Sears’s Bankruptcy and Auto Repair AG Settlements

By Adam Anderson

Introduction

Beginning in the early 1990s, attempting to stave off what a Harvard Business School Report calls a “declining market share,”1 Sears, Roebuck & Co. (Sears) instrumented two new programs. The first changed the method of remuneration for repair mechanics and the second encouraged reaffirmation agreements that would allow Sears to recoup funds from defaulting debtors who had declared bankruptcy. Both changes resulted in Sears facing multistate action by state attorneys general who received complaints from consumers about the changes. Tracing the history, structure, and effectiveness of each settlement, this paper reviews each of the cases and how they were handled both individually and collectively.

Question Presented and Brief Answer

What happened to and how effective were the two settlements Sears negotiated with multi-state teams of Attorneys General over allegations of defrauding auto repair consumers and violating bankruptcy laws?

Both settlements were effective in the sense that they acted as caveats for a large number of consumers who could have potentially encountered similar unfairness in the marketplace, and they were a warning to other businesses that the Attorneys General were watching.2 As to the specific issues, the settlements had varying degrees of effectiveness. The auto repair settlement, reached in 1992, created a fund both to repay harmed consumers in the form of coupons and to help educate all consumers about auto repair fraud. However, there has been no way of knowing

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1Harvard Business School, Sears Auto Centers (A) [hereinafter Sears (A)] 2 (May 31, 1996).

2This kind of evaluation of the settlement’s effectiveness falls under the heading “general deterrence” which is discussed infra. It is a difficult evaluation to quantify and whether that warning was heeded by other industry participants is almost solely measurable by guessing.
whether the coupons were used and, if they were, if they were adequately remedial. Also, the consumer education part of the fund seems to have disappeared without leaving any records documenting when, how, or if it was deposited and/or used.

Though it may be unfair to directly compare the two settlements because of a number of different factors, the bankruptcy settlement reached in 1997 seems to have been more effective in compensating harmed consumer by having Sears agree

“to cancel all questionable reaffirmations [sic] and return all improperly paid monies with 10 percent interest, which is expected to amount to some $100 million in refunds. In addition, $25 million more will be paid pro rata to the consumers as a penalty.”

The settlement also provided for creating a fund to be used for consumer education and payment of a several million dollar penalty to each state.

One reason for the discrepancy of settlement effectiveness is the era. The Multistate mechanism was more sophisticated in 1997 and Attorneys General were more experienced and better able to structure a settlement benefitting their constituents. Another reason is the nature of the dispute. While Sears’s wrongful action is very clear in the bankruptcy case (prima facie statutory violation), it is not clear what wrong Sears committed in the auto repair case, and as a result, Attorneys General had more bargaining power in the bankruptcy case.

Background, Factual and Legal

A. Auto Repair

1. Factual

Though it began as a small watch company in 1886, Sears grew so that through most of the twentieth century its Merchandising group was the undisputed global leader in retailing. In

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3Settlements are not reached in a vacuum. By 1997, the Federal Trade Commission (hereinafter the Commission) was much more activist than in 1992 which certainly contributed to the creation of an atmosphere in which similar litigation is either encouraged or discouraged. In 1997, it is safe to say that litigation of this sort was definitely not discouraged.

1988, however, because its retail lead was narrowing, Sears restructured the Retail division by acquiring Western Auto Supply Co. Still, the Merchandise group’s earnings dropped by 60% in 1990. Then Sears implemented an incentive program for its auto mechanics: any time a mechanic completed a job, he would receive a pre-determined amount in addition to his base salary. Describing the new program to a congressional subcommittee, one Sears mechanic said:

“On January 1, 1991 the mechanics, installers, and tire changers had their hourly wages cut to what Sears termed a fixed dollar amount, or FDA per hour which varied depending on the classification. At present, the mechanic’s FDA amount is $3.25 which, based on current Sears minimum production quotas, is 17% of my earnings. What this means is that for every hour of work, as defined by Sears, that I complete, I receive $3.25 plus my hourly base pay. If I do two hours worth of work in one hour I receive an additional $3.25 therefore increasing my earnings. . . Prior to this commission program when the mechanics were paid only an hourly wage, our production quotas were $35.00 per hour with the shop flat rate being $55.00 per hour. As of January 1, 1991 our quotas were changed to, and judged on, an FDA rate of $3.25 per hour. Since the FDA rate of $3.25 per hour is equal to one hour of shop flat rate work, the mechanic’s quota was therefore increased $20.00 per hour.”

Sears did not publicize its new incentive program, it was only discovered after registered complaints about auto repair fraud with the Bureau of Automotive Repair (BAR) from California’s Department of Consumer Affairs (DCA) increased 14% annually beginning in 1985. In 1992, consumers spent $100 billion on automotive repair with $25 billion going to “undercar services”, replacing mufflers, shock absorbers, and struts as well as repairing brakes. With the

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auto repair industry generally in a slump, competition intensified in the undercar market, and with car dealerships looking for profits in the repair market, car repairs grew from 11% of total profits to 86% between 1983 and 1990. After conducting a consumer survey in which over half the respondents claimed to believe auto repair shops were dishonest, the BAR speculated that fraudulent repair shops cost Californians $2.2 billion a year and began an industry-wide investigation.

