

ARE YOU COVERED?: BEHIND THE DRIVE TO REGULATE GAP WAIVERS

*Stephen D. Britt, Austin B. Kenney,
& Genevieve R. Walser-Jolly*



Stephen D. Britt



Austin B. Kenney



**Genevieve R.
Walser-Jolly**

Stephen D. Britt is special counsel in Severson & Werson's Financial Services Practice Group, where he defends national mortgage/automobile lenders and loan servicers against borrower complaints surrounding lender liability, title claims, wrongful foreclosure/repossession, and statutory/regulatory violations. He also handles contract litigation, construction defect, and insurance defense matters. Mr. Britt is a member of the Orange County Bar Association and the Association of Southern California Defense Counsel.

Austin B. Kenney is a member in Severson & Werson's Financial Services Practice Group. He counsels and defends financial institutions in state and federal consumer finance litigation and related regulatory and compliance matters involving auto finance, banking operations, privacy, mortgage, and unsecured credit lending. Mr. Kenney is a published author and regular speaker for organizations including the Conference on Consumer Finance Law, the Association of Consumer Vehicle Lessors, and the California Creditor's Bar Association.

Genevieve R. Walser-Jolly is a member in Severson & Werson's Financial Services Practice Group, where her practice includes complex litigation in representing auto finance companies victimized by sophisticated fraud rings; defending consumer cases under the TCPA; and developing data privacy programs. Ms. Walser-Jolly is vice president of Marketing for the Governing Committee for the Conference on Consumer Finance Law, and she is also a member of the Orange County Bar Association and the Vice-Chair for the Privacy and Cybersecurity Subcommittee for the Consumer Financial Services Committee with the American Bar Association.

I. INTRODUCTION

Guaranteed Asset Protection (GAP) waivers have long been a popular “ancillary product”¹ for sale by automobile dealers and finance companies to consumers. For an additional contract fee, a consumer can secure waiver of their obligation to pay the remaining debt balance above cash value in the event of a total loss (or unrecoverable theft) of a vehicle. Alternatively, the consumer can purchase GAP insurance, which offers similar protection but must be purchased through a licensed insurance agent or broker, much like collision or umbrella policies.² While insurance sales have long been regulated at the state level (although perhaps not widely), GAP waivers, as distinct products, traditionally have not been regulated . . . until now.

The past decade has seen a strong push at the federal and state level (primarily in California, Colorado, and Massachusetts) to regulate GAP waivers as ancillary products. This Article will: (1) broadly discuss the legislative and market factors that gave rise to this regulatory push; (2) analyze the history and passage of California AB 2311—now codified as Section 2982.12 of the Automobile Sales Finance Act—as a reflection of industry forces coming to bear on this landmark legislation; and (3) address best practices for heeding the new regimes.

II. DIFFERENTIATING GAP WAIVERS FROM GAP INSURANCE

The products are sometimes conflated by unwitting consumers and unscrupulous salespersons. However, GAP waivers and GAP insurance are fundamentally distinct products with different consumer protection mechanisms and inherent unique regulatory schemes (if any). GAP insurance means:

[I]nsurance in which a person agrees to indemnify a vehicle purchaser or lessee for some or all of the amount owed on the vehicle at the time of an unrecovered theft or total loss, after credit for money received from the purchaser’s or lessee’s physical damage insurer, pursuant to the terms of a loan, lease agreement, or conditional sales contract used to purchase or lease the vehicle.³

Thus, GAP insurance is typically offered to automobile consumers by insurance companies outside of and apart from the underlying vehicle finance transaction. Most states have statutes directing their state-level departments of insurance to regulate GAP insurance products.⁴

By contrast, GAP waivers are directly offered to consumers by automobile dealerships and finance companies. The GAP waiver is a market-

1. An “ancillary product” is sold as an “add-on” in connection with a vehicle sale or lease, such as a tire protection plan or an extended vehicle service plan.

