Civil Case No.
S222211

SUPREME COURT
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IN THE

Supreme Court of the State of California

JUDICIAL COUNCIL COORDINATION PROCEEDING NO. 4476
RACEWAY FORD CASES

CARL STONE, et al.,
Plaintiffs and Appellants,

vs.

RACEWAY FORD,
Defendant and Respondent

ANSWER BRIEF ON THE MERITS

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I. INTRODUCTION

Two different divisions of the Fourth District Court of Appeal have issued conflicting decisions on liability for a backdated re-written Retail Installment Sale Contract ("RISC"); *Nelson v. Pearson Ford* (2010) 186 Cal.App.4th 983, decided by Division One; and *the Raceway Ford cases* (2014), decided by Division Two. *Nelson* held that backdating created undisclosed "pre-consummation interest" in violation of various statutes. *Raceway* held that backdating "***could have*** (emphasis supplied) resulted in inaccurate [TILA] disclosures" depending on whether there was a refinancing, and remanded to the trial court, notwithstanding the fact that no inaccurate disclosures were established by petitioners at trial.

For the sake of justice and uniformity of decision, *Nelson* should be overturned, and *Raceway* should be affirmed in part and reversed in part, to reinstate the trial court's decision, without requiring any remand on the issue of liability for backdated re-written RISCs. Instead, this court should remand to the Court of Appeal to decide the matter of petitioners' appeal of the trial court's award of attorneys' fees to Raceway, as the prevailing party under the ASFA.

In hindsight, *Nelson* is a manifest misapplication of legal principles from outside of California, that has resulted in substantial injustice and confusion in California trial courts. Furthermore, *Nelson* was decided entirely on the basis of stipulations of counsel that led to summary judgment on the court's own motion. It appears that the only defense presented at trial was that the backdated contract "substantially complied"[1] with the laws. Moreover, the published opinion does not identify the facts to which the defense stipulated. As a result, *Nelson* fails to advance the

[1] Pearson Ford relied on the 1962 case of *Stasher v. Harger-Haldeman*, 58 Cal.2d 23, 29.

development of the common law. Future courts and litigants will not be able to tell if their cases are distinguishable, or how to distinguish them, because *Nelson* fails to discuss the stipulated facts upon which it is based.

As for *Raceway*, the trial court was correct and Division One should have affirmed as to the backdating claims. Raceway never raised or relied on any "substantial compliance" defense in its trial. Neither Raceway nor the petitioners ever claimed that backdated rewritten contracts constituted refinancing within the meaning of Regulation Z. Instead, Raceway proved that backdating made no difference whatsoever on the TILA disclosures for the members of Class 1.

The Class 1 petitioners in this case were represented by the same attorneys who represented the plaintiff in *Nelson*. Yet, even under the theory of liability approved by the *Nelson* court, the Class 1 plaintiffs herein could not establish any violation of Regulation Z, due to the statutory tolerance that allows a 1/8 of 1 percent variance between the APR stated on the contract and the APR actually paid by the consumer. Even under petitioners' theory, the APR disclosed by Raceway never varied enough to constitute a violation.

Finally, even if it were assumed for the sake of argument that backdating did make a difference in the accuracy of the TILA disclosures, and even if it were assumed for the sake of argument that the difference was more than 1/8 of 1%, Raceway would still have a defense to liability under Regulation Z, based on the "irregular first period" exception.

As for Class 2 (a.k.a. the "Smog Fee" Class)[2], Raceway respectfully

2 From the filing of the lawsuit through the decision by the Court of Appeal, Class 2 had always been referred to as either "Class 2" or the "Smog Fee Class." Raceway declines to adopt the new "fraudulent fee"

submits that those claims were moot long before trial. The evidence has shown that smog fees were erroneously, *and unintentionally*, assessed on certain contracts for used diesel vehicles. (Diesel vehicles do not require smog checks or certificates.) The error was in the programming of Raceway's computers, which mistakenly defaulted to insert the fee after the employee took it out, but before the contract was printed. Raceway immediately refunded the fee and corrected the computers as soon as it had notice of the problem. Raceway later provided supplemental refunds to represent interest on the fees (which had been omitted from the original refunds without the general manager's knowledge).

The erroneous smog test and certification fees are *de minimus*. In fact, the fee represented 1/5 of 1% of the Class 2 Representative's purchase. But petitioners have always taken the position that this error entitles them to elect a rescission remedy under the ASFA. This position is blatantly inequitable, and while it is true that the ASFA allows for rescission for certain violations, accidental inclusion of this fee was never grounds for rescission. For the reasons explained herein, this court should affirm Division Two of the Fourth District as to Class 2.

Finally, as to the attorney fees awarded to Raceway Ford by the trial court, as prevailing parties under the ASFA; the court of appeal vacated the award and remanded to the trial court for a redetermination after final adjudication of the Class 1 claims. This court should reverse as to Class 1 and order judgment in Raceway's favor, and then remand to the Court of Appeal for a decision on case no. E056595, concerning attorneys fees.[3]

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designation advanced by petitioners' brief, to avoid confusion in analyzing the record.

[3] The Court of Appeal vacated and remanded the fee order, without addressing the merits, due to its reversal and remand of the Class 1 claims.

CLASS 1

BACKDATED RETAIL SALES INSTALLMENT CONTRACT

II. CLASS 1 - BACKDATED RE-WRITTEN CONTRACTS

As mentioned above, there are actually three independent and complete defenses to the "pre-consummation interest" theory of liability advanced by petitioners:

1. The factual/mathematical defense that backdating does not shorten the term of the loan, and therefore does not affect the stated interest rate, irrespective of which date is designated to be "consummation";

2. The statutory 1/8 of 1% tolerance for variations between APR shown on the face of the contract and APR actually paid by the consumer [12 C.F.R. § 226.22(a)(2)], which need only be applied if the court determines that "consummation" occurred on the date of the re-written contract instead of the original contract; and

3. The "irregular first period" exception provided by 12 C.F.R. § 226.17(c)(4), which allows the creditor to ignore an irregular first period and treat it as though it were a regular period, for purposes of giving APR disclosures. This will always apply, and has the legal effect of nullifying any designation of the re-written contract date as the "consummation" date.

Nelson only addressed the statutory tolerance and assumed that consummation took place on the date of the re-written contract. *Nelson* made no mention of the evidence that Raceway presented; namely, that when the contract is backdated, the final payment date is backdated too, thereby ensuring that there are no changes to the TILA disclosures. *Nelson* also ignored the irregular first period exception.

However, in order to understand why the pre-consummation interest theory of liability has no merit, and before further analysis, it is appropriate to review the contract terms, and pertinent facts.

A. The Contracts[4]

1. In a California RISC, *the Dealer is the Lender*

All of the RISC's identify Raceway not just as the seller, but as "***Creditor***-Seller" (emphasis added) in the box at the upper right corner. This is the most important difference between the California backdating cases and *Rucker*, the Virginia case upon which the *Nelson* court relied. In *Rucker*, the dealer was not the lender, and merely assisted the buyer in finding a lender.[5]

In Virginia, the sale becomes "null and void" if the seller fails to assign the loan to a third party lender within five days.[6] Not so in California. In California, there are no conditions precedent or subsequent, and no requirement that the dealer has to assign the loan to a third party in order to avoid nullifying the sale. "A sale is deemed completed and consummated when the purchaser of the vehicle has paid the purchase price, or, in lieu thereof, has signed a purchase contract or security agreement, and has taken physical possession or delivery of the vehicle." (California Vehicle Code, § 5901(d).) So, in California, if and when a dealer assigns the loan to a commercial lender, that assignment is a secondary transaction.

2. Interest is Figured on a Daily Basis

The RISC's inform the consumer that the Creditor (Raceway) will

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[4] The portions of contracts reproduced as illustrations in this section of the brief taken from the Original RISC signed by Carl and Deborah Stone on June 13, 2004 (Defense Exhibit 202, which was the same as Plaintiff Exhibit 1, but more legible).

[5] *Rucker v. Sheehy* (2002) 228 F. Supp. 2d 711 (a.k.a. "*Rucker I*"), at 713: "The buyer's order and bailment agreement made clear that this was a spot delivery, because the sale was conditioned upon financing being obtained from a third party lender according to the terms of the RISC within five days from the date of the agreements."

[6] *Id*, at 713.

calculate TILA disclosures based on the number of days included over the life of the loan. This fact is stated at the top of every RISC, just below the boxes identifying the "Buyer" and "Creditor-Seller":

> You, the Buyer (and Co-Buyer, if any) may buy the vehicle below for cash or on credit. By signing this contract, you choose to buy the vehicle on credit under the agreements on the front and back of this contract. You agree to pay the Creditor – Seller (sometimes "we" or "us" in this contract) the Amount Financed and Finance Charge according to the payment schedule below. ***We will figure your finance charge on a daily basis.*** The Truth-In-Lending Disclosures below are part of this contract. [Emphasis supplied.]

