No. 14-8006

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

W. DANA VENNEMAN and THEODORE COLLINS, on behalf of themselves and all others similarly situated,
Plaintiffs-Appellees,

v.

BMW FINANCIAL SERVICES NA, LLC and FINANCIAL SERVICES VEHICLE TRUST,
Defendants-Appellants.

ON PETITION FOR LEAVE TO APPEAL FROM AN ORDER
OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY
THE HONORABLE ESTHER SALAS, JUDGE
CIVIL NO. 09-5672 (ES)

BRIEF OF AMICUS CURIAE AMERICAN FINANCIAL SERVICES ASSOCIATION IN SUPPORT OF PETITION FOR PERMISSION TO APPEAL

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INTEREST OF THE AMICUS CURIAE

The American Financial Services Association (AFSA), an unincorporated trade association, is the nation's largest trade association representing market-funded providers of financial services to consumers and small businesses. AFSA has a broad membership, ranging from large international financial services firms to single-office, independently owned consumer finance companies. AFSA's 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, credit card issuers, industrial banks, and industry suppliers. With leave of court, AFSA submits this brief in support of its members' interest in the proper interpretation and application of the laws governing consumer leases.[1]

For over 90 years, AFSA has served the consumer credit industry, protecting access to credit and consumer choice. AFSA represents financial services companies that hold a leadership position in their markets and conform to the highest standards of customer service and ethical business practices.

AFSA is a frequent advocate before legislative, executive, and judicial bodies on issues affecting its members' interests. It has appeared as an amicus

[1] No party or party's counsel authored this brief in any part, nor did any party or party's counsel, or any person other than the *amicus*, its members, or its counsel, contribute money that was intended to fund preparing or submitting this brief. *See* Fed. R. App. P. 29(c)(5).

curiae before the Supreme Court of the United States and numerous courts of appeals on issues of concern to the consumer credit industry.

Along with its affiliate, AFSA Educational Foundation (AFSAEF), AFSA is an important contributor to publications intended to educate consumers about consumer leasing and other aspects of consumer finance. Those publications include the Federal Reserve Board's *Keys to Vehicle Leasing* (*see* http://www.federalreserve.gov/pubs/leasing/#costs (listing AFSA and AFSAEF as contributors)) and *Understanding Vehicle Financing* (*see* http://www.afsaef.org/publication.cfm?id=43), published jointly by AFSAEF, the Federal Trade Commission, and the National Automobile Dealers Association.

AFSA's members are vitally interested in the issues raised by the petition for permission to appeal, which addresses the statutory provision that allows servicemembers to terminate leases for real or personal property in certain circumstances. Under a provision of the Servicemembers Civil Relief Act (SCRA), servicemembers who exercise their right to terminate a lease are entitled to a refund of "[r]ents or lease amounts paid in advance for a period after the effective date of the termination of the lease." 50 U.S.C. App. § 535(f). The question presented in the petition for leave to appeal is whether a capitalized cost reduction (CCR)—which the Consumer Financial Protection Bureau defines as "a payment in the nature of a downpayment on the leased property that reduces the

amount to be capitalized over the term of the lease" (12 C.F.R. § 1013, Supp. I, § 4(b))—is a "lease amount[] paid in advance for a period after" the termination date. The court below held this "payment in the nature of a downpayment"—which is not part of the amount divided into periodic payments—nonetheless was "paid in advance" for a period after lease termination, and thus must be refunded on a pro rata basis.

That holding unsettles the common understanding of CCRs, which have never been treated in any context as periodic payments that may not be owed if a lease is terminated early, for example by default and repossession. The pricing of consumer leases neither amortizes nor imposes a "rent charge" (analogous to interest) on amounts paid as CCRs. Were the decision below to remain in effect, where it might influence other courts construing the SCRA or addressing the nature of CCRs in other contexts, leases would have to be repriced to account for the risk that CCRs might be refunded in substantial part. That would raise costs and thus reduce access to consumer leases for servicemembers and other consumers alike, a result surely at odds with the intent of the SCRA. That result also would impede AFSA members' ability to ensure open and affordable access to consumer credit in the leasing context.

