



What's a Dealer to do about **ADVERSE ACTION NOTICES?**

You may be confused about your responsibility to customers where finance companies are involved. **You could be found liable if you don't err on the side of caution.**

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Adverse action notification under the Equal Credit Opportunity Act (ECOA) and the Fair Credit Reporting Act (FCRA) just became more confusing as a result of a recent opinion from the Federal District Court in the Eastern District of Virginia. If your dealership has not been sending adverse action notices and you are wondering whether your dealership should institute procedures for doing so or, are wondering what an adverse action is, then this article may help.

Two federal acts deal with a creditor's obligation to furnish certain information to a customer seeking financing

whenever a decision is made that is adverse to the customer. The purpose of the first act, the Equal Credit Opportunity Act (ECOA), is to prohibit creditors from discriminating against any credit applicant "with respect to any aspect of a credit transaction ... on the basis of race, color, religion, national origin, sex or marital status." Among its other goals, ECOA was enacted to eradicate credit discrimination, especially credit discrimination waged against married women whom creditors traditionally refused to consider for individual credit.

In the second act, the Fair Credit Reporting Act (FCRA), Congress's main goal was to ensure that credit re-

porting agencies exercised their “credit reporting responsibilities with fairness, impartiality, and respect to the consumer’s right to privacy.” FCRA was enacted to correct abuses which Congress perceived within the consumer credit reporting industry, and establishes a means for consumers to correct inaccuracies in their credit report.

Under both ECOA and FCRA, “creditors” are required to provide notice to consumers under certain circumstances when “adverse action” is taken with respect to the consumer’s application for credit or the customer’s interests. With limited exception, most courts consider dealerships to be creditors under both the ECOA and the FCRA. A “creditor” is defined as:

“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.”

If your dealership enters into retail installment contracts with customers when selling motor vehicles, or even if it just arranges for the customer to obtain credit from financing source, the dealership will be considered a creditor under both acts.

The types of action which will trigger the obligation to send an adverse action notice is a trickier issue. Under ECOA, the term “adverse action” is defined as:

“A denial or revocation of credit . . . or a refusal to grant credit in substantially the amount or on substantially the terms requested.”

In contrast, under FCRA an adverse action is not just limited to a creditor’s denial or revocation of credit. Under FCRA the term “adverse action” is defined more broadly because it contains a catch-all provision in which an action is considered “adverse” if it is “adverse to the interests of the consumer.”

Not surprisingly, whether an action is “adverse” and thus triggers the notice requirement under ECOA and FCRA depends upon the facts of the case. Some courts have found adverse action when:

a) a dealership has repossessed the vehicle it sold based upon the failure of a finance company to qualify the customer for credit, *Castro v. Union Nissan, Inc.*,

2002 WL 1466910 (N.D. Ill. 2002) as occasionally occurs when making a spot delivery.

b) a dealership decides not to submit a credit application to a finance company because it does not believe that the customer will qualify for financing, *Treadway, supra*.

c) a dealership raises the interest rate from the rate that was applied for by the customer, *Padin v. Oyster Point Dodge*, 397 F. Supp. 2d 712 (E.D. Va. 2005).

d) a dealership requires a customer to make an additional cash deposit toward the purchase price in order to obtain financing, *Rayburn v. Car Credit Center Corp.*, 2000 WL 1508238 (N.D. Ill. 2000)

e) a dealership decides that the customer needs a co-signer in order to secure financing, *Rodriguez v. Lynch Ford, Inc.*, 2004 WL 2958772 (N.D. Ill. 2004).

On the other hand, some courts have declined to find adverse action when:

a) a dealer secures financing on substantially the same credit terms with an alternate lending source, *Madrigal v. Kline Oldsmobile, Inc.*, 423 F.3d 819 (8th Cir. 2005); *Mayberry v. Ememessay, Inc.*, 201 F. Supp. 2d 687 (W.D. Va. 2002).

b) a dealer repossesses the vehicle it sold based solely on the customer’s failure to make a payment, *Castro v. Union Nissan, Inc.*, 2002 WL 1466810 (N.D. Ill. 2002).

c) a dealer refuses to extend credit because it learns that the customer had falsified the income stated in the application, *Mayberry v. Ememessay, Inc.*, 201 F. Supp. 2d 687 (W.D. Va. 2002).

d) a dealership provides a counter-offer to the credit terms sought, which the customer accepts, *Harper v. Lindsay Chevrolet Oldsmobile, LLC*, 212 F. Supp. 2d 582 (E.D. Vir. 2002).

For some time now, most dealerships have been operating under the understanding that when a finance company declines to fund a transaction and sends an adverse action notice to the customer, then the dealership’s obligation to send a notice has been satisfied. This understanding has been based upon several rather uniform decisions by courts that have considered the issue over the past few years. However, recently, the court in *Barnette v. Brook Road* (*Barnette v. Brook Road, Inc.*, Civ. Act. No. 3:05CV590 (E.D. Vir. July 18, 2006) di-

ADVERSE ACTION DEPENDS ON A NUMBER OF FACTORS

The timing and specific contents of an acceptable adverse action notice will depend upon a number of factors including: a) the level of gross revenue of the dealer, b) whether the customer’s credit application is complete, c) the nature of the credit decision, d) whether a counteroffer with different credit terms is to be extended, and e) whether the dealer wishes to take advantage of a regulatory election regarding notice contents. That being said, ECOA requires that the notice identify the creditor, inform the customer of the adverse action, and furnish the specific reasons for the credit decision.