Though Sears maintains otherwise, the BAR claimed there was a pattern of complaints against Sears and specifically investigated Sears’s auto repair shops. According to a DCA News Release, the “BAR conducted 38 undercover ‘runs’ at Sears shops throughout California.” In 34 of those runs, the BAR claimed mechanics either performed or recommended unnecessary procedures. Overcharges averaged $223, peaking on occasion at $550, while some cars left Sears’s shops in worse condition than before they were “repaired”; the BAR claimed that one car left without brakes.

Focusing on brake repairs because Sears widely advertised them for between $48 and $58, the BAR investigators often took vehicles only requiring a simple brake job to the centers. Too often Sears mechanics suggested repair or replacement of calipers, shock absorbers, coil springs, idler arms, or master cylinders, even though those parts were in good working order with often less than 20 miles of use. Jim Schoning, chief of the BAR, described some of Sears’s mechanics as resorting to scare tactics stating that “one of our undercover operators was told that

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9Richard J. Barnett, a Sears official on the senior regulatory counsel, claimed that complaints about Sears’s auto repair industry in California increased from 137 annually to 223, a minute fraction of the 18,000 complaints the BAR received every year. See Sears (A), supra note 1, at 4.
10Sears (A), supra note 1, at 4.
the front calipers on his car were so badly frozen that the car would fishtail if the brakes were applied quickly."

Resulting from the BAR’s investigation, California Senior Assistant Attorney General Herschel Elkins sent a letter and copies of the BAR investigation to Edward Brennan, Sears’s Chief Executive Officer, informing him “that the investigation revealed ‘substantial problems’ at Sears auto centers which ‘went deep’ into the management structure.”

Though Sears challenged the BAR’s investigation on several grounds, Sears entered negotiations with the BAR, the Contra Costa District Attorney, and the California Attorney General settling on a consent decree which stipulated how Sears’s auto repair business would be conducted. When attempting to reach a financial settlement, however, the negotiations fell apart.

Shortly thereafter, on June 11, 1992, the legal proceeding commenced when the DCA filed an administrative action seeking to revoke the license of all Sears auto centers in California for violating the state’s Auto Repair Act. The DCA alleged that Sears engaged in false or misleading statements, fraud, false advertising, failure to state clearly parts and labor charges on invoices, and willful departure from accepted trade standards. On the limited scope of the action, which concerned only licensing, the DCA had full authority to make the final decision. Next, the California attorney general’s office and the Contra Costa County district attorney’s office announced that each was considering legal action. But unlike the DCA action seeking only to revoke Sears’s licenses, successful civil action by the attorney general would probably have led to fines and other monetary damages.

It was at this time investigators discovered Sears’s incentive program.

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12 Id.

13 Sears (A), supra note 1, at 5.

14 See Id. at 6.

15 Id. at 7.
“Current and former Sears employees told BAR investigators that they were instructed to sell a certain number of alignments, springs, and brake jobs during every eight-hour work shift. They were also pressured to sell a specified number of shock absorbers or struts per hour. At one store, employees were told to sell five front-end alignments, eight sets of springs, eight sets of shock absorbers, and two tires each day. These employees also told BAR that if they did not meet these goals, they often were cut back in their work hours or transferred to another Sears department.”16

Jerry C. Waddy, a mechanic who had worked for Sears, filed suit against the company claiming he was fired for not meeting his quota of 16 daily oil changes. Seeking $1 million for wrongful discharge, Waddy claimed his manager advised him that cheating would save his job and that, before being fired, “we talked about the pressure, pressure, pressure to get the dollars.”17 Another Sears mechanic, preferring to remain anonymous, stated, “I’m torn between moral integrity, losing my job, and trying to figure out how to work all this out.”18 And a Sears service advisor said he requested a job transfer because he “couldn’t stomach the pressure to sell. It wasn’t right. You sold things to people to meet your quota for that day, but you didn’t feel right about doing it.”19

Roy Liebmen, a California deputy attorney general, described a corporate atmosphere in which, “there was a deliberate decision by Sears management to set up a structure that made it

16Id.


totally inevitable that the consumer would be oversold,” and DCA director Jim Conran accused Sears of a “systematic effort to bilk and rip off consumers on auto repair sales and parts.”

Sears’s problems were not limited to California. Only four days after the DCA announced legal action against Sears, the New Jersey attorney general’s office announced, after a four month investigation of auto repair shops, that it was charging Sears with systematically giving motorists inflated estimates for unnecessary repairs. Two days later the Florida attorney general’s office announced a pending investigation into Sears auto repair centers because of the large number of complaints received from consumers.

Meanwhile, Sears was losing a public relations battle. On national television, David Letterman’s Top 10 list lampooned the corporation by listing the “Top 10 repair jobs recommended by the Sears Automotive Department.” But Sears got hurt by more than mere jokes, its stock fell 12% in the first three weeks of June.

2. Legal

There is no law regulating the use of compensation plans, so attacking Sears legally required creativity. 15 USC § 45 prohibits the unfair or deceptive acts or practices in or affecting commerce and gives the Federal Trade Commission authority to ban deceptive advertising. Using 15 USC § 45, its amendments, and federal laws as a guideline, the states created their own


22Newsday, June 28, 1992, op. cit. On the list, Number 10 was “grease the ashtrays” and the Number 1 recommendation was “add a redwood deck.”