The petitioners' expert witness, Richard Ross, conceded that because these are simple interest contracts, interest is appropriately charged on a daily basis. (3 RT 507:23-25.)

This is important because it disproves the claim that TILA disclosures depend on the date that is placed on the contract. At best, that is a half-truth. TILA disclosures are calculated exactly as the contracts inform the customer that they will be calculated: "on a daily basis." The date placed on the contract (inception of the loan) is only relevant when considered in conjunction with the "One Final Payment" date (termination date of the loan) set forth in the payment schedule. It is the number of days in the loan that matters, not simply the date that the loan starts.

3. All RISC's Contain the Same TILA Disclosures and Payment Schedules

FEDERAL TRUTH-IN-LENDING DISCLOSURES				
ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate.	**FINANCE CHARGE** The dollar amount the credit will cost you.	**Amount Financed** The amount of credit provided to you or on your behalf.	**Total of Payments** The amount you will have paid after you have made all payments as scheduled.	**Total Sale Price** The total cost of your purchase on credit, including your down payment of $_____ is
_____ %	$ _____ (e)	$ _____	$ _____ (e)	$ _____ (e)

(e) means an estimate

YOUR PAYMENT SCHEDULE WILL BE:

Number of Payments:	Amount of Payments:	When Payments Are Due:
One Payment of		
One Payment of		
Payments		Monthly, Beginning
Payments		Monthly, Beginning
One Final Payment		

Late Charge. If payment is not received in full within 10 days after it is due, you will pay a late charge of 5% of the part of the payment that is late.
Prepayment. If you pay off all your debt early, you may be charged a minimum finance charge.
Security Interest. You are giving a security interest in the vehicle being purchased.
Additional Information: See this contract for more information including information about nonpayment, default, any required repayment in full before the scheduled date, minimum finance charges, and security interest.

Note that the inception date of the loan is not required anywhere in the TILA Disclosures. This corresponds with the "Formalities of conditional sale contracts" section of ASFA, at Civil Code section 2982. Although it incorporates all of the disclosures required by Regulation Z, and additionally requires other disclosures beyond the ones specified in Regulation Z, ***nowhere in the ASFA or Regulation Z is the inception date of the loan a required disclosure***

4. Raceway's *Unilateral* Rescission Rights

The contracts include the following clause on the reverse, describing the *unilateral* rescission right to Raceway, if Raceway cannot assign the contract to a financial institution with whom it regularly did business.

Rescission Rights

a. Seller agrees to deliver the vehicle to you on the date this contract is signed by Seller and you. You understand that it may take a few days for Seller to verify your credit and assign the contract. You agree that if Seller is unable to assign the contract to any one of the financial institutions with whom Seller regularly does business under an assignment acceptable to Seller, Seller may rescind (cancel) the contract.
b. Seller shall give you written notice (or in any other manner in which actual notice is given to you) within 10 days of the date this contract is signed if Seller elects to rescind. Upon receipt of such notice, you must immediately return the vehicle to Seller in the same condition as when sold, reasonable wear and tear excepted. Seller must give back to you all consideration received by Seller, including any trade-in vehicle.
c. If you do not immediately return the vehicle, you shall be liable for all expenses incurred by Seller in taking the vehicle from you, including reasonable attorney's fees.
d. While the vehicle is in your possession, all terms of the contract, including those relating to use of the vehicle and insurance for the vehicle, shall be in full force and you shall assume all risk of loss or damage to the vehicle. You must pay all reasonable costs for repair of any damage to the vehicle until the vehicle is returned to Seller.

This clause is oftentimes misunderstood to mean that Raceway was ***required*** to assign the contract in ten days or rescind. But that is not a correct interpretation of the rescission rights quoted above, or the contract taken as a whole, and there is no such requirement in ASFA. Once the contract is signed, the dealer actually has several choices of what to do with it.

a) Most often, the dealer will assign that customer's financing to a commercial lender (such as Ford Motor Credit, AmeriCredit, etc.). Note that this can happen at any time, and there is nothing in the contract or the ASFA which says that it must occur within ten days. The customer's consent is not required.

b) Alternatively, the dealer could accept the customer's payments directly, over the entire term of the financing (i.e., "carry the paper in-house") because it has an enforceable contract upon consummation. There is nothing in the contract or the ASFA which forbids a dealer from carrying its own paper. Again, customer consent is not required.

c) The dealer could propose a novation; that is, a different set of financing terms, presumably to more easily facilitate a subsequent assignment to a lender. This is done in lieu of exercising unilateral rescission rights. There is nothing in the contract or the ASFA which forbids the parties from entering into a novation. (In fact, as discussed below, there is a specific provision in the contract for how the parties can lawfully change their contract, and in the ASFA about how the parties can legally change their financing terms. So it is clear that the legislature contemplated the potential for lawfully amended financing terms between the parties). Obviously, this *does* require the customer's consent.

d) Finally, if the dealer cannot assign the contract on terms it finds acceptable, and the parties either cannot or will not enter into a novation or a mutual rescission, and the dealer does not want to carry the paper, then the dealer may exercise its unilateral right of rescission, as described above. As long as the right is exercised within ten days, the customer's consent is not required.

5. All RISC's Give Notice of the Dealer's Unilateral Rescission Rights

The contracts contained the following clause on the front side, for the customers to acknowledge and agree to the dealer's rescission rights on the reverse side:

NOTICE OF RESCISSION RIGHTS
If Buyer and Co-Buyer sign here, the provisions of the Rescission Rights section on the back giving the Seller the right to rescind if Seller is unable to assign this contract to a financial institution will apply.
Buyer X ______ Co-Buyer X ______

6. The Absence of Any Customer Right to Rescind

The contracts contain the following advisement immediately above a customer's signature line, notifying the customers that they do not have a right to rescind or cancel, and that their contracts were "final":

THERE IS NO COOLING OFF PERIOD
California law does not provide for a "cooling off" or other cancellation period for vehicle sales. Therefore, you cannot later cancel this contract simply because you change your mind, decide the vehicle costs too much, or wish you had acquired a different vehicle. After you sign below, you may only cancel this contract with the agreement of the seller or for legal cause, such as fraud.
Buyer Signature X ______ Date Jun 13 2004 Co-Buyer Signatu

Note that this language was required by the ASFA, at Civil Code section 2982(r).[7] There was nothing in the contract or the ASFA at the time which granted a customer a right to rescind.

7. Mutual Changes at Any Time

The contracts also contained two separate sections notifying customers how their contracts may be changed. The first notice appears at the right side of the contract, slightly below the middle of the page:

HOW THIS CONTRACT CAN BE CHANGED. This contract contains the entire agreement between you and us relating to this contract. Any change to the contract must be in writing and both you and we must sign it. No oral changes are binding.
X ______ Buyer Initials X ______ Co-Buyer Initials

[7] These contracts were entered into before the 2006 revisions to the ASFA, which added a requirement that sellers offer a contract cancellation option for certain used vehicles, subject to conditions not relevant here.

The language for the second notice of how to change the financing or payment terms is taken verbatim from the Auto Sales Finance Act, at Civil Code section 2982(h), and it appears in the contracts as follows:

> If you have a complaint concerning this sale, you should try to resolve it with the seller.
> Complaints concerning unfair or deceptive practices or methods by the seller may be referred to the city attorney, the district attorney, or an investigator for the Department of Motor Vehicles, or any combination thereof.
> After this contract is signed, the seller may not change the financing or payment terms unless you agree in writing to the change. You do not have to agree to any change, and it is an unfair or deceptive practice for the seller to make a unilateral change.
>
> Buyer Signature X ________________ Co-Buyer Signature X ________________

These provisions on changes are important to the issues presented in this case. First, they show that the legislature did anticipate that there would be times when the parties could mutually change their contracts, including the financing terms, which are exactly the types of changes at issue in this case. The legislature obviously wanted to provide for a lawful means to make these changes. Note also that this provision does not have anything to do with the dealer's unilateral rescission rights on the reverse side of the contract.

The one and only thing that is absolutely required for a lawful change to the contract is that the customer's consent to the change must be evidenced in a writing. However, at the same time that the ASFA allows such changes, the "Single Document Rule" of the ASFA (Civil Code, § 2981.9) prohibits the parties from simply signing an Addendum or other such consent. Every term of the contract must appear on the same piece of paper. So under the ASFA, the only way to lawfully change an original contract is by a replacing it with a re-written contract. (i.e., a novation, pursuant to Civil Code, § 1530).

8. Acknowledgment of Re-written Contract Form

When Raceway entered into re-written contracts with customers, it used an "Acknowledgment of Rewritten Contract" or "Acknowledgment of Rescinded Contract." The *Nelson* court held that such forms constituted a violation of the Single Document Rule, ostensibly because Mr. Nelson asserted that the only way to discern the date he signed the re-written contract was to check the acknowledgment form.

