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Under the microscope: A brief history of UDAP laws and predictions for post-Dodd Frank developments

*By Jeffrey Naimon, Kirk Jensen and Joshua Kotin**

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Beginning in mid-2011, the newly created Consumer Financial Protection Bureau will lead federal efforts to regulate financial products. As it assumes its responsibilities, the CFPB may be faced with the advocacy community's criticisms of UDAP laws, including claims that industries are inappropriately exempted (*e.g.*, insurance and utility companies), and that some state UDAP laws prohibit recovery of attorneys' fees in private lawsuits. UDAP laws, having evolved over more than 80 years, are likely to evolve again as interpreted by the CFPB.

This article reviews the history of UDAP from its antitrust origins to today's consumer protection focus, and outlines the Federal Trade Commission's test for unfair trade practices. The authors believe UDAP's history is not yet entirely written and that the CFPB will increasingly apply UDAP law in the consumer protection arena. To prepare for renewed UDAP enforcement, consumer financial service providers must make knowledge of, and compliance with these laws, their highest priority.

UDAP's antitrust beginnings

The 1914 FTC Act created the Federal Trade Commission. Monopolies were the primary focus of the law because, despite the previous period of trust-busting, monopolies continued. Indeed, in 1911, the U.S. Supreme Court decided *Standard Oil Co. v. United States*, which Congress felt gutted the Sherman Act and cleared the way for monopolies to thrive.

Sensing that more protections were needed for commercial competition, Congress acted not to protect consumers from predatory business practices, but to protect the public from the effects of monopolies. The goal of the FTC, according to Sen. Francis G. Newlands of Nevada, who drafted the Senate's report, was to create a third-party entity to overcome the problems inherent in unbridled competition and the freedom to contract.

While the FTC Act's counterpart — the Clayton Act — clearly defined the practices it prohibited, The FTC Act left undefined the term "unfair competition." The Senate report said there were too many unfair practices to define, and "after writing 20 of them into law it would be quite possible to invent others."

The Clayton and FTC Acts also differed in the remedies available. Where the Clayton Act allowed private parties to enforce its clear standards through litigation, Congress did not entrust the FTC Act's amorphous standard to private litigants. To avoid trivial litigation, Congress gave the FTC the power to enforce this standard and stop unfair competition, giving the agency discretion in this regard. In keeping with its antitrust goals, Section 5 of the FTC Act did not authorize the FTC to seek monetary damages, but only corrective measures to restore competitive balance.

The move to direct consumer protection

Responding to the FTC's difficulty in demonstrating harm under the initial FTC Act standard, Congress in 1938 enacted the Wheeler-Lea amendments. These shifted the FTC's focus from protecting consumers by avoiding monopoly to protecting consumers from deceptive advertising practices and other forms of consumer fraud. Section 5 of the FTC Act was amended to cover not only unfair methods of competition, but also unfair or deceptive acts or practices.

According to 1937 House Report No. 1613, new Section 5 enabled the Commission to "prevent such acts or practices which injuriously affect the general public as well as those which are unfair to competitors. In other words, this amendment makes the consumer, who may be injured by an unfair trade practice, of equal concern, before the law, with the merchant or manufacturer injured by the unfair methods of a dishonest competitor." While legislation explicitly brought consumer protection under the FTC, it maintained the FTC as the sole enforcer of the UDAP standard.

The road to modern UDAP

In the decades after the Wheeler-Lea Amendments, the boundaries of what constituted "unfair" acts or practices were shaped both in the courts and through FTC enforcement decisions. The definition eventually crystallized — albeit temporarily — with the Supreme Court's 1972 decision in *FTC v. Sperry & Hutchinson Co.* In *Sperry*, the Court rejected prior case law that attempted "to fence in the grounds" on which the FTC could find an act or practice unfair. It adopted a three-pronged test of whether an act or practice is unfair. The FTC would examine whether the act or practice: offends public policy or, in other words, is within at least the penumbra of some common law,

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Guest Commentary

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statutory or other established concept of unfairness; is immoral, unethical, oppressive or unscrupulous; or causes substantial injury to consumers.

In 1980, eight years after receiving its broad mandate, the FTC adopted a narrower interpretation in its *Policy Statement on Unfairness*. (*See* ftc.gov/bcp/policystmt/ad-unfair.htm.) Claiming to "refine" the *Sperry* standard, the FTC adopted its own three-pronged test to determine when it would find an act or practice unfair. That test retained the requirement that the act cause substantial injury and also required that the injury not be outweighed by any offsetting consumer or competitive benefits produced by the act or practice.

The third prong — that consumers themselves must not have been able to reasonably avoid the act or practice — reflects the agency's view that consumer choice ("the ability of individual consumers to make their own private purchasing decisions without regulatory intervention") should govern the market, unless sales techniques themselves prevent consumers from making free choices, hinder those choices, or unduly influence susceptible consumers.

The final statutory change occurred in 1994 when Congress codified the FTC's policy statement. However, while the FTC policy statement suggested that the Commission should sparingly rely on public policy as an independent ground for determining an act or practice to be unfair, Congress plainly stated that "public policy considerations may not serve as a primary basis for such determination."

State UDAP laws

Every state has laws prohibiting unfair and deceptive trade practices. States began enacting these laws in the 1960s, although it was really after the 1964 issuance of the Uniform Deceptive Trade Practices Act and the 1967 unveiling of the Model Unfair Trade Practices and Consumer Protection Law, that states rapidly began enacting consumer protection laws.

The key to understanding state UDAP laws is to look at what their plain language prohibits. There are two crucial differences between the FTC Act and state "mini FTC Acts," as they are sometimes called.