23See http://finance.yahoo.com listing Sears stock falling from 43.25 per share on June 1, 1992 to 38.125 per share on June 19, 1992; See also Standard & Poor’s Daily Stock Price Record: New York Stock Exchange, April, May, June 1992, at 434.

24With much thanks to Diahann Billings-Burford, and her paper for Multistate Litigation: The Role of the Attorney General (on file with the author), for her help with this section.
consumer protection statutes referred to as the Unfair or Deceptive Acts and Practices Statutes (UDAP).

UDAP statutes vary from state to state, but in every state there is a general prohibition of unfair, deceptive or unconscionable commercial conduct. Many UDAP statutes give the Attorney General far-reaching and fairly ambiguous authority to obtain injunctions and penalties against those using “unfair or deceptive acts or practices in trade or commerce.” Though the Attorney General is not required to wait for a judicially specified unfairness principle, UDAP allows courts to continuously redefine any standard. Through continuous refinement of UDAP, courts allowed the UDAP statutes to become flexible laws allowing states a broad scope of regulatory authority. One relevant limitation on UDAP statutes is that they are not applicable to unfair acts that could have been reasonably avoided by the consumer.26

Though the logic of UDAP’s application to Sears’s auto repair activity is not stated in any accessible document, the states used the UDAP statutes as basis for their complaints against Sears. It is not hard to see how the spirit of UDAP is applicable to Sears’s alleged actions. Seemingly, Sears deceived consumers by advertising services as a “bait” to lure them to the repair shops and then, using coercion, hard sale tactics, and dishonesty, defraud the consumer by charging more than what should have been. Unfortunately for the state prosecutors, there didn’t seem to be any real substantive evidence that this was the case. The undercover investigations, though indicative of what was probably happening, were subject to certain questions of credibility.27


27 See Sears (A), supra note 1, at 6.
Instead, the states, using UDAP, attacked Sears’s compensation plan. Tactically the maneuver worked, but the methodology is questionable. Sears was the only company sued for its auto repair practice, but it was not alone in paying its auto repairmen by commission. At the time the states sued, Compensation specialists noted that it was fairly common for automotive service employees to receive commissions, though it was less usual for service employees to have specific sales quotas. But similar quotas were reportedly used at Firestone.28

B. Bankruptcy

1. Factual

In 1997 Sears admitted to violating bankruptcy law. Sears acknowledged that is did not acquire judicial approval while allowing bankrupt customers, whose outstanding debt was erased by the bankruptcy proceedings, to sign reaffirmation agreements reinstating the legally forgiven debt. Asking customers to sign agreements after bankruptcy is standard practice in the retail industry, the wrinkle with Sears’s agreements is they were not filed with bankruptcy court.

Under 11 U.S.C. § 727(b) and 11 U.S.C. § 524(a)(2), debtors can obtain favorable discharge orders providing, among other things, that 1. “the named debtor is released from all dischargeable debts,” and 2. “all creditors whose debts are discharged by this order and all creditors whose judgments are declared null and void by paragraph 2 above are enjoined from instituting or continuing any action or employing any process or engaging in any act to collect such debts as personal liabilities of the above-named debtor.”29

While some debtors, in spite of the discharge order, will choose to keep some of their debts through reaffirmation agreements with the creditors in order to help their credit rating, discharged debt can not be reaffirmed without proper filing in court. Sears obtained its reaffirmation agreements in a different way.

28Letter from Mark Lewis, Hearing, supra note 5, at 86-86.

29In re Latanowich, 207 B.R. 326.
Probably the best summary of Sears’s actions is found in *In Re Latanowich*, a 1997 Federal Bankruptcy case from Massachusetts. Francis Latanowich was, at the time, an unemployed, married man with children and a total income of $500 per month from Social Security disability benefits and monthly expenditures of $1,449. He filed for and was granted bankruptcy in 1995 where he listed his total assets as $375 and his total debts as $12,805. Latanowich owed Sears $1,073. Though the facts from the Latanowich case are specific to Latanowich, they are useful to the extent they describe Sears’s mode of operation in the events leading to their eventual settlement with the states.

Describing Sears’s conduct, Latanowich describes Sears as initiating

“contact with the Debtor by mailing him a letter, accompanied by a proposed reaffirmation agreement. The letter informed the Debtor that Sears had received notice of his bankruptcy filing and included the Debtor’s account balance. It also informed the Debtor that Sears had a security interest in the merchandise represented in the account balance and set forth the dates of purchase for these items, their purchase prices, and their (then) current values. The letter then asked the Debtor to inform Sears of his intention as to his account. It listed three options: A. Sign Reaffirmation Agreement as to account balance, to be paid in monthly installments. B. Redeem merchandise, by making lump sum cash payment only. C. Return merchandise to Sears.”

The letter then stated that “should you elect to reaffirm for the account balance,” in order to help you establish “favorable credit history,” Sears will immediately grant you “a line of credit.”

