

1993

Automobile Finance, Warranty, and Insurance Extras: What the Consumer Should Know and How an Attorney Can Attack the Deceptive Practices

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Recommended Citation

Daniel G. Deneen *Automobile Finance, Warranty, and Insurance Extras: What the Consumer Should Know and How an Attorney Can Attack the Deceptive Practices*, 6 Loy. Consumer L. Rev. 5 (1993).

Available at: <http://lawcommons.luc.edu/lclr/vol6/iss1/3>

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Lead Articles

Automobile Finance, Warranty, and Insurance Extras: What the Consumer Should Know and How an Attorney Can Attack the Deceptive Practices

by Daniel G. Deneen

I. INTRODUCTION

Buying a car is usually one of the largest capital expenditures most consumers make, second only to buying a home. Despite its significance, consumers usually do not have an attorney scrutinizing their car purchases to ensure that an automobile dealer has treated them fairly. While consumers in recent years have become more savvy about the tricks of car dealers, most consumers are still relatively unaware of how dealerships profit from automobile finance, insurance, and warranty arrangements. By convincing a car buyer to use their financing or buy extra insurance and warranties, automobile dealerships can add hundreds or even thousands of dollars to their profits.

While consumers in recent years have become more savvy about the tricks of car dealers, most consumers are still relatively unaware of how dealerships profit from automobile finance, insurance, and warranty arrangements.

The problem is that these finance, insurance, and warranty deals can be confusing, complex arrangements that generally do not violate traditional common or statutory law. As a result, the consumer law attorney trying to make a claim against a car dealership must be creative, drafting the pleadings to allege as many legal theories for recovery as possible. This article outlines for the consumer and her attorney how some of these complex finance, insurance,

and warranty arrangements work and how an attorney can attack those practices for the benefit of her client.¹

The problem is that these finance, insurance, and warranty deals can be confusing, complex arrangements that generally do not violate traditional common or statutory law.

As a general legal principle, a dealership has not defrauded a buyer if the consumer pays more than she "should" have for an automobile, unless the dealer made fraudulent misrepresentations to entice the consumer to buy the car. The usual dealership tricks, such as personnel shuffling and loaded suggestions such as "this car won't be here tomorrow" or "we have another customer coming in this afternoon," are generally not actionable. Additionally, dealerships often pad their profits with "add-ons," such as rustproofing. While these services can be overpriced, a consumer does not usually have a cause of action arising from the purchase of these services.

II. FINANCE, WARRANTY AND INSURANCE OPERATIONS AND REPRESENTATIVE DECEPTIVE PRACTICES

A. Finance

Many consumers finance automobile purchases through installment contracts or leases. Consumers should shop around for independent credit sources such as banks or credit unions

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prior to purchasing an automobile. The pre-purchase search for a proper credit source should assist consumers in determining the dollar amount they can realistically afford to spend for an automobile. Lenders can also provide some guidance as to the price consumers should pay for a particular model and the approximate wholesale value of the consumer's trade-in vehicle.

If the customer has not obtained independent financing, automobile dealerships will assist the customer with financing. Dealerships have access to financing through lending institutions as well as financial affiliates of automobile manufacturers. In many instances, manufacturers offer very low rates through financial affiliates if customers can meet special conditions. Even a two percent difference (eight percent instead of ten percent) in interest rates on a \$15,000 automobile loan for forty-eight months will save consumers \$14.25 per month (\$366.19 instead of \$380.44), or \$684.00 over the course of the loan.

If financing is not procured at special rates provided by an affiliate of the manufacturer, dealerships can "sell" executed installment contracts to lending institutions or manufacturers' affiliates at a "buy rate" that varies as interest rates rise and fall. If an automobile dealership convinces a consumer to sign an installment contract for more than the "buy rate," the difference in the net present value between the contracted payment amount and what would have been the payment amount under the "buy rate" is transferred to a "dealer reserve account."

Using the previous example, if a dealership convinced a consumer to sign an installment contract calling for ten percent interest and "sold" the contract to a bank at a "buy rate" of eight percent, its "dealer reserve account" would be credited with \$583.50 at the time of sale, which is the net present value of \$684.00 discounted at eight percent. If the installment contract is subsequently paid off by the buyer, either when the automobile is traded or

after forty-eight months of payments, the \$583.50 in the reserve account is released to the dealer.