The first lies in the ability of the consumer, under state law, to enforce the law through the private right of action — in other words, the consumer's ability to sue for injury.

The second important difference is that some courts interpreting state UDAP statutes will analyze the scope of "unfairness" under the *Sperry* standard rather than the codified standard contained in the FTC Act. Although this is not true for every state, adoption of the *Sperry* standard allows courts to interpret unfairness more broadly.

UDAP's application in a post-Dodd Frank world

Today, federal banking agencies hew to the 1980/1994 standard for both unfair and deceptive practices. Charged with prescribing specific regulations defining unfair or deceptive acts or practices and adopting requirements to prevent such acts or practices, they have issued guidance outlining their treatment of unfair practices and deceptive practices. While such guidance outlines the agencies' official views, today's challenging financial environment has led to greater utilization of UDAP powers in enforcement and legislative/regulatory contexts. Bank regulatory officials have hinted at this possible shift.

April Breslaw, director of consumer regulation at the Office of Thrift Supervision, has stated: "Federal consumer protection laws are very robust, but they don't cover everything. That's when UDAP analysis can begin." Timothy Burniston, senior associate director within the Federal Reserve Board's division of consumer and community affairs, has stated that the rise in UDAP "reflects the fundamental shifting between what has been called 'consumer compliance' and what is now called 'consumer protection.'"

On the legislative/regulatory side, the Fed twice recently utilized its UDAP regulatory powers rather than more traditional Truth-In-Lending Act powers. The first time was in the context of the Home Ownership and Equity Protection Act; the second, in credit card regulation. Those actions were subsequently codified in the 2009 Credit CARD Act, and then, in the comprehensive 2010 Dodd Frank Act.

The ongoing financial and housing crisis may lead to additional federal and state UDAP enforcement. For example, in September and October 2010, many state attorneys general began reviewing hasty procedures in the execution of foreclosure filings by agents for mortgage lenders as potential unfair and deceptive practices.

Enter the CFPB

The most important developments in the UDAP arena may spring from the Consumer Financial Protection Bureau. The CFPB comes into full existence on July 21, 2011 with complete power to regulate and take enforcement action against unfair, deceptive, and abusive acts or practices related to consumer financial products or services.

It is premature to speculate on the CFPB's policy focus or enforcement approaches, but the FTC's 1980 policy statement on consumers "mak[ing] private purchasing decisions without regulatory intervention" will not likely drive the CFPB's agenda. Post-Dodd Frank, a government entity will focus squarely on the products offered by financial institutions and their distribution to consumers.

Moreover, providers subject to CFPB regulation must mind how the CFPB defines abusive acts. Abusive acts will include those that "materially interfere with the ability of a consumer to understand a term or condition of a consumer financial product." They will also include instances where an actor takes unreasonable advantage of: a lack of consumer understanding of the material risks, costs, or conditions of the product or service; the consumer's inability to protect his own interests in selecting or using a financial product or service; or the consumer's reasonable reliance on a covered person to act in his interests.

Although the FTC and CFPB will share UDAP duties, the CFPB will play a leading role in regulating financial products. With UDAP laws as a flexible enforcement tool, the law of unfair and deceptive practices is bound to figure prominently in future consumer protection efforts. ❑

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Consumer Financial Services

LAW REPORT

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Fair Debt

Inflated proof of claim in bankruptcy provides no basis for FDCPA claim

An appellate court has concluded that a proof of claim filed in a bankruptcy proceeding cannot form the basis for a claim under the Fair Debt Collection Practices Act. The court of appeals affirmed the dismissal by the court below of a consumers' class action claim that a creditor's inflated proof of claim violated the FDCPA by misrepresenting the amount of the consumers' debt. (*Simmons v. Roundup Funding, LLC, et al.*, No. 09-4984-cv (2d Cir. 10/05/10).)

Roundup Funding LLC filed a proof of claim for a $2,039 debt allegedly owed by Lamont and Melissa Simmons, who were seeking bankruptcy protection. The Simmons objected and Roundup's counsel, Malen & Assocs., filed an objection. The bankruptcy court reduced Roundup's claim to $1,100, the amount that they agreed they owed.

The Simmons brought a putative class action, claiming that Roundup's inflated proof of claim violated the FDCPA at 15 USC § 1692e(2)(A) because it allegedly misrepresented the amount of the debt owed by the consumers. Roundup and Malen each moved to dismiss. The District

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Class Action

Appeals court orders 2nd take on FACTA class certification denial

Neither potential liability disproportionate to the harm suffered nor the enormity of potential damages — or even the defendant's prompt good-faith compliance with the Fair and Accurate Credit Transactions Act's receipt truncation provision — warranted a District Court's denial of class certification to a moviegoer, said a federal appellate court. (*Bateman v. American Multi-Cinema, Inc.*, No. 09-55108 (9th Cir. 09/27/10).)

"We agree that none of these three grounds ... justified the denial of class certification on superiority grounds and that the District Court abused its discretion in relying on them," wrote Circuit Judge Richard A. Paez for the 9th U.S. Circuit Court of Appeals' three-judge panel. "We therefore reverse the denial of class certification and remand for further proceedings."

What eventually turned into a two-reel legal feature began when an automated box office at one of American Multi-Cinema Inc.'s movie theaters provided Michael Bateman with an electronically printed receipt that included both the first four and last four numbers of his debit or credit card account number. Bateman, alleging that such receipts violate FACTA's receipt truncation provision allowing no more than the last five digits to appear on receipts, filed a putative class action. Bateman,

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INSIDE

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