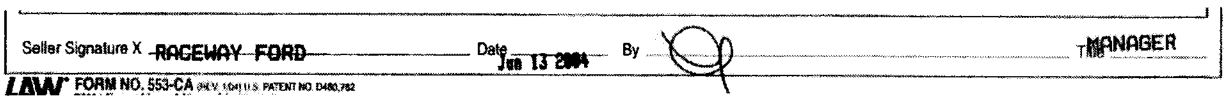
Ironically, in this case, Raceway backdated the Acknowledgments of Rescinded Contract Forms in addition to the re-written contracts. (See, for example, Carl and Deborah Stone's Acknowledgment of Rescinded Contract," (Exhs 2 and/or. 207), which was backdated to June 13, the same date as their first contract (Exhs and/or 202). So, a person cannot tell the date that the re-written contract was signed just by looking at the Acknowledgment. arguably then, it could be reasoned that a backdated acknowledgments in *Raceway* would not be a violation of the single document rule as construed under *Nelson.*

More importantly, the evidence showed that Raceway intended the Acknowledgment of Re-Written Contract form to constitute the "written consent" to the change in financing terms required by ASFA. Specifically, Raceway's General Manger, Tom Owings, testified that "the purpose of the form is to comply with the ASFA," and the box on the face of the contract that says "how this contract can be changed." So when Raceway used the acknowledgment form, it was intending to comply with the ASFA and the express terms of the contract. Furthermore, the evidence at trial was that Raceway only uses the form when both parties have mutually decided to enter into a subsequent contract that changes the terms of the first. (4 RT 619:9–621:14.)

9. Dates

All of the contracts had a maximum of only three places where the date was inserted: Once, at the section for credit life insurance and/or credit disability insurance (but that is inserted only if applicable); next, at the

Buyer Signature section immediately underneath the advisement that "THERE IS NO COOLING OFF PERIOD" (item #6, above); and last, at the Seller Signature Line at the bottom left corner of the contract:


Seller Signature X RACEWAY FORD Date Jun 13 2004 By Title MANAGER
LAW FORM NO. 553-CA

Interestingly, there is no specific provision in either Regulation Z or the ASFA which requires disclosure to the customer of the date he or she signed the contract, although they both include exhaustive lists of everything else that must be disclosed. Raceway hypothesizes that this is because, as Raceway proved at trial, the relevant measure for TILA purposes is the number of days in the life of the loan, and not when you start counting the days.

B. <u>The Circumstances Under Which Contracts Are Re-Written</u>

There is nothing in the ASFA or the sales contract which prohibits a dealer from proposing alternate financing terms to a customer, before the ten day right of rescission expires, in lieu of exercising rescission, as long as that dealer does not misrepresent anything to the customer.[8]

1. The Parties Have the Right to Enter Into Re-Written Contracts

The U.S. and California Constitutions acknowledge that "freedom of contract" is a basic right reserved to the people. "It is axiomatic that the

[8]For example, if a dealer were to allow its 10-day rescission right to expire, and then falsely represent that the customer would have to return the car if he/she did not agree to re-write their contract, then that would be actionable misrepresentation. After 10 days, the dealer no longer has a right to rescind, and the customer has an enforceable contract and does not have to agree to any changes. For another example of a type of actionable misrepresentation under Virginia law, see *Rucker v. Sheehy* (2002) 228 F. Supp. 2d 711.

parties to an agreement may modify it." *Vella v. Hudgins* (1984) 151 Cal.App.3d 515, 519. The same freedom which allows Raceway and its customers to enter into contracts in the first place also allows Raceway and its customers the right to re-write their existing contracts.

In fact, the ASFA expressly recognizes that after a dealer and customer enter into a sales contract, there may be times when they mutually agree to change the terms of financing or payments, and that mutual agreements to make such changes are lawful as long as consent to the change is evidenced in writing. The right to mutually change their financing terms is found in Civil Code section 2982(h), which provides, in pertinent part:

> The contract shall contain a notice in at least 8-point boldface type, acknowledged by the buyer, that reads as follows: . . . After this contract is signed, the seller may not change the financing or payment terms unless you agree in writing to the change. You do not have to agree to any change, and it is an unfair or deceptive practice for the seller to make a unilateral change.

Accordingly, the ASFA specifically allows for the possibility that dealers and customers may want to mutually change financing or payment terms, and that there should be a legal way to accomplish this. However, there is another provision in the ASFA, known as the "Single Document Rule" (Civil Code, § 2981.9) which requires that "Every conditional sales contract . . . shall contain in a single document all of the agreements of the buyer and seller with respect to the total cost and the terms of payment for the motor vehicle . . . ." Given this provision, it is apparent that the parties cannot merely issue an addendum or separate memoranda to effectively change their financing or payment terms.

So the issue becomes, how do the parties show a lawful mutual change in financing or payment terms without violating the single document rule? Since the new agreement must be memorialized in "a single document," which cannot co-exist with the original document, the ASFA's answer is that to legally effectuate a mutual change on a financing or payment term, a substitute contract is required, along with the customer's written consent to substitute the second contract in place of the first; i.e., parol evidence of intent to form a novation, as discussed below.

2. Mutual Advantages to Re-Written Contracts

For the dealer's part, if a contract can be modified so that a commercial lender will take it on assignment, that is usually preferable to rescission; particularly when the subject car was originally sold as "new" and upon rescission would have to be sold as "used." Whether "new" or "used," in the case of rescission, the dealer has to re-start the process of advertising and locating another buyer, when there is already a known customer interested in that vehicle. For a dealer, rescission unnecessarily wastes time and money, and rebuffs an interested customer.

For the customer's part, when a contract is modified in order to make it more palatable to a commercial lender, it is usually on terms less onerous and more desirable to the customer. Lenders will refuse assignment of the initial contract because of doubts that the customer can or will make the payments, for whatever reason. Typical grounds for rejection include: a derogatory auto credit history, past repossessions, an excessive number of installment accounts already open, delinquent past or present obligations, excessive obligations in relation to income, insufficient income for amount of credit requested, limited credit experience, insufficient length of employment, etc.

If the dealer proposes terms that are less onerous, for example, by lowering the interest rate, sales price of the vehicle, or price of the options, then the resulting change in financing terms can often make the difference between the dealer getting the sales contract assigned to a lender or not.

In fact, it is not always Raceway that proposes re-written contracts; customers can initiate the novation process just as easily. Petitioner Suzanna Moreno purchased her new 2004 Expedition on October 22, 2004. (2 RT 313:9–15.) But she asked Raceway for a new contract. She called her Finance Manager on Saturday the 23rd, because she was having regrets and concerns about whether she could afford the new car. So she called and made an appointment to come in on Sunday, the 24th. He offered her a new contract, which lowered the monthly payment from $520 to $489, and lowered the interest rate from 9% to 7.25%. (2 RT 351:18–356:2.)

Raceway's Finance Director, Colette Ferguson, testified that Raceway had no problems placing Ms. Moreno's loan with a lender, and her loan had already been successfully assigned to Ford Motor Credit. One of Raceway's finance managers, Scott Maluk, had called her and explained that she thought she might have a problem making the payment, and he wondered if there was anything Ms. Ferguson could do to help her. And so she called Ford Motor Credit, and then she authorized Mr. Malik to drop her interest rate from 9 percent to 7 and a quarter percent. When asked, "What was the reason for doing that?" She replied, "We were trying – we were trying to help one of our customers." Raceway paid a $50 cancellation fee to Ford Motor Credit in order to do it. (4 RT 591:1–593:17.)

C. Argument

1. Backdating the Start Date on the Contract Did Not Change the TILA Disclosures Because the "Final Payment Date" Was Backdated at the Same Time

As Division Two correctly observed in the *Raceway* decision:

> In a closed-end credit transaction such as the car loans at issue in this case, the APR is a function of the finance charge, the amount financed, and the term of the transaction. (See generally 12 C.F.R. § 226, appen. J. (2014).) Calculating the APR of a transaction using an earlier date as the beginning of the term yields a lower APR than a later date, ***assuming none of the other variables, including the end of the term, is changed.*** (See, e.g., *Nelson, supra*, 186 Cal.App.4th at p. 1001 [calculating APR of transaction at issue using October 2 as beginning of term yielded result of 21 percent; using October 8 yielded result of 21.23 percent].) (Opinion at p. 17.)

The key to the court's statement above is their assumption that when the contract is backdated, the final payment date does not change. At trial, Raceway proved through the evidence that when the contract is backdated, the final payment date does change; it is also backdated by the same number of days.

Note also that the above quote from the *Raceway* opinion, further illustrates why *Nelson* should be overturned: The *Nelson* opinion appears to assume, without actually stating, that the final payment date was not backdated. But the published decision never expressly states this. Indeed, the *Nelson* opinion does not discuss the term of the loan at all, and the reader is left to speculate whether or not that is one of the "facts" that Pearson Ford stipulated to. The *Raceway* analysis makes it clear that the final payment date is a key fact in APR analysis. Future litigants should be free to introduce evidence of final payment dates, and future courts should be free to evaluate evidence of final payment dates, but *Nelson* prevents it.

