

ALASKA STATE LEGISLATURE
SENATE TRANSPORTATION STANDING COMMITTEE

February 23, 2006

1:35 p.m.

MEMBERS PRESENT

Senator Charlie Huggins, Chair
Senator John Cowdery, Vice Chair
Senator Gene Therriault
Senator Albert Kookesh
Senator Hollis French

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 300

"An Act relating to the handling of negative equity in motor vehicle transactions."

HEARD AND HELD

SENATE BILL NO. 273

"An Act relating to a motor vehicle dealer's selling or offering to sell motor vehicles as new or current models or as new or current model motor vehicles having manufacturer's warranties."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 300

SHORT TITLE: MOTOR VEHICLE NEGATIVE EQUITY

SPONSOR(s): SENATOR(s) SEEKINS

02/14/06	(S)	READ THE FIRST TIME - REFERRALS
02/14/06	(S)	TRA, L&C
02/23/06	(H)	TRA AT 1:30 PM CAPITOL 17

BILL: SB 273

SHORT TITLE: MOTOR VEHICLE SALES

SPONSOR(s): SENATOR(s) COWDERY

02/08/06	(S)	READ THE FIRST TIME - REFERRALS
02/08/06	(S)	TRA, L&C
02/23/06	(H)	TRA AT 1:30 PM CAPITOL 17

WITNESS REGISTER

Senator Ralph Seekins
Alaska State Legislature
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Sponsor of SB 300.

Brian Hove, Staff
to Senator Ralph Seekins
Alaska State Legislature
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Answered questions on SB 300.

Ryan Makinster, Staff
to Senator John Cowdery
Alaska State Legislature
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Presented SB 273 and a proposed amendment;
answered questions.

Carol Lyberger
Lyberger's Car and Truck Sales
Anchorage, AK
POSITION STATEMENT: Testified that she was 100 percent in
support of SB 273.

Jon Cook, Legislative Director
Alaska Auto Dealers Association;
General Manager, Aurora Motors
Fairbanks, AK
POSITION STATEMENT: Stated strong support for SB 273 and the
proposed amendment.

Steve Sautner, Owner
Dealers Auto Auction of Alaska
Anchorage, AK
POSITION STATEMENT: Testified in support of SB 273, offering a
wholesaler's perspective.

ACTION NARRATIVE

CHAIR CHARLIE HUGGINS called the Senate Transportation Standing
Committee meeting to order at [1:35:10 PM](#). Present were Senators

John Cowdery, Hollis French and Chair Charlie Huggins. Senators Albert Kookesh and Gene Therriault arrived as the meeting was in progress.

SB 300-MOTOR VEHICLE NEGATIVE EQUITY

CHAIR HUGGINS announced SB 300 to be up for discussion.

SENATOR RALPH SEEKINS, Alaska State Legislature, sponsor, explained that SB 300 updates the definition of "principal balance" in the Alaska Retail Installment Sales Act to accommodate the proper disclosure of negative equity. It also clarifies how negative equity within a lease arrangement is handled. At one time, lending institutions required borrowers to monetarily participate in purchase transactions. Down payments of 25 percent were common, and term loans were held to a maximum of 36 months. Over the last several years, however, these guidelines have gone by the wayside. The strength and stability of the national economy have spurred consumers to demand lower-payment loans along with greater value.

He noted that banks, credit unions and acceptance companies have accommodated the marketplace by offering low-down or no-down payment options, as well as lengthening the allowable repayment period; this is particularly evident in retail auto sales, where qualified buyers may opt for 100 percent financing over the longest possible term. As a result, the point in time at which the vehicle's market value exceeds the outstanding balance on the loan occurs much later than it otherwise would.

SENATOR KOOKESH arrived at [1:40:04 PM](#).

SENATOR SEEKINS continued, explaining that until this point is reached, the owner's equity position is "upside down" or "negative" - the auto's value is less than the remaining loan. When the owner wants to trade for a different vehicle, a dealer must figure out how to accommodate the loan payoff in the trade-in. At one time, it was common practice in some states to simply inflate the price of the car enough so the trade-in covered the amount owed; the negative equity then disappeared. However, it failed to describe the transaction mathematically, and this practice fell into disfavor over time.

