

THE COMMON LAWYER

Fraud – It's bad business



By Justin Jakubiak

CHALLENGING ECONOMIC TIMES DON'T JUST IMPACT CONSUMER BEHAVIOUR, but often that of employees, agents and suppliers. While some will modify their behaviour to create new processes to maintain and increase revenue, others will employ darker tactics to maintain revenue – and in turn, as is the case for many commission-based dealership employees – their income level.

Commission income, and other target-based sales incentives, can be phenomenal motivators, but are also, without appropriate controls and safeguards, the root cause of many of the auto industry's worst behaviours.

The Bad

Among my dealership clients, I have seen a sharp increase in problematic employee behaviour over the past

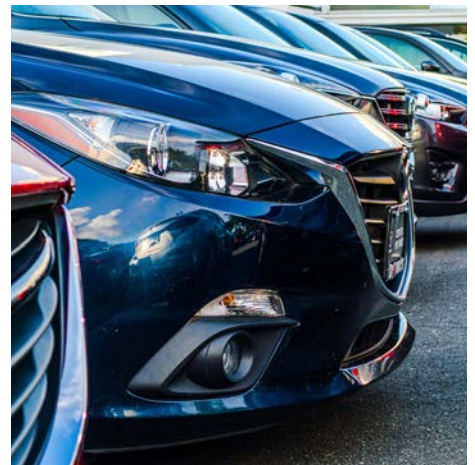
several months. The following are just a few examples:

- **Tied selling:** The practice of advising a consumer that they will only qualify for financing if they purchase an additional after-market warranty or a vehicle protection package.
- **Non-disclosure of material facts:** Such as failing to disclose a vehicle's former status as a daily rental, its prior accident history, or the nature and cost of prior repairs.
- **General misrepresentations:** Such as providing incorrect information to a lender about a vehicle's trim level or features to support an increased loan amount, often to accommodate large negative equity.
- **Creation of false documents:** False loan applications, false insurance documents, false consumer satisfaction surveys (for manufacturer incentive programs), and false warranty paperwork, to name a few.

Some may comment that the above are fairly typical and prevalent in the industry, regardless of good or bad economic times. While I don't completely disagree with this statement, I would say that the proliferation of this behaviour has been on the steady rise, and the behaviour is being seen among a greater scope of dealer employees; not just salespersons – but members of the service department, business office as well as management.

The Super Bad

In addition to the above, I have seen an increase in some 'super bad' behaviour that I would describe as much less typical of the industry. Recently, one of my client's photographers effectively stole a vehicle that two elderly clients wanted to sell to the dealership as they no longer needed it. The photographer used his position of trust at the dealership to effect both the theft and a subsequent sale. The unsuspecting purchaser believed that he was purchasing the vehicle from the dealer, with all the associated benefits and protections one gets by dealing with a licenced dealership... only problem was my client didn't know of the sale and didn't receive any of the sale proceeds! The poor sellers received a small fraction of what their vehicle was worth from the photographer, again believing they were dealing with a trusted and reputable dealership. Fortunately, my client learned of the theft and was able to make both the



vendors and the purchaser whole. The photographer is no longer employed, OMVIC has been made aware of the incident, as have the local police.

I must slash and sell this inventory to meet target...

I have experience with this next scheme from both sides... from the side of the dealer who has had a significant amount of inventory sold to other dealers below retail and, in some cases, even below wholesale cost, by an opportunistic salesperson; and from the side of the purchasing dealership who has received an angry demand letter.

This scheme is often the result of improper conduct by a rogue and under-supervised salesperson, or a more senior salesperson or manager whose seniority allows their deals to come under less scrutiny. Oftentimes the purchasing dealership is part of the scheme by paying a cash incentive to the salesperson for each value-priced vehicle purchased, in addition to the vehicle's selling price.

One established dealer had more than a million dollars of new inventory sold to other dealers for significantly less than their retail value, resulting in hundreds of thousands of dollars of losses. Unfortunately, the dealer principal, fully trusting his team of highly dedicated and senior staff, didn't notice that the fraud was occurring for several months, which allowed the losses to accumulate.

How did it happen? A new salesperson, but a family member of a long term, senior and trusted member of the franchise dealer's management staff, was selling vehicles to a handful of Toronto dealers for too good to be true prices and was accepting bird dogs in exchange. The employee got away with it for months because no one, including the dealer principal, suspected him given he was related to one of the dealership's most trusted employees.

