WINNING BIG VERDICTS AGAINST FRINGE MARKET SELLERS

By Thomas J. Methvin
Beasley, Allen, Crow, Methvin, Portis & Miles, P.C.

There are many important things that must be done in a quest to win a big verdict against a fringe market seller. The most important thing that must be done at the outset is to establish the theme of the case. Once that theme is established, all discovery must be aimed at proving this theme. If the theme is established early and can be proven, one will have a good chance of obtaining a large verdict.

I. THEORIES OF LIABILITY

Though there are many other tort theories available, this paper concentrates on common law fraud as it relates to different wrongful conduct that is common in the finance industry.

A. REQUIRING CREDIT INSURANCE

Finance Companies have a motive to pack insurance on all loans. The premium charged increases the amount financed, which increases the interest and profit to the company. Also, the finance company or its employees receive a commission from the sale of some of these products. Many times the sale of the insurance product is through one of the finance company's subsidiaries or sister corporations which adds to the profit. Most states allow the finance companies to sell insurance through their subsidiaries if it is disclosed somewhere in the documents (usually the fine print).

Credit insurance takes many forms. Credit life insurance is one form of credit insurance. It is designed to pay off the loan balance in the event of the consumer's death. Many consumers have been told by finance companies that they were required to purchase credit life insurance in order to receive the loan. Credit life insurance is some of the most costly life insurance sold in Alabama.

It is illegal in most states to require credit life insurance as a condition to receiving the loan. The fine print of the loan documents signed by the consumer always states that the insurance is not required and that it is completely voluntary. Many people who deal with the finance companies do not read the documents they sign. They usually trust who they are dealing with.

One theory of liability is common law fraud:

Lie: I promise you the insurance is required;

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Reliance: taking out the insurance;

Damage: the cost of the premium plus the interest.

Most of the time, there are health questions that are required to be answered before the credit life insurance policy can be issued. The finance companies realize that if the questions are answered in a fashion showing the consumer is in bad health that the insurance will not issue. Therefore, some don't ask the health questions so that the policy will issue. Later, when a claim is made, the insurance company can use the bad health of the consumer as grounds to deny the claim. The theory here is known as "clean sheeting". Clean sheeting is fraud. *See Liberty National v. Waite 551 So. 2d 1003 (Ala. 1989), See John Hancock v. Variable Life Insurance Company vs. Pierce, 537 So.2d 719 (Ala. 1987)*

Another form of credit insurance which has been required as a condition to receiving a loan is credit disability or credit accident insurance. This insurance is designed to make the payments of the consumer while he is disabled or in an accident. Many consumers have made claims on such insurance that have never been paid. The major ground used to deny claims is that the consumer was disabled at the time he took the policy out. However, many times no questions are asked regarding whether or not the consumer is disabled at the time the loan is made. The theory of fraud here is:

Lie: I promise that disability insurance will pay in the event you are disabled;

Reliance: purchasing the insurance;

Damages: paying the premium for it, plus interest.

Alternatively, if the consumer is uneducated and cannot read and write a fraudulent failure to disclose theory may be appropriate.

Another type of credit insurance is involuntary unemployment insurance. This insurance is designed to make the payments of the consumer if he loses his job involuntarily. In the fine print of many of the insurance policies, there is a provision that the consumer must be employed for 12 consecutive months before taking out the insurance in order for there to be coverage. Many times, no questions are asked regarding the length of the consumer's employment at the time he takes out the insurance. However, the consumer's lack of employment is used by the insurance company as grounds to deny coverage. The fraud theory here is:

Lie: I promise you the insurance will pay in the event you are unemployed;

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Reliance: taking out the insurance;

Damages: the premium payment plus interest.

B. PROPERTY DAMAGE INSURANCE

Another area of insurance packing in the consumer finance industry deals with collateral protection insurance. Many finance companies require that the collateral protection insurance be sold through the finance company. Of course, it is perfectly permissible to require insurance on the collateral. However, it is illegal in most states to require the consumer to purchase collateral protection insurance through the finance company. On many occasions, consumers are told they must buy the collateral protection insurance through the finance company in order to obtain the loan. Many times, the value of the collateral is inflated, which causes the premium on the insurance to be higher than the premium which the consumer would pay elsewhere. As stated above, there is a motive for the finance company to charge as high a premium as possible. The finance company receives interest on the total amount financed, commissions and many times the insurance is sold through a related corporation.

One theory of liability again is fraud:

Lie - I promise you that you are required to purchase insurance through the finance company;

Reliance: purchasing insurance through the finance company;

Damages: difference in the cost of insurance plus interest minus the amount the consumer could have paid elsewhere for the same insurance.

C. NON-FILING INSURANCE

This is a type insurance where the finance company charges a fee to the consumer in lieu of filing a UCC financing statement. The finance company charges a premium and supposedly gives the premium to an insurance company to cover it in case it has to repossess the collateral and is unable to repossess it solely because it failed to file a UCC financing statement to perfect its security interest. Theoretically, the finance company can then look to the insurance company for payment of the value of the collateral.