Dealerships do not inform a car buyer that she will be paying additional funds each month to a lender to compensate the lender for the payment to the "dealer reserve account." The greater the difference between the "buy rate" and the percentage rate on the installment contracts signed by the consumer, the larger the undisclosed windfall to the dealership.

In recent years, leasing an automobile has become a popular alternative to financing the purchase of a car. Dealerships often use the same tactics to profit from leasing transactions as they do to profit from financing arrangements. Lease payments are calculated based upon the sale price of the vehicle, the lease period, the value of the vehicle at the end of the lease period, and an internal interest rate. Before signing a lease, consumers should always insist that leasing agents, whether they are private lending institutions or dealerships, disclose all of the above factors. As with financing, consumers should make sure that the automobile dealerships do not profit by arranging a lease at an internal interest rate higher than that offered on the market. Otherwise, the lease arrangement could be very profitable to the dealership.

B. Service Contracts

Dealerships offer to sell service contracts, extended warranties, or customer service insurance to supplement standard manufacturers' warranties or to replace manufacturers' warranties when they expire. For simplicity, this article will collectively refer to these arrangements as service contracts.

In theory, service contracts are beneficial because they can provide peace of mind for the consumer by covering most of the cost of expensive repairs. During the service contract period, the consumer does not have to pay more than a deductible amount, no matter how costly the repairs. Although the

overall quality of automobiles is improving, the shift to complex electronic equipment and the internationalization of the parts market has made the cost of repairs increasingly expensive. Electric windows, power seats, automatic antennas, electronic sensors, and other parts can cost an exorbitant amount to repair or replace. These items usually are not covered under the standard "drivetrain" warranty, which only covers the engine and transmission. Only "bumper to bumper" warranties cover all repairs, including ones to electronic

The conflict of interest surrounding service contracts in which the dealership retains a financial interest, either directly through a "special reserve account" or indirectly through "kick-backs" or rebates, is flagrant and blatant.

devices. Despite the benefits service contracts appear to confer upon consumers, some contracts also unnecessarily duplicate the manufacturers' express and implied warranties. Generally, as with the price of a car, an inflated price for a service contract cannot be recovered in a lawsuit.

However, consumers may be able to pursue a legal remedy if they buy a service contract not offered through the automobile manufacturer or a truly independent third-party. With this type of service contract, the dealerships give customers promotional brochures, which imply in subtle language that the service contract is issued by a nationwide, independent network. Administrators handle telephone calls and other claim reports from customers. But in reality, the administrator simply acts as a shell for the dealership. A certain amount of money is set aside in a reserve account to pay for future repairs.

If no or few repairs are made by the expiration of the service contract, the dealership receives the money held in reserve. Because the cost of any repairs must be transferred from the dealer's reserve account, the dealership has a financial incentive to refuse to make covered repairs or to minimize repair costs when a customer returns a car to a dealership with a problem. As a result, the customer could claim the dealership had a conflict of interest and engaged in deceptive practices as the basis for a cause of action under consumer protection laws.

For example, the Western Diversified Casualty Insurance Company (Western) has established an extended service contract network called "The Advantage Plus." Western provides dealerships with extended service contract price sheets for new and used vehicles based upon "class codes" for each make and model, with variables depending on mileage, deductibles, and coverage length. The contractual relationship allows the dealerships to charge whatever prices consumers are willing to pay for the contracts, provided that the listed price is forwarded to Western.

Whenever an aggrieved consumer has a repair that has been denied under a service contract, a consumer law attorney should always thoroughly investigate the service contract network to discover any undisclosed arrangements and conflicts of interest.

In a documented case², a customer paid a dealership \$399 for a 24 month/24,000 mile Advantage Plus extended service contract on a used Volkswagen Jetta with 30,000 miles. The dealership kept \$160 as straight profit and for-

warded \$239 to Western. Western retained \$55 for an "Excess Loss Premium" to insure the service contract and part as an administrative fee. The balance of the funds, \$184, was placed in a "Service Reserve" bank account in the dealership's name. If no repairs were necessary to the Jetta by the end of the service contract, the dealer would receive the \$184, provided the aggregate of its other service contracts did not exceed the balance of the dealer's service reserve account.

