



Don't Fence Me In

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The U.S. Department of Justice, the U.S. Attorney's Office for the Western District of North Carolina, and the North Carolina Department of Justice announced a settlement of the federal government's first-ever discrimination lawsuit involving "buy here, pay here" auto financing. The settlement, subject to court approval, resolves a lawsuit alleging that Auto Fare and Southeastern Auto, two BPH dealerships in Charlotte, North Carolina, and their owner violated the federal Equal Credit Opportunity Act by engaging in a pattern or practice of "reverse redlining" by intentionally targeting African-American customers for unfair and predatory credit practices in the financing of used car purchases.

The lawsuit alleged that the two dealerships' sales prices, down payments, and interest rates were disproportionately high compared to other subprime used car dealers. Because the dealerships did not meaningfully assess the customers' creditworthiness or ability to repay, their rates of default and repossession allegedly were disproportionately high. Additionally, the dealerships allegedly engaged in repossessions when customers were not in default. North Carolina also alleged that the dealerships' actions violated the state's Unfair and Deceptive Trade Practices Act.

The press release announcing the settlement says that the settlement requires the dealerships to implement practices to ensure that the terms of their credit sales and repossession practices are no longer unfair and predatory. In many settlement agreements, that means that the defendant agrees to comply with the law applicable to its business.

A look at the terms imposed on the dealerships by the settlement, however, shows that the dealerships are prohibited by the terms of the settlement agreement from doing a number of things that other dealerships not subject to the settlement may legally do. Here are a few examples: limiting projected monthly payments to no more than 25% of a buyer's income; requiring interest rates to be at least five percentage points below the state's rate cap; mandating a lower interest rate for buyers who have specified evidence of lower credit risk; requiring competitive sales prices; prohibiting repossessions until at least two consecutive payments have been missed; providing down payment refunds to buyers who quickly go into default; and allowing buyers to obtain an independent inspection of the car before completing the purchase.

How is it that a government agency can require a dealership to do things not required by law or to refrain from doing things not prohibited by law? Good question.

It is such a good question that I did not know the answer to it, so I consulted my partner, Joel Winston, who was a federal enforcer for several decades before joining our firm.

What Joel told me is that “[t]his is what’s known in the trade as ‘fencing-in relief.’ The FTC has the authority in a remedial order, and frequently exercises that authority, to require law violators to take certain actions that go beyond what the law requires in order to ‘close off all roads to the prohibited goal.’”

“Fencing-in relief,” Joel explained, “is directed at a particular violator and is not intended to apply industry-wide generally or to enunciate an across-the-board legal standard. Decades of case law deal with how far beyond the violations alleged the government (mainly the FTC) can go in fencing-in relief. The government has a fair amount of latitude, so long as the relief is reasonably related to the violations and reasonably calculated to prevent future violations. On the other hand, despite what the regulators seem to think, the relief can’t simply be a wish list of what the government thinks is good or bad behavior.”

That said, get a load of this quote from Acting Assistant Attorney General Vanita Gupta of the Civil Rights Division: “It is not only illegal, but also fundamentally wrong, to target borrowers of color for predatory loans and exploit their need for a car to do essential tasks such as getting to work. Combating discrimination in all segments of the auto lending market is, and will remain, a top priority for the Civil Rights Division. I am pleased that these dealerships have agreed to reform problematic lending and servicing practices and adopt policies that promote responsible lending. ***I hope that other buy here, pay here dealerships will evaluate their practices in light of this settlement.***” [emphasis added]

So, does this action require all BHPH dealers to adopt the business restrictions and limitations imposed by the regulators in this settlement agreement? It does not.

It does, however, offer a view into the regulatory mindset of the federal and state authorities now policing the BHPH beat. The press release says, “The settlement requires the dealerships to implement a number of specific practices to ensure that the terms of their loans and repossession practices are no longer unfair and predatory.” These dealers are precluded from doing things that are otherwise legal, and that seems to indicate that the enforcers have concluded that actions that do not expressly violate state and federal law can be unfair and predatory.

Where does that leave other BHPH dealers? Seems to me that they, too, are fenced in, but the fence that constrains them is an invisible one they can encounter even when operating on the right side of the law.

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