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There is much abuse in this practice. Many times, there is no insurance at all. The finance company simply keeps the money. Other times, the money is paid to an insurance company and 100% of the premium is returned to the finance company. Other times, the non-filing insurance is charged on collateral that the debtor finances at point of purchase. This involves the finance company's purchase money security interest. Non-filing insurance on this transaction is useless because UCC financing statements are not required to perfect the security interest in such goods. Therefore, non-filing insurance is not necessary. As stated above, the motive for this is to increase the amount financed.

One theory of liability here is a scheme to defraud, or, fraudulent failure to disclose.

D. HOUSEHOLD GOODS AS COLLATERAL

The Federal Trade Commission has enacted strict regulations regarding household goods being used as collateral in consumer loans. Generally, most household goods cannot be used as collateral. 16 *C.F.R.* §444.2(a)(4). Since they cannot be used as collateral, they certainly cannot be repossessed. However, many finance companies take a security interest in these goods solely to be able to charge collateral protection insurance on it.

Some finance companies take a security interest in such things as fishing poles, clock radios, blankets, televisions, and other similar items. Since it is not real collateral, it is improper to charge insurance on it. The company has no insurable interest in it. They rarely try to repossess the collateral. The fraud theory here is a scheme to defraud and a fraudulent failure to disclose that the insurance charges are not required.

Normally, the defendants will try to remove these cases, stating that since FTC rules are the basis for the claim that the claim involves a federal question. However, the *Gully v. First National Bank in Meridian, 299 U.S. 109, 57 S.Ct. 96 (1936)*; *Merrell Dow Pharmecuticals, Inc. v. Thompson, 478 U.S. 804, 106 S.Ct. 3229 (1986)* cases require remand. These cases state that removal is not allowed simply because an element of your state law claim involves federal law.

E. FORCE PLACED INSURANCE

This type insurance deals with collateral protection. At the time of the loan, many consumers take out their own collateral protection insurance from a separate company. However, if the consumer does not keep the collateral protection insurance, the finance company in the loan contract has the right to purchase collateral protection insurance on the collateral. It is permissible, for the finance company to buy insurance similar to the insurance that the consumer let lapse. However, many finance companies have abused this privilege by purchasing

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insurance that gives them more protection than the consumer originally had with his insurance. For example, there are some policies force placed that protect the finance company against the consumer's default. In other words, if the borrower doesn't make his payments to the finance company, the insurance will make the payments. The premiums are the highest allowed by law and the finance companies are allowed to charge interest on the premium.

Perhaps the area that is most abused is that the insurance premium on this type insurance is based on the total gross balance of the loan, but in the event of a total loss of the collateral, the insurance will only pay the actual cash value, or depreciated value of the collateral. Many times, the collateral is worth less than the gross balance of the loan; i.e., cars, mobile home, and things that depreciate.

While the consumer pays a higher premium based on the total amount owed plus interest, the most the insurance will ever pay is a lesser amount; i.e., the value of the collateral.

One theory of liability is fraud. It can be couched in a failure to disclose or a scheme to defraud theory.

F. DEALER FRAUD

Many consumer financial transactions take place through dealers; i.e., sellers of goods and services such as cars, mobile homes, televisions, satellite systems, stereos, washing machines, etc. Most of us have seen things advertised wherein the dealers state they can handle the financing.

(1). Yield-Spread Premium

Most of the time, this dealer arranged financing is handled in the following manner. The finance company gives the dealer all of the necessary documents for the consumer to sign in order to consummate a loan, i.e., a retail installment contract, mortgage or UCC financing statements, truth in lending documents, etc. The dealer then sells the product and gets the consumer to sign all of the finance papers. In actuality, this is a loan from the finance company to the consumer, with the consumer making his payments back to the finance company from the very beginning. However, on paper, the dealer is shown to be the finance company.

This paper trail is created so the finance company can claim that it is purchasing the loan from the dealer and not making a direct loan to the consumer. Since the finance company is purchasing the loan, it can assert that it can purchase the loan for less than the face value of the loan (at a discount). Many times the finance company purchases the loan at a discount,

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which was agreed upon prior to the underlying loan ever being consummated.

Other times, the finance company will simply keep a certain amount of the amount financed in each deal. In other words, when the finance company "buys the loan", the finance company will keep for example $500.00 of the amount financed and never give it to the dealer. This is money that never leaves the hands of the finance company, yet the consumer is charged interest on it.

Practically, the act of buying the loan at a pre-approved discount or keeping part of the amount financed requires the dealer to raise his prices by $500.00 (in the example above) to make the same profit he would make if the money had not been kept by the finance company. It can be argued that the $500.00 that the finance company kept or the discount is a finance charge. If it is a finance charge, it should be disclosed to the buyer.

