What Does It All Mean?

"Abusive" Acts or Practices and the CFPB

Written Submission for CFPB Symposium on "Abusive"

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The statutory prohibition on "abusive" acts or practices in the Dodd-Frank Act leaves substantial discretion in the hands of the CFPB. Although the statute provides some criteria for a practice to be found abusive, the term has little statutory and legislative history to identify the kinds of practices that Congress thought this authority was needed to reach. By its nature, the term is both amorphous and elastic, and can potentially be stretched to cover many innocuous practices that occur in highly competitive markets.. As a result, the Bureau is considering whether to engage in rulemaking to define the term more specifically.[1] I first address the merits of clarification, and then the substance of what abusive practices should cover.

The CFPB Should Clarify the Meaning of Abusive

In 1938, Congress enacted the Wheeler Lea Amendments to the Federal Trade Commission Act. Those amendments added the prohibition on "unfair or deceptive" acts or practices that is the core of the Federal Trade Commission's consumer protection authority.[2] Neither term was defined; their meaning was left for the Commission to determine in the cases it chose to pursue. Indeed, the legislative history reflects a conscious decision not to define the terms because of the fear that inventive con artists would always be able to develop new schemes that would not fall within any set of practices that might be specifically identified as unfair or deceptive.[3]

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[1] CFPB, Spring 2019 Regulatory Agenda, RIN 3170-AA88, Mar. 6, 2019.

[2] Wheeler-Lea Amendment of 1938, Pub. L. No. 75-447, 52 Stat. 111, Codified as amended at 15 U.S.C. § 45. Originally, the statute prohibited only "unfair methods of competition." Nonetheless, the Commission pursued many cases that would today be thought of a consumer protection cases under this authority.

[3] *See* WHEELER-LEA AMENDMENTS, LEGISLATIVE HISTORY 107 (1938) (as compiled by the FTC library). According to Senator Wheeler, "[t]he trouble is it is difficult to give specific definitions in a case of this kind. . . . You cannot set forth a definition which will include all unfair acts and practices." *Id*. (U.S. Senate Committee on Interstate Commerce proceeding to amend the FTC Act, Mar. 3, 1936).

This state of affairs persisted for more than forty years. Until 1980, the Commission gave content to the statutory language of unfairness and deception by filing administrative litigation. The contours of these terms were defined by the cases the Commission filed in the exercise of its prosecutorial discretion and by the Commission's (and the courts') discussion of the alleged violation in their decisions. Then, in a relatively short period of time in the early 1980s, the Commission adopted separate policy statements addressing first its authority over unfair practices[4] and then its authority over deceptive practices.[5] Each policy statement clarified and refined the legal standards that the Commission would apply, and each narrowed the range of the Commission's discretion. In their own ways, each statement had a substantial impact on the development of the law, and enhanced the agency's effectiveness and focus on its mission.

The choice between the creation of specific rules and discretionary standards is a recurring theme in the law. In torts, for example, courts have considered the choice between an open-ended "reasonable person" standard for negligence, and the creation of specific rules, such as the doctrine of negligence per se or the "stop, look and listen" rule for railroad crossings.[6] In constitutional law, the firm rule of *Miranda*[7] replaced an open-ended inquiry into whether confessions were really voluntary.[8] In antitrust, the issue is the proper domain for application of rules of per se illegality versus the more open-ended rule of reason inquiry.[9] The tradeoffs between rules and standards have long been recognized, and have spawned a considerable literature.[10] Standards, too, can differ in their specificity, directing the decision maker to particular elements of a violation or leaving room for a broader consideration of potentially relevant factors.

