“ABUSIVE” ACTS AND PRACTICES: TOWARDS A DEFINITION?

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Written Submission Prepared for CFPB Symposium on “Abusive”

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INTRODUCTION

The Consumer Financial Protection Act's prohibition on "abusive" acts and practices adds a new element to the traditional prohibition on "unfair or deceptive acts and practices" or UDAP.[1] The Consumer Financial Protection Bureau (CFPB) is empowered to promulgate regulations designating certain acts and practices unfair or deceptive acts or abusive, and the CFPB, federal prudential banking regulators, and state attorneys general are empowered to bring actions to enforce the Consumer Financial Protection Act's prohibition.

The Consumer Financial Protection Act contains a limitation on the CFPB's use of "unfair" and also of "abusive" (but not on the use of "deceptive"):

> **(c) Unfairness**
>
> (1) *In general.* The Bureau shall have no authority under this section to declare an act or practice in connection with a transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service, to be unlawful on the grounds that such act or practice is unfair, unless the Bureau has a reasonable basis to conclude that—
>
> (A) the act or practice causes or is likely to cause substantial injury to

[*] This invited written submission constitutes my current views on "abusive." My views are of course subject to change in light of further discussion and analysis.

[1] 12 U.S.C. § 5536(a)(1)(B).

consumers which is not reasonably avoidable by consumers; and

(B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition.

(2) *Consideration of public policies*. In determining whether an act or practice is unfair, the Bureau may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

(d) Abusive. The Bureau shall have no authority under this section to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless the act or practice—

(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 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.[2]

Despite this statutory language that provides clear boundaries for what the Bureau may do in terms of utilizing "abusive", the "abusive"

[2] 12 U.S.C. § 5531(c)-(d).

proscription's precise contours are not yet fully understood, not least because it has been seldom deployed by the Bureau, and almost never independently of "unfair or deceptive" charges. Nonetheless, in the face of claims that the new term is creating undue uncertainty for the business community, the Bureau is now considering a potential rulemaking to define "abusive."[3]

Proceeding in with a definitional rulemaking would be a mistake. As an initial matter, it is unclear whether the Bureau has authority to define "abusive."[4] But even if it does, such a definitional rulemaking would be premature and unnecessary. There is no evidence that uncertainty over the reach of the new "abusive" prohibition has chilled business practices or innovation. The terms "unfair" and "deceptive" have never been formally defined, yet have existed for over eighty years without impairing American innovation. Moreover, there is substantial overlap between "abusive" and "unfair or deceptive," such that few, if any, products would raise compliance concerns solely regarding "abusive," but not also "unfair or deceptive." Accordingly, "abusive" can hardly be causing innovation-chilling legal uncertainty.

Additionally, the statutory language of the Consumer Financial Protection Act and the Bureau's enforcement actions to date provide a sense of the scope of "abusive," such that a rulemaking is not necessary for clarity. While the theoretical outer limits of "abusive" are unsettled, the boundaries of such theoretical reaches are not grounds for real uncertainty in the business community because the Bureau's limited enforcement resources necessarily result in prioritization of prosecution of the clearest and most egregious violations of the law, rather than "push the envelope" by bringing cases with aggressive legal theories. Put another way, there is a built-in structural restraint on the implementation of "abusive" irrespective of how it is defined.[5]

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

[4] I do not address this administrative law issue in this submission, but merely flag that the drafting of section 1031(d) as a limitation on the Bureau's authority raises potential administrative law problems for any definitional rulemaking, irrespective of content.

[5] Should the Bureau proceed with a rulemaking, this counsels for adopting a broader definition of "abusive," all else being equal, and for the Bureau not to shy

Nor would defining "abusive" actually provide meaningful certainty to businesses regulated by the Bureau. The Bureau lacks authority to bind state attorneys general to its definition.[6] At best, then, a definitional rulemaking would precipitously ossify "abusive" doctrine without the salutary benefit of common law development and potentially constrain the Bureau's ability to address unanticipated situations that arise in the future.

In the face of this background, the calls to define "abusive" are best understood not as earnest pleas for greater legal certainty. Instead, they appear to be a cynical attempt to neuter the effectiveness of an important tool in the Bureau's regulatory arsenal through a definitional process that aims to narrow the provision to the point that it is unusable.

I expand on these points in the remainder of this submission, but for the sake of completeness also address a number of points that might be considered in a definitional rulemaking.

I. It Is Premature to Define "Abusive" via Rulemaking

It is premature for the Bureau to undertake a rulemaking to define "abusive." The Bureau would do better to allow the term to be better defined through the common law process, a type of organic Hayekian social learning, rather than attempt to impose a definition through top-down regulation. There is no particular urgency in defining "abusive." The Bureau has used the provision extremely judiciously. It has appeared in only a small number of enforcement actions and almost always in a belt-and-suspenders tandem with charges "unfair" or "deceptive" for the same behavior. All of this suggests that leaving "abusive" undefined is not creating any particular problems or uncertainty for the businesses regulated by the Bureau.

away from a definition with potentially far-reaching implications because such radical implications will simply never be pursued.

[6] Again, whether the Bureau even has authority to define "abusive" in the first place is questionable.

A. Lack of Urgency to Define "Abusive"

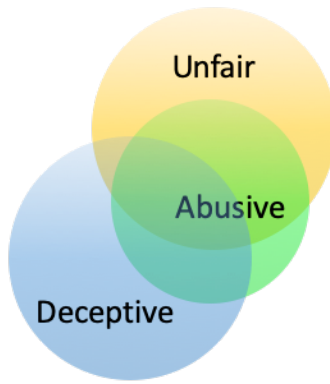
The major argument for defining "abusive" is that the term creates too much uncertainty for regulated persons, potentially chilling beneficial innovation. Yet when one presses on this argument, it does not hold water.

First, the Bureau has been most judicious in alleging "abusive" acts and practices, even across administrations. The Bureau has alleged "abusive" acts and practices under section 1031 of the Consumer Financial Protection Act in only 31 cases (a count that includes some companion cases against "related persons").[7] In all but *three* cases, the acts and practices alleged to be "abusive" were also alleged to be "unfair" or "deceptive."[8] In short, there is substantial overlap among the elements of the UDAAP triad, such that much of the behavior covered by "abusive" that is already covered by "unfair" or "deceptive". (See Figure 1.) There is no reason to believe that any future leadership of the Bureau will break from this precedent.

[7] These 31 cases include 50 separate counts of abusive acts and practices. The Bureau has also alleged that two sets of acts and practices undertaken in connection with payday and other small-dollar, short-term loans are abusive. CFPB, Final Rule, *Payday, Vehicle Title, and Certain High-Cost Installment Loans*, 82 Fed. Reg. 54472, Nov. 17, 2017, *codified at* 12 U.S.C. §§ 1041.4, 1041.7.