Accompanying the letter was a proposed reaffirmation agreement captioned

“Reaffirmation Agreement, Secured” that stated, in relevant part:

30 Id.

31 Id. at 7.
“Debtor wishes to either retain the property securing the account balance, to settle creditor's claims of nondischargeability under # 523, and/or to continue to use the Sears/Charge Account by reaffirming said debt and security agreement. 

“Debtor promises, reassumes and agrees to be bound by all the terms and conditions as set forth in the original security agreement, as amended from time to time, with Creditor including applicable finance charges. Debtor agrees to pay the sum of $ 1,161.34 in payments of $ 28.00 per month commencing 03/13/96 and on the same date of each and every succeeding month until said sum is fully paid. Creditor agrees to immediately reinstate a line of credit of $ 1,161.00 to the account.

THIS AGREEMENT IS NOT REQUIRED UNDER THE BANKRUPTCY CODE, ANY NON-BANKRUPTCY LAW, OR ANY AGREEMENT THAT IS NOT IN ACCORDANCE WITH THE PROVISION OF THE SECTION 524(C). THIS AGREEMENT MAY BE RESCINDED AT ANY TIME PRIOR TO DISCHARGE OR WITHIN SIXTY (60) DAYS AFTER THIS AGREEMENT IS FILED WITH THE COURT, WHICHEVER OCCURS LATER, BY GIVING WRITTEN NOTICE OF RESCISSION TO CREDITOR AT THE FOLLOWING ADDRESS:

Sears
45 Congress Street
Salem, MA 01970.”

Also included with the form was a “Declaration by Attorney for Debtor” containing the representations required by 11 U.S.C. § 524(c)(3) and a line for counsel's signature. And it included a proposed “Order Approving Reaffirmation Agreement,” which expressly noted that it

32 Specific payment amounts are details from the Latanowich case.

33 In re Latanowich, supra note 29, at 9.
was “only required if the above Debtor(s) are not represented by an Attorney.” The proposed order simply stated: “The above Reaffirmation Agreement having come before this Court and the requirements of 11 U.S.C. Sec. 524 having been satisfied, BE IT ORDERED that the above Reaffirmation Agreement is hereby approved.”

Latanowich, after receiving the letter, called a representative of Sears who informed him that unless he agreed to pay the full balance due, he would have to return the merchandise that was subject to Sears's security interest. When Latanowich “indicated that he needed additional credit to purchase clothing for his children, the representative stated that if” he agreed to reaffirm his Sears debt, “Sears would increase his credit limit to $200 above the amount then due.”

Under the impression that keeping the merchandise required reaffirming the debt, Latanowich agreed to sign the agreement. He claimed that in response to his question about whether Sears would notify the court, the Sears’s representative answered, “All you have to do is sign the paper. We'll take care of the rest.”

On January 29, 1996, Latanowich signed the reaffirmation agreement and returned it to Sears who received the agreement without filing it in Latanowich's bankruptcy case. According to the Latanowich court:

“this was not an oversight but a matter of policy on the part of Sears. Sears did not inform the Debtor that the agreement would not be binding unless submitted to the court. Nor did it inform him that it did not and would not file the agreement in the Bankruptcy Court.”

Sears restored his credit, though not in the full amount that had been promised, after Latanowich called to complain that it had not been restored. Latanowich used his credit to purchase clothing, tools, and automotive services, all totaling $338.91 for 9 months and was

34 Id. at 10.
35 Id.
36 Id. at 10-11.
billed monthly for 11 months for both the new debt and for the prepetition debt, including postpetition interest which averaged $21.50 per month during this period. Latanowich was able to make monthly payments on the balance for the first 9 months.

Explaining to the Latanowich court why Sears did not file the reaffirmation agreement, Mr. Harris, a Sears attorney, claimed it was because, in another case in the same district, a judge “entered an order of civil contempt under which Sears would incur sanctions if it filed further reaffirmation agreements containing certain prohibited language.”37 Since Sears did not learn of the Iappini order until after it had mailed the reaffirmation agreement to Latanowich, once he executed the agreement and returned it to Sears, Harris explained, Sears could not file it without incurring sanctions, so it decided not to file the agreement.

The Latanowich court found this explanation deficient in two respects. First, “it is not supported with evidence as to the timing of the events that created this alleged predicament.”38 Since the Iappini order was issued on November 28, 1995, the Court thought it highly unlikely that Sears did not receive notice of the order until after January 22, 1996 when it sent the Latanowich letter. The court also found evidence to show that, “even after dates by which Sears concedes that it had knowledge of the Iappini order and had instituted a policy of not filing reaffirmation agreements, Sears continued for many months to solicit such agreements from debtors in this district.”39

Second, the court decided that even if Harris’s explanation were true, it failed to explain why Sears did not use alternatives to filing the reaffirmation agreement so as to avoid violating the discharge injunction. According to the court, Sears “could have (1) informed the Debtor that the agreement had not been (and would not be) filed and therefore was not effective, binding, or enforceable, (2) discontinued billing on the account, and (3) refunded payments that the Debtor

38Id. at 14.
39Id.
made while under the belief that Sears had filed the agreement and that it was binding. 40 Instead, Sears did none of these things without explanation. Since the court claimed these remedies to be obvious and simple enough, it found no merit to Sears's explanation that it had no option other than to do what it did.

