Burns & Levinson LLP

AUTOMOTIVE UPDATE

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WHY "SIDE AGREEMENTS" WITH YOUR CUSTOMERS ARE A BAD IDEA

Your Sales and F&I teams are probably willing to go the "extra mile" to close a sale with a customer, but when that "extra mile" includes making a "side agreement" to lend the customer money to close the deal, it's time to re-evaluate the transaction.

You might be surprised to learn that Sales and F&I employees will sometimes cut "side agreements" with the customer, in which the dealership will lend the customer a small amount of money as necessary to assign the loan and close the deal. Your initial reaction might be "but that doesn't happen in my dealership," and while we hope that is true, it is happening more often than it should.

As attorneys who represent many dealers, we have seen a variety of situations where the dealership's employees have extended credit to customers in an effort close the deal. This often occurs when the customer just needs a few more dollars down in cash to get financing. For example, we recently had a situation where a Sales Manager had a customer sign an "I Owe You" form documenting a loan from the dealership in the amount of $1000. The customer then used the loan money towards his cash down payment. We have also seen examples where F&I employees have drafted promissory notes where the dealership lends the customer money for insurance premiums on new vehicles sold.

Not surprising, "side agreements" are a bad idea all the way around. Typically, the employees making these deals think that the loans are "low risk," but they are not. The employees will often try to document the "side agreement" in writing, so there is an enforceable contract between the dealership and the customer, but these "side agreements" might not be in compliance with federal "Truth in Lending" requirements. Regardless, your dealership certainly does not want to be in the position of playing the role of debt collector when one of these customers fails to pay their loan back. More often than not, these customers disappear and dodge all efforts for collection. The dealer loses money.

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But there is a bigger liability associated with this practice that your employees likely do not know about. If your employees are making "side agreements" with your customers, your dealership is likely in violation of your indirect lending agreements with your lenders. For example, the M&T Massachusetts Dealer Agreement ("M&T Agreement") contains language that forbids these "side agreements." Under the M&T Agreement, a dealership assigning its contracts to M&T makes an affirmative representation that the contract being assigned is the only agreement between the customer and the dealership concerning the transaction. The dealer also represents that the amount identified as the "down payment" in the purchase agreement is correct and was actually received by the dealer in the form of a check or cash from the customer. A "side agreement" between the dealer and the customer violates these provisions and could jeopardize your lending relationship.

In addition, these "side agreements" could violate the representations made by the customer when he or she signs the purchase and sale agreement. For example, the Reynolds and Reynolds Massachusetts standard form motor vehicle purchase agreement ("P&S") states that "Purchaser represents and warrants that no credit other than that stated above has been extended to him by dealer." When your employees enter into "side agreements" with the customer, your dealership is extending "credit" to the customer in violation of the P&S. As soon as you make a "side agreement" regarding the extension of credit, that "representation" by the customer in the P&S is no longer accurate.

Your lenders rely upon the accuracy of the documents that your dealership prepares during the financing process. When misrepresentations are made, the lender could try to hold your dealership responsible for any losses if the customer defaults on the loan. The risk is simply not worth it.

We recommend that you educate your employees about the dangers of this practice. A transaction that might appear to be "low risk" to a Sales or F&I employee could come back to haunt the dealership if the lender discovers the "side agreement" with the customer.

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Burns & Levinson is a Boston-based, full service law firm with more than 125 attorneys in Massachusetts, New York and Rhode Island. The firm has grown steadily and strategically throughout the years, and has become a premier law firm with regional, national and international clientele. Core areas of practice are Business Law, Business Litigation, Intellectual Property, Private Client Legal Services and Real Estate.

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