[8] Those cases are the enforcement actions against *Aequitas, Paypal*, and *Zero Parallel*. Yet a closer examination suggests that even these cases could have had "unfair" or "deceptive" charges as well, for the same predicate behavior. The facts alleged by the Bureau in both *All American* and *Paypal* as supporting an "abusive" charge lend themselves to plausible charges of "unfairness." The facts alleged by the Bureau in *Zero Parallel* could plausibly have been charged as a deceptive omission. Aequitas was sued by state attorneys general for "unfair" and "deceptive" acts and practices for the same behavior that the Bureau brought an "abusive" charge.

Figure 1. Relationship of the UDAAP Triad



Second, an analysis of the Bureau's "abusive" cases indicates that most of them deal with "fringe" financial products generally used by the subset of consumers who face some level of financial distress: payday loans and other small-dollar, short-term loans; buy-here-pay-here auto loans; check cashing; structured settlement or pension loans; or debt settlement. Notably, many of these firms are not subject to federal supervisory authority.

"Mainstream" financial institutions are virtually absent from the list of "abusive" allegations. Only two abusive cases have been brought against insured depository institutions—Wells Fargo for its creation of unauthorized deposit and credit card accounts—and TCF National Bank for its overdraft opt-in practices.

Even more tellingly, "mainstream" consumer financial products simply do not appear in the "abusive" roster. Not a single abusive complaint has been brought involving actual loan accounts in the three largest consumer credit product markets: mortgages, credit cards, and indirect auto loans. And not a single case has been brought involving payment systems.

Third, there is no evidence that uncertainty on the issue is affecting business practices at all; the claims of certain trade associations on the matter are completely unsubstantiated.[9] There is

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[9] *See* Center for Capital Markets Competitiveness, *Consumer Financial Protection Bureau: Working Towards Fundamental Reform*, Mar. 23, 2018, at 14-15.

no indication whatsoever that competition or innovation are in any way being stifled by a lack of regulatory definition of "abusive."

Indeed, given the high degree of overlap between "abusive" and "unfair" and "deceptive," most products that would raise compliance concerns due to "abusive," would also raise concerns regarding "unfair or deceptive," such that "abusive" is not the issue preventing the rollout of such products. The unusual case where compliance personnel are worried about "abusive," but not "unfair or deceptive," can readily be addressed through the Bureau's no-action letter process.

Fourth, even if defined, "abusive" will inevitably remain a standard like unfair or deceptive that depends on the totality of the circumstances. Absent bright line, product-specific safe harbors, uncertainty will still remain. Any reduction in uncertainty will be one of degree, not of kind.

The dearth of enforcement activity for "abusive" acts and practices, particularly surrounding the largest consumer financial product markets subject to CFPB regulation—payments, mortgages, credit cards, and auto loans—makes it difficult to say that there is any particular urgency in addressing the scope of "abusive." Absent concrete empirical evidence to the contrary, the Bureau should not act precipitously to define "abusive."

B. FTC Precedent

The Bureau would do well to emulate the example of the FTC, which did not act precipitously to define "unfair" or "deceptive" under section 5 of the FTC Act. Section 5 of the FTC Act was enacted in 1938. To date, the FTC has never undertaken a rulemaking to adopt a general definition of "unfair."[10]

The FTC's 1965 Cigarette Practices Rule, adopted in response to the first Surgeon-General's report linking cigarette smoking with health problems, described factors the FTC considers regarding whether a practice that neither violates the antitrust laws nor is

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[10] The FTC's Credit Practices Rule was promulgated under "unfair" in 1984. I note the present anomaly that the Credit Practices Rule does not apply to insured depository institutions following the repeal of Reg AA by the Fed in light of the transfer of regulatory authority to the CFPB.

deceptive is nevertheless unfair.[11] But this was not a formal definition,[12] and indeed was vague enough to be of little direction beyond describing "unfair" as within the penumbra of unconscionable.

It was not until 1980 that the FTC issued a policy statement on "unfairness"[13] and until 1983 that it issued a policy statement on "deception."[14] These policy statements were issued only after Congress defunded the FTC for attempting to regulate advertising of sugar cereals aimed at children; they were not the product of the FTC's organic thinking on the issues, but an attempt to mollify an angry Congress. In any event, these policy statements do not formally bind the FTC (although part of the "unfairness" policy statement was subsequently embraced by Congress and included in the FTC Act) and may not even be cited in FTC litigation documents.

During the decades prior to the policy statements, the contours of "unfairness" and "deception" were shaped through FTC litigation—a common law process consisting of both the internal FTC staff and Commission analysis of the facts as known to the FTC and then court rulings on the record developed at trial. Through the common law process, the contours of both "unfair" and "deceptive" became well-understood by the business community, such that there is little complaint today about the doctrines creating unacceptable uncertainty for businesses.

C. Benefits of a Common Lawmaking Process

The common lawmaking process allows for a more careful definition of "abusive" than a rulemaking because it continually tests the doctrine through new factual situations that allow for on-going learning and tailoring of the doctrine rather than a one-time off-the-rack rulemaking. Moreover, delaying formalization of the doctrine until a substantial period of common law making has passed will ensure that the doctrine were not artificially constrained or prematurely petrified, leaving the CFPB without the tools to address unexpected,

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[11] 29 Fed. Reg. 8355 (1964).

[12] *FTC v. Sperry-Hutchinson Co.*, 405 U.S. 233, 244 n. 5 (1972).

[13] FTC, Policy Statement on Unfairness, Dec. 17, 1980, *appended to International Harvester Co.*, 104 F.T.C. 949, 1070 (1984).

[14] FTC, Policy Statement on Deception, Oct. 14, 1983, *appended to Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984).

but troubling situations in the future and inviting future, bolder Congressional action.

D. The Bureau Has Alternative Tools Better Suited to Addressing Any Uncertainty Related to "Abusive"

"Abusive" is inherently shaped by the particular set of facts and circumstances at issue. Such situations are not well addressed by general, blunderbuss rulemakings. Instead, the CFPB has a better, more precise surgical tool—no-action letters.

To the extent that a firm is concerned that it might be subject to an "abusive" action by the Bureau, it is free to seek a no-action letter, which would immunize it (and it alone) for the particular factual scenario described in the letter. To the extent broader guidance is necessary, the CFPB has other tools beyond formal notice-and-comment rulemaking, such as policy statements and supervisory guidance, that it can use to telegraph its thinking on "abusive." Indeed, the Bureau has already utilized some of these tools, detailing guidance various debt collection, mortgage servicing, credit card, phone payment fees, and general sales practices that could be abusive.[15]

E. The Bureau Lacks Authority to Bind State Attorneys General to Its Interpretation of "Abusive"

It is important to note that while section 1031(d) is often referred to colloquially as a "definition" of "abusive," that is not how the statute actually operates. Section 1031(d) is not drafted as a definition—contrast it with section 1002[16]— but as a limitation on what the *Bureau* may do in terms of rulemaking or enforcement. The language of section 1031(d) provides that "the *Bureau* shall have no authority".[17]

This drafting is not happenstance. The House version of what became the Dodd-Frank Act contained a provision entitled "Unfair,

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[15] CFPB, *Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts* 5-6, CFPB Bull. 2013-07 (July 10, 2013); *see also id.* at 4; CFPB, *Mortgage Servicing Transfers*, CFPB Bull. 2013-01 (Feb. 11, 2013); CFPB, *Marketing of Credit Card Promotional APR Offers*, CFPB Bull. 2014-02 (Sept. 3, 2014); CFPB, *Detecting and Preventing Consumer Harm from Production Incentives*, CFPB Bull. 2016-03 (Nov. 28, 2013); CFPB, *Phone Pay Fees*, CFPB Bull. 2017-01 (July 31, 2017).