2. This may include properly licensed dealers.

3. See CAL. INS. CODE § 1758.992(h)(1).

4. See, e.g., CAL. INS. CODE § 1758.992(h)(1); N.Y. INS. LAW § 1113 (a)(26).

driven product (that is, one historically defined by contract rather than statute), whereas the rules and mechanics of GAP insurance are traditionally defined by state and federal regulation. Many states,⁵ such as California,⁶ explicitly exclude GAP waivers from statutory schemes that authorize departments of insurance to regulate GAP insurance policies.⁷

III. RECENT EFFORTS TO REGULATE AND LITIGATE GAP WAIVER PROTECTION

In recent years, GAP waivers have drawn the ire of state and federal agencies, legislators, and consumer bars.⁸ These entities pay particular scrutiny to the handling of GAP waiver refunds upon early lease or finance contract termination. In response, state and federal regulators and public officials have pushed for new regulation. As discussed below, these concerns have resulted in regulatory pushes, at both the federal and state level, to regulate GAP waiver contract sales and ensure fair handling of early termination refunds.

A. Federal Regulators Lead the Charge.

In March 2019, the Consumer Financial Protection Bureau (CFPB) signaled that it would be stepping up enforcement of legislation and regulation pertaining to early cancellation and refund of related premiums and fees for finance and insurance products, such as GAP waiver coverage.⁹ It

5. See *Survey of United States GAP Regulations for Exclusive Use by the Equipment Leasing & Finance Association*, MCGLINCHAY STAFFORD, PLLC (Jan. 1, 2014), https://www.elfaonline.org/docs/default-source/legal/2014elfagapsurvey.pdf?sfvrsn=d46ddf0d_2 (providing a comprehensive survey of state statutes and regulations relating to GAP waivers as of January 2014).

6. See, e.g., CAL. INS. CODE § 1758.992(h)(2).

7. In *Automotive Funding Group, Inc. v. Garamendi*, California's Insurance Commissioner appealed from a judgment that a debt cancellation program (functionally equivalent to a GAP waiver), offered by a finance lender, was not an insurance product within his regulatory purview. The court affirmed the judgment in favor of the lender. Citing another case for the proposition that "one fundamental hallmark of insurance . . . is shifting one party's risk of loss to another," the court specifically found that the lender's program could not be considered insurance because the lender retained the risk of loss of the security (for a fee) rather than shifting the risk of loss to the buyer's vehicle insurer. *Auto. Funding Grp., Inc. v. Garamendi*, 114 Cal. App. 4th 846, 856–57 (2003).

8. Various market forces are at play, but one cited factor is "vehicle price increases," which "drive up consumer demand for debt cancellation agreements." Kristi Richard, *Regulatory updates and considerations for GAP providers and creditors*, AUTO FIN. EXCELLENCE (Mar. 25, 2022), <https://www.jdsupra.com/legalnews/regulatory-updates-and-considerations-7870104/>.

9. *Supervisory Highlights: Issue 19, Summer 2019*, CONSUMER FIN. PROT. BUREAU 3 (Sept. 2019), https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-19_092019.pdf ("Abusive act or practice when selling add-on GAP products.").

then put that plan into action in May 2021, by entering into a consent order with a California auto-loan finance company “for illegally charging interest for late payment on its Loss Damage Waiver (LDW) product without its customers’ knowledge,” resulting in the company issuing refunds to consumers and a paying a \$50,000 civil penalty to the CFPB.¹⁰ Subsequently, a report was issued on May 2, 2022,¹¹ explaining that the CFPB targets servicers who engage in “unfair practices” by failing to request refunds from the third-party administrators for “unearned” fees related to GAP, and failing to apply the applicable refunds to the accounts after repossession or other early termination of the contracts.¹²

10. See *CFPB Takes Action Against Auto Lender for Unfair Loss Damage Waiver Practices*, CONSUMER FIN. PROT. BUREAU (May 21, 2021), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-auto-lender-for-unfair-loss-damage-waiver-practices/> (“California Auto Finance to Provide Refunds and Credits, Correct Credit Records, and Pay a Civil Money Penalty.”).

11. *Supervisory Highlights: Issue 26, Spring 2022*, CONSUMER FIN. PROT. BUREAU 4 (May 2022), https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-26_2022-04.pdf (“Overcharging for add-on products.”).