But Latanowich was, by no means, the only victim of Sears’s policy. After a Massachusetts bankruptcy judge learned of Sears’s actions and ordered it to submit a list of all cases in which it had not filed a reaffirmation agreement, Sears produced a list containing 2,733 names in Massachusetts, alone. (Sears also admitted to engaging in similar behavior in different areas of the nation.41) The judge began proceedings to determine whether Sears had violated Section 524 with this practice and considered ordering a $500 per-case penalty, in addition to ordering refunds for the debtors. For a short time, Sears tried to defend its actions, presumably arguing that unfiled agreements were not illegal, only unenforceable. Higher officials, though, concluded after a short time that their position was indefensible. (While the Code does not explicitly prohibit a creditor from obtaining, but not filing, such agreements, it does bar any “act” to collect a dischargeable claim. The Code excepts valid agreements from that bar, but it would violate the letter and spirit of the law to allow agreements that did not meet the requirements of Section 524 to serve as a defense to a violation of the discharge injunction.) Sears’s management agreed to entry of a temporary injunction on April 17 1997 and offered refunds and $100 gift certificates to all persons who signed such agreements. It also agreed to review their files nationwide and extend their settlement offer to all similar cases.

On Tuesday, April 22, Assistant Attorneys General (AAG) from Massachusetts held a conference call with AAGs from about 20 other states, the Department of Justice, and the Federal Trade Commission to discuss what actions the states wished to take under their

40 Id. at 14-15.

41 See United States’ Memorandum of Law in Support of its Assented to Motion for Preliminary Injunction and Other Equitable Relief.
consumer protection statutes, which might have included bringing deceptive practices claims against Sears and imposing penalties.

2. Legal

Basically, a discharge of debt granted in a bankruptcy proceeding acts as injunctive relief for the debtor against the creditor and efforts to collect. According to 11 U.S.C. § 524(c), discharged debt may be reaffirmed (the debtor can agree to be held liable to the creditor) only if stringent requirements are met. Most notably, an agreement concerning debt reaffirmation must 1) be reached before discharge is granted, 2) have language clearly stating, for the debtor’s benefit, that “the agreement may be rescinded at any time prior to discharge or within sixty days after such agreement is filed with the court,”42 and 3) be filed with the court according to the relevant state law. Since Sears waited until after discharge to approach the debtors with reaffirmation agreements, those agreements could only be valid if the court holds a hearing for the debtor and informs him 1) that such agreement is not required by law, and 2) of the legal consequences of reaffirming his debt.43

It is important to note that only reaffirmation agreements which meet the strict criteria set forth in the U.S.C. and accompanying state law are enforceable. And in the event any money is collected by a creditor under an unenforceable agreement it must be returned in full to the debtor.44

Also at issue in the discussion of Sears’ practices are the various state laws protecting consumers and prohibiting unfair and deceptive practices discussed above in the auto repair legal section.

Settlement Details, Sears and the States agree


44 See In re Gardner, Bkrtcy.D.Me., 57 B.R. 609 (holding that any funds garnered by a creditor from a debtor pursuant to an unenforceable reaffirmation agreement must be surrendered).
A. Auto Repair

Though there seems to be a dearth of official documentation of the settlement between the states and Sears, it was reputed to consist of a Sears sponsored Automotive Repair Industry Reform Fund of $200,000 dedicated to educating consumers about auto repair and facilitating attorneys general in their study of current auto repair practices and rules. In addition to the fund, Sears supposedly agreed to provide any consumers having purchased any one of a number of services with coupons valuing up to $50. Sears announced that the coupon reimbursement program would cost them up to $46.6 million and the other aspects would cost, after taxes, an additional $15 million.

Conspicuously absent from literature concerning Sears’s settlement over its auto repair practices are details about actually fulfilling the settlement agreement. Robert DelTufo, the Attorney General of New Jersey who is largely credited with successfully negotiating the $200,000 settlement characterizes the settlement as “an innovative way to fix the problem and deal with restitution and fines.” Even so, he can only vaguely remember what actually happened to the money. DelTufo remembers the fund being formalized under the auspices of the National Association of Attorneys General (NAAG) although Dennis Cuevas, Consumer Protection Project Manager and Counsel for NAAG, was unaware of both the fund and any documentation that might concern it.

B. Bankruptcy

45These services included brake calipers, coil springs, shock absorbers, master cylinders, and idler arms. Harvard Business School, Sears Auto Centers (C) [hereinafter Sears (C)] 2 (August 4, 1994).