Easy Money - The Additional Income Stream

The last dealer targeted fraud I will highlight is where an established dealer is promised easy money. It's never easy.

Several clients have been approached by other dealers seeking to 'join forces' with them to obtain access to the dealer's finance portal and additional lenders as a result. The approaching dealers promise to do all the heavy lifting, and to pay a few hundred dollars for each completed transaction.

Sometimes this works out great, and it is a perfect marriage; but too often, the deals are problematic and imbued with fraud – fake ids, untruthful employment information, non-existent vehicles and sometimes loan applicants who are no longer alive.

My latest client-victim is a long time OMVIC registrant with an excellent history. Nearing retirement, he has been slowly winding down his business and saw this as an ideal opportunity to earn a bit of extra income with little to no work on his part. Before entering the business venture, he reviewed OMVIC's website and saw that the people he would be 'partnering' with were OMVIC registered with seemingly clean registration histories.

Unfortunately, and due to his trusting nature, numerous deals were processed through his portal that should not have been. Lenders have come knocking and want many of the deals to be purchased back. Unfortunately, the transactions were for expensive vehicles and the banks are looking to recover hundreds of thousands of dollars.

Identifying Employee Fraud

A big part of my role as counsel is helping dealerships recognize the signs of potential fraud. Having management staff who are well trained is the first step in preventing fraud at all levels and in all forms. Here are some common indicators:

- **Behavioural Changes:** Employees exhibiting unusual behaviour—such as excessive secrecy, changes in work habits, or high levels of defensiveness—may be engaging in dishonest activities.
- **Financial Irregularities:** Discrepancies in financial records, such as unexplained cash shortages or unapproved expenses, should be closely examined.
- **Lifestyle Changes:** Rapid changes in an employee's lifestyle, such as acquiring expensive assets, may signal that they are living beyond their means due to fraudulent activities.



• **Complaints from Customers**

or Vendors: Frequent customer complaints regarding financial transactions can hint at fraudulent behaviour.

• **Increased Absenteeism:** Employees committing fraud may take unexpected sick days or use vacation time irregularly.

Preventing Employee Fraud

While it is impossible to completely eliminate the risk of fraud, dealerships can take several proactive measures to minimize it:

1. Implement Strong Internal

Controls: Establishing and enforcing strict internal controls - such as dual signatures for transactions and regular audits - can significantly reduce the risk of fraud.

2. Conduct Background Checks:

Perform thorough background checks during the hiring process. Knowing an employee's past can help mitigate future risks.

3. Encourage Reporting:

Create a company culture that encourages employees to report suspicious behaviour. Establishing anonymous reporting channels can help employees feel safe voicing concerns without fear of retaliation.

4. Regular Training and Awareness

Programs: Regularly educate employees about fraud, its impacts, and detection methods. Awareness can create a vigilant workforce.

5. Fraud Risk Assessments: Conduct periodic fraud risk assessments to identify vulnerabilities within the organization and address them proactively.

6. Utilize Technology: Implementing advanced software and analytics can help identify unusual patterns in financial transactions, flagging potential fraud for review.

7. Create a Clear Fraud Policy:

Documenting a clear written policy regarding fraud, along with consequences for dishonest behaviour, helps to deter potential fraudsters.

Conclusion

Fraud, maybe now more than ever, is a critical issue for businesses in Ontario and across Canada.

By understanding its indicators and implementing preventive measures, dealerships can protect themselves against financial losses and damage to their reputation – as well as repercussions with OMVIC. These issues not only affect company finances but can also damage workplace



morale and reputation. It's crucial for dealerships and dealer principals to recognize the indicators of employee fraud and implement effective strategies for prevention.

Continuous vigilance, education, and robust internal controls are key to creating a fraud-resistant workplace culture.

Justin is a Partner with Fogler, Rubinoff LLP and is recognized by the Law Society of Ontario as a Specialist in Civil Litigation – most importantly, he loves cars and the automotive industry, representing auto clients throughout Canada.

This article is intended for general information purposes only and should not be relied upon as legal advice. Views and opinions are Justin's alone and do not necessarily represent the views and opinions of the UCDA or Fogler, Rubinoff LLP. ■



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