At trial, Raceway applied the classic causation test: "But for the fact that the contract was backdated, what would the disclosed interest rate have been?" In answer to this question, Raceway introduced a re-written contract that was prepared without backdating, and the TILA disclosures were identical to the contract with backdated. Backdating had no effect because when the start date of the contract is backdated (for example, from June 16, 2004 to June 13, 2004, as in the case of lead plaintiff Carl Stone), the computer also automatically moved the "final payment" date by the same number of days (from June 16, 2010 to June 13, 2010). So, whether Raceway set the contract date for June 16, 2004 or June 13, 2004, it made no difference to the interest rate or charges, because the computer likewise automatically moved the final payment date by the same number of days. The number of days in loan period stayed the same, either way: 2,192. (4 RT 681:9 – 682:11.)

Trial Exhibit 391 was admitted without objection. (4 RT 606:16-22.) It was an exact replica of Carl and Deborah Stone's re-written contract, except for the one and only difference that instead of backdating it to June 13, 2004 (the date they signed their original contract), it was dated June 16, 2010, exactly as the Class 1 plaintiffs contend that it should have been done. Raceway's General Manager, Tom Owings, laid the foundation for the exhibit, and testified that he prepared it on Raceway's computer system. But the TILA disclosures for the non-backdated contract Mr. Owings prepared were identical to the TILA disclosures for the backdated contract that the Stones actually received from Raceway on June 16, 2004. (4 RT 604:10 – 606:14.) The number of days in the loan stayed the same because the final payment date was backdated when start date was backdated.

Under petitioner's theory of liability, their expert calculated his TILA figures and "pre-consummation interest" amounts by using June 16, 2004, as the start date of the contract, and June 13, 2010, as the final payment date. (3 RT 495:24–496:2). This shortened the life of the loan on the Original RISC by three days.

When Mr. Owings was asked if it was possible for Raceway to input one date as the date of the contract and then vary the dates for completion, he testified that there was no ability to make such changes. If you enter June 13 as the first payment date, then the final payment date will always be June 13. If you enter June 15 as the first payment date, then the final payment date will be June 15. (4 RT 603:5–25.)

Furthermore, Mr. Owings testified that he would never want his employees to have the ability to override the computer installed dates because "it would just be an absolute mess in terms of calculating correct disclosures if you allowed people to vary or go any way they wanted." (4 RT 603:26–604:5.)

Note that this defense applies regardless of which date the court designates as "consummation" because consummation date is not one of the items included in the mandatory TILA disclosures.

2. The 1/8 of 1% Tolerance For Differences Between the TILA Disclosures on the RISC and the TILA

Disclosures Calculated By Petitioner

Even if the evidence failed to show that the final payment date was always backdated when the RISC was backdated, and even if this court were to accept the date of second signing as "consummation," Raceway would still prevail because of the tolerance provided by Regulation Z.

As explained in the *Raceway* opinion:

> In addition, Regulation Z allows for a small margin of error with respect to calculation of the APR. A disclosed APR is "considered accurate" under Regulation Z if it is "not more than 1/8 of 1 percentage point above or below" the rate determined utilizing the authorized methods. (12 C.F.R. § 226.22(a)(2) (2014).) Thus, a second or subsequent contract that is backdated only a short period of time could conceivably fall within the margin of error allowed by Regulation Z, even though the disclosed APR was calculated using a date earlier than the date the contract was signed. Several of the allegedly backdated contracts introduced into the record below were apparently backdated by no more than one day. (Opinion, at 23.)

But the statutory tolerance is nothing new to petitioners' counsel, since it was raised and discussed *Nelson*. It was petitioners' obligation to produce proof of a violation to the trial court, such as an actual APR that varied by more than 0.125% of a disclosed APR, and they failed to do so.

3. Regulation Z Provides an Applicable Exception to TILA Disclosures for Loans with Irregular First Periods

In addition to Raceway's factual defense that the final payment date was backdated for every backdated contract, and the APR 1/8 of 1% tolerance defense, there is a third applicable defense, set forth in 12 C.F.R. § 226.17(c)(4), for irregular first periods:

> *In making calculations and disclosures, the creditor may disregard any irregularity in the first period that falls within the limits described below and any payment schedule irregularity that results from the irregular first period:*
>
> . . .
>
> *(ii) For transactions in which the term is at least 1 year and less than 10 years, a first period not more than 11 days shorter or 21 days longer than a regular period;. . . .*

The Commentary to § 226.17(c)(4) provides this further guidance:

> 1. Payment schedule *irregularities. When one or more payments in a transaction differ from the others because of a long or short first period, the variations may be ignored in disclosing the payment schedule, finance charge, annual percentage rate and other terms*
>
> . . .
>
> 3. Use of special rules. *A creditor may utilize the special rules in section 226.17(c)(4)*

> *for purposes of calculating and making some disclosures but may elect not to do so for all of the disclosures. For example, the variations may be ignored in calculating and disclosing the annual percentage rate but taken into account in calculating and disclosing the finance charge and payment schedule.*

These sections and commentary are directly applicable to the APR disclosures made to Class 1 here. Raceway is expressly permitted to calculate the finance charge and payment schedule using the actual days, while disregarding the irregular first period, and treating it as though it were a regular period, for purposes of the APR disclosure. Thus, if the original RISC was accurate under Regulation Z, then the re-written RISC is also accurate when disregarding the odd days, so long as the period to the first payment remains no shorter than 19 days (i.e., 11 days less than the ordinary one month period) or longer than 51 days (i.e., 21 days more than the ordinary one month period). In this way, the exception for irregular periods set forth in 12 C.F.R.§ 226.17(c)(4) is more broad than the 0.125% tolerance set forth in 12 C.F.R.§ 226.22(a)(2).

For example, Carl Stone signed his first RISC on June 13, 2004. The contract had a first payment date of July 13, 2004, which is 30 days from the date of contract, an exactly regular period. Petitioners' expert witness, Richard Ross, conceded that the first contract, signed June 13, 2004, contained an accurate APR of 9.9%. He further conceded that all of the disclosures on the original June 13, 2004 contract were correct and in compliance with TILA. (3 RT 489:7-28.)

Mr. Stone signed his re-written contract three days later, on June 16,

2004. Petitioners contend that the re-written contract should have been dated June 16, 2004. Petitioners' expert then recalculated disclosures to what he claimed they should have been, using a contract start date of June 16, 2004, but with a contract end date of June 13, 2010.[9] (3 RT 495:24–496:2.) Furthermore, petitioners' expert witness testified that under the dates he was using, the first period on the re-written contract would have been 27 days long, but each period thereafter was 30 days. (3 RT 496:3-8.)

What petitioners should have done (but didn't) was to apply the irregular period exception of 12 C.F.R. § 226.17(c)(4). A regular period is 30 days. Since 27 days is between 19 and 51 ("not more than 11 days shorter or 21 days longer than a regular period"), the exception allows Raceway to calculate the disclosures as though the first period was a regular 30 day period (just as it was stated in Mr. Stone's original contract). The alleged mathematical discrepancy based on the 27 day first period calculation is not actionable because it is excepted from Regulation Z.

4. Consummation of the Contract and Its Significance

In *Raceway,* Division Two drew a distinction between consummation of the sale and consummation of the credit transaction. (Opinion at p. 20.) Raceway respectfully submits that in California, this is a distinction without a difference. On its face, the RISC identifies Raceway as both the "Seller" and the "Creditor." There is no sale unless the vehicle gets paid for; i.e., credit is extended. No credit is extended unless it's to pay for the particular vehicle which is the subject of the sale. Each of the Class

[9] Note that Raceway's uncontroverted evidence at trial was that no contract could be dated this way, and that because of the way the computers were programed, anytime the start date of the contract was backdated, the "final payment date" for the end of the loan would likewise be backdated the same number of days. (See testimony of Raceway General Manager, Tom Owings; 4 RT 602:24–604:9.)

1 plaintiffs paid for their vehicles on credit. There is no way for the customers to receive the money from their credit transaction unless they are simultaneously completing their sales transaction. They do not get to put the money in their pocket and spend it at another time or on anther purchase. Neither party is consummating a sale without credit, or credit without a sale. The sale and the credit transaction must, of necessity, co-exist, in California, *where the dealer is the lender*. Cases from other jurisdictions (such as Virginia, for example) would not apply if the dealer is merely acting as a go-between for the customer and a third party lender.

Although the ASFA provides numerous definitions in Civil Code section 2981, subdivisions (a) through (q), nowhere does it define when or how the conditional sale contract is "consummated."

Nelson relied entirely upon *Rucker I* in deciding that the applicable definition is the one from Regulation Z. *Nelson, supra*, (2010) 186 Cal.App.4th 983, citing *Rucker I, supra*, (E.D. Va. 2002) 228 F. Supp.2d 711. (AOB, p. 26.)

