by supplying the purchaser with a contract containing the required disclosures "as little as one second before consummation, provided that there is no evidence that the customer could not have kept or taken away a copy of the contract with the TILA disclosures before he or she signed it."

However, plaintiffs' attorneys have also had their victories. Most plaintiffs in TILA disclosure litigation rely on *Polk v. Crown Auto, Inc*., a decision that has been read to require a creditor to provide a separate written copy of the TILA disclosures before a consumer signs an installment contract. Several courts have followed this interpretation of *Polk*, and a strict application of Regulation Z's "in a form the consumer may keep" language has been recognized as the law in some jurisdictions. Obviously, courts were divided on the issue, with no clear resolution in sight.

For whatever reason, comparatively few TILA disclosure cases were filed in Texas or the Fifth Circuit until recently. While some circuits were busy following *Nigh* and others *Polk*, the Fifth Circuit (and several other federal jurisdictions) never had to choose. The Federal Reserve was aware of the "circuit split" on the one hand, and of the lack of controlling authority on the other. The Reserve knew that it had a problem on its hands, and acted to resolve that problem earlier this year.

On April 9, 2002, The Reserve issued "Comment 17(b)-3," a publication intended to clear up the controversy concerning the TILA disclosure requirements once and for all. A portion of the text accompanying the release of that comment stated:

> The practice of putting TILA disclosures on the same document with the credit contract is common in connection with motor vehicle installment sales. Several recent court decisions have addressed whether creditors that use a single document must provide consumers with a separate copy of the disclosures to keep before providing a second copy that the consumer may execute to become obligated on the credit contract. The court decisions have not been uniform in their result.
>
> The comment clarifies that creditors satisfy TILA by giving a copy of the document containing the disclosures to the consumer to read and sign. Commenters generally agreed with this aspect of the proposal. In response to commenters' suggestions, the final comment has been revised to clarify that a creditor need not give the consumer two copies.
>
> Comment 17(b)-3 also clarifies that it is not sufficient for the creditor merely to show the document containing the TILA disclosures to the consumer before the consumer signs and becomes obligated. Rather, a creditor must give the disclosures to the consumer, so that the consumer is free to take possession of and review the disclosures in their entirety before signing.
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> Commenters disagreed over the extent to which the comment should address the ability of a consumer to take physical possession of, and keep, the document containing the disclosures. Consumer advocates believe that a consumer should be able to take possession of and keep the disclosure whether or not the consumer consummates the transaction at that time. Some industry commenters contended that the creditor need only present or show the document to the consumer.
>
> Comment 17(b)-3 is being adopted substantially as proposed. Allowing a consumer to take possession of and review TILA disclosures in their entirety-including any required information that may be on the reverse side or continued on the next page-is essential to meaningful disclosure and fulfillment of the regulation's requirement that disclosure be in a form the consumer may keep. Whether or not the consumer signs and becomes obligated, the consumer will have received a copy of the disclosures.
>
> Some industry commenters asserted that even though creditors must provide consumers written disclosures before consummation, there is no requirement that consumers receive a copy to keep at the time the credit transaction is consummated. These commenters suggest that creditors are required only to give consumers a copy to keep within a reasonable time after consummation. The Board believes such a result would be inconsistent with the regulation's requirement that consumers receive a copy, in a form they may keep, before consummation. Under the final comment as adopted, consumers must receive a copy to keep at the time they become obligated.

This comment is hardly the slam-dunk clarification that many had hoped for. In fact, it appears to say two contradictory things: First, that "creditors satisfy TILA by giving a copy of the document containing the disclosures to the consumer to read and sign," and second that "consumers must

receive a copy to keep at the time they become obligated." To some extent, it leaves open the question of whether supplying the TILA disclosures in the contract – then retaining the contract until funded – satisfies TILA.

The illustration to the comment is not much more enlightening:

> Illustration: 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.

If you are a pragmatist, reading this illustration might cause you to ask, "What difference would it make if the copy of the installment sales contract was supplied hours instead of seconds after the contract was signed? What if the copy were sent over the next day . . . or the day after that?" After all, the consumer has already signed the contract; he is not exactly free to "comparison shop" for credit anymore. And he won't be retroactively informed about his borrowing decision just by virtue of being handed a piece of paper. The simple fact is that the consumer either read the contract before he signed it, or he didn't. Giving him a copy afterward won't make him wise, and it won't make him shop around.

Nevertheless, the illustration above *is* the law. Many laws, like this one, don't make perfect sense. It's generally more trouble to point out the flaws in a law than it is to comply with that law, and that is exactly the case here. The Federal Reserve's comments and illustrations are meant to create a "safe harbor" for consumer lenders. If you follow the illustration above – to the letter – you won't violate TILA's timing requirement. (You can still be sued for violating TILA, but, at least on this point, you'll win.)