12. A blog post heralding the report explains the CFPB’s rationale and intention in regulating ancillary products in this context:

The add-on product’s potential benefits apply only for specific time periods, such as four years after purchase, and only under certain circumstances. Auto dealers and finance companies often charge consumers all payments for any add-on products as a lump sum at origination of the auto loan, and they generally include the lump sum cost as part of the total vehicle financing agreement. Consumers typically make payments on these add-on products throughout the loan term, even if the product expires years earlier.

Our examiners have focused on the way servicers handle these add-on product charges when the loan ends before the add-on product’s potential benefits end. . . . [E]xaminers found that servicers engaged in unfair practices by failing to request refunds from the third-party administrators for ‘unearned’ fees related to one such add-on product, GAP, and failing to apply the applicable refunds to the accounts after repossession and cancellation of the contracts. At that point, the consumers did not have the cars that had been subject to the GAP product, and the product no longer offered any possible benefit to consumers. Examiners found that servicers later sent deficiency notices to consumers and reported balances to third-party debt buyers that included these inaccurate amounts in the deficiency balances owed by consumers.

“The CFPB,” it noted, “will continue to scrutinize servicer practices to make sure that borrowers aren’t overcharged when their loans end early.” See Allison Brown, *Overcharging for add-on products on auto loans*, CONSUMER FIN. PROT. BUREAU (May 2, 2022), <https://www.consumerfinance.gov/about-us/blog/overcharging-for-add-on-products-on-auto-loans/>.

The CFPB has also leaped into pending litigation regarding GAP product servicing practices. In January 2022, it filed an amicus brief in *Davidson v. United Auto Credit Corp.*,¹³ a case before the Fourth Circuit Court of Appeals in which a service member sued an auto lender for allegedly violating the Military Lending Act (MLA) by packaging a GAP insurance contract,¹⁴ which was covered by the MLA, with a vehicle purchase contract, which was not.¹⁵ The CFPB argued that the package deal created a “hybrid loan,” which required any GAP product provisions to comply with MLA requirements.¹⁶ At the time of this writing, arguments before the Fourth Circuit are set to take place later this year.

The CFPB is not alone in its regulatory enforcement efforts. The Federal Trade Commission also recently signaled its intent to increase regulation of GAP waivers. In June 2022, it issued 16 CFR Part 463,¹⁷ to “fight deceptive advertising, crack down on bait-and-switch marketing, and put a stop to hidden add-on charges when consumers go vehicle shopping.”¹⁸ The regulation also outlines specific areas it plans to place in its cross-hairs, specifically calling out GAP waiver coverage.¹⁹

B. States Follow Suit.

State Attorney Generals have also begun taking turns using GAP waivers as a political punching bag.²⁰ In February 2022, California Attorney General Rob Bonta held a press conference weighing in his support for further regulation of GAP coverage, including his explicit support for Assembly Bill 2311, which was then pending before California’s Legislature.²¹

13. *Davidson v. United Auto Credit Corp.*, No. 21-1697 (4th Cir. 2022).

14. While not specific to GAP waiver as a product, the *Davidson* case is a salient example of the CFPB’s all-fronts push on ancillary product servicing practices.

15. Seth Frotman & Jim Rice, *Protecting servicemembers from predatory lending*, CONSUMER FIN. PROT. BUREAU (Jan. 7, 2022), <https://www.consumerfinance.gov/about-us/blog/protecting-servicemembers-from-predatory-lending/>.

16. *Id.*

17. See generally Motor Vehicle Dealers Trade Regulation Rule, 87 FED. REG. 42012 (July 13, 2022) (to be codified at 16 C.F.R. pt. 463), <https://www.federalregister.gov/documents/2022/07/13/2022-14214/motor-vehicle-dealers-trade-regulation-rule>.

18. Press Release, *FTC Proposes Rule to Ban Junk Fees, Bait-and-Switch Tactics Plaguing Car Buyers*, FED. TRADE COMM’N (June 23, 2022), <https://www.ftc.gov/news-events/news/press-releases/2022/06/ftc-proposes-rule-ban-junk-fees-bait-switch-tactics-plaguing-car-buyers>.