He noted that today new vehicles may be sold at non-negotiable prices, such as when there is a factory incentive program. Furthermore, the Federal Reserve Board has provided guidance on this issue through revisions to Regulations M and Z, which

control the manner in which lease and credit transactions, respectively, are disclosed. Regulation M was revised to provide a dedicated disclosure line on the lease agreement in cases where a prior loan or lease balance - negative equity - is rolled in to the new lease transaction. Regulation Z was revised to alter the definition of "down payment," thereby solving the negative-equity issue as it pertains to a loan transaction, Senator Seekins reported.

He said the vast majority of banks and credit unions are federally regulated and follow federal disclosure laws; state laws don't come into play. However, acceptance companies like GMAC or Ford Motor Credit must follow both federal and state laws. The dual-adherence requirement has created a disparity in the manner in which loan and lease transactions are disclosed when there is negative equity in Alaska. While federal law has been revised to accommodate this situation, Senator Seekins said, state law hasn't been.

He concluded, saying SB 300 resolves this disparity by updating the definition of "principal balance" as it pertains to the state's disclosure requirements for retail sales contracts found in Title 45, Chapter 10. It also adds corresponding language to Chapter 25 pertaining to the handling of negative equity with respect to lease agreements. These modifications bring state and federal law into alignment and resolve the concern for acceptance companies that do business in Alaska.

[1:43:03 PM](#)

SENATOR COWDERY asked how dealers and car financing companies currently address this situation.

SENATOR SEEKINS answered that they generally try to get additional cash down payments, for example. In his own dealership the previous week, a customer had \$19,000 in negative equity on a vehicle; it was eight-year financing, and the dealership could do nothing to help. "If we sell the contract to a bank, we're OK," he added. "We can't sell it to an acceptance company." He pointed out that dealerships would rather do business with acceptance companies, through which they get preferable interest rates and additional cash bonuses from the manufacturer.

[1:45:11 PM](#)

SENATOR COWDERY asked whether a loan would be made to an individual if there was negative equity.

SENATOR SEEKINS replied that an outside loan could be obtained, but it's something most dealerships don't like to do.

SENATOR COWDERY asked whether the change [proposed in the bill] is for convenience or is cost-driven.

SENATOR THERRIAULT arrived at [1:46:13 PM](#).

SENATOR SEEKINS answered that it is more to bring acceptance companies under the same types of regulations and disclosures that the federal government has, thereby allowing acceptance companies to compete with banks on an equal footing.

SENATOR COWDERY asked if the Department of Law (DOL) supports this bill.

SENATOR SEEKINS said he didn't believe [DOL] had been asked. However, states commonly try to bring their laws into compliance [with federal laws], and most states' laws are now in compliance with Regulations M and Z. He added that [the bill] was requested by the acceptance companies.

SENATOR COWDERY offered his belief that the attorney general wanted to testify on the bill, but wasn't available.

CHAIR HUGGINS suggested hearing from him at a later date.

SENATOR SEEKINS indicated the attorney general hadn't expressed an opinion to his office. In response to Chair Huggins, Senator Seekins said he hadn't heard negative feedback from any of the finance institutions.

CHAIR HUGGINS asked about pros and cons for the customers.

SENATOR SEEKINS answered that the loan would still be made based on the customer's ability to pay. Generally, a loan for a car is an accommodation, trying to help the customer buy the car that he or she wants. He said most dealers can handle contracts through banks, and this brings it down to a matter of equity. There may be \$1,000 additional cash for people working through Ford Motor Credit, for example, but if there is negative equity, the dealership cannot help the customer take advantage of that under state law now.

CHAIR HUGGINS posed a situation in which a customer has \$5,000 in negative equity. He asked what allows a dealership to leverage that to a customer's advantage.

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SENATOR SEEKINS noted that in the past, negative equity was adjusted in the paperwork. Now the situation is disclosed and yet it's financed anyhow, because the customer's creditworthiness allows making those [larger] payments. In response to Chair Huggins and Senator French, he affirmed that currently it can be rolled over into new financing - but through banks or credit unions, not acceptance corporations.