AFSA's members have a strong interest in being able to provide competitive, reasonably priced consumer credit, including consumer leases. That

ability depends on predictable interpretations of the laws governing the terms and elements of a consumer lease or other credit transaction. A decision by this Court would provide necessary guidance in the treatment of CCRs under the SCRA and other provisions of law.

ARGUMENT

Permission to appeal should be granted because the proper characterization of capitalized cost reductions (CCRs) in consumer leases—both under the Servicemembers Civil Relief Act (SCRA), 50 U.S.C. App. § 535(f), and more broadly—is a matter of substantial importance to all who finance consumer leases as well as to the consumers who benefit from the availability of leasing. The district court concluded that a CCR is "paid in advance for a period after" the payment itself (*id.*)—in effect a prepayment on all future periodic payments under the lease agreement.

In deciding that CCRs are advance *periodic* payments of an obligation that has been financed, the district court departed from the understanding of federal and state governments, consumer organizations, and the industry that CCRs are down payments that *reduce* the amount financed—not prepayments on future periodic lease payments. Were the district court's understanding applied in any other legal setting, litigation seeking to apply a wide variety of state unfair practices and consumer protection laws likely would proliferate in the wake of defaults and

repossessions on leases.

Even the narrow question under the SCRA is of substantial significance because of the many hundreds of thousands of servicemembers whose leases may be affected by the resolution of that question. If CCRs in servicemember leases are now refundable on a pro rata basis, the risks to lessors necessarily increase. Lessors will have to spread the costs of providing for those increased risks among all consumers. Thus, a prospective lessee will need a higher credit rating and will pay a higher financing charges, reducing consumer access to leasing generally.

Accordingly, appellate resolution of this important question—not yet decided by any appellate court—is urgently needed. This Court should accept the appeal in order to provide a definitive resolution to the issue within this Circuit.

A. The Status Of Capitalized Cost Reductions—The Initial Down Payments—In Consumer Leases Is A Question Of Substantial Practical Importance to the Consumer Credit Industry.

1. Consumer leasing plays an increasingly important role in the American economy, particularly within the automobile industry. Leases now make up more than 27% of new vehicle financing transactions. CNBC, *Auto Leasing Surges to Record High* (Sep. 3, 2013), available at http://www.cnbc.com/id/101003126.

An automobile lease is not a long-term rental agreement. Rather, in the transaction at the core of an automobile lease, the lessee is financing the amount

that the value of the vehicle is expected to depreciate during the lease term. Thus, the lessee finances the difference between the new vehicle's retail price and its expected residual value at the end of the lease term. For a $40,000 vehicle that will be worth $20,000 at the end of the lease term if driven within the lease's mileage limits, the capitalized cost would be $20,000. This allows consumers to make lower monthly payments on a new vehicle, an attractive approach for consumers who trade in their vehicles after two or three years.

The lessee finances the full capitalized cost unless she chooses to reduce the amount financed by making a cash down payment, presenting a trade-in, or taking advance of a rebate or dealer incentive. These capitalized cost reductions (CCRs) reduce the adjusted (or net) capitalized cost that is financed. The monthly payment amortizes the adjusted capitalized cost and includes a "rent charge," which serves a function similar to interest, on the unpaid balance.

2. The district court held that a CCR is a "prepaid lease amount" (Opn. 12) that is an advance payment for a later period within the meaning of the SCRA. That holding has practical implications that are not fully addressed in the decision below.

The district court recognized that a CCR may include "the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost." Opn. 11 (quoting 12 C.F.R. § 213.2 [now 12 C.F.R.

§1013.2]). Under the district court's holding, it appears that, after a termination subject to the SCRA, the lessee could seek and possibly receive a pro rata refund not only of any cash down payment, but also of the value of her trade-in or any other "noncash credit." Giving a pro rata refund on a trade-in could leave lessors with leases that substantially differ from the ones they bargained to assume from dealers.