48Phone conversation with Dennis Cuevas, 1 Dec 2000.
By May of 1997, Sears was named as defendant in two separate actions seeking remedy for Sears’s alleged violation of bankruptcy laws. Allegations against Sears in U.S. Bankruptcy Court for the District of Massachusetts stated that the corporation 1) “pursuant to a regular policy and practice, obtained reaffirmation (or similar) agreements from individual debtors, by which the debtors agreed to repay all or part of their pre-petition indebtedness to Sears, and did not file such agreements with the bankruptcy court in which the debtors’ Chapter 7 proceeding was pending, as required by the Bankruptcy code,”49 2) that Sears “deceived” bankrupt debtors by claiming the reaffirmation agreements would be appropriately filed; the agreements were legally enforceable; that the debtors owed money which, in fact, they did not; and “by threatening actions that Sears either did not intend to take or was not legally permitted to take,”50 3) that through its actions, Sears “abused” the bankruptcy court process, “constituted unfair and deceptive acts and practices” as defined by the Massachusetts Consumer Protection Act,51 and “violated the state unfair and deceptive practices law of each state in which Sears ha[d] engaged in such practice,”52 and 4) that Sears’s conduct “damaged” the debtors by encouraging them to pay Sears “under illegal and unenforceable agreements” as well as instrumenting conditions so that the debtors “unwittingly deprived themselves” of protection under the Bankruptcy Code.53

Massachusetts’s attorney general’s office, acting on behalf of a named class, and two private parties filed in District Court believing that their additional filing would “facilitate their

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50Id.

51Mass. G.L. ch. 93A


53Id. at 3.
ability to further protect the interests of the class,"54 as well as enable them to assert related claims against Sears’s actions that would not fall under the jurisdiction of the Bankruptcy Court. In addition to making similar allegations to those brought in Bankruptcy Court, the District Court action claimed Sears’s conduct “constituted a violation of the federal Racketeer Influenced and Corrupt Organizations Act55 . . . and of the federal Truth in Lending Act56 .”57

For relief, the action brought in bankruptcy court petitioned for a judgement that Sears’s conduct was unlawful and an order for Sears to refund all payments garnered from the improper agreements, as well as assess punitive damages for Sears’s willful Bankruptcy Code violations.58 In addition to the same remedy sought in the bankruptcy action, the District Court case sought various orders estopping Sears from continuing its practice, requiring them to file information with the courts regarding the debtors who signed reaffirmation agreements, and fining Sears an unspecified amount to be paid to the United States of America.59

Even before the action filed in District Court, Sears acknowledged publicly that failing to appropriately file the reaffirmation agreements resulted from “flawed” legal judgment and execution. As part of the announcement acknowledging wrong doing, Sears also indicated that it planned to compensate those debtors whose reaffirmation agreements had not been handled correctly.60

After Sears acknowledged its behavior was problematic and legal actions were filed in both courts, settlement discussion began. The first step toward a settlement with Sears was an

54 Id. at 4.
57 See Draft, supra note 49, at 5.
58 Id. at 3.
59 Id. at 4.
60 Id. at 6.
agreement in principle reached with all 50 states participating in the settlement. Sears agreed to cancel all questionable reaffirmations and return all improperly paid monies with 10 percent interest, some $100 million in consumer refunds. In addition, $25 million more was to be paid pro rata to the consumers as a penalty. Sears also agreed to pay $35 million as a penalty to the states to be allocated in proportion to the victims in each state and to provide a $5 million fund that to be available for consumer education and enforcement purposes.61

Following the agreement in principle was the formal settlement which, without specifying dollar amounts, stipulated that Sears would, among other things: 1) agree to rectify its position as to all individuals fitting the definition of the specified class;62 2) agree to correct its behavior by correctly filing any subsequent consent decrees; 3) compile a list of all those persons within the correct time period who entered into incorrectly handled reaffirmation agreements with Sears;63 4) cease and suspend all billing of an individual within two days of identifying that individual as a member of the settlement class; 5) remit, by check sent to their last know mailing address, to the identified class members “all amounts paid by them to Sears with respect to reaffirmed debt, net of post-petition purchases, with interest”;64 6) provide each member of the settlement class a Sears gift certificate, usable for purchase of any Sears good or service, in the amount of $100; 7) continue extending credit to those class members qualified by the agreement; and 8) waive its interest in any goods held by members of the settlement class.65

61See NAAG, supra note 4.

62The “Settlement Class” was defined in the settlement agreement as all individuals who, in filing a petition for relief under the Bankruptcy Code, listed Sears as a creditor, later entered a reaffirmation agreement with Sears which was not correctly filed with the appropriate bankruptcy court. See Draft, supra note 49, at 13.

63The correct time period was specified as between January 1, 1992 and April 1, 1997, but the consent decree also specified that Sears was not limited to that time period and was responsible for any other individuals whose agreements might have been handled incorrectly at another time.

64See Draft, supra note 49, at 18. Also specified in the agreement was a rather involved calculus to be used in determining the amount to be paid to the individuals. Since that is without the scope of this paper, it is not included.

65Information for this paragraph, unless otherwise noted, is taken from Draft, supra note 49, at 13-25.
**Settlement Aftermath**

Unfortunately, Sears has been unresponsive to requests for information pertaining to its settlement agreements, and, in both cases, relevant state attorney general offices do not have, or will not say they have, follow-up information pertaining to the settlements. Similarly, Francis Latanowich, the plaintiff in the Massachusetts bankruptcy case notifying authorities of Sears’s practice, did not respond to repeated phone calls. However, there is a little information available to illuminate the effects of the settlements.

**A. Auto Repair**

Before reaching the settlement agreement, but after accusations against Sears were public, Edward Brennan, Sears’s Chairman and CEO, announced an immediate elimination of the commission incentive plan. After publicly admitting that the “auto center incentive compensation programs and goal-setting process for service advisors created an environment where mistakes did occur,” Brennan commented that commissions were to be replaced by a program designed to reward mechanics “for achieving higher customer satisfaction levels.”  