[16] 12 U.S.C. § 5481.

[17] 12 U.S.C. § 5531(d) (emphasis added).

Deceptive, or Abusive Acts or Practices Defined."[18] It defined "unfair" and "deceptive" with reference to the FTC Policy Statements on those topics, and defined "abusive" as requiring both an act or practice

> (A)…reasonably likely to result in a consumer's inability to understand the terms and conditions of a financial product or service or to protect their [sic] own interests in selecting or using a financial product or service; and
>
> (B) the widespread use of the act or practice is reasonably likely to contribute to instability and greater risk in the financial system.[19]

The Senate version of the provision, which is what became law, verbatim jettisoned the definitional framework and instead replaced it with a provision framed as a limitation on Bureau powers. [20] Indeed, the Senate bill's provision is clearly not definitional because it does not address "deception." It would make little sense for the Senate bill's provision to be definitional when it does not define one of the terms in the UDAAP triad, even though a definition was readily available in the House bill.

Although there is no discussion of the change in the drafting in the legislative history, it cannot be dismissed as insignificant; Congressional legislative counsel are skillful and as a matter of course urge that definitions that apply to multiple statutory sections are placed in a general definitional section or a definitional section specific to a part of an act. Given that "abusive" is a term that appears in multiple sections,[21] it would stand to reason that if Congress were to define the term, it would have done so in section 1002 with other definitions or in a provision with definitions specific to a part of the Consumer Financial Protection Act, such as with section 1061.[22] Put another way, there are two separate provisions in the Consumer Financial

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[18] H.R. 4173, Wall Street Reform and Consumer Protection Act of 2009, 111th Cong., Dec. 11, 2009.

[19] *Id.*

[20] S.3217, Restoring American Financial Stability Act, 111th Cong., as introduced, April 15, 2010.

[21] 12 U.S.C. §§ 5511, 5536, 5538

[22] 12 U.S.C. § 5561.

Protection Act that are clearly labelled as "definitions."[23] The absence of such a label from section 1031 plus the wording of that section indicates that it is not a definitional section.

The significance of the drafting of Section 1031(d) is that it is not a limitation on the interpretation of "abusive" by *state attorneys general*. State attorneys general have the power to enforce the Consumer Financial Protection Act against most covered persons and service providers.[24] The Bureau lacks authority to limit state attorneys general to its interpretation through a rulemaking. The provision that state attorneys general would be enforcing is not section 1031, but section 1036, which contains that actual prohibition on abusive acts and practices. Indeed, state attorneys general are free to treat the terms "unfair" and "abusive" to mean something different than the limitations described for the Bureau in section 1031.

What this means is that any rulemaking undertaken by the Bureau to define "abusive" under section 1031 would bind solely the Bureau. The Bureau has no power to limit state attorneys general to any definition it promulgates of abusive.

Indeed, the Bureau is able only to *expand* the power of state attorneys general regarding abusive. State attorneys general lack the authority to bring enforcement actions against national banks and federal savings associations (but not federal credit unions) under section 1042(a)(2), absent a Bureau rulemaking.[25] If the Bureau were to define "abusive," then state attorneys general could bring actions against national banks and federal credit unions for "abusive" acts and practices, however so defined.

The Bureau's inability to bind state attorneys general to any definition of abusive counsels for restraint in defining the term. While the Bureau can tie its own hands, the fact that it cannot tie those of state attorneys general—who have of late been more vigilant in enforcement actions than the Bureau—shows that the Bureau cannot eliminate uncertainty for regulated firms through a definition.

[23] 12 U.S.C. §§ 5481, 5561.
[24] 12 U.S.C. § 5552(a).
[25] 12 U.S.C. § 5552(a)(2).

Attempting to eliminate uncertainty for regulated firms through definition of abusive is a futile activity.[26]

F. The Bureau May Not Have Legal Authority to Define "Abusive" in a Way That Narrows the Term

The Bureau may also lack legal authority to define "abusive" in a way that narrows it. Section 1031(b) gives the Bureau specific legal authority to:

> prescribe rules applicable to a covered person or service provider identifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. Rules under this section may include requirements for the purpose of preventing such acts or practices.[27]

Because this is a specific grant of authority, standard cannons of statutory interpretation provide that it controls over the general of authority to the Bureau under section 1012.[28]

The specific authority given to the Bureau is to identify acts and practices as "abusive," that is to flag particular acts and practices, much like the FTC's Credit Practices Rule does with "unfair." The authority granted is not to provide safe harbors, exemptions, or limitations on what is "abusive."[29] Moreover, Congress specifically authorized rules with preventative requirements. The negative

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[26] I also note that the CFPB cannot bind private litigants to its definition of "abusive". Some state UDAP statutes merely require a predicate illegal act. A violation of section 1036 would suffice, and the Bureau's definition of "abusive" would not necessarily bind a private litigant, given that it would not bind a state attorney general, and thus cannot be seen as a definitive interpretation of the law.

[27] 12 U.S.C. § 5531(b).

[28] 12 U.S.C. § 5512(a)-(b)(rulemaking authority granted to carry out Bureau's "purposes" and "objectives"). While the objectives listed in section 1011 include ensuring that consumer financial markets "operate transparently and efficiently to facilitate access and innovation," 12 U.S.C. § 5511(b)(5), a definitional rulemaking would not advance that objective for the reasons described above. Accordingly, a definitional rulemaking for "abusive" it also is not within the scope of the CFPB's general rulemaking authority.

[29] *Cf.* 12 U.S.C. § 5511(b)(3) (creating general authority to exempt persons, products, or services from the Consumer Financial Protection Act).

implication is that there is no exemption authority for UDAAP. This suggests that the Bureau may well lack legal authority to define "abusive" in any way that narrows the term.

G. The Real Goal of Defining "Abusive" Is to Prevent Consumer Protection Regulation, Not Create Legal Certainty

It is hard to credit calls to address legal uncertainty over "abusive" as being made in good faith. As explained above, there is no actual problem regarding legal uncertainty that is specific to "abusive," and the Bureau cannot resolve that uncertainty even if it has rulemaking authority (*Chevron* step one) in the matter because it cannot bind state attorneys general.

