

Automotive News

SPOT DELIVERIES: SLIPPERY SLOPE FOR DEALERS

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AUTOMOTIVE NEWS

DECEMBER 29, 2008 - 12:01 AM ET

Bill Heard Enterprises Inc.'s Chevrolet empire was crumbling. Rising fuel prices were gutting the group's high-volume sales of SUVs and pickups.

As showroom traffic at Heard dealerships fell, so did the bar for getting customers into loans, says a former manager at one of the group's two Las Vegas-area stores. The dealership began targeting what he calls the "credit-challenged." It delivered vehicles to customers on the spot, sometimes at lower interest rates than those for which the customer was likely to qualify.

Handing over the keys before completing the financing is a sales tactic known as spot delivery. It's a tempting tactic to move the metal in tough times. But as Heard Enterprises learned, it is a risky practice for dealers.

In the Las Vegas store's last days, the bank rejected the deal about 20 to 30 percent of the time. Some buyers had to return their vehicles, the manager says. Others had to re-sign with additional cash down or a higher interest rate. And some were switched into less expensive vehicles that met the bank's lending criteria.

"Those criteria seemed to be ignored a great deal of the time as the pressure was put on the managers to put vehicles on the street," says the manager, who asked not to be identified because he is searching for a new job.

"I think the philosophy was to throw enough s—t against the wall and some of it had to stick. As it got closer to the end, less and less was getting bought by the banks."

In September, Heard Enterprises filed for Chapter 11 reorganization, closing all 14 of its Chevrolet dealerships. While the case is extreme, it serves as a warning to dealers who routinely practice spot delivery.

Spot delivery is inherently risky — and not just for customers. Done wrong, it can leave a dealer exposed to allegations of predatory lending and to the risk that comes with having millions of dollars in unfinanced inventory roaming the streets.

Yet spot deliveries are tempting for dealers who are trying to sell a car before the customer goes to a rival dealership. That's especially true now, as the number of Americans with tarnished credit grows and one sale can keep a dealership afloat.

There is no way to know for sure how many dealers use spot delivery, but Better Business Bureaus and attorney general offices in several states have fielded consumer complaints about the practice.

"Although the number of dealers spotting cars today has slightly decreased because of tighter lending practices, it is still a necessary evil in the subprime market for the long term," says Raul Vazquez, a dealer consultant and CEO of direct marketing agency Focus Inc. in Tampa, Fla.

Vazquez says it takes longer to get loans approved and funded for subprime customers. Yet most customers aren't willing to wait. Rather than watch a customer walk away, most dealers will hand over the keys right then and there, he says.

Dealers who offer spot delivery, he says, must be certain the terms of the sale will stick.

"You have to know the lender guidelines. You have to have a sales manager who's watching the deals," Vazquez says. "There are too many guys out there that say, 'Let me put the car out there and maybe I'll get them into a loan.' You just can't do that, because it's too risky for the dealership."

Spotless deliveries

Here are ways to limit a dealer's legal and financial risks of using spot delivery as a sales tool.

- Know the law.** Several states regulate spot deliveries, and the rules can vary widely. Contact your state attorney general's office or department of motor vehicles for details.
- Checks and balances.** Don't leave decisions about when and how to spot-deliver vehicles to a single sales manager or F&I manager. Have a policy in place, and make sure all employees follow it.
- Set limits.** Auto loans can be approved in 10 days. Anything more than 30 days is asking for trouble.
- Communicate.** Explain to customers that the vehicle purchase isn't final until financing is secured. Just because they have the keys doesn't mean they own the car.
- Put it in writing.** Have the customer sign a form that clearly states what spot delivery means. The dealer and customer also should sign a form stating that if financing cannot be secured the customer is under no obligation to sign another contract.
- Deal with it.** If a problem arises, tackle it immediately. Don't wait until the customer has gone to the attorney general or a lawyer.

Growing risk

The risk is growing. Almost every lender has tightened its guidelines, especially for subprime loans. Others have abandoned the subprime loan business. That leaves dealers competing for a shrinking pool of money.

On Oct. 28, Myers & Fuller P.A., a Tallahassee, Fla. law firm that specializes in dealer issues, sent a letter to its clients warning them against offering spot deliveries. Doing so, the letter states, could cause them to be considered in breach of contract with their floorplan lender, a situation known as "out of trust."

In essence, once a car leaves the lot, the dealer must repay his source of wholesale financing.

"It is important to understand what the phrase 'out of trust' means when used by a floorplan lender," the letter states. "It may mean that the lender considers any vehicle not in physical inventory on the dealership premises is deemed 'sold' and the lender demands immediate payment.