Another form of the dealer discount works as follows. The dealer will call the finance company and ask what interest rate the finance company is willing to make the loan to the particular consumer. The finance company agrees to make the loan for example at 10%. The dealer will then add 2% on top and make the loan at 12%. The dealer and finance company will split the 2%. The consumer is never told that the finance company was willing to make him the loan at 10%. This is sometimes referred to as a yield spread premium. It is a jury question whether or not the finance company and dealer are required to disclose the yield spread premium to the consumer. The theory of liability in the dealer discount area is that the company fraudulently failed to disclose to the consumer that there was a finance charge. Many times, the consumer never would have entered into the loan if he had known the true facts or if he had known that he could have gone elsewhere and gotten the financing cheaper.

(2). Revolving Door-to-Door Sales

Another area of consumer fraud involves revolving credit in which some finance companies have designed a custom credit card program to cater to door-to-door sales and financing. This financing includes satellite dishes, vacuum cleaners, vinyl siding, hearing aids and many more products. The satellite dish industry particularly has used this scheme to finance products, normally thought of as a one time purchase.

Many times, this credit program is structured like that of a dealer in a yield-spread situation. The finance company is removed by a shell agreement from the distributor who in turn recruits local dealers in area targeted by the program. The finance company again takes the position of a buyer of financial paper and not the actual entity behind the credit scheme.

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Often, the fraud occurs when the dealer's employee makes misrepresentations to the consumer regarding the price of the satellite system or fails to disclose the actual interest and finance charges included in the credit purchase. Many times the sale is made as though it is a sale over time with a local company with low monthly payments for a fixed period of time. Many times, the consumer has no idea of the nature of the revolving credit he has just entered into.

This credit card financing is open ended financing. Under the Truth-in-Lending regulations, the finance company is not required to disclose the total amount financed or the total amount of payments over time since it is open ended. It has been alleged by many that the finance industry has specifically used the credit card type financing because the disclosures keep the consumers more in the dark. The disclosures required in this type financing are much less than those required in closed end financing.

II. WORK-UP OF CASES INVOLVING FRINGE MARKET SELLERS

There are numerous areas that a successful practitioner must explore when working up one of these cases. Below are some of the most important.

Study state and federal agencies for any complaints;
Locate any ex-employees of defendant to testify about practices;
Request policy and procedures manuals that employees of the company are required to follow;
Request any training videotapes;
Request statistics such as penetration rates and loss ratios;
Do a Westlaw search to see if the company has been sued for similar acts;
Access your state's court system database to find other similar lawsuits;
Check your Attorney General's Consumer Division to see if there have been any investigations of the company;
Check the Better Business Bureau for complaints against the company.

A. CUSTOMER LISTS FROM DISCOVERY

(1) Why they are needed.

One of the most common defenses in lender litigation is that the bad actor, acting as agent for the lender, was a renegade agent. In other words, the lender argues that while it tries to police the people working for

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it, it is an imperfect world and sometimes mistakes are made in monitoring its agents. To combat this argument, similar occurrence evidence is needed. Similar occurrence evidence serves to combat the one bad apple defense and also to show notice of a problem. If a lender knew there was a problem and closed its eyes to the problem in order to make money, then an effective punitive damage argument can be made. One of the most effective ways of identifying other similar occurrences is to get the customer list from the lender.

(2) How to get the list.

Initial discovery should include a request for a list of all customers' names, addresses and phone numbers. The scope of this request may be limited to certain geographic areas and will almost certainly be objected to by defendants. The lists are needed in order to find pattern and practice witnesses to testify at trial.

(3) How to get their testimony into evidence:

The witnesses generated by the customer list are excellent evidentiary additions to any case. Some courts will limit the number of such pattern and practice witnesses allowed to testify at trial. Be sure to select the ones with facts most similar to yours. You must also pay attention to the date the witness dealt with the lender in relation to the date the Plaintiff dealt with the lender. Case law in most states establishes that these witnesses can be used to show scheme, intent and motive by the finance company.

Do not overlook this type of discovery in any case. The magnitude of a such a lender's alleged wrongdoing may only be truly identified by such pattern and practice testimony.

III. VOIR DIRE

The Voir Dire questions vary from case to case. A successful practitioner needs to develop the theme of his or her case in the voir dire. Questions need to be asked that push that theme. For example, if a finance company has taken advantage of an elderly widow, one of the questions in voir dire may be "Does anyone think that it is okay for a finance company to take advantage of an elderly widow?"

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A successful practitioner will also want to know who is predisposed to be against his or her client's position. One should also ask questions dealing with who believes in caps on punitive damages, tort reform, etc.

IV. Sample Opening – (see attached opening statement from *Carlisle v. Whirlpool*)

V. Sample Direct (See attached direct examination from *Carlisle v. Whirlpool)*

VI. Sample Cross-Examination (See attached cross examination from *Carlisle v. Whirlpool*)

VII. Sample Closing (See attached closing from *Carlisle v. Whirlpool*)

IV. CONCLUSION

The main thing to remember in your quest to win a big verdict against a fringe market seller is to identify the wrongful conduct and develop a theme early in the case. All discovery should be aimed at your theme. A central theme in a lot of these cases is that the defendant has entered into a widespread scheme to defraud the less fortunate of society. Most jurors, rich or poor, can identify with this and want to punish that conduct.

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