Instead, what is really going on here is an attempt to neutralize the "abusive" power in the hands of the CFPB by imposing additional, non-statutory limitations on its use, such as cost-benefit analysis and scienter requirements or creating defenses and safe-harbors.

II. THE TEXT OF THE CONSUMER FINANCIAL PROTECTION ACT PROVIDES SOME CONTOURS FOR DEFINING "ABUSIVE"

While I believe it is premature to define "abusive" via rulemaking and that the Bureau's authority is doubtful, the text of section 1031 and other provisions of the Consumer Financial Protection Act provides some sense of the contours of "abusive." This is important for two reasons.

First, it goes to show that there is really quite limited uncertainty about the meaning of "abusive." And second, it provides a guide to what would be appropriate or not to include in a definitional rulemaking if the Bureau should in fact go down that ill-advised path. I start by considering some general textual implications before turning to a close reading of the text of section 1031(d) itself.

A. "Abusive" Lacks a Scienter Requirement

Some of the most important limitations on a reading of section 1031(d) come from other provisions in the Consumer Financial Protection Act. For example, section 1031(c) restricts the Bureau to proscribing acts and practices as "unfair" unless the act or practice (1) "causes or is likely to cause substantial injury to consumers" that (2) "is not reasonably avoidable by consumers", and (3) "is not outweighed by countervailing benefits to consumers or to competition."[30]

Section 1031(c)'s restriction on the Bureau's "unfair" power is virtually identical to that found in section 5 of the Federal Trade Commission Act.[31] Given the nearly identical language and the similar functions of the CFPB and FTC, it is fair to assume that Congress generally intended to incorporate FTC Act jurisprudence, as it existed in July 2010, in the Consumer Financial Protection Act.

The most important implication of the incorporation of FTC Act jurisprudence is that there is no "scienter" or intent requirement for "abusive." The text has no such requirement. Indeed, neither "unfair" nor "deceptive" have a scienter requirement. Thus, an accidental mishap, such as the failure of a computer system can be unfair to consumers who are substantially harmed by the mishap, cannot readily avoid it, and receive no offsetting benefit.[32] Similarly, it is well established in federal and state deception jurisprudence that no intent is required for deception, in contrast to common law fraud.

Additionally, the negative implication of other provisions of the Consumer Financial Protection Act that have express scienter requirements is that there is none for "abusive." For example, Congress imposed an express scienter requirement for "substantial assistance" violations under section 1036(a)(3), namely that it be provided "knowingly or recklessly."[33] Similarly, under section 1002(25), an independent contractor may only be a "related person" and thus a "covered person" under the Consumer Financial Protection Act if that person "knowingly or recklessly" participates in a violation of law or breach of fiduciary duty.[34] These provisions show that Congress knew quite well how to impose a scienter requirement when it wanted to do so in the Consumer Financial Protection Act. The

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[30] 12 U.S.C. § 5531(c)(1).

[31] 5 U.S.C. § 45(n).

[32] *See, e.g.,* Consent Order, *In the Matter of UniRush LLC and Mastercard International Incorporated*, 2017-CFPB-0010, Feb. 1, 2017.

[33] 12 U.S.C. § 5536(a)(3).

[34] 12 U.S.C. § 5481(25)(C)(iii).

strong negative implication from these other provisions of the Consumer Financial Protection Act is that there is no scienter requirement for "abusive" under section 1031(d).

Accordingly, none of the CFPB's "abusive" complaints to date have pled scienter of any level, knowing, reckless, or even negligent. There is no basis for finding a scienter requirement in "abusive."

This is not to say that scienter has no role to play in the application of "abusive," only that it is not an inherent requirement of "abusiveness" that should be incorporated in a definition. Intent should be a factor that the Bureau (and state attorneys general) consider in determining whether to bring an action and on what terms they will settle an action, with lack of intent being a mitigating factor. But there is no basis whatsoever for formalizing a scienter requirement in a regulatory explication of abusive.

B. No Particular Quantum of Harm or Materiality Is Required for "Abusive"

Another negative textual implication from the other provisions in the Consumer Financial Protection Act relates to the quantum of harm required for "abusive." A quantum of harm requirement is essentially a materiality requirement.

Section 1031(c) requires "substantial harm" for "unfairness." FTC Act jurisprudence on "substantial harm" is that it may be satisfied either by a large harm to an individual consumer or by a small harm to many consumers. Notably, however, there is no express harm requirement of any sort, much less a "substantial harm" requirement in section 1031(d). Read literally, neither "material interference" nor "taking unreasonable advantage" inherently requires any legally cognizable harm to consumers. The implication from this is that "abusive" does not require any particular quantum of harm, even though as a practical matter, enforcement actions will always consider the extent of harm.[35]

This textual difference between section 1031(c) "unfairness" and section 1031(d) "abusive" makes sense because the general focus on "abusive" is different from that of "unfair." Whereas "unfair" is

[35] Whether Article III of the Constitution requires some level of harm for a public enforcement action is beyond the scope of issues I consider here.

focused on the consumer—harm, avoidability, balancing of costs and benefits—"abusive" is focused primarily on the business, namely whether it has engaged in bad acts materially interfered or taken unreasonable advantage.[36] "Unfair" and "abusive" are thus obverse faces of the same consumer protection coin.

The lack of a materiality requirement matters for situations where the consumer would have behaved the same even absent the "abusive" violation. For example, imagine a consumer who reasonably relies on a covered person, say a loan broker, to act in her interests. If that person does not and takes unreasonable advantage of the consumer, it would be "abusive" even if the consumer would have proceeded to transact on the same terms had the consumer known that the loan broker was not acting in her interests.

Likewise, a consumer that did not understand that there was an additional mortgage closing fee might proceed with the transaction even after learning of the fee. The fee might not be material relative to closing costs or the mortgage amount, but this does not matter for "abusive," even if it would for "deceptive" (which has a materiality requirement) or "unfair" (which requires a "substantial" injury).

Again, as a practical matter, the Bureau will inevitably consider the quantum of harm in its enforcement decision, but there is no statutory basis for reading in a materiality requirement, particularly in the face of the language of section 1031(c).

C. There Is No General "Reasonable Avoidability" Element in "Abusive"

A comparison of sections 1031(c) and 1031(d) also makes clear that there is no general "reasonable avoidability" requirement for "abusive". Whereas section 1031(c) refers to harm being "reasonably avoidable," which is an objective test, no such language appears in section 1031(d). The negative implication is that there is no reasonable avoidability requirement for "abusive."

[36] The distinction may be significant from a compliance standpoint because it encourages regulated firms to examine their practices from a different angle, namely with a focus on their own acts, rather than on the consumer's vulnerabilities. Put another way, "abusive" may help ensure better compliance with "unfairness" and "deception".