California Vehicle Code section 5901(d) provides: "A sale is deemed completed and consummated when the purchaser of the vehicle has paid the purchase price, or, in lieu thereof, has signed a purchase contract or security agreement, and has taken physical possession or delivery of the vehicle." *The Class 1 plaintiffs admit that "[E]ach of the members of Class 1 consummated their original purchases upon signature of their original purchase contracts and taking delivery of their respective vehicles."* (3 AA 0535: 12–14.)

Federal case authority concedes that for Truth-in-Lending purposes, state law governs over Regulation Z on the issue of when "consummation" occurs.

> Under Regulation Z, consummation "means the time that a consumer becomes contractually obligated on a credit transaction." 12 C.F.R. §226.2(a)(13). When a consumer "*becomes contractually obligated*" is, in turn, determined by looking to state law. State law governs. [Emphasis original.] When a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; Regulation Z does not make this determination. A contractual commitment agreement, for example, that under applicable law binds the consumer to the credit terms would be consummation. Consummation, however, does not occur merely because the consumer has made some financial investment in the transaction . . . unless, of course, applicable law holds otherwise. *Jackson v. Grant* (9th Cir. 1989) 890 F. 2d 118, 120, quoting 12 C.F.R. Pt. 226, Supp. 1 (Official Staff Interpretations), Commentary 2(a)(13).

Accordingly, our trial court was correct in its Statement of Decision, finding that Vehicle Code section 5901(d) controls in this case. Note that this conclusion is devastating to the appellants' case. Obviously, if "consummation" occurred at the signing of the first contract, then there's no accrual of "pre-consummation interest" between the first and second contracts.

However, even if this court is inclined to agree with Division Two, and find two different types of "consummation" and/or that consummation occurred on the signing of the second contract, it should not lose sight of the fact that the irregular period exception will still apply.

5. *Nelson* Should Be Disapproved and Overruled Because the *Nelson* Court Should Not Have Relied Upon *Rucker v. Sheehy*

The *Nelson* holding seems premised upon a finding set forth in the opening paragraph: "Backdating the contract rendered inaccurate the disclosed annual percentage rate (APR), and resulted in Nelson paying interest for a time period that no contract existed." (*Nelson, Id,* at 994.) *Nelson* also asserted that *Rucker v. Sheehy Alexandria, Inc.* (E.D. Va. 2002) 228 F. Supp.2d 711 was "factually on all fours with the present action" (*Id.*, at 998), and it's clear that *Rucker I* was the reason that the *Nelson* court found that "no contract existed" between the first and second signings for Reginald Nelson.

But the *Nelson* court was mistaken, and the analysis is flawed because of fundamental and irreconcilable differences between Virginia law and California law regarding vehicle purchase contracts, and when each state deems a vehicle purchase "consummated."

Plaintiff's "pre-consummation interest" theory had its genesis in *Rucker I. Rucker I* involved a *Virginia* contract which expressly stated that it *automatically became null and void* if the dealer failed to obtain third party financing within five days after signing. (*Rucker I*, at 713.) Note that this is radically different from California contracts, which merely provide that the transaction may be rescinded at the dealer's option if and only if the dealer notifies the customer within 10-days. So, in the absence of such notification, a California contract becomes automatically enforceable by the customer. In *Rucker I*, there is the opposite result. If the dealer failed to obtain financing in five days, the contract becomes automatically void and unenforceable, and no sale ever consummates under Virginia law. (*Rucker I, Id.*)

The facts of *Rucker I* are helpful to illustrate why it should not have been applied in *Nelson*. Emily Rucker signed her contract, *executed a bailment agreement*, and drove the car home, on April 3. (*Id,* at 713.) However, the defendant/dealer, Sheehy, failed to obtain financing in five days, and so the contract became void and unenforceable as of April 9. (*Id.*) Thereafter, Sheehy made no effort to contact Ms. Rucker to tell her the contract was void, or to ask her to return the car. (*Id.*)

Instead, the dealer continued to contact lenders, until on April 13, it found one (Mercury Finance) willing to take assignment, under more onerous terms[10], if Ms. Rucker signed another contract. (*Id.*) Sheehy then asked Ms. Rucker to return and sign a new contract, *without telling her that the original contract failed to fund and became null and void.* (*Id.*) Rucker signed a second contract sometime after April 13, 2001. However, Sheehy backdated that second contract to April 3, 2001. (*Id*, at 714-75.) All of these circumstances point to a deception by Sheehy, without a doubt.

Emily Rucker does not compare to the Class 1 Plaintiffs herein. The important distinction for our purposes is that in the *Rucker I*, there was at least a ten-day period of time, from April 3 to April 13, when *no contract existed* between the customer and the dealer. Accordingly, it was impossible in *Rucker I* for the second contract to have been a novation of

[10] The new terms doubled the down payment; called for a shorter period of time to pay off the loan; and imposed a higher APR to finance a smaller sum. Additionally, the April 13 proposal gave less value for the money, due to deleting the extended warranty (a near $1,000 value).

the first, because a novation, by definition, is the substitution of a new obligation *for an existing one, not for a voided one.* (Civil Code, § 1530.)

That is the difference between *Rucker I* and the Class 1 Plaintiffs at issue in this case. In this case, under California law, the first contract did not lapse or become void before the Class 1 Plaintiffs mutually decided with Raceway to substitute with their re-written contracts. Raceway did not lie to its customers by falsely representing a void contract as being in force.

Raceway was not engaging in the "spot deliveries" described in *Rucker I,* wherein the entire sale was contingent upon the dealer finding a lender. Rather, Raceway Ford *was* the lender on the date the contract was signed and consummated. Raceway's assignment of the right to collect payments was a separate and secondary transaction with a commercial lender.

Under California Vehicle Code section 5901(d), Raceway had "completed and consummated" contracts with each Class 1 customer as soon as they signed their original contracts and took delivery of the cars. Plaintiffs' Second Amended Complaint concedes that "each of the members of Class 1 consummated their original purchases upon signature of their original purchase contracts and taking delivery of their respective vehicles." (3 AA 0535:12–14.)

Under California law, the only effect of the passage of time without assignment to a lender is Raceway's loss of its rescission rights after ten days. The contract itself remains as valid and enforceable as ever. Under California law, the mere passage of time without assignment to a lender does not void the sales contract, and has no effect on the consummation date.

Sheehy had no more right to put "April 3" on Emily Rucker's second contract than it would have had to date an April 13-first-time-visit customer's contract with April 3.

The same cannot be said of the Class 1 Plaintiffs herein. They had constantly valid contracts with Raceway, and the interest disclosed and charged between the first and second contract was not "pre-consummation" or in any way wrongful.

Interestingly, the *Rucker I* court went on to note that "No controlling circuit authority addresses the question of whether the backdating of the April 13 RISC constitutes a violation of TILA." (*Id.*) The *Rucker I* court concluded that under the facts of that case, April 13 (and not April 3) was the true consummation date (*Id,* at 716), and awarded Rucker the statutory maximum damages of $1,000 (as opposed to the rescission sought by Class 1 in this case.)

As discussed herein, Raceway never asserted "the doctrine of substantial compliance" as a defense at trial. It would be manifestly unjust to preclude other, meritorious defenses on grounds of *stare decisis*, as appellants suggest.

As the California Supreme Court previously held:

> The doctrine of stare decisis expresses a fundamental policy ... that a rule once declared in an appellate decision constitutes a precedent which should normally be followed ... . It is based on the assumption that certainty, predictability and stability in the law are the major objectives of the legal system ... ." But, as Justice Frankfurter wrote, it equally is true that "*stare decisis* is a principle of policy and not a

> mechanical formula of adherence to the latest decision, however recent and questionable, when such adherence involves collision with a prior doctrine more embracing in its scope, intrinsically sounder, and verified by experience." As this court has stated: "Although the doctrine of *stare decisis* does indeed serve important values, it nevertheless should not shield court-created error from correction." "Previous decisions should not be followed to the extent that error may be perpetuated and that wrong may result." See also the concurring opinion of Justice Mosk in *Smith v. Anderson* quoting *Wolf v. Colorado* "Wisdom too often never comes, and so one ought not to reject it merely because it comes late." *Peterson v. Superior Court* 10 Cal.4th 1185, 1195. Citations omitted.

According to the Master Chronological Index of Witnesses supplied by the Court Reporter (1 RT iii), 13 different witnesses testified in this trial, which lasted from March 3 through March 9, 2010. Hundreds of pages of documents were admitted into evidence.

In this respect, our case is very different from *Nelson v. Pearson Ford Co.* (2010) 186 Cal.App.4th 983. In *Nelson*, the reviewing court noted in its recitation of the facts:

> On the first day of trial, the parties agreed there were no triable issues of material fact.

> Accordingly, the court indicated it would revisit previously filed motions for summary judgment or adjudication. The parties then tried this matter to the court based on certain stipulated documents and facts. The court ultimately concluded that there were no triable issues of material fact. *Id*, at 996.