Therefore, conform. Conform as quickly as possible. In order to take refuge in TILA's "safe harbor," all you'll need is "a multi-copy form containing a credit agreement and TILA disclosures." Different colored carbon copies are recommended. After the consumer "reviews and signs the form," separate the copies for him and hand one back (this is the most important step . . . if you leave this one out, you're out of the harbor). Then, just for good measure, take a snapshot of the consumer as he leaves your office – with a copy of the TILA disclosures stapled to his lapel. Put it in your files. One day you may need it in court. "I've heard Mr. Smith's testimony, Your Honor, but let me show you a picture of him, marked Defendant's Exhibit 1 . . . ."

AROUND THE CIRCUIT

- Right To Nursing Home Care

On November 17, 1999, Mildred Tanco moved into an assisted living facility operated by Avalon Residential Care Homes, Inc. In an effort to pay her bills at Avalon, Tanco filed a claim for benefits under her long-term care nursing home indemnity policy. The policy, issued by GE Financial Assurance Co., provided coverage for "Necessary Nursing Home Stay" as defined by the policy. GE Financial denied Tanco's claim, reasoning that the Avalon facility did not qualify as a "Nursing Home" under the policy. Tanco did not sue GE Financial for denial of her claim. Rather, Avalon took direct action against the insurer, alleging violations of the Fair Housing Act.

The FHA generally prohibits discrimination in the sale or rental of housing, and Avalon's complaint contended that GE Financial's refusal to pay benefits for care at the assisted living facility amounted to discrimination "in the sale or rental" of a dwelling "because of a handicap" – behavior specifically prohibited under the FHA. But Judge Lindsay of the Northern District of Texas dismissed Avalon's claim, holding that the FHA did not create a cause of action under these circumstances. Because GE Financial neither "sold" nor "rented" the Avalon facility, it was not a proper defendant for an FHA claim.

-Terrorist Attacks

After the September 11, 2001 terrorist attacks, all United States airports were closed by the Federal Aviation Administration, causing deep losses for many hotel chains. 730 Bienville Partners, one such chain, had purchased a commercial property insurance policy from Assurance Company of America, including a "Civil Authority Extension" to coverage. That extension covered losses "caused by action of civil authority that prohibits access to your premises" – things like road repairs or expansions.

Bienville claimed that the Civil Authority Extension applied to the losses it suffered as a result of the FAA's airport closure following 9/11. Essentially, the chain was arguing that, because the FAA had prevented travelers from flying to their destinations, a "civil authority" had prevented guests from

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reaching Bienville's hotels.

Judge Martin Feldman of the Eastern District of Louisiana didn't see it that way; he rejected Bienville's claim, finding that the terms of the policy were unambiguous and stating, " To recover for business losses under the Civil Authority Extension of commercial property insurance, the loss of business income and necessary expenses must have been caused by action of civil authority that *prohibited access* to the insured's hotels. While the closure of the airports and cancellation of flights may have prevented many guests from getting to [Bienville's] hotels, the guests were not prohibited from getting access to the hotels."

-Foundation Damage

Lance and Randa Keeling purchased a Standard Texas Homeowners' Policy from State Farm Lloyds. That policy specifically excluded losses "caused by settling, cracking, bulging, shrinkage, or expansion of foundations, walls, floors, ceilings, roof structures, walks, drives, curbs, fences, retaining walls or swimming pools." At some point during the policy period, the Keelings discovered that their home had a water intrusion problem. On January 26, 1999, they notified State Farm that Baker Brothers Plumbing had verified a leak somewhere in the sewer line beneath their house. Subsequent testing revealed two plumbing leaks under the Keeling's utility room. This damage, stemming from plumbing leaks, would have been covered by the policy.

After receiving notice of the Keeling's claim, State Farm hired an engineer to determine the cause of the water damage. This engineer conducted a structural evaluation of the home, including an "inspection and survey of the premises, field and laboratory soil testing, interview with owner, and review of independent plumbing tests and repairs." Based on his investigation, the engineer concluded that only a portion of the damage was caused by the plumbing leaks. He opined that certain foundation damage and cracking in various parts of the house were not caused by the leaks. State Farm therefore only paid a small fraction of the Keeling's claim.

An expert *hired by the Keelings* arrived at a different conclusion, and testified that all of the damage to the home had been caused by introduction of moisture into the foundation, and could only have been caused by a plumbing leak. This evidence, viewed in the light most favorable to the Keelings, was sufficient to create a fact issue as to whether the damage to their home was caused by a plumbing leak. Summary judgment on that issue would have been inappropriate.

The Keelings' expert's testimony also precluded summary judgment in favor of State Farm under the doctrine of concurrent causation, as his testimony provided a reasonable basis for a jury to conclude that 100 percent of the foundation damage to their home was caused by a "covered peril." State Farm's motion for summary judgment on that issue was also denied.

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