To be sure, section 1031(d)(2)(B), refers to the "inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service." But it pointedly does not refer to "reasonable avoidability" or even to the "*reasonable* inability of the consumer to protect the interests of the consumer…" The lack of the word "reasonable" as a modifier of "inability" in section 1031(d)(2)(B), particularly light of the inclusion of "reasonable" to modify "reliance" in section 1031(d)(2)(C), suggests that section 1031(d)(2)(B) allows a subjective test in addition to an objective one.

D. There Is No Cost-Benefit Analysis in "Abusive"

Another negative implication of various provisions of the Consumer Financial Protection Act is that there is no cost-benefit analysis of any sort in an enforcement application of "abusive." Congress expressly required a cost-benefit analysis for any CFPB rulemaking, which would include a rule-making under "abusive."[37] Congress also imposed a separate type of cost-benefit analysis as part of "unfairness" rulemakings or enforcement actions, namely that the consumer harms must not be outweighed by benefits to consumers or competition.[38]

No such cost-benefit analysis language is to be found in the limitation on the Bureau's power to proscribe an act or practice as "abusive." This implies that a cost-benefit analysis is not part of the "abusive" determination. Accordingly, consideration of offsetting benefits to consumers or competition are not appropriate to incorporate into a definition of "abusive," even if they are appropriate factors for the Bureau to consider in the enforcement process, both in terms of whether to bring an action and in terms of settlement.[39]

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[37] 12 U.S.C. § 5512(b)(2).

[38] 12 U.S.C. § 5531(c)(1)(B).

[39] I note that the definition of "unfair" contains an express limitation on consideration of public policy. 12 U.S.C. § 1031(c)(2). I do not believe there is a negative implication that may be drawn from this, however. That is, the exclusion of such a provision for "abusive" does not imply that public policy may be considered and even serve as a primary basis for an "abusive" determination, as there is nothing in the text of section 1031(d) that would invite public policy as a primary consideration. At most, section 1031(d)(2)(C), might invite consideration of public policy regarding whether a consumer's reliance on a covered person is reasonable.

E. Disclosure Is Not a *Per Se* Defense

Disclosure is not a defense against unfairness, even if it is a factor to be considered in "reasonable avoidability." Likewise, an act or practice can still be deceptive even if terms are disclosed. The completeness of the disclosure plus its prominence, presentation, placement, and proximity (physical and temporal) all matter. Indeed, it is well established that an initial misleading statement cannot be corrected by a subsequent accurate disclosure.[40] So to with "abusive."

The Bureau has brought several enforcement actions involving situations where terms have been disclosed:

- In *Cash Express*, the right of setoff was disclosed and even acknowledged, but the disclosure was made years earlier, and was "nullified" by defendant's practice of physically keeping the check away from consumers until the check cashing transaction and set-off of debt were complete.[41]
- In *Freedom Stores*, the forum selection clause alleged to be abusive was undisputedly part of the contract, even if consumers did not notice it.[42]
- In *Security National Automotive Acceptance Company*, the contract contained language disclosing an authorization of contacts with the servicemember consumers' commanding officers.[43]

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[40] *See, e.g.*, *CFPB v. Gordon*, 819 F.3d 1179 (9th Cir. 2016) ("A later corrective written agreement does not eliminate a defendant's liability for making deceptive claims in the first instance."). While detrimental reliance is not an element of deception under FTC Act jurisprudence (it is presumed if the representation was material), *see* NAT'L CONSUMER LAW CENTER, *UNFAIR AND DECEPTIVE ACTS AND PRACTICES*, § 4.12.12.2, it helps explain why a subsequent corrective disclosure is inadequate—consumers might have relied in the interim and either forgone opportunities or acted in reliance.

[41] Consent Order, *In the Matter of Cash Express, LLC*, No. 2018-BCFP-0007, Oct. 24, 2018, at ¶¶ 26, 35.

[42] Complaint, *CFPB v. Freedom Stores, Inc.*, No. 2:14-cv-643, E.D. Va., Dec. 18, 2014*, at* ¶¶ 65-66 (CFPB "abusive" claim), 76-77 (state attorney general "abusive" claim). *See also id.* ¶¶ 46-49, 84-87 (unfairness claim predicated on disclosed right to contact commanding officers).

[43] Complaint, *CFPB v. Security National Automotive Acceptance Company, LLC*, No. 15-cv-401, S.D.Ohio, June 17, 2015, at ¶¶ 12-13, 25-26.

- In *All American Check Cashing*, the defendant allegedly had price disclosure signage but it was placed in a hard-to-read location.[44] Similarly, the defendant allegedly disclosed its fees on receipts, but physically covered up the receipts to prevent consumers from seeing the fees.[45]
- In *TCF National Bank*, the bank did make the required overdraft disclosures in most cases, only allegedly manipulated them.[46]

All of this suggests that disclosure is not a defense to "abusive," even if it is a factor that might be considered, particularly in regard to consumers' reasonable reliance on a covered person to act in their interests under section 1031(d)(2)(C). The *All American Check Cashing* case indicates that disclosures can be covered up physically in ways that negate their effectiveness. Material interference under section 1031(d)(1) can thus coexist with disclosure. And the *TCF National Bank* case presents an important instance of a covered person engaging in deliberate manipulation of disclosures in order to increase consumer assent to a service. These cases suggest that the very act of disclosure can itself be part of the abusive behavior, such that it cannot possibly be a *per se* defense to an abusive allegation.[47]

III. THE FOUR PRONGS OF "ABUSIVE" IN SECTION 1031

A. Relationship of the Prongs of "Abusive"

Turning to the four prongs of "abusive" in section 1031, it should first be obvious that they are alternatives, but also non-exclusive. That is an act or practice need only fall under one prong in order to be abusive, as indicated by the "or" preceding section 1031(d)(2)(C), but an act or practice could well fall under multiple prongs.

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[44] Complaint, *CFPB v. All American Check Cashing, Inc.*, No. 3:16-cv-00356-WHB-JCG, S.D. Miss., May 11, 2016, at ¶¶ 67-68.

[45] *Id.*

[46] First Amended Complaint, *CFPB v. TCF National Bank*, No. 17-cv-00166-RHK-KMM, D. Minn. Mar. 1, 2017, at ¶¶ 58-104.

[47] *See* Lauren E. Willis, *When Nudges Fail: Slippery Defaults*, 80 U. CHICAGO L. REV. 1155 (2013).

For example, in *RD Legal Funding*, the Bureau alleged that a structured settlement firm was claiming that structured settlement advances (a form of credit) were in fact assignments (straight sales). The Bureau argued that this constituted material interference under section 1031(d)(1) because the misstatement interfered with consumers' understanding of the product.[48] The Bureau further argued that because consumers did not understand the product was a credit product, they could not understand the credit terms, so the business was taking unreasonable advantage of their lack of understanding of the terms and conditions, in violation of section 1031(d)(2)(A).[49] And the Bureau additionally alleged that because consumers do not understand the terms and conditions, they cannot protect their interests, so the business was taking unreasonable advantage of their inability to protect their interests under section 1031(d)(2)(B).[50] Thus, one act can readily trigger three prongs of "abusive," and, presumably, with a different fact pattern, all four prongs.

