FOCUS ON DEALERS:
BEST PRACTICES FOR HANDLING VEHICLES SUBJECT TO RECALL

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The automotive industry has experienced an unprecedented number of recalls over the last two years. Because of the liability automotive dealers can face for selling unsafe vehicles, dealers must understand the legal landscape surrounding recalls so they can make prudent decisions for the safety of their customers and their business. So, what is the law relating to recalls, and how should dealers respond if a vehicle in inventory is subject to an open recall? This article seeks to answer some of these questions and provide guidance for dealers faced with these issues.

Recalls Generally

Recalls can arise either because a vehicle does not comply with Federal Motor Vehicle Safety Standards ("FMVSS") or because of a defect related to motor safety. Recalls related to failure to comply with the FMVSS are relatively rare. Manufacturers spend a significant amount of time and money ensuring vehicles meet legal standards prior to selling them to dealers. Most recalls relate to discovered problems with a vehicle or a vehicle's equipment that creates a safety risk. Not all recalls are created equal. For example, a recall relating to an air conditioner or radio that does not work properly does not affect safety like a recall involving an accelerator on a vehicle that may stick.

New Vehicles

Federal law prohibits the sale of any new vehicle with an open recall. The Motor Vehicle Safety Act strictly prohibits dealers from selling new vehicles that are subject to recalls issued either by the manufacturer or by the National Highway Traffic Safety Administration, unless and until the defect is corrected. *See* 49 U.S.C. 30120(i)(1).

If a new vehicle cannot be sold because of an open recall, federal law protects dealers. These protections include requiring the manufacturer either repurchase vehicles subject to recalls or provide a remedy for dealers to implement immediately. Regardless, manufacturers must compensate the dealer with one percent of the price the dealer paid for the vehicle, per month, prorated from the receipt of the "stop sale" notice until the vehicle is repurchased or the remedy is implemented. Manufacturers must also compensate for parts and labor associated with the remedy. *See* 49 U.S.C. 30116(a) and (b).

In these situations, agreements and/or communications between manufacturers and franchised dealers may set forth a process for applying for recall compensation. If not, dealers should inquire with manufacturers about the procedures they have in place for filing recall compensation claims for new vehicles. A manufacturer that fails to comply with this law can be

subject to civil liability for damages, court costs, and attorneys' fees as long as the action is brought not later than three years after the claim accrues. *Id.*

Used Vehicles

The Motor Vehicle Safety Act does *not* address used vehicles. *See* 49 U.S.C. § 301 12(b). Therefore, federal law does not prohibit a dealer from selling a used vehicle subject to recall. It also does not require the manufacturer to compensate the dealer for maintaining a vehicle subject to recall in the dealer's inventory.

Many dealers do not want to stockpile a used vehicle subject to recall in inventory, particularly when the part necessary to repair the recall is back-ordered or unavailable. Although dealers may sell and deliver used vehicles subject to recall without violating federal recall laws, it does not mean this is necessarily a good idea.

First, for franchised dealers, the franchise agreement may create legal obligations by the dealer to the manufacturer. The agreement may include vague statements that a dealer will cooperate with the manufacturer in carrying out a recall, or it may include specific requirements. If the recall involves a "stop sale" order by the manufacturer and the dealer ignores the order, the repercussions can be serious. The manufacturer may consider the dealer's refusal to heed the order to be a breach of a franchise agreement. If a customer has an accident as a result of the defect, the manufacturer may also use the dealer's refusal to heed its directive as a basis for denying indemnification to the dealer if a lawsuit is brought (and assuming the agreement contains an indemnification provision).

If the franchise agreement does not include a contractual prohibition from selling used vehicles subject to a "stop sale" order, the manufacturer may still direct the dealer to stop selling such vehicles independent of any contractual obligation. The issuance of such instructions by the manufacturer – and the dealer's refusal to follow them – could be construed by a court or public opinion as increasing the responsibility of the dealer if the defect for which the recall was issued causes damage or injury.

The Dilemma and Potential Liability

In many cases with vehicles subject to a recall, the repair has not yet been identified or the necessary parts are not available. This creates a dilemma for a dealer that sells used vehicles. The dealer is faced with either (a) stockpiling inventory of automobiles subject to a recall, or (b) selling the vehicles in spite of the recall.