"This can occur with dealers who make many sales through spot deliveries and the lender changes the definition of 'sale' in midstream."

GMAC Financial Services LLC, Heard Enterprises' main financing company, denies that it is changing definitions or rules. When GMAC provides floorplan financing, the dealer has a window from the time a vehicle leaves the lot until payment is due, says spokesman Mike Stoller. That window varies from dealer to dealer, but all dealers know exactly what their window is, he says.

It's not a new policy, and the window hasn't suddenly become smaller. But GMAC is "watching its risks" more closely now, Stoller adds. In other words, dealers who might have gone unnoticed with sloppy spot deliveries in the past are under the microscope now, and GMAC won't hesitate to label them as out of trust.

'Yo-yo financing'

In fact, Stoller says, he wonders why any dealers would risk spot delivering now, unless they were sure that they could get financing.

"We're not outlawing spot delivery. They can do what they need to do to get by," he says. "But it just doesn't strike me as being very wise in this environment."

The current lending climate has exacerbated problems with spot delivery that until now were largely considered consumer issues.

Officials in state attorney general offices tell of dealers calling customers days, weeks, even months later to say that financing fell through. The customer is usually given a choice: Renegotiate the loan, almost always at less favorable terms, or return the vehicle and pay for any damage or mileage incurred. In many cases the dealership already has sold the customer's trade-in vehicle, leaving the customer with little choice but to sign the new terms.

John van Alst, a lawyer with the National Consumer Law Center in Boston, says that in the cases he has seen, the dealer knew as the customer drove away that financing was unlikely to be approved.

In those cases, he says, the dealer intentionally misled the consumer with the intention of bringing the consumer back later in a disadvantaged position. It's why van Alst and other critics have another name for spot delivery: "yo-yo financing."

"They've already shown their friends and family that they've gotten a new car. And then the dealer brings them back in and forces them to agree to new and worse terms," he says, such as a larger down payment.

Differing opinions

Spot delivery is a necessary selling tool, says Michael Charapp, a Washington dealer lawyer and president of the National Association of Dealer Counsel. Something goes wrong only rarely, he says. Even then, it's usually because the customer made a mistake or lied on the credit application, not because the dealer sought to deceive.

In fact, the loan process is becoming more precise, not less, he says. Services such as DealerTrack and RouteOne allow dealers to submit digital credit applications to a network of lenders and learn almost instantly if a loan will go through.

Rosemary Shahan, president of Consumers for Auto Reliability and Safety in suburban Los Angeles, counters that those instant loan rulings are proof that the vast majority of yo-yo transactions are deliberate.

When dealers had to wait until the bank opened on Monday to fax over a stack of weekend sales contracts, there might have been an excuse, says Shahan. Not now. She says spot delivery is a "huge issue" that hurts dealers as much as consumers.

"It's like the industry is eating its young," she says. Consumers end up in cars they can't afford and take on more debt than they can handle. "People end up being so upside down that you drive them away from the market."

Even the courts can't agree on whether the practice is predatory, much less legal. A hodgepodge of state laws adds to the confusion.

In 2005, Eric Johnson, a lawyer with the Oklahoma City law firm of Phillips Murrah P.C. who specializes in automotive finance, conducted a review of state spot delivery laws.

He found three states severely restricted or prohibited spot delivery: Wisconsin, Michigan and Maryland. Another 32 states, he says, told dealers to "proceed with caution." The remaining 15 states gave the green light to dealers for spot delivery.

Says Johnson, who comes from a family of car dealers: "It's really, 'Operate at your own risk.' "

Weak waivers

Keith Whann, a dealer lawyer and former Ohio assistant attorney general, recommends dealers have customers sign what he calls an "acknowledgement of voluntary re-sign."

The form states that the customer understands the deal isn't final and that if financing can't be secured at the agreed-upon terms the buyer is under no obligation to re-sign the contract or purchase the vehicle.

But the value of those forms is murky. Courts have issued conflicting rulings on their legality.

Some dealers are deciding not to chance it. Emanuel Jones, a Georgia dealer who is buying Heard Enterprises' flagship Columbus store, says spot deliveries are part of the sales process. Banks aren't open seven days a week, but his Ford and Toyota stores are.

"However, when the credit market tightens," Jones says, "and you're still doing a lot of spot deliveries, you're going to run into a lot of problems. In my store we had to curtail a lot of spot deliveries for customers we thought were marginal."

Chrissie Thompson contributed to this report