Unsurprisingly, administrative agencies generally prefer broader and more discretionary standards to the strictures that defined rules impose, and the CFPB's approach to abusive practices has been no different. Discretionary standards allow more flexibility, and because agencies never know what choices they may wish to make at some future time, they are traditionally reluctant to foreclose options. Agencies are comfortable with an open-ended legal standard, even if it is a little vague, because it leaves open the possibility of future changes and reduces the risk that the agency's determinations will be reversed by the courts, particularly when the agency's interpretation is entitled to some measure of judicial deference. Moreover, if

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[4] *FTC Policy Statement on Unfairness*, Appended to *In the Matter of International Harvester Co.* ("Unfairness Policy Statement") 104 F.T.C. 949 (1984) (Docket No. 9147), *available at* http://www.ftc.gov/bcp/policystmt/ad-unfair.htm.

[5] Deception Policy Statement, appended to *In the Matter of Cliffdale Associates, Inc.*, 103 F.T.C. 110 (1984), *available at* http://www.ftc.gov/bcp/policystmt/ad-decept.htm.

[6] *See* Baltimore & Ohio R.R. v. Goodman, 275 U.S. 66 (1927); *cf.* Pokora v. Wabash Ry., 292 U.S. 98 (1934) (limiting *Goodman* because of "the need for caution in framing standards of behavior that amount to rules of law").

[7] Miranda v. Arizona, 384 U.S. 436, 467-77 (1966).

[8] *See* Brown v. Mississippi, 297 U.S. 278, 285 (1936).

[9] *See, e.g.*, NCAA v. Board of Regents of the University of Oklahoma, 468 U.S. 85, 100 (1984) (applying rule of reason to joint venture's agreement to limit output that would otherwise be condemned as per se unlawful).

[10] See Section 20.3 in Richard A. Posner, Economic Analysis of Law, 6th Ed. (Aspen Law and Business, 2003). See also Louis Kaplow, Rules vs. Standards: An Economic Analysis, 42 Duke L.J. 557 (1992), and Colin Diver, The Optimal Precision of Administrative Rules, 93 Yale L.J. (1983).

the standard encompasses too much, agencies can always use prosecutorial discretion to avoid bad cases or pointless cases. A broad standard is particularly attractive for a prosecutorial agency like the CFPB, as it was for the FTC for most of its history. A legal standard that says, in the extreme, the prosecutor always wins has obvious advantages for the prosecutor. Any relevant factors that the law does not require the agency to prove can always be addressed in deciding whether to bring a particular case.

Despite their advantages for the prosecutor, there are both internal and external trade-offs when choosing broad general standards instead of offering more explicit guidance. Externally, the trade-off is over deterrence of conduct that could be found illegal under the broad or vague standard even though it is socially desirable.[11] Some socially beneficial conduct is inevitably deterred even though an agency would never have brought a case.

By its nature, overdeterrence is difficult to demonstrate. It is hard to prove that but for legal uncertainty, a company may have undertaken a particular course of conduct.[12] Nevertheless, concern about overdeterrence – the chilling effect – is a central feature of First Amendment jurisprudence.[13] Overdeterrence as a result of the uncertainty surrounding the meaning of abusive is most likely where the CFPB has used it most often, in addressing "fringe" financial services such as payday loans, auto title loans, and check cashing services. That corner of the financial services industry is one where consumers would likely benefit the most from innovative new products and services. Overdeterrence of beneficial practices could have its worst effects on the credit-challenged consumers who turn to these products.

A more serious consequence of an overly broad legal standard is internal: a lack of focus on the part of the agency's staff. The legal standard not only informs the private sector about what is permissible and what is not, it also directs the staff as to what kind of conduct they should seek to challenge. By giving enforcers discretion to investigate any case, a broad standard may lead them to spend scarce resources challenging conduct that may violate the standard but is unlikely to cause harm. If the law permits the agency to challenge anything, it is much more difficult to rule out bad ideas and direct resources to the problems that the agency really should be addressing. Moreover, the legal standard identifies the questions the staff needs to address in the course of an investigation. Questions that do not have to be answered to establish the illegality of the conduct may be questions that are never seriously considered, even if they are very important questions to address. If the legal standard fails to require the staff and higher level reviewers to address the important questions, they can easily be overlooked.