SENATOR FRENCH voiced concern about people living beyond their means, and reported reading in Forbes that the savings rate in the U.S. just went negative for the first time since 1933. He said, however, this bill is more a symptom than a cause, and he sees no reason to harm institutions doing business in Alaska.

He expressed interest in seeing Regulations M and Z. He also requested a handout that shows how the paperwork could be done under the federal system, but not the state system.

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SENATOR SEEKINS indicated he'd provide the requested information.

SENATOR COWDERY asked whether [a dealer] can make a cash loan to an individual.

SENATOR SEEKINS answered that he could, but doesn't. He explained, "Part of our agreement with most finance institutions is, we don't loan money as part of their down payment. ... We disclose it as what it is." He said on a lease transaction, if not properly disclosed, the negative equity could be termed - without the definition in Regulation M - as a personal loan and then not be properly disclosed. Therefore, the federal government changed its process of disclosure in a lease transaction so that it is not a personal loan.

He pointed out that for every loan on a vehicle, there's a decision that the finance institution makes: Does the person have enough disposable income to make those monthly payments? If so, and if the person has a good credit history, there is a willingness to finance an "upside down" or negative-equity

situation. It isn't considered a personal loan, and is still a transaction on the car.

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SENATOR COWDERY observed that it seems like a personal loan.

SENATOR SEEKINS said many cars have negative equity for the first two or three years after purchase. He noted that so-called gap insurance is sold in the marketplace today: if the vehicle is totaled, the loan is paid off, even though the car's value doesn't equal what is owed.

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CHAIR HUGGINS asked what a dealer could do for someone with \$5,000 in negative equity.

SENATOR SEEKINS explained that there are three ways to help a customer "get out of that car": cash, having enough margin in the new vehicle to make up most or all of it, or financing the negative equity. First, as the dealer he'd determine the car's actual cash value - wholesale value - to him; he'd also determine what is owed. If there's a \$5,000 gap, but a \$3,000 "markup in the car," he may allow \$1,500 of that markup "to go back into the vehicle." This leaves only a \$1,500 gap. At that point, if the customer is creditworthy, the dealer might not request more of a down payment, or else the customer might pay a \$1,500 down payment. That would put the customer at 100 percent financing on the new vehicle.

He noted that if the dealer can find a finance institution willing to finance \$1,500 more than it otherwise would, because of the customer's creditworthiness, then the dealer - if he properly discloses it - can have that negative equity financed, provided it's through a bank or credit union, under federal law.

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SENATOR SEEKINS, in response to Chair Huggins, said all the options are available to a dealer. All he's doing [with SB 300] is bringing the acceptance corporations under the same regulations as the federal banks and credit unions. However, a customer may end up paying more in interest, or might not be able to get a bonus incentive from the acceptance corporation. In some cases, incentives from acceptance corporations provide an additional \$1,000 that the customer could apply to the down

payment, he noted. Having it equal in terms of disclosure can sometimes be a benefit for the buyer, he suggested.

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BRIAN HOVE, Staff to Senator Ralph Seekins, Alaska State Legislature, offered to answer questions during Senator Seekins' brief absence.

SENATOR COWDERY asked, in essence, whether the interest for financing a \$5,000 equity gap would be the same as the financing for a new car.

MR. HOVE answered that it's the same contract. The customer would be paying off the old contract and rolling it into a new one - a single contract with one set of terms and conditions, including interest.

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CHAIR HUGGINS recalled there are variables, however, and the institution could change the interest rate, for example.

MR. HOVE answered that it comes down to expanding options for the buyer with regard to financing sources. He suggested this offers the buyer an opportunity to get a better deal, since acceptance corporations aren't included currently.

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SENATOR SEEKINS added that this came as a request from "the legal department." He said several acceptance corporations want this clarified so that they're clearly on an equal footing [with banks and credit unions].

CHAIR HUGGINS advised that he'd see about the availability of the attorney general [to testify at the next hearing], and would determine whether banking institutions want to offer their perspective as well.

SENATOR FRENCH indicated when the attorney general is present he'd like to hear whether this is a good idea and perhaps should be done for home sales as well.

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CHAIR HUGGINS pointed out that homes normally appreciate over time, whereas automobiles depreciate rapidly.