The Bureau has not been consistent in whether it treats violations of different prongs of abusive based on the same behavior as multiple counts. If an act or practice were to fall under multiple prongs of abusive, I believe it would be appropriate for the Bureau to consider bringing multiple counts of "abusive" acts and practices in a complaint and to consider each count a separate and distinct violation for the purposes of calculating liability.

B. Material Interference With Consumer Understanding

The first prong of abusive defines it as encompassing any act or practice that "materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service."[51] There are two elements that need to be considered in this prong: "material interference" and "consumer understanding".

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[48] Complaint, *CFPB v. RD Legal Funding, LLC*, No. 1:17-cv-00890, S.D.N.Y., Feb. 7, 2017, at ¶¶ 72-75.

[49] *Id.* (the complaint does not cite section 1031(d)(2)(A), but states that defendant "takes unreasonable advantage of consumers' lack of understanding of material costs or conditions of RD's offers of credit," which would be a 1031(d)(2)(A) violation.)

[50] *Id.*

[51] 12 U.S.C § 5531(d)(1).

1. *Materiality*

Materiality is a well-established legal concept that requires more than a *de minimis* effect. While it is often applied in reference to whether it would affect the behavior of a reasonable consumer or investor, such measure is problematic, in that there are situations in which a reasonable consumer might not change her behavior, yet would still suffer a harm as a result of the interference.

For example, suppose that a consumer is willing to pay 100 for a product, but is able to obtain for 90, but which the consumer believes to be 60 because of the business's interference with the communication of the terms to the consumer. The consumer would still buy at 90, such that the interference would not alter the consumer's behavior. Yet surely such an interference would be material, insofar as the consumer is not getting the deal she thought she was, and that might affect the consumer's *other* consumption decisions. Thus, if the consumer believes that she has committed to spending 60, rather than 90, the consumer might go and spend an extra 30 in reliance on the cost of the transaction being 60.

Alternatively, consider an example where because of a business's interference a consumer believes that a credit insurance product covers a risk that is in fact excluded under a policy. The consumer might reasonably forgo obtaining alternative insurance coverage based on the belief that she is already covered. If the risk eventually materialized, the consumer could no longer buy new insurance to cover that loss.

In both situations a consumer might be harmed based on reasonable reliance on a misperceived term or condition. Note that while this interference could theoretically affect competition and thus the terms on which the consumer would transact in a perfectly efficient and complete market, such assumptions do not need to be made for concluding that the interference here is material because its effect is more than *de minimis*.

Accordingly, "material" should be understood as an interference that has more than a *de minimis* effect on consumer understanding, as such a definition would both encompass situations where a reasonable consumer's behavior would be affected and those where a reasonable consumer's behavior would not change, but the consumer could nevertheless be harmed based on reasonable reliance on the term or condition as actually understood.

2. Lack of Understanding of Terms and Conditions

The specific language of section 1031(d)(1) in regard to consumer understanding is helpful to understand what "interference" might mean. Section 1031(d)(1) refers to consumer understanding of *terms and conditions*. This contrasts with section 1031(d)(2)(A)'s reference to consumer understanding of *material risks, costs, or conditions*. The textual implication is that material interference does not extend to interference with an understanding of a deal's economics generally, but is narrower and only covers interference with understanding of the actual deal terms.

Admittedly, this might be a strained distinction—a consumer's understanding of actual deal terms necessarily relates to an understanding of the risks of involved in the transaction. But a consumer can understand that a prepayment prohibition does not allow the consumer to pay off a loan prior to its maturity date without understanding that such a prohibition prevents the consumer from refinancing the loan if better terms become available in the future. Arguably, it is only material interference with understanding of the former, rather than the latter, that would give rise to section 1031(d)(1) liability.

3. Interference

a. Incorrect or Misleading Disclosures

Given this textual analysis, a limitation on "material interference" to understanding of terms and conditions would, on the simplest level, appear to cover materially incorrect disclosures (including omitted disclosures). To the extent that terms or conditions have not be disclosed to a consumer correctly, the consumer will almost necessarily misunderstand the terms and conditions of a product or service. This does not mean that every TILA disclosure violation constitutes material interference. For example, a lack of itemization of finance charges might not be material interference if the total finance charge is properly disclosed. But failure to properly disclose terms that would affect consumer behavior regarding the product or generate reasonable reliance by the consumer should be considered material interference.

b. Physical Interference

Second, material interference would seem to cover *physical* interference with information flows to a consumer, such that the consumer would be deprived of information necessary to understand the terms and conditions of a consumer financial product or service. Examples of what this might include are physically covering up part of a contract when the consumer is asked to sign,[52] physically covering up a receipt showing fees,[53] and deliberate placement of disclosure signage in locations where the consumer cannot readily see it, such as on the front of a sales counter, when the consumer will be standing up at the counter.[54]

c. Buried Disclosures

Similarly, material interference could also extend to the making of disclosures of terms and conditions in a manner that all but ensures limited comprehension. For example, oral disclosures made at an unreasonable fast pace, unreasonably small print and illegible fonts (particularly with visually impaired populations or elderly populations with a prevalence of presbyopia), or unduly complex language in disclosures that could readily be put into plain English (again, particularly when made to a population known to have limited English skills or a low reading grade-level).[55] Likewise, minimizing the time the consumer has to see a disclosure,[56] or ensuring that a disclosure is

[52] Anne Fleming, *The Rise and Fall of Unconscionability as the "Law of the Poor,"* 102 GEO. L.J. 1383, 1395 (2014) ("Although the form contract was short—approximately six inches long—the salesman would fold over the contract before presenting it to Williams with the signature line visible and tell her, '[j]ust sign your name down here.'").

[53] Complaint, *CFPB v. All American Check Cashing, Inc.*, No. 3:16-cv-00356-WHB-JCG, S.D. Miss., May 11, 2016, at ¶¶ 67-68.

[54] *Id.*

[55] *See Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (1965) (complex financial contract with consumer with third-grade education); GAO, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers, GAO-06-929, Sept. 2006, at 6 (half of US adult population reads at or below eighth grade level, but credit card disclosures are written at the tenth to twelfth grade level); CreditCards.com, *Study: Credit card agreements unreadable to most Americans*, Sept. 8, 2016, *at* https://www.creditcards.com/credit-card-news/unreadable-card-agreements-study.php.

[56] Complaint, *CFPB v. All American Check Cashing, Inc.*, No. 3:16-cv-00356-WHB-JCG, S.D. Miss., May 11, 2016, at ¶¶ 67-68.

deliberately separated temporally from a solicitation of assent,[57] given after a solicitation of assent,[58] or given substantially before a transaction[59] could all be material interference.