All service contract networks proceed on an assumption that a high percentage of service contract purchasers will return to the selling dealerships for repairs. Reportedly, some service contract networks provide a "kickback" if proper claim ratios are maintained by a dealership. Others provide compensation based upon a ratio of net claims to net sales.

The conflict of interest surrounding service contracts in which the dealership retains a financial interest, either directly through a "special reserve account" or indirectly through "kickbacks" or rebates, is flagrant and blatant. If a customer visited a dealership with a cracked gasket two weeks before the service contract expired, the dealership would have a financial incentive to make a temporary repair, such as putting a pint of sealant into the system, rather than to make a permanent repair, which would involve the costly replacement of the gasket. In contrast, when a dealership repairs a vehicle under a manufacturer's or truly independent warranty, the third party pays for the repairs and the dealership does not have an incentive not to make the proper repair.

In consumer litigation, the dealership and the administrator often both deny liability. As a result, whenever an aggrieved consumer has a repair that has been denied under a service contract, a consumer law attorney should always thoroughly investigate the service contract network to discover any undisclosed arrangements and conflicts of interest. Of course, as consumers and

their attorneys become more educated about how these service contracts work, new and even more ingenious ways in which dealerships can profit from the sale of service contracts will spring up like the heads of the mythical Greek serpent Hydra.

C. Credit Life and Disability Insurance

Dealerships also offer credit life and disability insurance policies, which can be a source of additional profits to the dealer. Under these policies, loan payments or outstanding loan balances are paid if a person becomes disabled or dies. While these policies do provide a benefit to the consumer, the cost of the policies offered through the dealerships are often quite high in relation to the small risk of death or disability. Further, if the loan is arranged through the dealership above the "buy rate," the profit to the dealership may be further increased. If the dealership claims that a consumer must purchase this insurance to obtain a loan, it has made a fraudulent misrepresentation, and the consumer would have a cause of action against the dealership.

III. CONSUMER RELIEF

The consumer law attorney must be every bit as resourceful at attacking finance, warranty, and insurance arrangements as automobile dealerships are at designing schemes to squeeze hundreds of dollars of extra profit out of consumers. As illustrated above, the tactics used by automobile dealerships are complicated, confusing, and generally do not openly violate commonly utilized areas of the law. To get through the courthouse door, the consumer law attorney must draft her pleadings to properly allege all legal theories for recovery. The facts should be set forth in the pleadings in such a manner that the dealer's conduct amounts to a breach of traditional common law theories, if possible. The complaint should also allege any possible violations of the Uniform Commercial Code, the Magnuson-Moss Warranty -- Federal

Trade Commission Improvement Act,³ and any applicable statutory consumer laws available in the jurisdiction.

The consumer law attorney must be every bit as resourceful at attacking finance, warranty, and insurance arrangements as automobile dealerships are at designing schemes to squeeze hundreds of dollars of extra profit out of consumers.

Consumers should expect defendants to file numerous motions to dismiss that appear to be valid on their face. Because Illinois and most other states allow alternate pleadings, attorneys should plead enough alternate theories to ensure that motions judges and defense attorneys understand that one of the parties will be found liable under one of the many theories set forth in the complaint. Although a judge could technically and properly dismiss one count, she probably will not dismiss all counts if the effect would be to deny the consumer plaintiff relief against all defendants solely because of the manner in which the defendants set up the transaction.

A. Traditional Methods of Recovery

Manufacturers often deny warranty claims to customers who try to revoke acceptance of defective automobiles even though legally, the consumers should be allowed to return the vehicle for a new one. Under Illinois' New Vehicle Buyer Protection Act, a consumer is entitled to return an automobile during the statutory warranty period⁴ after four or more unsuccessful attempts to repair a major problem or thirty business days in the repair shop.⁵ While other states have similar laws, not all provide as much protection as

the federal Magnuson-Moss Warranty Act. Therefore, consumer lawyers should advise clients stuck with "lemons" to proceed first with the non-binding arbitration process under this Act. If arbitration results are unsatisfactory, consumers may then file suit under the Magnuson-Moss Warranty Act to obtain appropriate relief.⁶

In the service contract area, consumer law attorneys should file suit against the dealership, the administrator, and against a joint venture comprising both of them if neither the dealership nor the administrator will assume contractual responsibility for the service contract. Agency law and third-party beneficiary law within the jurisdiction should be researched. The complaint should set forth the responsibilities of each party under all areas of the law.