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[11]An unclear legal standard will reduce the overall level of deterrence, because it will reduce the perceived likelihood that conduct will be found a violation. *See* Posner, supra note 10.

[12] In the context of concerns about the chilling effects of surveillance, there have been efforts to quantify overdeterrence. See Jon Penney, *Chilling Effects: Online Surveillance and Wikipedia Use*, 31 Berkeley Tech. L.J. 117 (2016).

[13]See, e.g., Thornhill v. State of Alabama, 310 U.S. 88 (1940). Similar concerns are present in the context of commercial speech as well. As one court noted in narrowing FDA regulation of health claims, the First Amendment embodies a "preference for disclosure over suppression. . . ." *Pearson v. Shalala*, 164 F.3d 650, 658 (D.C. Cir. 1999).

The history of unfairness at the FTC offers a cautionary tale in the dangers of unbridled discretion, both to regulated industries and to the agency itself. Initially, the unfairness prohibition was rarely used. In 1964, however, the Commission relied in part on unfairness to justify a rule that would have required disclosures of the health hazards of smoking.[14] The test the Commission developed examined three questions: whether the practice "offends public policy"; "whether it is immoral, unethical, oppressive, or unscrupulous"; or "whether it causes substantial injury to consumers."

Perhaps because of the hostile congressional reaction to the cigarette rule, the Commission initially made little use of the unfairness theory it had articulated. Then, in 1972, the Sperry &Hutchinson Co. case reached the Supreme Court. Although the Court reversed the Commission's decision, a footnote to the opinion appeared to bless the unfairness criteria articulated in the Cigarette Rule.[15]

The Commission took the Court's footnote as a legal blessing for a wide-ranging attack on *any* practice that might have *any* adverse effect on *any* consumer, and set up an internal task force to explore the limits of its authority. It launched numerous rulemaking proposals based on unfairness.[16] Among other things, these rules would have specified warranty terms and regulated warranty performance in the mobile home industry; required over-the-counter drug advertising to use precisely the same terms approved for labels; required detailed disclosures of the possible side effects of over-the-counter antacids; and, eventually, banned all advertising directed to children. These proposals routinely cited all three prongs of the unfairness test, with little clarity about which test was actually to be employed or which facts were critical to an ultimate decision to adopt or reject the rule.[17] Thus, factors prominent in one rulemaking were virtually ignored in others. The proposals themselves, particularly the children's advertising rulemaking, provoked a hostile political reaction. The Washington Post condemned the Commission as the "National Nanny" for the proposal, and Congress shut the agency down for several days by cutting off funding.[18]

The exploration of standardless unfairness in rulemakings in the 1970s was, in retrospect, a disaster for the Commission. The beckoning invitation in Sperry & Hutchinson for the FTC to become the second most powerful legislature in Washington proved irresistible. Enormous staff resources were devoted to projects that produced nothing of substance for consumers. The results of the Commission's forays into legislative activities revealed the necessity to develop a

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[14] Trade Regulation Rule on Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to Health Hazards of Smoking, 29 Fed. Reg. 8324, at 8355 (1964), withdrawn, 30 Fed. Reg 9485 (1965) (hereinafter referred to as Cigarette Rule).

[15] FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 244, n.5 (1972).

[16] The growth and demise of rulemaking at the FTC are discussed in Timothy J. Muris, Rules Without Reason: The Case of the FTC, AEI J. on G. Soc'y Reg. 20-26 (Sept./Oct. 1982).

[17] Theresa A. Schwartz, Regulating Unfair Practices Under the FTC Act: The Need for a Legal Standard of Unfairness, 11 Akron L. Rev. 1 (1977).

[18] Editorial, The Washington Post, (Mar. 1, 1978), reprinted in MICHAEL PERTSCHUK, REVOLT AGAINST REGULATION, THE RISE AND PAUSE OF THE CONSUMER MOVEMENT 69-72 (1982).

substantive theory of unfairness and direct the Commission and the staff's attention to practices that create real problems for real consumers.