SENATOR SEEKINS reiterated his intent to put all those finance institutions on an equal footing in terms of full disclosure. [SB 300 was held over.]

CHAIR HUGGINS called a brief at-ease.

SB 273-MOTOR VEHICLE SALES

CHAIR HUGGINS announced SB 273 to be up for consideration.

SENATOR COWDERY, sponsor, advised members of a proposed amendment to the bill, to amend Section 1, page 1, line 11, to delete "for sales in this state" and add, after "vehicle", the phrase "pursuant to which the dealer's area of responsibility is located within the State of Alaska". He deferred to his staff for an explanation.

SENATOR FRENCH objected for discussion purposes.

RYAN MAKINSTER, Staff to Senator John Cowdery, Alaska State Legislature, explained that in 2004, HB 272 was passed with regard to unscrupulous advertising or sales practices. Some people were selling slightly used cars as new, or were ambiguously claiming that they were new cars. In that bill and some other legislation, AS 08.66.015 was changed, becoming more far-reaching than intended. The legislation had "current model" to deal with this problem, Mr. Makinster noted. However, many people trade in vehicles soon after buying them. The language prohibited sale of a current-model vehicle for any reason unless it had a manufacturer's certificate of origin. Under current law, a vehicle would have to be held by a dealer until the next year's model was introduced.

He said this law isn't being enforced. It would be a bad business practice for dealerships and, according to the Department of Law (DOL), would hurt the consumer overall. For example, Mr. Makinster said, a serviceman going overseas wouldn't be able to turn in a car because no dealership would want to pay for that car and have it sit on the lot until the next year's model came out.

He explained that SB 273 therefore removes "current model" from statute. Thus a new vehicle can be sold only if in possession of the certificate of origin and if the dealer has the

manufacturer's sales and service agreement. "So basically a manufacturer-dealer can only sell new cars," he added. "A used-car dealer, under no circumstance, can sell a new car." He said this protects the consumer because it doesn't allow a used-car dealer to purport that a used car is new.

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CHAIR HUGGINS asked whether registration provides the primary evidence that a car isn't new.

MR. MAKINSTER said the manufacturer's certificate of origin remains with the car until registered; it is then relinquished to the state's department of motor vehicles and the car automatically becomes a used car. That is how it occurs in most states. Some states, however, have more ambiguous statutes.

CHAIR HUGGINS requested clarification about what would change.

MR. MAKINSTER answered that it wouldn't change anything being done right now. The statute as written isn't being enforced, which is why DOL has requested this change. If it were enforced, a vehicle might have to sit on a dealer's lot until the next model year came out.

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SENATOR COWDERY related his understanding that the attorney general's office said, if this were enforced, there would be about a \$5,000 fine for every transaction.

MR. MAKINSTER concurred, but clarified that the fine would apply to every attempt to sell, which could attach even to advertisements.

SENATOR FRENCH requested clarification on whether there is a prohibition on selling it at all, or if the person just cannot sell it as a current-model vehicle.

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MR. MAKINSTER responded that, according to DOL, the prohibition is on selling it - because "current model" isn't defined in statute, it can be interpreted as an inability to sell a current-model vehicle.

SENATOR FRENCH remarked that it seems to go along with the letter from Mr. Sniffen [of DOL, in packets].

MR. MAKINSTER, in response to Chair Huggins, said the change [proposed in the amendment offered by Senator Cowdery] was at the request of the auto dealers association; it was received only two days ago. He reported that DOL believes it is a good change.

He informed members that Mr. Sniffen of DOL, who would testify at the next committee hearing, said this new language is probably better because "sales in this state" is somewhat ambiguous with regard to dealers in other states, who might have agreements with the manufacturer to have Alaska under their umbrella of responsibility. Mr. Makinster also noted that Mr. Sniffen said this is mostly a matter of style, but also clarifies what "sales in the state" means.

CHAIR HUGGINS brought up the issue of Canadian dealers in particular.

MR. MAKINSTER said that was what the original bills dealing with this matter were trying to address. He relayed that Mr. Sniffen said it has been resolved through other legislation. "This is basically cleanup language," Mr. Makinster added.