Indeed, burying material terms and conditions in long, prolix contracts might itself be material interference given that it is well-understood that no reasonable consumer reads long form contracts. Similarly burying material terms and conditions in a disclosure that is given together with other lengthy disclosures and without being specially flagged could constitute material interference.[60] This is not to suggest that businesses cannot have products with extensive terms and conditions, only that the manner in which they are disclosed is relevant to the question of material interference—dumping pages of text on a consumer without doing more makes it likely that a reasonable consumer will not understand the material terms and conditions of the contract.

d. Overshadowing and Lulling

Related to the problem of disclosures buried in fine print is the possibility of material interference through overshadowing and lulling. The concept of overshadowing is well developed in Fair Debt Collection Practices Act jurisprudence, where the required content of an FDCPA debt validation notice may not be overshadowed by other content. Overshadowing can potentially be material interference. For example, a credit card billing statement that emphasizes through text placement and prominence the minimum payment due, while downplaying the total balance due might be an example of overshadowing such that it materially interferes with consumer understanding of the terms of the financial product or service. Consumer testing would probably be necessary to make a determination in this instance, and adherence to the layout of sample forms provided by the Bureau should be a complete defense, but the

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57 First Amended Complaint, *CFPB v. TCF National Bank*, No. 17-cv-00166-RHK-KMM, D. Minn. Mar. 1, 2017, at ¶¶ 55-56.

58 *Id.* at ¶¶ 105-111, ¶¶ 87-104 (existing customers received for-fee overdraft disclosures only after being asked for assent in the form of being asked if they wanted their "card to continue to work as it does today.").

59 Consent Order, *In the Matter of Cash Express, LLC*, No. 2018-BCFP-0007, Oct. 24, 2018, at ¶¶ 26.

60 First Amended Complaint, *CFPB v. TCF National Bank*, No. 17-cv-00166-RHK-KMM, D. Minn. Mar. 1, 2017, at ¶¶ 58-76, 105-111.

general point that material interference can include overshadowing remains.

The concept of "lulling" is related to both deception and overshadowing. Lulling involves creating circumstances that discourage consumers from taking actions to protect their interests. For example, the CFPB's suit against T3Leads, a payday loan lead aggregator, alleged that "inaccurate statements by T3's lead generators decrease the likelihood that consumers will read the lengthy disclosures on a lender's webpage."[61]

Lulling need not be by inaccurate statements, however. It can be accomplished by other means that give consumers a false sense of security. For example, it could be through use of a trusted celebrity pitchman in advertisements who implicitly vouches for the product. Whether such activity rises to the level of material interference is ultimately dependent upon the specific facts and circumstances. Likewise, it could be accomplished through product advertising that gives consumers a misleading impression about the likely use of the product.[62]

e. Role of Behavioral Economics

"Material interference" might be informed by insights from behavioral economics. Behavioral economics has identified certain common "cognitive biases" among many consumers—ways in which a substantial share of consumers will routinely mis-analyze risks and rewards and behave suboptimally from an ex post perspective. Insofar as a financial product or service exploits a cognitive bias, it might be considered as material interference.

I would caution against taking too broad of an approach here. The field of behavioral economics is still developing. Many of its findings are based on limited and constrained experiments that may not be replicable or translate to all conditions.[63] Moreover, some of

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[61] Complaint, *CFPB v. D and D Marketing, Inc., d/b/a T3Leads*, No. 2:15-cv-9692, C.D. Cal., Dec. 17, 2015, at ¶ 42.

[62] 82 Fed. Reg. 54472, 54621-622 (noting lulling effect of payday advertising through phrases such as "until next payday" and that loans are to "tide over" consumers until they next receive income).

[63] *See, e.g.*, Charles Plott & Katherine Zeiler, *The Willingness to Pay-Willingness to Accept Gap, the "Endowment Effect," Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005).

the phenomena documented by the behavioral economics literature are also susceptible to explanation through traditional economics.[64] The Bureau should not at this time expressly incorporate behavioral economics (or any flavor of economics or other social science) into a definition of "abusive," but should instead take a catholic approach that will treat behavioral economics as one of many tools in the analytical toolkit that can be used to better understand a situation.

The relative merits of behavioral versus neo-classical economics are ultimately a side-show when considering what "abusive" means. The meaning of "abusive" is not determined in reference to economic theory. "Abusive" is a legal, not an economic concept. Economics has never addressed the idea of "abusive" acts or practices any more than economics has addressed such standard legal categories of "reasonableness" and "proportionality" or "fair." Economic theory can help inform an understanding of abusive, but the term cannot be reduced to an economic concept.

C. Taking Unreasonable Advantage of Consumers

The other three prongs of "abusive" in section 1031(d)(2) all require a business to "take unreasonable advantage" of a situation. Before turning those particular situations, a consideration of what it means to "take unreasonable advantage" is in order.

1. Protection of Consumer Autonomy

The starting point for most consumer financial transactions is contract. Most consumer financial relations are contractual, and contract provides the first and best line of consumer protection. As long as consumers have the ability to freely exercise decision-making about whether or not to enter into a transaction, consumers maintain substantial ability to avoid harms, and the competitive forces of the market will generally work to drive out bad products. Preserving such consumer autonomy is important; the role of government is not to second-guess consumer decisions. Yet market failures do exist, and consumer autonomy is only meaningful when it can be fully and freely exercised. Moreover, while most consumer financial relations are contractual and thus at least theoretically offer the consumer the opportunity to "just say no," some relationships—credit reporting,

[64] *See, e.g.,* Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 MICH. L. REV. 215 (1990).

debt collection, and third-party loan servicing, and lead resale, for example—are involuntary.

Section 1031(d)(2) comes into play for situations in which consumers cannot fully and freely exercise their autonomy: informational problems that result in a consumer not understanding the transaction; situations where the consumer lacks the ability to exercise meaningful choice (both contractual relationships and non-contractual ones); or betrayal of the consumer's reliance on other parties to act for the consumer. Thus, section 1031(d)(2)(A) deals with informational asymmetries and other information problems for consumers, section 1031(d)(2)(B) deals with consumers' situational distress, vulnerability, or lack of choice, and section 1031(d)(2)(C) deals with consumer's reliance on covered persons to act for them.

This reading of section 1031(d) is consistent with the FTC's Policy Statement on Unfairness. The Unfairness Policy Statement notes that most FTC unfairness cases:

> are brought, not to second-guess the wisdom of particular consumer decisions, but rather to halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decisionmaking.[65]

The section 1031(d) language closely mirrors and appear to have been inspired by this language from the FTC Policy Statement. "Material interference" echoes the "seller behavior that unreasonably creates…an obstacle to the free exercise of consumer decisionmaking," while "takes unreasonable advantage" echoes "seller behavior that unreasonably…take advantage of an obstacle to the free exercise of consumer decisionmaking."