To control the damage, the FTC in 1980 developed a policy statement on its unfairness jurisdiction that set limits on its authority. Reviewing the previous cases, the Commission concluded that a practice was unfair only if it caused substantial consumer injury, without offsetting benefits to consumers or competition, that consumers could not reasonably avoid.[19] The Policy Statement was adopted in a litigated case in 1984.[20] These elements were codified into the statutory definition of unfair practices that was enacted in 1994,[21] and is essentially the same as the definition of unfair practices in the Dodd-Frank Act.[22] Far from impeding the use of the prohibition on unfair practices, the Policy Statement and its subsequent codification enabled a rebirth of the use of unfairness to address a wide variety of practices that were not necessarily deceptive.[23]

The FTC's Deception Policy Statement was also highly effective in directing the agency, and its staff's, attention to the kinds of cases that were at the core of the consumer protection mission. Unlike unfairness, the Commission had developed an extensive, and expansive, body of law concerning deception. Read broadly, the case law gave the Commission the authority to do just about anything, based largely on its own extreme interpretations of advertising. The rule, known as the "fools test,"[24] subjected the Commission to withering academic criticism for many of its cases. Judges, however, deferring to the Commission's presumed expertise in interpreting advertising, allowed most of its decisions to survive review. This led to cases against a permanent hair dye because it would not color hair that had not yet grown out,[25] and another against a desktop encyclopedia that did not in fact contain "everything you ever wanted to know about every conceivable subject."[26] By the time the Deception Policy Statement was issued in 1983, the Commission had long since abandoned bringing cases based on the fools test, but it

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[19] Unfairness Policy Statement, *supra* note 4.

[20] *International Harvester*, 104 F.T.C. at 1070 (1984).

[21] 15 U.S.C. § 45 (n). The statutory definition also resolved the one open issue where the Policy Statement itself was ambiguous at best. Under the new definition, public policy constitutes simply one form of evidence that the Commission may consider in evaluating consumer injury. It cannot be used as an independent basis for finding a practice unfair. Relying on public policy is a particularly problematic form of unfairness analysis, because there are so many conflicting public policies from which the agency must choose. The issue is discussed at length in Timothy J. Muris and J. Howard Beales III, The Limits of Unfairness Under the Federal Trade Commission Act, (Association of National Advertisers, 1991).

[22] 12 U.S.C. § 5531(c)

[23] See J. Howard Beales III, "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection," 22 Journal of Public Policy and Marketing 192 (2003).

[24] The test is based on an early court opinion declaring that the Commission: "should have the discretion, undisturbed by the courts, to insist if it chooses "upon a form of advertising clear enough so that, in the words of the prophet Isaiah, 'wayfaring men, though fools, shall not err therein.'" Charles of the Ritz Distributors Corp. v. FTC, 143 F.2d 676, 680 (2d Cir. 1944), quoting General Motors Corp v. FTC, 114 F.2d 33,36 (2d Cir. 1940).

[25] *Clairol, Inc.*, 33 F.T.C. 1450 (1941)

[26] *National Committee for Education*, 39 F.T.C. 171 (1944).

had never clearly chosen which line of cases it believed it should follow. The Policy Statement did not explicitly disavow the early cases based on the fools test, but it articulated the legal standard in a different way, one consistent with the later cases, and one that emphasized the general meaning of the communication to ordinary consumers. Thus, the Policy Statement rejected the fools test. It held that a practice is deceptive if it is "likely to mislead consumers, acting reasonably in the circumstances, to their detriment."[27] Courts reviewing CFPB enforcement actions have adopted essentially this same definition of deception.[28] By emphasizing the reasonableness test that the Commission had used in its more recent line of cases, the Deception Policy Statement made it much more difficult to bring the kinds of cases that flourished in the heyday of the fools test.