The *Nelson* court further noted, at the "Discussion" section of the opinion:

> The parties do not contest the trial court's conclusion that there were no triable issues of material fact; rather, they dispute the trial court's application of the various statutes to the facts. We independently review the interpretation of the governing statutes, and application of the statutes to the undisputed facts. (Citation.) *Id.*, at 997.

The *Nelson* trial court record contained no conflicting evidence whatsoever. *Nelson* was resolved as a motion for summary judgment. The record shows there was no weighing of conflicting evidence. The same cannot be said of this case. In this case, there were no stipulated facts, and the trial court was called upon to resolve not just legal disputes, but factual ones as well.

The *Raceway* Statement of Decision makes specific references to factual findings and witness credibility assessments on disputed evidence. For example, it includes Judge Holmes' determination that the substitution of the second contract for the first "represents the intent of the parties." It states that "the evidence showed no violation of the 'Single Document Rule' of the Automobile Sales Finance Act". It includes the conclusion that "This court disagrees" with petitioners' key factual "assertion that the car deal could not have been legally consummated until the execution of the second contract." (4 RT 0957–0961.)

D. Conclusion

For the reasons set forth herein, the decision of the Fourth District Court of Appeal should be affirmed in part and reversed in part, in order to reinstate the trial court's Statement of Decision, without requiring any remand on the issue of liability for backdated re-written Retail Installment Sales Contracts.

CLASS 2

SMOG FEES

III. CLASS 2 – SMOG FEES ON DIESEL VEHICLES

A. Summary of Facts

1. The Error on Randal Kidd's Contract

On August 5, 2003, Randal Kidd signed the original RISC, for the purchase of a used Ford F-250. He later signed a re-written RISC for the same vehicle. (See POB, at pg. 7.) Both contracts included a $50 "Smog Fee Paid to Seller" at line "1.C." of the "Itemization of the Amount Financed." Both contracts included an $8.25 "Smog Certification Fee Paid to State" at line "4" of the "Itemization of the Amount Financed." (POB, at pg. 7.)

2. Raceway's Lack of Scienter

The Ford F-250 comes in gas and diesel versions. (3 RT 554.) But RISCs have nothing on the form to identify whether the vehicle which is the subject of the contract has a gas or a diesel engine. (3 AA 0595-598 [Tab 28] Exh. 5 and 3 AA 0610-0613 [Tab 28] Exh. 7).

Colette Ferguson has been Raceway Ford's Finance Director since 1998. (1 RT 98:4-10.) Although it is undisputed that Ms. Ferguson personally reviews the paperwork for every sale before Raceway assigns them to a third party lender, she also gave the following uncontroverted testimony at trial:

- In the course of reviewing the paperwork, she is not provided any sort of information as to whether the vehicles are diesel versus gas. (1 RT 99:8–100:2.)
- There is no way to tell from the contracts whether the vehicle is gas or diesel (1 RT 100:2-4.)
- It is *not* true that every Ford 250 is a diesel; they have come in gas and diesel versions "for a long time." (1 RT 100:5-12.)

- She has owned an F-250 that was a gasoline vehicle. (1 RT 100:12-13.)
- Although every car at Raceway has a stock number, there is nothing in the stock number to indicate it's a diesel vehicle. (1 RT 100:14-18.)
- There is nothing that would come to her to indicate in any way whether a used vehicle was a diesel. (1RT 100:19-20.)
- The smog certificates were kept in a different jacket from the jacket she sees. The smog certificates were locked in the business office, with the inventory jacket, which she does not have access to. She works with the finance jacket and when her work is done, she gives it to the business office, where it is combined with the inventory jacket to become the "deal jacket". (1 RT 143:1-15; 1 RT 163:6-27.)

Furthermore, although Ms. Ferguson conceded that on a *new* vehicle, she can tell from the invoice when a vehicle is a diesel (1RT 100:22-26); Tom Owings correctly pointed out to Petitioners' counsel in his testimony that smog tests have only been required and performed on *used* vehicles, not new vehicles. (3 RT 554:17-24.)

3. Raceway's First Notice of the Error & Investigation As to How It Happened

Mr. Owings testified that Raceway never instructed employees to collect smog fees or smog certification fees on diesel vehicles. (4 RT 623:20-23.) He first became aware that smog fees had been collected on Robert Loverso's vehicle on about January 14, 2005, when he received the letter from petitioners' counsel. (4 RT 623:24–624:3.) In response, he contacted Mr. Loverso and set up an appointment to meet with him in Mr. Owings' office on a Saturday. (4 RT:624:4-13.)

Mr. Loverso kept the appointment. (4 RT 625:8–10.) With regard to the smog fee charge, Mr. Owings testified that in his experience, it never should have happened. He didn't think it was possible and he "had to see it with [his] own eyes." (4 RT 625:22–626:7.) In front of Mr. Loverso, Mr. Owings recalled the inventory screen for Mr. Loverso's vehicle on his computer. He wanted to see what mode of power was input by the inventory clerk. He was "shocked" to see that it said 'D' for diesel, because his initial hypothesis had been that the inventory clerk must have mistakenly misidentified it as a gas vehicle. (4 RT 626:8–19.)

Mr. Loverso had an F250, four-wheel drive diesel, and at the time, the F250 was available in a diesel and non-diesel (or gas) version. (4 RT 627:10-18.) It is the inventory clerk who ordinarily inputs the gas or diesel designation on the inventory screen. (4 RT 627:3-9.)

After Mr. Owings found the "D" for diesel, and when he was still sitting there with Mr. Loverso, he next went to the sales manager screen to see what it would disclose, "and sure enough, there were, as the contract had indicated, the smog charges." (4 RT 627:26–628:5.)

The sales manager does not input the smog charges on the sales manager's screen. (4 RT 9–12.) When asked how the smog charges appear, Mr. Owings responded that the sales manager "relies on the inventory clerk to input the proper mode of power. And then the computer program would determine the correct smog fee." (4 RT 628:13–16.) If the inventory clerk inputs it as a diesel, it should default to no smog fee. (4 RT 628:14-19.) Here, the inventory clerk properly inputted the vehicle as a diesel, and yet the computer charged a smog fee. (4 RT 628:20–25.) The computer system is not supposed to do that. (4 RT 628:28–629:1.)

Next, Mr. Owings looked at the finance manager screen and saw that it also showed the smog fee. (4 RT 629:2–7.) It could only have gotten there through computer error. The default setting did not work. (4 RT 629:11-14.)

Mr. Owings immediately went to the managers at the sales desk and told them to be careful on any diesel sale, because they have a problem in their computer system. He told them that if they sold any used diesels over the weekend, they should handwrite the contract if they have to, but to make it right. (4 RT 629:15-21.)

The following Monday, Mr. Owings contacted Data Consultants[11] (the provider of the "Grapevine" computer software system used at Raceway) and asked them to send a technician. (4 RT 629:22-24.)

Then, Mr. Owings went to Colette Ferguson (also on Monday) to ask her if any of her subordinates could be responsible, because he considered the F&I Department to be responsible for ensuring that contracts are accurate. (4 RT 629:26-630:2.)

He demonstrated what he meant to Ms. Ferguson, by having her call up the fee and asking how did a smog fee get in Robert Loverso's deal? (630:3–8.) He also sampled two other diesel transactions; one for Darrell Rogers and another for Perla Ramirez. (4 RT 630:15–20.)

New vehicles do not receive smog tests; they are for used vehicles only. When he checked Perla Ramirez' transaction, for a new vehicle, it did not have the problem with the smog fees. However, Darrell Rogers' transaction was for a used vehicle, and it had the identical problem as Mr. Loverso. (4 RT 630:24–631:10.) After he found the erroneous smog fee on the Rogers transaction, Mr. Owings "knew it had to be the computer." (4

[11] Mr. Owings had testified earlier that Data Consultants manufactured the "Grapevine" software package used at Raceway. (4 RT 600: 13–601:16.)

RT 631:11–15.)

Data Consultants sent a technician. Mr. Owings explained the problem to him, and the technician went to work on it at Raceway's premises. (4 RT 631:16–28.) When he was finished, he demonstrated to Mr. Owings that it had been corrected. Mr. Owings tried it out multiple times and it was corrected to his satisfaction. (4 RT 632:3-9.)

Mr. Owings' testimony regarding the discovery of the computer error was fully corroborated by Colette Ferguson. When Ms. Ferguson was asked if she knew how it happened that the erroneous smog fees got included, she explained that it was a computer error that she found out about when the Loverso file was brought to her. (1 RT 152:16–154:1) She testified that she tried to manually override the computer to make sure that it did not assess the smog fee, but the computer would not allow her to do so. Every time she tried to print up a contract that she had tried to change, the computer would insert the smog fee back in the contract. "So that's when we became aware that it was a computer error." (1 RT 153:25–154:6.) The computer would not let her override the fee. (1 RT 154:10–12.)