19. *Id.*

20. See Marcie Belles, *State AGs ratchet up pursuit of GAP refunds*, AUTO FIN. NEWS (Mar. 25, 2022), <https://www.autofinancenews.net/allposts/comp-reg/state-ags-ratchet-up-pursuit-of-gap-refunds/>.

21. Press Release, *Attorney General Bonta and Assemblymember Maienschein Announce Legislation to Strengthen Protections for Car Buyers*, OFF. OF THE ATT’Y

The next month, a major finance company reached a \$1.8 million settlement with the Massachusetts Attorney General regarding allegations that it failed to pay legally-required interest after delays in providing GAP enrollment fee refunds.²² Meanwhile, in Colorado, a series of investigations initiated by Attorney General Phil Weiser led to distribution of nearly \$6 million in refunds to Colorado borrowers for GAP waiver coverage in June 2022.²³

Plaintiffs' attorneys have also begun to take advantage of the confusion surrounding the ever-evolving GAP product refund requirements. One recent class action lawsuit involving allegations of failure to properly refund fees paid for GAP upon early contract termination resulted in a \$500 million settlement against a major lender.²⁴ Unsurprisingly, copycat suits have ensued against a number of lenders and dealerships.²⁵

C. California AB 2311: A Forecast of Things to Come?

Legislation of GAP waiver protections at the state level has accelerated in recent years. Statutes in approximately eleven states require creditors to issue refunds to customers for GAP waivers upon early termination of a contract, whether through early payoff or repossession.²⁶ As of April 5, 2022, "at least 15 other states²⁷ offer[ed] statutory protections to buyers of GAP waivers."²⁸ However, at least twenty states explicitly state that lenders

GEN., CAL. DEP'T OF JUST. (Feb. 16, 2022), <https://oag.ca.gov/news/press-releases/attorney-general-bonta-and-assemblymember-maienschein-announce-legislation>.

22. Press Release, *GM Financial to Pay More Than \$1.8 Million Relating to Its Auto Loan Servicing Practices*, OFF. OF THE ATT'Y GEN., COMMONWEALTH OF MASS. (Mar. 7, 2022), <https://www.mass.gov/news/gm-financial-to-pay-more-than-18-million-relating-to-its-auto-loan-servicing-practices>.

23. Press Release, Lawrence Pacheco, *Red Rocks Credit Union returns more than \$300,000 in GAP refunds to Colorado consumers*, OFF. OF THE ATT'Y GEN., STATE OF COLO. (June 23, 2022), <https://coag.gov/press-releases/6-23-22/#:~:text=To%20date%2C%20the%20attorney%20general,Law%2C%20is%20leading%20this%20investigation>.

24. See *Herrera v. Wells Fargo Bank, N.A.*, No. 8:18-cv-00332-JVS-MRW, 2021 WL 9374975 (C.D. Cal. Nov. 16, 2021).

25. See *Quinn v. Hyundai Cap. Am.*, No. 21STCV37386 (Oct. 10, 2021) (Super. Ct. of Cal., Cnty. of Los Angeles); *Ashberry v. USAlliance Fed. Credit Union*, No. 7:21-cv-07582 (S.D.N.Y. Sept. 10, 2021); *Gaillard v. Cap. One Auto Fin.*, No. 3:21-cv-02228-JMC (D.S.C. July 21, 2021); *Jones v. PNC Bank, N.A.*, No. 1:21-cv-02000, 2022 WL 4465901 (N.D. Ill. Sept. 26, 2022).

26. Joey Pizzolato, *GAP-focused legislation set to double in 2022*, AUTO FIN. NEWS (Mar. 10, 2022), <https://www.autofinancenews.net/allposts/comp-reg/gap-focused-legislation-set-to-double-in-2022/>.

27. Prior to the enactment of AB 2311, those fifteen states were: Alabama, Colorado, Indiana, Minnesota, Missouri, Nevada, New Jersey, Oregon, South Carolina, Texas, Utah, Vermont, Washington, Wisconsin, and Wyoming.