The Deception Policy Statement has instead been the basis of a very strong, bipartisan consensus about what kinds of cases the FTC should be bringing. Consistent with the notion of greater internal focus discussed above, the Policy Statement was a clear directive to the staff about the kinds of cases it should be seeking.

The centerpiece of the Commission's consumer protection enforcement agenda since the adoption of the Deception Policy Statement has been aggressive actions in federal district court against a wide variety of fraudulent promotions. It has attacked fraud involving dietary supplements, weight loss products, advance fee loans, work at home schemes, pyramid schemes, and a variety of Internet frauds. In such cases, the meaning of the communication to consumers is clear, and it is false. Consumer injury is equally clear, and often substantial. The Commission had successfully obtained strong injunctive relief to prevent future violations, and secured substantial redress payments for consumers who were injured by the scams. The clear recognition in the Deception Policy Statement that the real test of the meaning of a claim is how consumers themselves understand it has been an important part of maintaining this focus. When claims are express, as in fraud cases, likely consumer understanding is clear, and convincing a court that consumers are likely misled is not particularly difficult.

What Does Abusive Mean?

The CFPB is authorized to prevent "unfair, deceptive, or abusive" acts or practices.[29] This is an expansion of the FTC's authority, which covers "unfair or deceptive" acts or practices. The Bureau's statute does not define deception, it defines unfairness in a manner virtually identical to the definition in the FTC Act. It also limits "abusive" to an act or practice that:

(1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
(2) takes unreasonable advantage of— (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or

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[27]Deception Policy Statement, appended to *In the Matter of Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984).

[28] See *Consumer Fin. Prot. Bureau v. Gordon, 819 F.3d 1179 (9th Cir. 2016)* (An act or practice is deceptive if: "(1) there is a representation, omission, or practice that, (2) is likely to mislead consumers acting reasonably under the circumstances, and (3) the representation, omission, or practice is material."

[29] 12 U.S.C. 5531 (a).

> service; (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[30]

Some have argued that these limitations do not include consideration of the costs and benefits of the practice.[31] Although costs and benefits are central to an unfairness theory, they are not mentioned in the limitations on abusive practices. Nevertheless, they should be a key feature of any analysis of what constitutes abuse.

First, in considering the statute as a whole, it would make little sense to empower the Bureau to enjoin an "abusive" act or practice if the injunction itself (or the required conduct) were an unfair act or practice. That would be exactly the situation, however, if an allegedly abusive practice created more benefits for consumers than the injury it might cause. The costs of eliminating the abusive practice are certainly an injury to consumers, and the offsetting benefits are the benefits of eliminating the practice itself. The injury is not reasonably avoidable, because in the presence of a CFPB order or rule, it is legally required. If the costs of the remedy exceed its benefits, the remedy itself is therefore an unfair practice. It is not a logically coherent reading of the statute to allow it to *require* one statutory violation in order to correct another.

Second, identifying abusive practices without regard to the benefits and costs of the practices is inconsistent with sound regulatory principles that have been endorsed by every President since Ronald Regan:[32] Agencies should regulate "only upon a reasoned determination that the benefits of the intended regulation justify its costs."[33] It would be particularly anomalous for a consumer protection agency to ignore the potential costs of its actions, because those costs are ultimately paid by consumers, either in the form of higher prices or reduced availability of valuable financial products and services.

Incorporating cost-benefit considerations is also consistent with the structure of the statute. Unfairness, after all, comes first in the list of practices the Bureau is authorized to stop. It is reasonable to construe unfair practices as the general category, with deceptive and abusive practices as (possibly overlapping) subsets of the general category.

In fact, that is the way the Federal Trade Commission has construed the relationship between unfairness and deception under the FTC Act, which prohibits "unfair or deceptive acts or practices." In International Harvester, the Commission considered the failure to disclose a particular safety risk under theories of both deception and unfairness. It concluded that on the facts of the case, the failure to disclose was unfair, but it was not deceptive. In discussing the relationship between the theories, the Commission wrote:

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[30] 12 U.S.C. 5531 (d).