The actual warranty documents (such as a warranty information booklet) may state, in convoluted language buried in definitions and other areas, that the dealership is actually the responsible party. If the consumer has not received this document until after the sale of the service contract, the language in this

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document should not be allowed to bar the suit if this fact was not disclosed to the consumer.⁷

The lengthy warranty information booklet is also likely to contain "magic language" inserted by the administrator's attorneys in an attempt to exculpate it from repairs. Warrantors

will often claim that consumer misuse or abuse caused a breakdown. The warrantors may also attempt to deny coverage if the consumer performed any self-repairs or did not document regular maintenance. As a rule of thumb, the hastier the "administrator" is to provide an excuse to deny repairs without complete examination of the circumstances, the more culpable the administrator or dealership is for the repair.

Additionally, consumers should consider withholding payments to the lender as a means of relief, as allowed under federal law.⁸ The rule allowing consumers to withhold payments, "was designed to preserve the consumer's claims and defenses and restore the right of nonpayment to the consumer by eliminating the creditor's holder-in-due-course status."⁹ The rule also "enables the consumer to assert defenses and, in some instances, claims against an assignee-creditor which could previously have only been asserted against a seller."¹⁰

B. Uniform Commercial Code Recovery

Section 2-711 of the Uniform Commercial Code (U.C.C.) can be used if the provider of a service contract does not honor the parties' agreement. Consumer law attorneys should argue that the service agreement should be considered a warranty under Section 2-313 of the U.C.C. Section 2-715 of the U.C.C. provides for the recovery of incidental and consequential damages, which would certainly include the cost of repairs, if repairs were not made. If there has been a breach of an express warranty, the Magnuson-Moss Warranty Act should be used as a supplement to the U.C.C. because of its more liberal remedies, which include compensation for the time and inconvenience of making repairs, as well as attorney fees.¹¹

Consumer law attorneys should also explore the possibility of filing a count based upon the tort of bad faith breach of contract.¹² Section 1-203 of the

U.C.C., which imposes an obligation of good faith in the performance of all contracts and warranties made under the U.C.C., might be used to pursue "bad faith" violations of the U.C.C. in the sale of an automobile or service contract. Case law in Illinois has adopted the implied covenant of good faith in every contract absent express repudiation.¹³

C. Equitable, Common Law and Statutory Consumer Fraud Relief

Common law and statutory equitable theories should also be explored. Attorneys should ask such questions as: Has there been an unjust enrichment? Can a constructive trust be imposed upon funds in the a dealer reserve account since the consumer was not made aware that the dealership was receiving extra funds? Can one of the parties be equitably estopped from a defense because of their prior conduct?

A common law fraud count might also be attempted. However, the pleading and proof requirements for this theory are quite burdensome.¹⁴ In contrast, Illinois' Consumer Fraud and Deceptive Business Practices Act (Act) affords broader consumer protection than the common law action of fraud. As the Illinois Appellate Court stated in the recent case of *Duran v. Leslie Oldsmobile, Inc.*: "The Consumer Fraud Act eliminated the requirement of scienter, and innocent misrepresentations are actionable as statutory fraud. ... Statutory fraud has been held to include misrepresentations of not only existing material facts, but of future promises. ... A plaintiff's diligence in ascertaining the accuracy of misstatements was also eliminated as an element of statutory fraud."¹⁵

Paragraph 2 of the Act proscribes not just false statements but "the use or employment of any deception, fraud, false pretense, ... misrepresentation or the concealment, suppression, or omission of any material fact."¹⁶ Paragraph 2 also proscribes the use or employment of any practice described in Section 2 of the Uniform Deceptive Trade Practices Act.¹⁷