28. Motor Vehicle Conditional Sale Contracts: Guaranteed Asset Protection

do not have to issue such a refund unless required by the terms of the contract.²⁹ At least thirty pieces of legislation were introduced in the 2021–2022 legislative sessions of states across the country.³⁰

On February 16, 2022, one such bill—Assembly Bill 2311—was introduced in the California State Assembly.³¹ As advertised,³² the new law

Waivers: Legislative Analysis for the Cal. Assemb. Committee on Judiciary, Cal. Assemb. Bill 2311, at p. 1 (Apr. 5, 2022).

29. *GAP coverage is drawing more legislative attention*, ARIZ. INDEP. AUTO. & RV DEALERS ASS'N (Mar. 28, 2022), <https://aiada.net/gap-coverage-is-drawing-more-legislative-attention//>.

30. Joey Pizzolato, *GAP-focused legislation set to double in 2022*, AUTO FIN. NEWS (Mar. 10, 2022), <https://www.autofinancenews.net/allposts/comp-reg/gap-focused-legislation-set-to-double-in-2022/>.

31. The bill's author, Rep. Brian Maienschein, summarized the bill as follows:

This bill would establish provisions to govern the offer, sale, provision, or administration, in connection with a conditional sale contract, of a guaranteed asset protection waiver (GAP waiver), defined to mean an optional contractual obligation under which a seller agrees, for additional consideration, to cancel or waive all or part of amounts due on the buyer's conditional sale contract subject to existing law in the event of a total loss or unrecovered theft of the motor vehicle specified in the conditional sale contract. The bill, among other provisions, would prohibit conditioning the extension of credit, the term of credit, or the terms of a conditional sale contract upon the purchase of a GAP waiver and permit cancellation by the buyer at any time without penalty. The bill would prohibit the sale of a GAP waiver pursuant to these provisions where the loan-to-value ratio exceeds the maximum loan-to-value ratio of the GAP waiver, unless the terms of the GAP waiver disclose that limitation and the buyer is informed of that limitation. The bill would also require prescribed information on the GAP waiver to appear on a document separate from the conditional sale contract, to be separately signed by a buyer or potential buyer. The bill would govern termination of a GAP waiver, including the refund of GAP waiver costs on termination. The bill would require the contract including the GAP waiver to include a statement that the purchaser is generally entitled to a refund of the unearned portion of the GAP waiver charges on a pro rata basis, as specified. The bill would also authorize the buyer to recover from the holder 3 times the amount of any guaranteed asset protection charges paid, if a holder of a conditional sale contract that includes a GAP waiver, except as the result of an accidental or bona fide error of computation, violates termination provisions for a GAP waiver. The bill would include GAP waivers in the existing required disclosures.

Bill Text: CA AB2311, LEGISCAN (Feb. 16, 2022), <https://legiscan.com/CA/text/AB2311/id/2605292>.

32. Concurrence in Senate Amendments, Cal. Assemb. B. 2311, 2021–22 Leg., Reg. Sess. (Cal. 2022), https://www.severson.com/wp-content/uploads/2022/09/202120220AB2311_Assembly-Floor-Analysis.pdf [hereinafter Maienschein].

would offer car buyers³³ four categories of protections:

First, it would “ensure any unearned amounts that car buyers pay for GAP waivers are promptly and automatically refunded if they pay off their loans early or cancel GAP coverage.”³⁴ GAP waivers could be cancelled any time, without additional fees. Refunds would be calculated *pro rata* based on the unused portion of the GAP contract relative to principal owed and could be applied to cancel an equal portion of the loan. “Making the right to cancel explicit, and any refunds automatic,” the author said, “ensures that buyers are given the money that they are rightly owed [according to common law].”³⁵

Second, it would require certain disclosures to be given to buyers. These would include disclosures that GAP waivers are purely optional and cannot be leveraged by dealers or finance companies to consumers’ disadvantage; requiring buyers to separately itemize the GAP waiver cost; and specifying the holder (not the dealer or original lender) is responsible to the buyer. Contact information for third-party product administrators would also need to be disclosed.³⁶