[31] See e.g., Carey Alexander, Note: Abusive: Dodd-Frank Section 1031 and the Continuing Struggle to Protect Consumers, 85 St. John's L. Rev 1105 (2011).

[32] Executive Order 12291 (1981).

[33] Executive Order 12866 (1993).

The Commission s unfairness jurisdiction provides a more general basis for action against acts or practices which cause significant consumer injury. This part of our jurisdiction is broader than that involving deception, and the standards for its exercise are correspondingly more stringent. It requires the complete analysis of a practice which may be harmful to consumers. To put the point another way, unfairness is the set of general principles of which deception is a particularly well-established and streamlined subset.[34]

The Commission explained the reason for making this distinction as follows:

Deception is a particularly troublesome form of conduct. It is harmful to consumers, undermines the rational functioning of the marketplace, and, unlike some other practices we are called upon to review never offers increased efficiency or other countervailing benefits that must be considered. In view of deception s unalloyed negative qualities, the three elements of the deception analysis represent streamlined procedures adopted by the Commission to deal most effectively with such practices.[35]

The task of identifying actionable "abusive" practices should be, like the elements of deception, a search for criteria that identify practices that are always, or almost always, injurious in their net effects. Such practices can be addressed, whether in cases or in rules, using a set of criteria that are less demanding than the full cost-benefit analysis that unfairness requires.

One area where the concept of "abusive" practices may be particularly useful is where a seller takes advantage of either individual consumers or a well-defined subset of consumers who are known to have particular limitations. Sellers dealing with a consumer with known cognitive limitations, for example, who rely on disclosures and explanations suitable for the typical consumer, can easily be said to be engaged in an abusive practice. This use of abusive may be more appropriate in the context of examinations, rather than enforcement actions or rulemaking, because the examination context may be more able to identify discrete groups of consumers needing a higher level of protection.

The notion that some might not understand, or might not be able to protect their own best interests, however, cannot be generalized. There will *always* be some consumers who fail to understand a term, and a seller can arguably be said to take "unreasonable advantage" of the subset who does not fully understand the risks or has more limited ability. It is essential to also consider the interests of the broader population, however, where most consumers likely do have a reasonable understanding of the terms and risks of a transaction. Full consideration of the benefits and costs of a practice, and of potential remedies, is essential in such circumstances. Failure to do so will mean financial services are less available, or available on less reasonable terms for the ordinary consumers who make informed decisions about the alternatives that are best for them.

[34] International Harvester, 104 F.T.C. 949, 1060 (1984).

[35] Id. at 1056.

This was exactly the problem with the FTC's early deception jurisprudence. The attempt to require marketing communications that no one could possibly misunderstand made it far more difficult – and far riskier – for sellers to provide information about important property characteristics. This is where the overdeterrence problems discussed above are most likely to occur. As one commentator noted, "some sorts of messages must be either complex or noninformative. If complexity confuses, perhaps some confusion is acceptable."[36]

The provision of financial services is surely an area where some complexity is essential, and some misunderstanding is inevitable, if for no other reason than both sellers and consumers are dealing with predictions about uncertain future events. Some will be wrong, but those errors cannot justify denying others the benefits of open competition in the marketplace.

Conclusion

A clearer policy on the appropriate use of the statutory prohibition on "abusive" practices will necessarily limit the Bureau's discretion to some extent. That is exactly why it is a worthwhile endeavor. Clearer criteria reduce the risk of overdeterrence for legitimate businesses. More importantly, they direct staff attention and resources to pursuing the kinds of practices that should be the centerpiece of the Bureau's agenda: practices that impose significant costs on consumers, with few or no offsetting benefits. It is an effort well worth undertaking.

[36]George J. Alexander, Honesty and Competition: False Advertising Law and Policy under FTC Administration (1967) at 227.