ECOA requires that the notice be sent within 30 days of the receipt of a completed application, or within 30 days of the adverse action if the application is incomplete at the time.

Whether an adverse action notice under FCRA is required and if so, the specific contents of an adverse action notice also depend upon several factors, including: a) whether the adverse action is based upon credit information received about the customer or some other factor, and b) whether the source of the credit information is a credit reporting agency, a third party, or an affiliate of the creditor. Assuming that the adverse action is based upon information contained in a credit report that the dealership obtains from a credit reporting agency, then in general terms, the FCRA requires that the customer be notified of the adverse action, that the notice identify the name and contact information of the credit reporting agency who furnished the consumer’s credit report, and that the notice inform the customer of the right to obtain a free copy of the report from the reporting agency and the right to dispute the accuracy or completeness of reported information. Although FCRA does not specify a particular deadline within which a creditor must furnish the adverse action notice, generally creditors furnish the FCRA adverse action notice contents in the same notice that they send to the customer in order to satisfy ECOA.

verted from what was seemingly settled law in many jurisdictions.

In the *Barnette* case, an individual received a flyer from an ad agency indicating that she had been pre-approved for a loan of up to \$16,687 at a particular dealership. She visited the dealership, filled out a credit application, and negotiated a monthly payment of \$350 with a salesperson. The customer was aware that the dealership was not the lender, and that a third party would provide the loan. The dealership shopped the customer's credit application to two lenders. One of the lenders conditionally approved a \$12,000 loan to the customer with a payment of \$500 per month upon receipt of proof of income. The customer then selected a car, and signed documents memorializing the sale. Among the documents that the customer signed was an installment sales contract between the customer and the dealership (with a section allowing assignment of the contract to the lender) and a buyer's order which conditioned the sale upon approval of the finance contract.

Before the first payment became due, the lender, who had conditionally approved the customer, declined to accept the customer's finance contract because the customer had not furnished sufficient proof of income. The lender alternatively stated that it would accept the deal if the customer had a co-signer. The customer refused to return the vehicle. The two lenders to whom the dealer submitted the credit application each sent notices to the customer indicating the reasons that they declined to extend credit.

Notwithstanding that the lenders had each sent adverse action notices, the customer sued the dealer for, among other claims, failing to also send the customer an adverse action notice under ECOA and FCRA. The dealer argued that it relied upon the lender to send out adverse action notices, rather than sending them itself.

The *Barnette* court first looked at whether the dealership was a creditor that had a duty under ECOA to send an adverse action notice. Although the court found the dealership to be a creditor, the court found that the dealership had not made an adverse credit decision under ECOA. Rather, the court found it was the two lenders who had made the adverse credit

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whenever a credit package is submitted to multiple financing sources, if any of the financing sources rejects a credit package and fails to send an adverse action letter, a dealer can be found liable, even though other finance sources may have complied with the adverse action notice requirement.

decision under ECOA, and that the dealership merely conveyed the lenders' decision to the plaintiff.

However, the court found that FCRA was broader in scope when defining the term "adverse action" than ECOA. The court noted that although ECOA limits its applicability to "adverse credit decisions," the definition of "adverse action" under FCRA extended to any action that would be considered "adverse to the interests of the consumer." The court found that by canceling the sale and repossessing the vehicle, the dealer had undertaken actions which were "adverse to the interests of the consumer" and concluded that the dealership therefore had an independent duty under FCRA to send an adverse action letter to the customer. Although the dealership argued that the adverse action letters sent by the two lenders satisfied the notice requirements under FCRA, the *Barnette* court disagreed, finding that the dealership "must also have provided the required notice."

Even had the dealer successfully persuaded the *Barnette* court that it was not required to send an adverse action notice under FCRA, it, like most other dealerships, runs the risk that one or more of its

finance sources will decline to fund a transaction and yet fail to send the adverse action notice required under ECOA and FCRA. Both the dealership and the lenders who receive the customer's credit application package from the dealership have a concurrent duty to send the adverse action notice. As a result, whenever a credit package is submitted to multiple financing sources, if any of the financing sources rejects a credit package and fails to send an adverse action letter, a dealer can be found liable, even though other finance sources may have complied with the adverse action notice requirement.

It is possible that the *Barnette* decision will be appealed and that the appellate court will side with the dealer. However, dealers still run the risk that their finance source may fail to adhere to federal adverse action notice requirements — leaving the dealer on the hook for violating these federal acts. As a result, your dealership may wish to institute its own adverse action notification policy to mitigate this litigation risk. Although the specific contents of an acceptable adverse action notice will depend upon the nature of the decision and the impact on the customer, in general terms, for dealers ECOA requires the notice to inform the customer of the declination of credit and furnish the reasons for the declination, while FCRA requires the notice to identify the source of credit information received about the consumer (such as the name and contact information of the credit reporting agency that furnished the consumer's credit report) whenever the dealer's adverse action is based upon the consumer's credit report, and must inform the consumer that they have a right to obtain a copy of the report from the agency and the right to dispute the reported information. Because this area of the law continues to develop in the court system, make sure that you discuss the litigation risks and the merits of establishing an adverse action notice program with an attorney who is familiar with this area of federal regulatory compliance. ■

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