Third, it would regulate pricing. Cost of a GAP waiver would be capped relative to the principal owed on the vehicle contract and could not cover less than the amount financed, unless specifically disclosed to and acknowledged by the consumer. In order to guard against sale of low-value GAP waivers, sale would also be restricted to consumers who financed less than 70% of the vehicle’s value.³⁷

Fourth, it would ensure that both injured consumers and public attorneys (i.e., the State Attorney General and district attorneys) could enforce the law by codifying it within California’s Automobile Sales Finance Act, which already afforded private rights of action against vehicle dealers and contract holders alike.³⁸

Indeed, the law as initially designed had teeth: if a seller or holder of a conditional sale contract violates the GAP waiver refund provisions, “the buyer may recover from the holder three times the amount of any guaranteed asset protection charges paid.”³⁹ The only exception to this

33. Notably, the statute applies expressly and exclusively to GAP waivers sold in connection with conditional sale contracts—not leases.

34. Maienschein, *supra* note 32, at 2.

35. *Id.*; see also CAL. CIV. CODE § 2982.12(b)(4) (prohibiting waiver cancellation penalties); CAL. CIV. CODE § 2982.12(b)(2) (governing *pro rata* refunds).

36. Maienschein, *supra* note 32, at 3; see also CAL. CIV. CODE § 2982.12(a)(4) (prescribing disclosures); CAL. CIV. CODE § 2982.12(a)(3) (prohibiting purchase contract or credit terms on purchase of waiver).

37. Maienschein, *supra* note 32, at 3; see also CAL. CIV. CODE § 2982.12(a)(5)(B)(ii) (prohibiting sale where loan-to-value ratio of vehicle contract exceeds that of waiver).

38. Maienschein, *supra* note 32, at 4; see also CAL. CIV. CODE § 2982.12.

39. CAL. CIV. CODE §§ 2983.1(a)–(b), 2984.3.

penalty is in the case of “an accidental or bona fide error of computation.”⁴⁰

Unsurprisingly, the bill received glowing reviews from consumer advocacy groups,⁴¹ plaintiffs’ attorney groups,⁴² and California’s Attorney General (who ultimately sponsored the bill).⁴³ The initial draft of the bill, however, included provisions unacceptable to both dealership groups and lenders alike, who claimed it showed “the California AG has no understanding of GAP,” and that “[f]or the amount of coverage you get, it is actually one of the most affordable policies you can buy.”⁴⁴ Dealer groups particularly objected to the bill’s low cap on GAP product prices, restricted to just two percent (2%) of the financed amount.⁴⁵ Lender groups, on the other hand, opposed the bill’s short refund timeframe requirements, its complex loan-to-value ratio calculation requirements, and the inclusion of a clause that would have outright voided GAP products that had been created with incorrect loan-to-value calculations.⁴⁶

Rather than focusing their efforts on trying to kill the bill, dealer groups offered a host of amendments hoping to make the bill seemingly more practical and palatable.⁴⁷ This strategy paid off when, following their input,

40. CAL. CIV. CODE § 2983.1(a).

41. See Letter from Consumer Federation of California to California Assembly Judiciary Committee (Mar. 28, 2022), at AP-22; Letter from Consumers for Auto Reliability and Safety to Brian Maienschein, Rep., Cal. State Assemb. (Mar. 29, 2022), at AP-16 (hailing the enforcement provisions under AB 2311 “by making violations of its provisions enforceable under the Rees-Levering Act”).

42. See Letter from Consumer Attorneys of California to Brian Maienschein, Rep., Cal. State Assemb. (Mar. 15, 2022), at AP-23; Letter from National Consumer Law Center to California Assembly Judiciary Committee (Mar. 29, 2022), at AP-17.

43. Letter from Anthony Lew, Deputy Att’y Gen., State of Cal. Dep’t of Just., to Brian Maienschein, Rep., Cal. State Assemb. (Mar. 2, 2022), at AP-21.

44. Jerry Reynolds, *The California Attorney General Needs To Learn About Gap Insurance*, CARPRO (Mar. 2, 2022), <https://www.carpro.com/blog/the-california-attorney-general-needs-to-learn-about-gap-insurance>.