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CHAIR HUGGINS asked if [SB 273] would have any negative impacts for the buyer.

MR. MAKINSTER said he didn't believe so; according to DOL, this would actually help consumers, who would be allowed to buy a car and turn a car in. As for used-car dealers, he noted that Section 2 repeals [AS 08.66.015(b)], which reads:

(b) A person who does business as a dealer in the state may not offer to sell or sell a motor vehicle as a new or current model motor vehicle having a manufacturer's warranty unless

(1) the dealer has a current sales and service agreement with the manufacturer and the agreement requires the dealer, upon demand of the motor vehicle buyer, to perform or arrange for, within a reasonable distance of the dealer's place of business in the state, the repair and replacement work required of the manufacturer under the warranty; or

(2) the dealer offers to give the buyer a rebate to cover the repair and replacement work that the dealer cannot perform or arrange for within a reasonable distance of the dealer's place of business.

He pointed out that someone could have a used current-model vehicle, and that a used car could have a manufacturer's warranty. The existing language limits purchasing options for a buyer. Thus the bill allows consumers to buy new but slightly used cars from a wider range of dealers, not just new-car dealers.

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CHAIR HUGGINS observed that the bill allows a person to transfer a warranty when selling a car.

MR. MAKINSTER concurred.

CHAIR HUGGINS opened public testimony.

CAROL LYBERGER, Lyberger's Car and Truck Sales, Anchorage, said this bill is a good change and just cleans up an old law. She offered an example, saying this will make every dealership in compliance with state law. She expressed 100 percent support. In response to Chair Huggins, she indicated she believes it is friendly to both customers and dealers.

[2:21:02 PM](#)

JON COOK, Legislative Director, Alaska Auto Dealers Association; General Manager, Aurora Motors, Fairbanks, informed the committee that he strongly supports SB 273 and the proposed amendment. He said it can't be overstated how beneficial this is. Agreeing this is a housekeeping issue - since dealers in Alaska are technically out of compliance with state law and yet it isn't enforced - he noted that it would be detrimental to consumers if the current law were enforced, which could happen someday if the statute remained on the books. He specified that repeal of subsection (b) also would be most welcome.

SENATOR FRENCH asked how many cars come back after the first year of their sale.

MR. COOK replied that his dealership gets perhaps a dozen a year, and he believes several hundred are returned each year in Alaska. In response to Chair Huggins, Mr. Cook noted that his

organization's membership includes the vast majority of new- and used-car dealers in Alaska. He has worked on this issue for more than a year, but hasn't heard objections. He suggested it would help used-car dealers especially, since they cannot sell a current-model vehicle at all under the existing statute. He indicated he couldn't see any negative impacts on customers, but there would be many problems under the current statute, if enforced, including a worsening of the negative-equity situation discussed earlier in the meeting.

STEVE SAUTNER, Owner, Dealers Auto Auction of Alaska, Anchorage, expressed support for SB 237. He explained that wholesalers would like to be in compliance with state law because they sell new, previously owned vehicles, particularly repossessed vehicles, dealer-consigned vehicles and rental vehicles, which they'd like to sell as soon as possible. There are several thousand such 2006 vehicles in Alaska, and dealers cannot absorb all of them. This change is needed so dealers can be in compliance.

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MR. SAUTNER, in response to Senator Cowdery, said about a third of the vehicles he gets are repossessions; a third are dealer-consigned vehicles, including aged inventory and new-car trade-ins; and a third are rental vehicles and off-lease vehicles. A lot of current-model-year vehicles are returned from rental lots every year; many go to the Seattle markets now, but increasingly they are liquidated.

CHAIR HUGGINS asked about any drawbacks to dealers or customers from these proposed changes.

MR. SAUTNER replied that he isn't in the retail side of the business, but doesn't see any negatives from either side.

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[Cynthia Drinkwater of DOL informed members that she was on teleconference to answer questions and that Mr. Sniffen would be available for future hearings.]

CHAIR HUGGINS asked whether anyone else wished to testify. He announced that SB 273 would be held over. [The proposed amendment was not adopted.]

There being no further business to come before the committee,
Chair Huggins adjourned the House Transportation Standing
Committee meeting at [2:31:29 PM](#).