But Brennan’s admission and announcement of change did not stop a subcommitte of the U.S. Senate Committee on Commerce, Science, and Transportation from holding hearings “to examine the extent of fraud within the automobile repair industry.”  After the hearings, Senators Slade Gorton from Washington and Richard Bryan from Nevada, both of whom previously served as Attorney General for their respective state, formally requested that the Federal Trade Commission investigate practices in the automotive-repair industry, citing “a disturbing pattern in the auto repair industry at large of defrauding customers through bait and switch tactics, exploiting consumers’ concern for safety by selling unneeded repairs and parts, and inflating repair bills.”

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67Sears (C), *supra* note 45, at 2.

68Hearing, *supra* note 5, at 1.
Additionally, all 72 of Sears’s California auto centers were placed on a three-year probation that allowed the state to suspend Sears’s license in the event customer overcharges continued. Jim Conran, the DCA director, claimed that “Sears is on a very short leash,” and that the DCA would closely monitor Sears’s auto repair activity.69

Sears also suffered from adverse public relations. By the end of 1992, even though Sears seemed to have dealt with the legal consequences of their auto repair incentive program, the company claimed its sales were about 10% less than before the allegations in June. One former customer summarized: “We had an all-American relationship with Sears.” But after his fiancee was charged $650 when she took her 1987 Ford to a Sears auto center for a strut job advertised at $89.99, the customer explained, “trust shaken is not easily gained back.”70

B. Bankruptcy

Interestingly, the bankruptcy settlement aftermath is not nearly as dramatic as in the auto repair case. A New York Times article even speculated that “there is no evidence that the vast majority of Sears customers care about” the ‘black eye’ and ‘clear failure’ “growing out of bad advice from [Sears’s] own legal department.”71 Unlike after the auto repair fiasco in which Sears lost consumer confidence as evidenced in both poor retail sales and poor stock performance, publicity over the bankruptcy case did not seem to do much to Sears.

Nevertheless, Arthur Martinez, Sears’s CEO at the time, immediately began to research and expose the compass of the infractions to all potential adversaries.72 Quoted as saying, “there’s not a dollar’s worth of profit worth having if it compromises your integrity,” Mr.

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72Id.
Martinez claimed to “beef up education programs” for his employees in the hopes of avoiding similar incidents in the future.\textsuperscript{73}

Despite its show of good faith, the U.S. Justice Department opened an investigation into whether its debt-collection activities violated criminal laws.\textsuperscript{74} However, there did not seem to any record of criminal actions taken by the federal government against Sears.

One reason for the disparity between the aftermats of the two cases is very likely the manner in which Sears handled itself. Where Sears stonewalled and even attacked state prosecutors in California, it acknowledged the wrong doing and began working along side the various prosecutors in an attempt to sanitize the system. Though it is not a factor in this analysis because it is difficult to objectively quantify, it is quite possible that Sears’s different approach to the bankruptcy case played a key role in the different reaction it received from its opponents.

**Conclusions**

In order to judge and compare the effectiveness of the settlements, there must be determinable criteria upon which to judge and compare them. Among the possible criteria candidates is whether a wrong was identified and effectively stopped. Another criteria could be whether, in theory, the agreed upon remedy was sufficient to compensate for the committed wrong. A third criteria could be whether the remedy was effectively and efficiently executed. Still a fourth, and important, criteria is general deterrence, but since deterrence is inherently difficult to quantify, it will not be discussed here.\textsuperscript{75}

As to whether a wrong was identified and effectively stopped, both settlements were, at least facially, equally effective. In the bankruptcy case there is no question that Sears broke the law. Sears’s activity was found out and brought to a halt. In like fashion, Sears’s practice of

\textsuperscript{73}Id.

\textsuperscript{74}Id. at 2.

\textsuperscript{75}For one interested in determining whether the settlements acted as deterrents to other possible bad actors, I would suggest, especially in the auto repair context, an in depth study of current trends of compensation in auto repair shops.
over-charging consumers was discovered and ended. However, as has been discussed earlier, it is not as clear what law Sears violated with its compensation plan. Especially considering the evidence that similar compensation plans were used in the auto repair industry. Since Sears was the only large entity identified and attacked for using the compensation plan, it is possible that the auto repair settlement did not have the comprehensive effect it might have.  

Without completely dismissing the auto repair settlement, it is clear that activities such as false advertising and dishonest representation are illegal and, since that is what many consumers felt was happening, the settlement effectively brought it to an end. Viewing the settlement that way puts it once more on par with the bankruptcy settlement.

Sole use of this criteria is attractive as an analysis of the settlements because it seems to give a definite yes or no answer. But limiting the analysis to only whether the wrong was stopped is possibly a shortsighted view of the settlement process. Supposedly the point behind the settlement is more than merely stopping and fixing one wrong, it is, in addition, to make a general effect for good. And that general effect is not calculated when restricting analysis to the first criteria.