The Uniform Deceptive Trade Practices Act has been adopted by at least twelve states. The prefatory notes to the Illinois Act state that an important provision of the Act is subsection 12 which proscribes conduct not specifically enumerated which "similarly creates a likelihood of confusion or of misunderstanding."¹⁸ The commentators further state that because the ingenious ways of the unethical businessman have usually been one step ahead of the law, this provision is essential in order to assure the objectives of the Act -- the enjoining of trade practices which confuse or deceive the consumer.¹⁹

In the service contract example, promotional brochures and salespersons' representations regarding the warranty create the likelihood of confusion or misunderstanding concerning the true party behind the extended service contract and appear to be actionable. An attorney should also use the Act if any of the salesperson's actions or the dealership's written materials are confusing.

If the dealer's overall scheme, as opposed to the dealer's actions specific to a particular consumer, are the gravamen for the action, a class action suit should be considered.

Illinois statutory law states that consideration should be given to the interpretations of the Federal Trade Commission (FTC) and the federal courts relating to Section 5(a) of the Federal Trade Commission Act.²⁰ In the financing "kickback" situation described previously, an FTC decision stated: "Purchasers should be specifically informed when a seller of an auto gains financially, i.e., receives a 'kickback', when he arranges the financing of an auto."²¹

As evidenced by the complex nature

of these claims, an attorney representing a client who has been duped by an automobile dealership has her work cut out for her. The courts have become more generous in awarding substantial damages for consumer fraud claims. For example, in *Totz v. Continental Du Page Acura*,²² the trial court awarded, and the appellate court affirmed, punitive damages of \$5,000 and attorney fees of \$17,625 on a compensatory damages claim of \$407.50. However, not all courts are as liberal when awarding damages. The *Totz* court reasoned that punitive damages were proper because the Consumer Fraud and Deceptive Business Practices Act placed the dealer on notice that failing to disclose a material fact with the intent that the buyer rely on the omission could result in legal action. In addition, the dealer's conduct was outrageous. Lastly, the substantial award for attorney fees was justifiable because the factual and legal issues involved in the case were complex.²³

D. Class Action Recovery

If the dealer's overall scheme, as opposed to the dealer's actions specific to a particular consumer, are the gravamen for the action, a class action suit should be considered. Consumer law attorneys should cite trial courts to the case of *Eshaghi v. Hanley-Dawson Cadillac Co.*²⁴ in motions to certify for class action suits. The *Eshaghi* court stated :

[T]he consumer class action is an inviting procedural device to cope with frauds causing small damages to large groups. The slight loss to the individual, when aggregated in the coffers of the wrongdoer, results in gains which are both handsome and tempting. The alternatives to the class action -- private suits or governmental actions -- have been so often found wanting in controlling consumer frauds that not even the ardent critics of class actions seriously contend that they are

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truly effective. The consumer class action, when brought by those who have no other avenue of legal redress, provides restitution to the injured, and deterrence to the wrongdoer.²⁵

IV. CONCLUSION

Automobile dealerships will continue to use a multitude of schemes in attempting to pry hundreds or even thousands of extra dollars from a consumer's purchase of a car. When a dealership has practiced fraud or deception to achieve extra profit to the detriment of consumers, the dealership should be attacked aggressively and relentlessly by a consumer law attorney. The attorney should use multi-count actions and discovery, which may reveal questionable business practices by the dealership. Further, the attorney should also explore the possibility of class action litigation.

The consumer law attorney must be selective in the cases she takes since the opponents will always be prepared to offer great resistance and the litigation will be lengthy and difficult. However, appropriate financial compensation is available as illustrated by the *Eshaghi* and *Totz* cases mentioned above.

