

What 4th Circ. Military Lending Case Means For Auto Finance

By Sasha Leonhardt and Cierra Newman (April 14, 2023)

A split U.S. Court of Appeals for the Fourth Circuit ruled on April 12 that vehicle financing transactions including guaranteed asset protection, or GAP, plans are exempt from the protections of the Military Lending Act.

The MLA's statutory text exempts a credit that is "offered for the express purpose of financing the purchase and is secured by the car." The question before the Fourth Circuit in *Davidson v. United Auto Credit Corporation* was whether financing the cost of a GAP plan as part of the vehicle financing would put the entire transaction outside the scope of that exemption.

The circuit's decision clears up uncertainty in stating that GAP plans fall within the vehicle-finance exemption, but an amicus brief from the government suggests that the U.S. Department of Defense may attempt to address this issue more directly in future rulemaking. In the wake of *Davidson*, however, it is unclear if any rulemaking to include automotive credit that finances GAP under the MLA could survive a court challenge.

Background

Davidson, an active duty service member, purchased a car using a retail installment contract that also financed GAP. He said the contract violated the MLA because it required arbitration and did not include the required MLA-related disclosures.

Davidson filed suit in the U.S. District Court for the Eastern District of Virginia, arguing that the phrase "express purpose" in the MLA meant that a borrower's decision to purchase and finance a separate GAP plan would subject the contract to the MLA.

The district court disagreed, reasoning that though GAP was an optional, standalone financial product, it was "inextricably tied to Plaintiff's purchase of the vehicle" and "protects the purchase in the event of theft or damage to the vehicle that results in a total loss."

Davidson appealed to the Fourth Circuit in a closely watched case featuring several high-profile amici.

The Defense Department, Consumer Financial Protection Bureau and U.S. Department of Justice jointly filed an amicus brief supporting *Davidson*, arguing that the "express purpose" language meant financing GAP subjected vehicle credit to the MLA.

Industry trade associations filed a joint brief supporting the creditor, as did a brief from seven members of Congress who voted for the MLA. These amici urged the court to reject *Davidson*'s argument, claiming that the "plain language of the MLA" and its legislative history indicated that financing GAP did not subject the automotive credit to the MLA.



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4th Circuit: 'We Do Not Care and We Do Not Ask'

The Fourth Circuit, in an opinion written by U.S. Circuit Judge Julius N. Richardson and joined by U.S. Circuit Judge Stephanie D. Thacker, held that the phrase "for the express purpose" in the MLA means "for the specific purpose," and that vehicle credit that finances GAP is not included under the MLA.

The opinion summarized the court's holding in a "checklist" to determine whether vehicle financing is exempt from the MLA:

- Was it procured in the course of purchasing a car?
- Was it offered for the specific purpose of financing the purchase of that car?
- Was it secured by the car?

If the answer to all three questions is "yes," then the credit is not covered by the MLA. Critically, the court noted that "we do not care and we do not ask" whether GAP was financed as well.

The Fourth Circuit engaged closely with the statutory language — consulting dictionaries, reviewing the MLA's structure, and analyzing U.S. Supreme Court precedent to hold that, so long as the credit finances the purchase of an automobile and is secured by the automobile, that is its "express" purpose.

The Fourth Circuit specifically rejected Davidson's argument that "express purpose" means "sole purpose." The court held that an extension of credit may have more than one express purpose, but even if one purpose is to finance GAP, the credit nevertheless would be exempt from the MLA.

The court also rejected Davidson's argument that vehicle credit that finances GAP should be subject to the MLA to protect service members, noting that "it is unclear" whether subjecting such credit to the MLA would favor service members, or would harm them by limiting their ability to finance the purchase of GAP.

U.S. Circuit Judge J. Harvie Wilkinson III dissented from the opinion, arguing that "express purpose" language in the MLA means the "specific, precise, and exact" reason the borrower obtained financing. He said the majority's view could lead "mischievous" creditors to take advantage of the exemption "by strapping new products and add-ons" to vehicle financing.

DOD's Prior Interpretive Rules

The Defense Department has taken conflicting positions on GAP since it first issued MLA rules in 2015, but Davidson puts this issue to rest.

The department in a 2016 interpretive rule said secured cash-out financing is still subject to the MLA, but did not address GAP.

It expanded the interpretive rule in 2017 to state that automotive credit that financed GAP would also be subject to the MLA because GAP is a "credit-related product or service" — even though neither the MLA nor the defense department's MLA regulations include this additional provision.

The Defense Department reversed course in 2020, withdrawing the 2017 rule and reverting to the 2016 version.

The court dismissed the entire colloquy out of hand. The court noted that the department's MLA regulation mirrored the statute itself, and thus the department was not entitled to any deference when it merely "interprets a rule that parrots the statutory text."

What's Next for Auto Finance and Dealers After Davidson

With Davidson, the Fourth Circuit is the highest court to have ruled — consistent with every other federal court to have considered this issue — that financing GAP will not cause an auto loan to be subject to the MLA.

While Davidson could seek a rehearing en banc from the entire Fourth Circuit or appeal to the Supreme Court, the weight of authority supports excluding vehicle credit that finances GAP from the MLA. For the moment, it appears, auto financing sources and dealers can breathe easy.

The CFPB, Defense Department and Justice Department's joint amicus brief, however, suggests that this may not be the end of the debate.

They assert that the Defense Department has the "authority to promulgate appropriate regulations [under the MLA] through notice-and-comment rulemaking that address GAP coverage."

And elsewhere, the government's brief says that the Defense Department is conducting "'additional analysis' on GAP coverage and other financial products" and anticipates "issuing additional guidance" regarding GAP and the MLA.

After Davidson, however, any attempt by the Defense Department to include vehicle financing including GAP under the MLA's coverage will face significant challenges.

The Fourth Circuit's decision in Davidson was based exclusively on the term "express purpose" in the statutory text. Even with its rulemaking authority, the Defense Department is bound by law passed by Congress, and it is unclear whether the Defense Department could craft a rule that directly conflicts with the statutory text as interpreted in Davidson.

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