Using the second criteria, whether the settlements theoretically provided for sufficient compensation, both settlements are equally strong. Both require Sears to remedy the past with both individual consumers and consumers as a whole through the state, that general good alluded to above. They both use what seems to be a sufficient calculus for the remedy since they each require that all wronged individuals be compensated as much as can be reasonably determined. In addition, both settlements assess what amount to punitive damages in order to make the consumer climate better not just for those consumers actually harmed, but for all participating consumers.

76It is important to note, however, that even if the states targeted Sears for engaging in a practice used by the entire industry, if the practice is something that should be stopped, only targeting Sears, a high profile member of the industry, could be a resource-efficient method of deterring other members of the industry. See supra note 75.
Even so, a mere theoretical judgement of the two settlements does not take in to consideration the different contexts in which each was created. Judging from a procedural standpoint, it seems that the bankruptcy case was an easier case for the attorneys general to settle for two reasons. First, Sears committed a clear wrong. It violated the bankruptcy statute in an easily definable fashion that made it difficult for Sears to smooth over. Second, though not entirely tangible, the political climate was more conducive to holding large corporations to strict legal standards. It is quite possible that Sears never vigorously challenged the allegations because it knew there would be little sympathy from government officials.

Finally, by 1997 attorneys general were more experienced in this kind of settlement proceeding. Unlike the auto repair settlement in 1992 where Sears’s attorneys succeeded in controlling the situation by freezing all bad press until persuading the attorneys general to agree with to their proposed settlement terms, attorneys general were more experienced with settlements of this type and instead of allowing Sears to control the flow of information, they controlled it in their favor.

So while the second criteria takes in to account the broader scope of the settlement, it is unfair to compare two settlements spawned from completely different political climates. Therefore, without severe concessions to almost intangible stimulus, the second criteria is insufficient by itself as an adequate measure of two settlements. Though it is very helpful in analyzing the results of only one.

When judging these two cases, it is difficult to use the third, and probably the best, criteria. Determining effective accomplishment of the settlement terms is nearly impossible because literature documenting the actual satisfaction of the settlements is either scarce or nonexistent. This conspicuous absence, while prohibiting evaluation based on a certain criteria,

77Hartigan, supra note 46. Though his role is not detailed anywhere that I could find, Mr. Hartigan, former Attorney General of Illinois at the time he negotiated for Sears, accomplished a phenomenal task by controlling what could have been an even greater public relations disaster for Sears. In fact, other than the public relations fiasco Sears suffered early in California, there are virtually no articles available discussing Sears and auto repair fraud.
speaks volumes about what future settlements should attempt to do. It is very easy to settle with Sears when it agrees to put $200,000 in a fund for consumer education, or when it boasts that the coupons it will issue to rectify its wrong will be worth $46.6 million. But its another thing to ensure Sears pays the money and that the settlement is as effective practically as it sounds theoretically. If a settlement does not require an accounting of its terms after the fact, it is quite possible that at the change of an administration or during an emergency the enforcement of the settlement is forgotten and never reviewed.

A specific example is the $200,000 fund Sears agreed to open in the auto repair settlement. After a complete search of all available records and probing discussions with involved individuals, including the New Jersey Attorney General who negotiated the settlement with Sears, no record or accounting of what happened to that money could be found. Similarly, while someone must have an accounting of how many coupons were distributed and how many redeemed, that information is not readily available. As such, it is impossible to tell how effective the settlement really was, if at all. Though it is truly unlikely that anyone acted in bad faith, it is tragic that the only tangible evidence of the auto repair settlement with Sears is the settlement document itself.

Likely, the most important information to be learned from analyzing and comparing the auto repair and bankruptcy settlements is that there is a difference between agreeing to something on paper and gauging that agreement’s effectiveness afterward.

**Areas for Future Study**

What this analysis leaves for future work are suggestions to improve the process. One area that might be researched is the use of coupons in consumer settlements and whether they are a type of compensation worth modeling in future settlements. Since coupons are only redeemable with the defendant, does using coupons effectively compensate the consumer, or merely serve to reward the defendant with more business? Additionally, the use of independent funds as a means to benefit the larger class of consumers through education or otherwise could be tested and possibly improved with further research.
But one question that is in desperate need of answering is how to keep the settlement parties (i.e. the Attorneys General and the defendant) accountable to the consumers for whom they are settling so the actual effectiveness of the settlement can be gauged. One possible solution might be to require that the attorney general’s office responsible for the settlement make an announcement about the settlement follow-up as public as the settlement announcement itself. This is probably an unrealistic solution because, as James Tierney suggests, “the fun of the case is ‘over’ and the AAG's who did it are on to the next battle.”78 Another possibility might be to somehow require follow-up by the “lead” states in the settlement.79 A possible problem might be actually enforcing the “required” follow-up.

If the Multistate mechanism will be used repeatedly, it is in the best interest of prosecutors and the public alike to ascertain the ultimate effectiveness of the mechanism. Though the two cases presented here are not a comprehensive review of settlements obtained through Multistate means, they are sufficiently far apart in time to make a claim that without improving the follow-up process we might never know how effective the Multistate process is.

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78Email from James Tierney, Adjunct Professor at Columbia Law School and former Attorney General of Maine, on file with author, (29 Jan 2001).

79So called “lead” states are, like lead counsel, those states acting as coordinators for all the states participating in a settlement.