45. See *GAP coverage is drawing more legislative attention*, ARIZ. INDEP. AUTO. & RV DEALERS ASS’N (Mar. 28, 2022), <https://aiada.net/gap-coverage-is-drawing-more-legislative-attention/>.

46. See Letter from California Bankers Association to Brian Maienschein, Rep., Cal. State Assemb. (Mar. 23, 2022), at AP-30.

47. For example, the California New Car Dealers Association requested revisions be made to the bill to remove its interchangeable references to “holders” and “sellers” of GAP products, its vague definition of “GAP waivers,” its failure to clarify who is responsible for fulfilling refund obligations to consumers, the bill’s requirements that dealerships calculate complicated vehicle valuation formulas, requirements that dealers void GAP protection and offer a refund when they discover they have committed a calculation error, and the bill’s failure to provide any exceptions to harsh statutory penalties when a bona fide error has been committed in calculating GAP protection prices. See Letter of

AB 2311 was amended to remove vague language in the bill that would have required GAP waiver refunds whenever the statute was violated,⁴⁸ cleaned up required disclosures to buyers,⁴⁹ and placed limits on onerous requirements to make GAP waiver records “publicly available” to consumers.⁵⁰ It also clarified what would be required when a dealer or seller discovered an accidental violation of the statute after a customer utilized GAP waiver coverage.⁵¹

Despite these efforts, industry groups were not finished. An amendment proposed on June 20, 2022, added an exception to the bill’s total ban on GAP waiver sales with high loan-to-value ratios (conditioned on providing particular buyer disclosures), and removed requirements that would have voided GAP protections in instances of bona fide errors of loan-to-value computation.⁵² Perhaps most importantly, this amendment raised the cap

California New Car Dealers Association to California Assembly Judiciary Committee (Mar. 29, 2022), at AP-25. Furthermore, the National Independent Automobile Dealers Association (NIADA) partnered with the Independent Automotive Dealers Association of California (IADAC) “to propose amendments to the author of AB-2311 so the consumer remains covered and protected from potential significant and certain financial calamity should they experience a total loss of their vehicle.” See *NIADA Partners with IADAC to Challenge Harmful Legislation*, NIADA ADVOCACY BLOG (June 7, 2022), <https://niada.com/blog/niada-partners-with-iadac-to-challenge-harmful-legislation/>.

48. For example, the original draft of the bill would have required GAP refunds when a conditional sales contract violated vaguely described “prescribed parameters.” The amended version of AB 2311 would “void a GAP waiver in the case of an accidental or bona fide error of computation and entitle the buyer to a refund of prescribed charges.” See Cal. Assemb. B. 2311, 2021–22 Leg., Reg. Sess. (Cal. 2022), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220AB2311 (choose “03/30/22 - Amended Assembly” from the “Version” dropdown; then click “Go”).

49. The initial draft of the bill required GAP waiver disclosure forms to include the name of the “the lender or other entity taking assignment of the conditional sales contract.” This was amended to require only the name of the seller be listed. *Id.*

50. This initial draft of the bill simply required sellers to make electronic records available to consumers, whereas the amended version clarified such documents only need be made available “in response to any subpoena or other administratively or judicially enforceable request, until four years after the date the refund was tendered.” *Id.*

51. The amended draft of the bill now required holders to refund GAP waivers upon learning of an “accidental or bona fide error of computation” resulting in improper loan-to-value ratios in cases of total loss, in which case “a total loss or unrecovered theft of the motor vehicle specified in the conditional sales contract occurs before the buyer is notified of and receives the refund, in which case the buyer shall remain entitled to the full benefit of the waiver.” *Id.*

52. This amended version of the bill also added a requirement that GAP waivers include a statement that purchasers are entitled to receive refunds for un-

on charges for GAP protection waivers from 2% to 4% of the amount the buyer finances.⁵³

Thereafter, industry groups engaged in “candid dialogue” “with the Attorney General’s staff and . . . office” to reach a compromise, hailed by industry groups as “providing appropriate consumer protections while assuring a healthy, competitive industry of providers and sellers.”⁵⁴ The final negotiated amendment AB 2311 clarified its various statutory definitions and adjusted the equations utilized to determine loan-to-value restrictions.⁵⁵ These negotiated amendments caused industry groups to move from a position of outright opposition to the bill to a position of neutrality.⁵⁶