Finally, Ms. Ferguson was asked, based on her experience as the Finance Director, if there was anyone at Raceway who could have corrected the computer so that the smog fees did not get assessed. She replied that there was not, and it was a computer programming issue. (1 RT 154:13–17.) When she was asked, in her experience as the Finance Director, whose fault was it that the fees got assessed? She replied: "I'm going to blame it on the computer. There would be no way for us to have been able to correct it or known it was a diesel vehicle." (1 RT 154:18–22.)

4. Raceway's Correction to Its Customers

After he had the computers corrected, Mr. Owings ran a report to find all the diesel vehicles with the inappropriate smog charges. (4 RT 632:14-28.) He then ordered refund checks and had them mailed to those customers. (4 RT 632:38–633:1.) The refund to Robert Loverso included $50 for the smog fee, $8.25 for the certificate, a $4 tire fee, $3.87 for the tax, and $17.88 for the finance charges, such that the amount of his check was roughly $84. (4 RT 633:5–634:14.)

Mr. Owings had been intending to make similar refunds to all of the other customers, and he instructed his staff to include all the same categories of items in the refund checks. So, the refund checks did include the smog fee, the certificate fee, and the tax differential. (4 RT 634:15–28.) But even though he instructed his staff to include the finance charges, he did not find out until later in the litigation that another employee failed to follow those instructions. (4 RT 634:21–635:21.)

Mr. Owings testified that after the lawsuit had started, he was preparing either a declaration, or for a deposition, and was going over the cancelled checks to customers when he realized that they were all for the same amount. He further testified, "And so I knew there would not be any interest in it because they couldn't all have the same interest rate. So I made inquiries and found that [John Dieringer] had countermanded my order and told them to cut the checks without the interest." (4 RT 635:22–636:3.)

When he found out that the first set of checks went out without any interest included, Mr. Owings testified that he told Mr. Dieringer to immediately send the interest. (4 RT 636:4–6.) Because he wanted to do it quickly, he thought that the best way to do it would be to take the highest percentage interest rate on the contracts that he had seen, which was 20 percent, and pay everybody the 20 percent across the board rather than waste time calculating individual amounts. He wanted to correct it immediately because, "I had given my word that it had been done and it had not been done." (4 RT 636:6–19.) Mr. Owings then authenticated defense Exhibits 385 and 386 as being photocopies of the first and second sets of refund checks that were issued to the members of Class 2.

The only Class 2 representative to testify at trial was Randal Kidd. Mr. Kidd testified on cross-examination that Raceway Ford sent him a check to refund the smog fees that were charged on his vehicle. (2 RT 257:8–14.) He authenticated defense Exhibit 275 as true and correct copies of the front and back sides of the first check that he received from Raceway, and he testified that it was his signature endorsing the check. (2 RT 257:5–27.)

Mr. Kidd received a second refund check from Raceway, and he authenticated defense Exhibit 277 as the copy of that check, which he said he cashed. (2 RT 257:28–258:11.) When asked if there was anything more that he would like Raceway to do to correct the fact that he was erroneously charged a smog fee, Mr. Kidd testified, "I don't remember. I don't under - - - I don't understand." (2 RT 258:23–259:13.) He never said Raceway should refund his payments or rescind his contract, as is now sought in this appeal. The "Total Sale Price" of his purchase on credit, including his down payment of $1,000 was $42,731.20. (3 AA 0595-0598 [Tab 28]; Exh. 5.)

B. <u>Argument - Class 2</u>

1. The Law Does Not Grant Rescission For Any and All Alleged Breaches of the ASFA

Petitioners have never contested Raceway's evidence, or the trial court's finding that the erroneously collected fees were refunded. Instead, Petitioners argue that refunds with interest were not enough. They claim the appellate court should have reversed and awarded them an election of rescission under the ASFA. (POB at p. 45.)

Petitioners' brief includes a detailed, but largely irrelevant, discussion of the legislative intent of the ASFA. There is no authority to stand for petitioners' proposition that the legislature intended to give free cars for bona fide errors like the ones presented here. The ASFA was enacted to protect motor vehicle purchasers from abusive selling practices and excessive charges by requiring full disclosure of all items of cost. (*Bermudez v. Fulton Auto Depot, LLC* (2009) 179 Cal.App.4th 1318, 1323.) even the *Nelson* court agreed that it was not intended to provide a windfall to buyers. (*Nelson v. Pearson Ford Co.*, *supra* 186 Cal.App.4th 983, 1003.) If the ASFA were applied the way that petitioners urge this court to apply it, then customers would be incentivized to remain silent as to an accidental oversight in their contract, rather than to correct it. Worse yet, a customer could mislead a dealer into including something as part of a contract that the customer could later disavow.

But in truth, the ASFA ***does not*** authorize rescission as a remedy for the erroneous collection of smog fees.

The section of the ASFA that allows rescission remedies is Section 2983, which provides in pertinent part:

> (d) When a conditional sale contract is not enforceable under Section 2983 or 2983.1, the buyer may elect to retain the motor vehicle and continue the contract in force or may, with reasonable diligence, elect to rescind the contract and return the motor vehicle. . . .

First and foremost, the statute authorizes the buyer to elect rescission *only if the contract is unenforceable under one of the other two specified*

ASFA sections: 2983 or 2983.1.[12]

In conjunction with the above, §2983 provides:

> If the seller, except as the result of an accidental or bona fide error in computation, violates any provision of Section 2981.9 or of subdivision (a), (j), or (k) of Section 2982, the conditional sale contract shall not be enforceable, except by a bona fine purchaser, assignee or pledge for value or until after the violation is corrected as provided in Section 2984, and if the violation is not corrected the buyer may recover from the seller the total amount paid . . . .

So, before addressing petitioners' contention about a "bona fide error in computation," this Court should first look to see if there has been a violation of the next specified Sections: 2981.9 _or_ 2982(a) (j), or (k). If not, then the analysis should be over, and it must end in favor of Raceway.

Section 2981.9 is also known as the "Single Document Rule." Preliminarily, Raceway must point out that nowhere in petitioners' opening brief does it set forth any particulars as to how the Single Document Rule could have even theoretically been breached by the erroneous collection of

[12] At the time, Section 2983 had four subsections. Subsections (a-c) of Section 2983.1 did not apply. Subsection (a) only applied to violations on contracts other than "simple interest" contracts, under subdivision (l) of Section 2982, and subdivisions (b) and (c) pertained to enforceability with regard to a commercial lender who acquires the contract as a holder in due course; e.g., Ford Motor Credit, AmeriCredit, etc. Such issues are not present in this case, where the only defendant is the seller of the vehicle, Raceway. Thus, the only applicable subsection was and is 2983.1(d).

a smog fee on a diesel vehicle.

The point is that while a breach of the single document rule might arguably provide grounds to make the contract unenforceable under the ASFA, and, in turn, provide grounds for rescission under the ASFA, that still does not mean that the erroneous inclusion of smog fee charges on a diesel vehicle breaches the single document rule.

Specifically, Section 2981.9 states:

> Every conditional sale contract subject to this chapter shall be in writing and, if printed, shall be printed in type no smaller than 6-point, and shall contain in a single document all of the agreements of the buyer and seller with respect to the total cost and the terms of payment for the motor vehicle including any promissory notes or any other evidences of indebtedness. The conditional sale contract or a purchase order shall be signed by the buyer or his or her authorized representative and by the seller or its authorized representative. An exact copy of the contract or purchase order shall be furnished to the buyer by the seller at the time the buyer and the seller have signed it. No motor vehicle shall be delivered pursuant to a contract subject to this chapter until the seller delivers to the buyer a fully executed copy of the conditional sale contract or purchase order and any vehicle purchase proposal and any credit statement

> which the seller has required or requested the buyer to sign and which he or she has signed during the contract negotiations. The seller shall not obtain the signature of the buyer to a contract when it contains blank spaced to be filled in after it has been signed.

There is nothing about the Class 2 smog fee claim that implicates the Single Document Rule cited above, so it is clear that Section 2981.9 does not provide a basis for the requested rescission.

Turning next to Section 2982, subdivisions (a), (j) or (k): it is equally clear that they do not apply to Class 2. Section 2982 concerns "Formalities of conditional sale contracts," and all it does is incorporate the same disclosure requirements as are found in Regulation Z; i.e., the requirement that fees actually charged must be conspicuously disclosed.

Subsection (a) states: "The contract shall contain the following disclosures, as applicable, which shall be labeled "itemization of the amount financed:" and includes the smog fee among the required disclosures. As the Court of Appeal noted, it is clear from looking at the Kidd contracts (Exhs. 273 and 280) that the smog fee charge was disclosed on line 1C, as $50.00, and the smog certification fee was disclosed on line 4 as $8.25. If Raceway had charged those fees to Mr. Kidd without putting them on his contract, petitioners might have an argument here. But that's not what happened. In this case, the fees were conspicuously disclosed; albeit erroneous. That's not what this statute is designed to prevent. This is a ban on *hidden* charges, not disclosed but erroneously included ones.