Selling the vehicles in spite of the recall is not prohibited by federal law (as discussed above), but it also subjects the dealer to potential liability. Under South Carolina's (and most states') tort law relating to products liability, a "seller" of a defective and unreasonably dangerous product can be subject to strict liability. *See* S.C. Code § 15-73-10. Therefore, if a customer is injured as a result of the defect that was the subject of the recall, a dealer can be liable based solely on the fact that it sold the vehicle. In addition to a strict liability claim,

dealers may also be subject to negligence, breach of warranty, fraud, misrepresentation, or unfair trade practices causes of action.

What to Do?

If a manufacturer notifies a dealer of a safety recall concerning a used vehicle offered for sale, the dealer must determine the appropriate next steps. Since all recalls are not created equal, dealers should establish a policy on how to make a legal and practical determination concerning the best course of action. This may range from not selling any used vehicle subject to recall, to working with legal counsel and the service department to determine whether to offer the vehicle for sale, to selling the vehicle with appropriate disclosure of all open recalls.

The "safest" approach with regard to used vehicles subject to a safety recall is to hold the vehicles in inventory until they can be repaired at the dealer (i.e., either the dealer holding the inventory or the local brand dealer). For dealers implementing this policy, they should also establish procedures for identifying recalled vehicles *before* acquiring them at auction or in trade. Since manufacturers are not required to pay compensation to dealers for used vehicle inventory subject to recall (and since many recalls can involve backlogged parts or parts that are unavailable), a lot full of recalled vehicles can be burdensome on inventory.

It is often impractical for a dealer to stop selling used vehicles subject to a safety recall. If this is the case, a dealer can still implement policies to limit liability. One policy should be that before any vehicle is sold, a search is conducted to determine whether there is a safety recall. In late 2014, the NHTSA established a VIN-specific look-up tool at www.safercar.gov. This site allows the user to enter a VIN and obtain the government's most recent information about the vehicle's open safety recall record.

Dealers who opt to sell used vehicles subject to an open recall should check recall history at the time of purchase and the time of sale of a vehicle. If a remedy is available and the vehicle is a brand the dealer represents, the recall should be fixed prior to resale. The dealer should also request prompt, full reimbursement from the manufacturer. Dealers can also include a link to the www.safercar.gov site on its website so that potential customers can inquire on their own as they consider possible vehicles in the dealer's inventory for purchase.

If parts are unavailable or no remedy is available for the recall, the dealer should provide a printout of the recall history from www.safercar.gov at the time of sale of any used vehicle. This information will allow the customer to make an informed decision. If the customer decides to purchase the vehicle notwithstanding the open safety recall, a good practice is to have the customer sign and date the printout of the recall history. A copy of the signed document should be retained in the sale documents to avoid potential accusations of misrepresentation that could arise later. Taking this step at closing is prudent because recall results may change on a daily basis. It is important that the customer receives the most current information at the time of sale.

It is also advisable for a dealer to run a private vehicle history report at a website like www.carfax.com, www.autocheck.com, or other similar provider. These reports provide a vehicle's history beyond just listing any open recalls and ensure that the purchaser has this

additional information to consider at the time of sale. Like the printout of the recall history, a good practice is to have the customer sign and date the private vehicle history report and retain it in the sales documents. This is another means of ensuring there is documentation of disclosure to the customer, and it also provides yet another layer of disclosure to insulate from liability.

Disclosure carries with it certain risks. No matter how well the disclosure document is drafted, and even if the customer signs it, there is no guarantee a court will uphold the disclosure in a lawsuit by an injured consumer. After all, strict liability holds that any party in the chain of distribution may be liable for selling a defective and unreasonably dangerous product. Therefore, a dealer that sells cars to a wholesaler is not necessarily insulating itself from a claim for liability, and this practice does not relieve the need to disclose open recalls or other issues with a vehicle.

At the same time, *not* disclosing this information also subjects a dealer to liability. Dealers should only make representations about a vehicle they know to be accurate, whether it relates to the recall status of a vehicle, the vehicle's condition, or anything else. If a dealer lists its inventory on a website or in publications and makes general claims about safety and reliability of the vehicles it sells, such representations can pose problems if some of the advertised vehicles have open safety recalls. (This is another justification for including a link to the www.safercars.gov website and/or a private vehicle history report provider on webpages advertising vehicles for sale).