The negotiated version of the bill faced very little opposition in either the State Assembly or State Senate, receiving a total of only three votes against it in floor votes in both chambers.⁵⁷ On September 13, 2022, California Assembly Bill 2311 was signed into law by California Governor Newsome, and enacted as Civil Code Section 2982.12.⁵⁸ This new statute

earned portions of the GAP waivers on a pro rata basis, permitted disclosures to buyers to be included as an addendum, rather than being included in the sales contract, and removed language that would have penalized both the seller and holder for errors in computation to limit liability solely to the holder. *See* Cal. Assemb. B. 2311, 2021–22 Leg., Reg. Sess. (Cal. 2022), https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=20210220AB2311 (choose “06/20/22 - Amended Assembly” from the “Version” dropdown; then click “Go”).

53. *Id.*

54. *See* Letter from American Property Casualty Insurance Association, California New Dealers Association, Consumer Credit Industry Association, Guaranteed Asset Protection Alliance, Independent Auto Dealers Association of California, National Independent Auto Dealers Association, to Brian Maienschein, Rep., Cal. State Assemb. (Aug. 5, 2022), at AP-24.

55. Specifically, the amendment clarified the definition of “holder” under the statute to “means the person entitled to enforce the conditional sale contract against the buyer at the time. It also removed requirements that GAP waiver disclosures in conditional sales contracts be set aside in a red outlined box. Finally, it removed the costs of the GAP waiver, credit insurance, and service contracts from the equation utilized to determine the loan to value ratio restrictions. *See* Cal. Assemb. B. 2311, 2021–22 Leg., Reg. Sess. (Cal. 2022), https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=20210220AB2311 (choose “06/20/22 - Amended Assembly” from the “Version” dropdown; then click “Go”).

56. *Id.*

57. Cal. Assemb. B. 2311, 2021–22 Leg., Reg. Sess. (Cal. 2022), https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=20210220AB2311 (select the “Votes” tab).

58. Office of the Attorney General California Department of Justice, *Attorney General Bonta and Assemblymember Maienschein’s Legislation to Strengthen Protections for Car Buyers Signed into Law*, EIN PRESSWIRE (Sept. 14, 2022, 12:29 PM), <https://www.einpresswire.com/article/590906804/>.

makes California the most recent state to implement statutory restrictions and requirements on GAP waiver products, a trend industry insiders believe “should double in the next year or so.”⁵⁹

IV. BEST PRACTICES TO AVOID REGULATORY SCRUTINY AND LITIGATION

To respond to increasing efforts to regulate and litigate GAP waivers refunds, dealers and servicers should identify potentially problematic practices that could prevent compliance and draw unwanted scrutiny.

Clearly, dealers should provide the requisite disclosures. They can help themselves by using universal contract forms that include the disclosures and conspicuous cancellation provisions. Holders should monitor dealers to ensure uniformity and provide material support where possible in order to ensure that the contracts being sold can be feasibly financed and serviced.

Finance companies should, where possible, avoid requiring consumers to return to dealers for GAP waiver refunds, rather than issuing the refunds themselves and seeking recoupment from dealers after the fact. Most importantly, they should fully understand their obligations under each state’s laws, and proactively determine:

- Which GAP forms the lender is able to finance;
- How refunds are calculated;
- Which party will be responsible for payment of refunds to the borrower;
- Timing of the refunds; and
- Evidence needed to prove a refund has been paid.

These issues need to be resolved both with dealers *and* with consumers (in the case of direct-to-consumer sales of ancillary products).

By implementing policies and procedures to ensure pro rata refunds are timely processed when required, either by contract or by law, servicers and dealers may both be able to avoid the ire of regulators and consumer attorneys in this time of uncertainty surrounding refunds.

59. Joey Pizzolato, *GAP-focused legislation set to double in 2022*, AUTO FIN. NEWS (Mar. 10, 2022), <https://www.autofinancenews.net/allposts/comp-reg/gap-focused-legislation-set-to-double-in-2022/>.