The district court also recognized that a CCR is paid to the dealer, not the bank or finance company that purchases the lease from the dealer. Opn. 13. But even though the lessor never received the CCR, the district court held that the lessor had been indirectly compensated because the CCR increased the amount by which the value of the vehicle exceeded the amount financed. *Id.* The decision below disregards the fact that the trajectory of depreciation in the value of a leased vehicle is often not linear across the life of the lease (usually front-loaded, but affected by other factors such as the type and intensity of vehicle use). Also overlooked are the substantial transaction costs in the disposition of a returned vehicle. Both of these phenomena may render illusory any supposed excess in the value of the vehicle over the reduced capitalized cost. Those practical issues at a minimum call for prompt and close appellate review.

Indeed, a CCR may simply offset the "negative equity" on a lessee's trade-in when the amount the lessee owes on the trade-in exceeds its current market value.

In that situation, the dealer has to pay off the loan on the trade-in in order to dispose of it. Thus, the CCR would not reduce the unpaid capitalized cost on the lease to an amount below the expected depreciation. Under a future application of the district court's holding, a lessor might be required to refund a CCR that was paid to a dealer who repaid a different lender or lessor on a different loan or lease, without providing even a theoretical advantage to the lessor financial institution that would be responsible for the refund.

To be sure, the decision below did not clearly hold that all CCRs are necessarily refundable under the SCRA. On one hand, the district court held that "CCR payments fall under 'lease amounts' to be refunded" (Opn. 14), and concluded that a "CCR is a lease amount pursuant to the SCRA." *Id.* at 15. On the other hand, the court stated "that, in certain instances, [a] CCR *can* constitute a prepaid lease amount that must be returned to the lessee upon proper invocation of the protections of the SCRA." Opn. 12-13. The district court provided little guidance as to how lessors (or courts) may distinguish a CCR that is a refundable advance periodic payment, and a CCR that is not. The only criterion discussed in the decision was language in plaintiffs' lease forms that characterized a CCR as an amount due at signing and included the CCR in the total amount to be paid by the end of the lease term—both of which are disclosures required by federal law. *See* 12 C.F.R. § 1013.4(b) (requiring disclosure of "amount due at lease signing or

delivery"); *id.* § 1013.4(e) (requiring disclosure of "the amount you will have paid by the end of the lease" or similar phrase, to include amount due at signing, total amount of periodic payments, and other charges); *id.* § 1013, App. A (model lease form). Thus, the decision below either makes all CCRs refundable under the SCRA—even when the result would be absurd—or else provides no meaningful guidance to determine when a CCR is refundable and when it is not.

3. The district court's decision creates uncertainty about compliance with the Consumer Leasing Act, 15 U.S.C. § 1667 *et seq.*, which applies to automobile leases that finance amounts of $50,000 or less. *See id*. § 1667(1), (4). The disclosures required under the Consumer Leasing Act distinguish between "any payment by the lessee required at the inception of the lease" (*id.* § 1667a(2)) and "periodic payments" (*id.* § 1667a(9)). Other provisions of the Act reflect this distinction between periodic payments and other payments. For example, in a provision designed to protect consumers from excessive unforeseen liability at the end of a lease for depreciation in the vehicle's value, the Consumer Leasing Act presumes that the original estimated residual value was unreasonable if the actual residual value exceeds the estimate by more than three times the "average payment allocable to a monthly period under the lease." *See id.* § 1667b(a).

By holding that a CCR—a payment at lease inception—is an advance payment for a later "period" within the meaning of the SCRA, 50 U.S.C. App.

§ 535(f), the decision below appears to conflate the two classes of payments. If the district court is correct that a CCR is "allocable to a monthly period under the lease" (15 U.S.C. § 1667b(a)), then the reasonable (and presumptively permissible) gap between estimated and actual residual value would be larger when a CCR was paid than otherwise.

4. By characterizing a CCR as an advance periodic payment rather than a down payment, the decision below also raises questions about the status of a CCR under the law of New Jersey (where the district court sits) and other states. Under New Jersey law, "'[c]apitalized cost reduction' means any payment made by cash, check, rebates or similar means that are in the nature of down payments made by the lessee and any net trade-in allowance granted by the lessor at the inception of the lease for the purpose of reducing the gross capitalized cost." N.J. Rev. Stat. § 56:12–61.[2] A CCR explicitly "does not include any periodic lease payments due at the inception of the lease or all of the periodic lease payments if they are paid at the inception of the lease." *Id.* Thus, as it stands, a CCR is "in the nature of [a] down payment[]" in New Jersey state court, but is a prepayment on periodic lease payments in federal court. Definitive resolution by this Court is warranted.

