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California Court of Appeal Undermines Substantial Compliance Defense

By *Scott M. Pearson and Joseph A. Escarez*

The substantial compliance defense is often critical for companies doing business with consumers, as the class action bar frequently brings claims based on technical (but otherwise inconsequential) noncompliance with consumer protection statutes. In *Flannery v. VW Credit, Inc.* (4th Dist. Case No. D063937), the California Court of Appeal undermined this defense, holding that a vehicle finance company lost its right to a post-repossession deficiency judgment by failing to use the exact notice language required by California's Vehicle Leasing Act, Cal. Civ. Code § 2985.7, *et seq.* (the "VLA").

Under the VLA, when finance companies repossess leased vehicles, they must advise the consumer of his or her right to an appraisal and how amounts owed on the lease were calculated. The statute provides specific notice language, and it punishes noncompliance by barring deficiency judgments against lessees who did not receive the required disclosures. In *Flannery*, the notice contained all of the required language except for a phrase repeating the earlier-stated purpose of why the consumer may obtain an appraisal (to accurately determine the deficiency amount).

Reversing the trial court's substantial-compliance-based dismissal of the complaint without leave to amend, the Court of Appeal held that because the VLA excuses certain bona fide calculation errors, the Legislature must have intended for all other VLA requirements to be strictly enforced. The court also made policy arguments against the substantial compliance doctrine, generally and as applied here, taking the position that courts should not be burdened with having to determine whether alternative disclosures satisfy the purposes of the statute, and that the loss of a deficiency judgment after repossession provides no basis for finding an "undue windfall" justifying application of the doctrine.

While *Flannery* applies to a narrow issue concerning the VLA, it underscores the risks of altering specific disclosures called for by statutes or regulations. While changes can improve the disclosures from a consumer protection standpoint or serve reasonable business purposes such as eliminating an additional page from a form contract, the safe course of action from a compliance standpoint is to use the exact required language.

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