Subsection (j) of Section 2982 is also inapplicable, since it concerns limits on disclosed finance charges *other than "simple-interest" contracts.*

The contracts in this case are all "simple-interest," and therefore, subsection (j) does not render those contracts unenforceable.

Finally, subsection (k) of Section 2982 is likewise inapplicable to the smog class because it concerns provisions for delinquency charges, which are not an issue at all in this case.

In sum, there is nothing in the ASFA which renders these contracts void and/or unenforceable due to the erroneous addition of smog fees for diesel engines. In the absence of an ASFA basis to hold the contracts void or unenforceable, rescission is not authorized under the ASFA.

2. Raceway's Bona Fide Error in Computation Bars Rescission

Even if it were assumed solely for the sake of argument that petitioners could establish a violation of either the single document rule and/or section 2982(a), (j), or (k), the ASFA still precludes rescission if the violation is due to an "accidental or bona fide error in computation."

Here, petitioners argue ***without supporting authority*** that the error in Raceway's computer programming is not a "bona fide error in computation." (See POB pgs. 16-17.) Petitioners' circuitous contention and tortured logic that "computer errors" do not constitute "errors in computation" should be disregarded. Throughout this case, petitioners' absurdly narrow reading of the statute would only allow "a bona fide error in computation" to exist as a defense for math errors akin to "1 + 1 = 3." But if that's the case, why bother having that exception in the statute at all? As Mr. Owings testified, although some dealerships completed contracts by hand in the 1970's, by the time he arrived in California in 1985, all the dealerships he worked at were completing their contracts with computers. (4 RT 599:4–600:12.) That is 27 years of human beings not having to add numbers on contracts. The odds of a computer making an "automatic populate" error, such as the one that occurred here, are remote enough. Raceway respectfully suggests that the odds of a computer making the error akin to "1 + 1 = 3" are so remote as to be meaningless, and statutes are not enacted for meaningless purposes. Raceway contends that the claims related to the smog fees qualify as "bona fide errors in computation" and rescission should be barred on that basis.

3. Allowing Rescission in This Case Would Be Inequitable

Even if it were assumed solely for the sake of argument that rescission was ever theoretically available under these circumstances, rescission in this case should be disallowed on equitable grounds. In *Donovan v. RRL Corp.* (2001) 26 Cal.4th 261, this Court specifically addressed equitable considerations in connection with bona fide mistakes in the purchase of vehicle. Similar to the situation in *Donovan*, it would be "contrary to common sense and ordinary business understanding and would result in the loss of heretofore well-established equitable rights to relief from certain types of mistake" to allow rescission under these circumstances. (*Id.* at 288.) Equity cannot stand by "with folded hands" and see Raceway "driven to bankruptcy" if petitioners' position of "no compromise, no exception [and] no middle ground" is accepted and rescission is allowed even after full refunds with interest have been provided. (*Id.* at 287.)

In essence, the request for rescission by Class 2 should be ruled out because at this point it is just a claim for punitive damages by another name. In spite of all their rhetoric about the lofty purposes of the ASFA, petitioners have to know that there is no evidence of malice, fraud or oppression sufficient to justify a punishment to put Raceway out of business. The evidence is undisputed that Raceway's computer software accidentally included a small, inapplicable fee. Raceway never tried to deny it or cover it up. Mathematically, it represented less than 1/5 of one percent of the "total sale price" of the goods at issue. ($84 total refund to Mr. Kidd = 0.00196577 of Kidd's approximately $42,731.20 total sale price.) Randall Kidd purchased his Ford F250 truck in August of 2003, on a five year contract that should have been fully performed by August 5, 2009, (Exh. 7) which is now more than six years ago. It is a warped premise arguing for a ridiculous windfall, particularly since Mr. Kidd stopped paying for his vehicle and it was repossessed. (2 RT 260:19-20.)

4. The Court of Appeal was Correct in Finding No ASFA Violation

Although based on different grounds, the Court of Appeal was also correct in finding that petitioners did not prevail on their ASFA claims. As discussed above, for purposes of this Appeal, petitioners have based their smog related claims solely on Civil Code section 2982, a portion of the ASFA entitled "Formalities of conditional sales contract." As the Court of Appeal aptly pointed out, the parties entered into a contract in conformity with the ASFA in which the parties ultimately realized there was a bona fide mistake due to computer error. The record also contains undisputable evidence that Raceway subsequently corrected its mistake as soon as Raceway discovered it. The Court of Appeal was correct in finding that petitioners could not assert a claim under the ASFA because under section 2982, "members of Class Two received all the information that the ASFA required them to receive … ." (Opinion pg. 44.)

Contrary to Petitioners' Opening Brief, the Court of Appeal's Opinion on the disclosure of smog related fees will not allow "dealers to engage in massive fraud." (POB pgs. 23-24.) Petitioners inappropriately attempt to compare this case to that of *Nelson v Pearson Ford Co., supra,* 186 Cal.App.4th 983 or *Thompson v. 10,000 RV Sales Inc.* (2005) 130 Cal.App.4th 950, wherein charges in those contracts ***were intentionally deceptive*** causing the contracts to not accurately describe the parties' agreements. As discussed above, that was not the case here. In this case, the Court of Appeal was clear that consumers would have statutory or common law claims that would provide them with a remedy, especially if, unlike Raceway, the dealership had charged fees with fraudulent intent. (Opinion pg. 44.)

Finally, petitioners' contention that the Court of Appeal put the "burden of compliance with the ASFA on consumers" is an outright misstatement of the Opinion. (POB pgs. 22-23.) The Court of Appeal actually stated "this is not to say that the blame for the improper charges should be placed on the consumer." Rather, the Court of Appeal makes the distinction between a finding of whether the ASFA's disclosure provisions were violated, and a finding of whether Raceway was wrong for charging the inappropriate fees.

C. Conclusion – Class 2

Raceway promptly issued smog fee refunds to the Class 2 customers as soon as it learned of the error. Raceway issued supplemental refunds, representing interest on the original refunds, years before the trial began. The Class members knew they had received their refunds with interest, and the only reason for pursuing this case was to escalate litigation costs, risks and attorneys' fee claims through an invalid demand for class-wide rescission.

The trial court's Statement of Decision was correct. The members of Class 2 had already received anything and everything they could possibly be entitled to. The equity arguments against rescission are blatantly obvious. If this Court finds petitioner's interpretation was the way the law really worked, every California car purchaser would be hoping and praying to be the "victim" of a similar mistake. Any finding by this Court which would allow rescission under these circumstances would be "contrary to common sense and ordinary business understanding and would result in the loss of heretofore well-established equitable rights to relief from certain types of mistake."

Most importantly, the Court of Appeal was also correct in finding that there was no violation of the ASFA with respect to Class 2. The contracts accurately disclose the economics of the transaction agreed to by the parties in all respects. Further, the Court of Appeal did not reach the question of whether Raceway or other car dealers were liable under some other statute or law for charging inappropriate smog fees ***as the ASFA cause of action was the only one appealed in this case.*** Petitioners would like to make this about car dealers being able to commit massive fraud. However, simply put, petitioners failed to allege a cause of action under which relief could be granted and now have no alternative but to attempt to twist the Court of Appeal Opinion and the findings of the trial court into some broad propositions for which this case does not stand.

Dated: June 30, 2015

Respectfully submitted,

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WORD COUNT

[Cal. Rules of Court, rule 8.520(c)]

I hereby certify that the foregoing "Answer Brief on the Merits" is produced using 13-Point Times New Roman type and the text of this brief consists of approximately 12,904 words, including footnotes, as counted by the Microsoft® Word 2010 word-processing program used to generate the brief. Counsel relies on the word count of the computer program used to prepare this brief.

Dated: June 30, 2015

Kellie S. Christianson

Raceway Ford Cases
California Supreme Court Case No. S222211
Court of Appeal, State of California, Fourth Appellate District
Division Two Case Nos. Case Nos.: E056595 [Related Case E054517]
Riverside Superior Court Case no. JCCP4476

PROOF OF SERVICE

(CODE CIV. PROC., § 1013a(3), C.R.C, RULE 8.25)

STATE OF CALIFORNIA, COUNTY OF ORANGE

I am employed in the County of Orange, State of California. I am over the age of 18 years and am not a party to the within action; my business address is 20 Pacifica, Suite 400, Irvine, California 92618-3371.

On June 30, 2015, I served the following document(s) described as **ANSWER BRIEF ON MERITS** on the interested parties in this action as follows:

☑ **BY MAIL:** I placed a true and correct copy of the document(s) in a sealed envelope for collection and mailing following the firm's ordinary business practices. I am readily familiar with the firm's practice for collection and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service in a sealed envelope with postage fully prepaid.

☐ **BY OVERNIGHT COURIER:** I enclosed the document(s) in an envelope or package provided by an overnight delivery carrier and addressed it to the parties shown herein. I placed the envelope or package at my place of employment in accordance with regular business practices for collection and overnight delivery.

Executed on June 30, 2015, at Irvine, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Patricia D. Tonti-Mace

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