Selling a used vehicle subject to an open safety recall without disclosing that fact may be actionable for fraud, misrepresentation, or violation of the South Carolina Unfair Trade Practices Act. The Federal Trade Commission ("FTC") has taken the position that representing used vehicles offered for sale as safe and reliable can be unfair or deceptive for vehicles with unremedied recalls. Similarly, the FTC also views an advertisement that a vehicle is "certified" as a representation of its safety and quality, and it has claimed that it is an unfair and deceptive practice to sell a vehicle with an open safety recall as "certified." A manufacturer may also prohibit certification of a vehicle with an open recall under its certification program. Disclosure and documentation of a vehicle's recall status through a signed disclosure document can insulate against these potential liability theories.

It is also important to note that disclosure to the customer will have no bearing on the legal rights between a manufacturer and a franchised dealer. If a franchised dealer sells a used vehicle subject to a "stop sale" order with a disclosure, the manufacturer may still consider the sale to be a breach of its directive and use it to shift liability to the dealer if an accident relating to the recall occurs.

Conclusion

Dealers need to be aware of and carefully consider the risks if they choose to sell used vehicles subject to open safety recalls. It only takes one catastrophic event to ruin a business. For the public, which will form the jury, "recall" generally means, "My vehicle is not safe." The reality is that it is unlikely that jurors will have sympathy for a dealer who sold a vehicle subject

to a safety recall because the dealer's business could not have survived without moving forward with sales.

Dealers can insulate against this risk by informing themselves of the recall history for their vehicles and fixing any for which there is a remedy that is readily available. If the remedy is not available and the dealer opts to sell the vehicle anyway, the dealer should consider some means of disclosure to the customer and documentation of same. This may involve creating a disclosure document for signature by the customer and/or having the customer sign a screenshot of recall, history, or safety information provided to the customer. If a dealer becomes aware of potential legal action, the dealer should retain counsel to assess its legal rights, including whether any indemnity may be available from the manufacturer.

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USED VEHICLE RECALL DISCLOSURE ACKNOWLEDGEMENT

THIS FORM SUPERSEDES ALL VERBAL COMMENTS REGARDING THE VEHICLE'S RECALL STATUS

Dealership Name/Address _____

_____(hereinafter "Dealer").

Year _____ Make: _____

Model: _____ VIN: _____

At time of sale, Dealer checked the federal government website, www.safercar.gov, to determine whether the vehicle listed above is subject to any open recalls. Dealer printed a copy of the screen shot from the website for the vehicle, which the buyer(s) identified below (hereinafter, "Buyer(s)") signed. Buyer(s) acknowledge they have received a copy of the screen shot.

FOR VW DIESEL VEHICLES, ONLY. If the vehicle identified above is a VW diesel, Dealer has (*at time of sale*) also checked Volkswagen's website (www.vwdieselinfo.com) to determine whether the vehicle is subject to a future VW emissions recall. Dealer has printed a copy of the screen shot from the website, which Buyer(s) signed. Buyer(s) acknowledge they have received a copy of the screen shot. Buyer(s) also acknowledge that the timing of the anticipated VW diesel recall and the precise nature of the repair(s) to be performed are not known at this time, and that the information provided by VW on its website is the best information available at this time.

By signing this disclosure statement, the undersigned Buyer(s) acknowledge

(Buyer(s) Initials)

____ ____ • **Dealer disclosed any recall status of the vehicle prior to execution of the vehicle sale or lease agreement;**

____ ____ • **Buyer(s) have been provided with a copy of the screen shots from www.safercar.gov and www.vwdieselinfo.com (*if applicable)* at the time of sale, as well as a private vehicle history report;**

____ ____ • **The nature of the recalls (if any) have been fully explained to Buyer(s);**

____ ____ • **Buyer(s) understand the nature of the recalls (if any);**

____ ____ • **Buyer(s) took this recall status information into account in agreeing to purchase or lease the vehicle, and in agreeing upon the vehicle's value;**

____ ____ • **Buyer(s) accept the vehicle, having been made aware of any open recalls that currently exist for said vehicle; and**

____ ____ • **Information provided by www.safercar.gov and www.vwdieselinfo.com is made available by third parties not affiliated with Dealer, and Buyer(s) acknowledge Dealer is not responsible for any errors or omissions in the report.**

Buyer:_____
Printed:_____
Date: _____

Co-Buyer:_____
Printed:_____
Date: _____

Sales Rep:_____
Printed:_____
Date: _____