More importantly, the successful litigant in consumer law litigation receives the personal satisfaction of having suc-

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ceeded in the face of difficult opposition for the benefit of a good cause. ♦

ENDNOTES

- ¹ For a more extensive article on consumer remedies, see Andy Norman, *Lemon Law Cases: What Lawyers for Consumers Should Know*, 80 ILL. BAR J. 392, 399 (1992); *The Sour Truth About Lemon Laws*, CONSUMER REP., Jan. 1993, at 40.
- ² *Radford v. Western Diversified Servs., Inc.*, No. 90-LM-279 (Ill. Cir. Ct. filed 1990). This case was settled by the parties and dismissed by the McLean County Circuit Court.
- ³ 15 U.S.C., § 2301 *et seq.* (West 1992).
- ⁴ The "statutory warranty period" is defined as one year or 12,000 miles, whichever occurs first after the date of the delivery of a new vehicle to the consumer who purchased it. 815 ILL. COMP. STAT. 380/2 (West 1993).
- ⁵ 850 ILL. COMP. STAT. 380/1 *et seq.* (West 1993).
- ⁶ See *supra* note 3.
- ⁷ See *Session v. Chartrand Equip. Co.*, 479 N.E.2d 376 (Ill. App. Ct. 1985), and other cases cited in Roger D. Billings, Jr., *Handling Automobile Warranty and Repossession Cases*, § 6.35 (2d ed. 1992), disallowing disclaimers of warranties if the disclaimers conflict with express oral warranties.
- ⁸ See 16 C.F.R. § 433.2 (1992); see also *Ford Motor Credit Co. v. Morgan*, 536 N.E.2d 587 (Mass. 1989).
- ⁹ *Felde v. Chrysler Credit Corp.*, 580 N.E.2d 191, 196 (Ill. App. Ct. 1991), *cert. denied*, 587 N.E.2d 1013 (1992).
- ¹⁰ *Id.*
- ¹¹ See *supra* note 3, §2310.
- ¹² See Marvin F. Milich, *The Evolution of the Tort of Bad Faith Breach of Contract: Current Trends and Future Trepidation*, 94 COM. L.J. 418 (1989).
- ¹³ *Washburn v. Union Nat'l Bank & Trust Co.*, 502 N.E.2d 739, 743 (Ill. App. Ct. 1986).
- ¹⁴ In Illinois, the elements of common law fraud are: (1) a statement by defendant; (2) of a material nature as opposed to opinion; (3) that was untrue; (4) that was known or believed by the speaker to be untrue or made in culpable ignorance of its truth or falsity; (5) that was relied on by the plaintiff to his detriment; (6) made for the purpose of inducing reliance; and (7) such reliance led to the plaintiff's injury. In addition, such reliance must be

reasonable. *Duran v. Leslie Oldsmobile, Inc.*, 594 N.E.2d 1355, 1360 (Ill. App. Ct. 1992).

- ¹⁵ *Id.* at 1360-61.
- ¹⁶ 815 ILL. COMP. STAT. 505/2 (West 1993).
- ¹⁷ *Id.*
- ¹⁸ 815 ILL. COMP. STAT. 510/2 (West 1993).
- ¹⁹ *Id.*
- ²⁰ 815 ILL. COMP. STAT. 505/2 (West 1993).
- ²¹ *In re Peacock Buick, Inc.*, 86 F.T.C. 1532, 1546.
- ²² *Totz v. Continental Du Page Acura*, 602 N.E.2d 1374 (Ill. App. Ct. 1992).
- ²³ *Id.* at 1386-87.
- ²⁴ *Eshaghi v. Hanley Dawson Cadillac Co.*, 574 N.E.2d 760 (Ill. App. Ct. 1991).
- ²⁵ *Id.* at 766. See also J. Landers, *Of Legalized Blackmail and Legalized Theft: Consumer Class Actions and the Substance-Procedure Dilemma*, 47 SO. CAL. L. REV. 842 (1974).

Announcements

Coupon Clipping Worth the Effort

Many shoppers are finding that coupon clipping is worth the effort. Shoppers redeemed a record 7.7 billion coupons last year, saving \$4.5 billion, according to figures from coupon processor NCH Promotional Services.

Coupon clipping is not for everyone, however. A recent study published in the *Journal of Consumer Studies and Home Economics* showed that 40 percent of consumers did not reap savings at least equal to the cost of their time.

Those who do clip coupons maintain that the habit does not have to be time-consuming. By finding stores that double or triple coupons, starting a coupon exchange, and scouting the best coupon sources, shoppers can save money and save time.