[2] The laws of many other states similiarly characterize CCR as "in the nature of down payments." 815 Ill. Comp. Stat. 636/10.30; *see also*, *e.g.*, Ind. Stat. 9-32-2-8; Md. Com. L. § 14-2001(d)(1); Wis. Stat. § 429.104; Wash. Stat. 63.10.020; Fla.

5. As the petition points out, the district court's characterization of CCR as an advance partial periodic payment conflicts with industry practice and leasing authorities, including the Federal Reserve Board's *Keys to Vehicle Leasing* (to which AFSA contributed, *see* p.2, *supra*). In particular, the decision below calls into question many other sources of consumer information that analogize CCR to a down payment. For example, a Consumers' Checkbook source defines CCR as "lease-speak for a downpayment." Consumers' Checkbook, *Leasewise: The Language of Leasing*, available at http://www.checkbook.org/auto/lw-terms.cfm. "The bigger your capitalized cost reduction (the more you put down), the lower the amount you will be financing and the lower your monthly payment will be." *Id.* A Wells Fargo website defines CCR as "[t]he sum of any down payment, net trade-in allowance, and rebate and other non-cash credit used to reduce the gross capitalized cost." *See* https://www.wellsfargo.com/autoloans/resources/glossary#Q6. In helping consumers evaluate the differences between purchasing and leasing, the Americans Well-informed on Automobile Retailing Economics, "a vehicle financing industry coalition to help consumers understand how auto financing works," tells consumers that a CCR is "like a down payment." http://www.autofinancing101.org/media_center/files/Buying%20Vs%20Leasing%20March2011.pdf. And Cars.com defines CCR as a "down payment or other credit

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Stat. § 521.003; N.Y. Personal Prop. Law § 331(12).

that lowers the capitalized cost of a lease." http://www.cars.com/go/advice/Story.jsp?section=lease&story=leaseGlossary&subject=buy_lease.

6. The broader uncertainty about the nature of CCRs created by the decision below threatens to disrupt the leasing market. Lessors now may need to factor in the possibility that they will have to rebate CCRs down payments for vehicle leases. Lease forms may also need to be modified to separately track for CCRs, at least as the component of a CCR that encompasses amounts consumers pay (as opposed to rebates or trade-ins). The holding also may complicate and disrupt lessors' financial relationships with dealers, because CCRs are paid to dealers not lessors, but the lessors bear the risk of a pro rata rebate.

7. Moreover, the result reached in the decision below—unless sharply limited to SCRA context—may be misapplied in lawsuits invoking not just the CLA but a wide variety of state unfair practice and consumer practice laws. Deft attorneys could use the opinion below to argue that a CCR must be treated as an advance periodic payment in other contexts such as default, and that the contrary industry practice reflecting the common understanding was somehow improper or unfair. Although we believe those claims would be meritless, responding to them (and to lawsuits founded on them) would consume substantial resources of AFSA members, increasing the costs of credit to consumers

* * * * *

In short, the decision below raises substantial questions that warrant definitive resolution and clarification by this Court.

B. The District Court Erroneously Held That A CCR—The Initial Down Payment—On A Lease Is An Advance Periodic Payment Subject To Pro Rata Refund Under The SCRA.

Permission to appeal also should be granted because the decision below is erroneous. The district court held that a CCR is not a down payment, but rather is an "advance" payment for "period[s]" extending through the end of the lease. The petition points out conflicting legal authority taking the opposite approach, from the Federal Reserve Board among other sources.

After this litigation began, however, the new Consumer Financial Protection Bureau succeeded to the Federal Reserve Board's former authority to enforce the Consumer Leasing Act, 15 U.S.C. §§ 1667-1667f, and Regulation M (now codified as 12 C.F.R. § 1013 rather than 12 C.F.R. § 213). *See* Pub. L. 111–203, § 1100A(2), (10) (2010). As the petition observes (at 14-15), CCR is defined as "the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost." 12 C.F.R. § 1013.2(f). And it is the "*adjusted capitalized cost*," or "the gross capitalized cost less the capitalized cost reduction," that is "the amount used by the lessor in calculating the base periodic payment." *Id.* (italics in original).

There is more. In describing required disclosures of the "amount due at lease signing or delivery," Regulation M requires the lessor to "itemize each component by type and amount," specifically distinguishing between CCR and any "advance monthly or other periodic payment." 12 C.F.R. § 1013.4(b). In a separate section, the lessor must disclose "[t]he number, amount, and due dates or periods of payments scheduled under the lease, and the total amount of the *periodic* payments." *Id.* § 1013.4(c) (emphasis added). *See also id.* § 1013.4(f) (requiring disclosure "of how the scheduled periodic payment is derived" and making clear that CCR is not part of the base amount divided into "periodic payments").

The Bureau's Supplement I to Regulation M—"Official Interpretations"—confirms that the Bureau views CCR as a down payment as a matter of federal law. Explaining the amounts due at lease signing or delivery, the official interpretation of 12 C.F.R. § 1013.4(b) defines "capitalized cost reduction" as "a payment *in the nature of a downpayment* on the leased property that reduces the amount to be capitalized over the term of the lease." 12 C.F.R. § 1013, Supp. I (emphasis added). Again drawing the distinction with prepaid periodic payments, the Bureau confirms that CCR "does not include any amounts included in a periodic payment paid at lease signing or delivery." *Id.*

The SCRA should be construed consistently with the Consumer Leasing Act. In both CCR is a down payment rather than an advance installment on periodic payments due later.

CONCLUSION

The petition for leave to appeal should be granted.

Respectfully submitted.

Dated: February 4, 2014

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By: /s/ Donald M. Falk
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CERTIFICATE OF COMPLIANCE

1. Pursuant to Fed. R. App. P. 29(d) and 9th Cir. R. 32-1, the undersigned hereby certifies that the attached brief is proportionally spaced, has a typeface of 14 points or more, and contains 3,402 words, exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B).

2. The brief has been prepared in proportionally-spaced typeface using Microsoft Word 2007 in 14-point Times New Roman font. As permitted by Fed. R. App. P. 32(a)(7)(C), the undersigned has relied upon the word-count feature of this word-processing system in preparing this certificate.

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In accord with Third Circuit Local Appellate Rule 28.3(d), the undersigned hereby certifies that he is a member of the bar of this Court.

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CERTIFICATE OF IDENTICAL COMPLIANCE OF BRIEFS

In accord with Third Circuit Local Appellate Rule 31.0(c), the undersigned hereby certifies that the text of the electronic brief is identical to the text in the paper copies.

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CERTIFICATE OF VIRUS CHECK

In accord with Third Circuit Local Appellate Rule 31.0(c), the undersigned hereby certifies that Symantic Endpoint Protection, Version 11.0.7000.975 (virus definition last updated February 4, 2014), a virus detection program, has been run on the electronic file of this brief and no virus was detected.

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CERTIFICATE OF SERVICE

I hereby certify pursuant to Fed. R. App. P. 25(b) that I electronically filed the BRIEF OF AMICUS CURIAE AMERICAN FINANCIAL SERVICES ASSOCIATION IN SUPPORT OF PETITION FOR PERMISSION TO APPEAL with the Clerk of the Court for the United States Court of Appeals for the Third Circuit by using the appellate CM/ECF system on February 4, 2014 and sent 7 hard copies of the brief to the Clerk's Office the same day. I certify that the following participants are registered CM/ECF users who have consented to electronic service [Fed R. App. P. 25(c)(1)(D)]; that service will be accomplished by the appellate CM/ECF system and that I have served one copy of the paper BRIEF OF AMICUS CURIAE AMERICAN FINANCIAL SERVICES ASSOCIATION IN SUPPORT OF PETITION FOR PERMISSION TO APPEAL on each participant by Federal Express overnight delivery:

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See Fed. R. App. P. 25(d)(1)(B); 3d Cir. L.A.R. 31.0(d).

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