2. Prohibition on Unjust Enrichment

The fundamental lack of consumer autonomy outlined in sections 1031(d)(2)(A)-(C) helps explain what it means to "take unreasonable advantage" of consumers in such situations. Section 1031(d) is placing a restriction on the terms a business may obtain

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[65] FTC, Policy Statement on Unfairness, Dec. 17, 1980, *appended to International Harvester Co.*, 104 F.T.C. 949, 1070 (1984).

when a consumer lacks the ability to meaningfully exercise free decisionmaking.

In such a situation, section 1031(d) requires firms to act with complete fairness toward consumers in situations in which the consumer lacks the ability to meaningfully exercise free choice. "Taking unfair advantage," thus sounds in "unjust enrichment," a well-established equitable cause of action that focuses on improper gains by the defendant, rather than on harm to the consumer.

A prohibition on "unjust enrichment" does not mean that a firm cannot earn a just profit in its dealings with a consumer in such situations. But it does mean a prohibition on any supracompetitive terms when dealing with consumers in such situations.

As the Bureau noted in both the ability-to-repay and payment practices sections of the Final Rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans:

> in any transaction involving a consumer financial product or service there is likely to be some information asymmetry between the consumer and the financial institution. Often the financial institution will have superior bargaining power as well. Section 1031(d) of the Dodd-Frank Act does not prohibit financial institutions from taking advantage of their superior knowledge or bargaining power to maximize their profit. Indeed, in a market economy, market participants with such advantages generally pursue their self-interests. However, section 1031 of the Dodd-Frank Act makes plain that there comes a point at which a financial institution's conduct in leveraging its superior information or bargaining power becomes unreasonable advantage-taking and thus is abusive.[66]

Asymmetries in information or bargaining power are not prohibited by the Consumer Financial Protection Act, nor is profit-maximization. But their confluence in particular situations may constitute illegal unreasonable advantage taking. Specifically, when an information asymmetries rises to the level that the consumer lacks understanding

[66] 82 Fed. Reg. 54472, 54621, 54743, Nov. 17, 2017.

of the risks, costs, or conditions of a product or service or when an asymmetry in bargaining power rises to the level that the consumer lacks the practical ability to protect her interests in selecting or using a product, then a prohibition on unjust enrichment springs under section 1031(d)(2)(A)-(C).

3. *Unjust Enrichment Includes Obtaining Supracompetitive Terms*

In the American free enterprise system, all firms—and consumers—are presumed to be attempting to take advantage of their counterparties as part of their wealth-maximizing motivation. Contracts are presumed to be Pareto optimal—no party will contract unless it subjectively believes its welfare is enhanced through the contract, and those gains from trade necessarily come in part from a counterparty. In that sense, all parties are taking advantage of each other when they contract.[67] Or in the terminology of unjust enrichment, all parties believe they will be enriched when they contract.

The free enterprise system is founded, however, on an assumption of fair play in the market place, and the best guardian of fair play is competition. Numerous markets, however, are marked by suboptimal competition, and it is in this space that firms (and consumers) are able to leverage situational advantages to the point that their enrichment is unjust. This is also where regulation should step in, to try and return the market to something as close to possible as the situation that would obtain if there were perfect competition.

Thus, "unreasonable advantage taking" is obtaining more favorable terms and conditions than would obtain in a perfectly competitive market. Accordingly, the inquiry for "taking unreasonable advantage" should be whether there are *any* supracompetitive terms and conditions in a consumer financial product or service.[68] To the

[67] *See* 82 Fed. Reg. 54472, 54621, 54743, Nov. 17, 2017 ("[I]n a market economy, market participants …generally pursue their self-interests.").

[68] It is important to note that a term might be common within an industry and still be supracompetitive. Thus, suppose that most credit card issuers have arbitration clauses in their contracts. If another credit card issuer added an arbitration clause to its contracts without losing market share (or having to offer offsetting benefits for consumers), that arbitration clause would be supracompetitive, even though it is a common term.

extent that a covered person or service provider is obtaining terms that exceed those of its competitors or that can plausibly be alleged to be supracompetitive, the act or practice should be presumed to be "abusive" if one of the three situations outlined in section 1031(d)(2) exists. Put another way, if there is any producer surplus that exceeds that in a perfect competitive equilibrium, that would be "unreasonable advantage."

4. A Producer Surplus Standard Is the Appropriate Analytical Lens In Most Situations

Welfare analysis generally considers either "consumer surplus" or "total surplus." The former looks at the benefits to the consumer, and is similar to a Pareto optimal standard, while the latter looks at the total benefits from a transaction, without regard to their distribution, and is similar to a Kaldor-Hicks optimality standard.[69] Neither is appropriate for "abusive."

A "total surplus" standard is often used in antitrust analysis, but it is plainly inappropriate because it does not consider the distribution of the surplus, and distribution is key to whether advantage taking is reasonable or not. If all of the surplus from a transaction goes to the business, it is hard to imagine that it is anything other than taking unfair advantage.

Yet "consumer surplus," is not quite right either. "Consumer surplus" focuses on the consumer, but the statutory language of section 1031(d)(2)—the "takes unreasonable advantage" is focused on the gains to the business. As between the business and the consumer, it is not always a zero-sum game. The business may receive gains from an act or practice that are not directly from the consumer. For example, a lead generator is not compensated directly by a consumer, but the lead generator might still profit from consumers' lack of

[69] An act or practice that decreases consumer surplus more than it increases producer surplus might also constitute taking unfair advantage, even if it is a standard market practice and thus not a supracompetitive term. *See* 82 Fed. Reg. 544472, 54744 (noting that "Lenders take advantage by imposing financial harm on consumers when they make repeated efforts to extract funds from consumer accounts, and those actions are unreasonable in light of the low expected value of those re- presentments.") The Bureau has not proposed repealing this section of the Final Rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans or otherwise questioned its own past legal analysis.

understanding about a product.[70] Alternatively, a finance company might purchase student loans from a school-lender as part of a scheme to maintain the school's eligibility for title IV Higher Education Act funds.[71] The finance company's gains in such a situation are not simply at the expense of the student borrowers, but also at the expense of the U.S. Department of Education. Thus, a better approach is to concentrate on "producer surplus"—the gains to the business—because it captures gains for which "consumer surplus" fails to account.

Likewise, some acts or practices have a negligible effect on the average consumer's surplus—an arbitration clause, for example, only matters to that limited number of consumers who will have disputes, which is an exceedingly low likelihood for any individual consumer to the point that the clause is of negligible value when viewed *ex ante*. Yet from the standpoint of the business, the clause is quite valuable when viewed *ex ante* because of the law of large numbers: if only one in a hundred thousand transactions (.0001) has a dispute, the consumer will reasonably discount the value of the clause to virtually nothing, but if the business does 10 million transactions in a year, the clauses will matter in 1,000 transactions annually, which might be material. Thus, producer surplus, rather than consumer surplus is the better framework given an industry marked by many small dollar transactions.

5. *Supracompetitive Producer Surplus Should Be Presumed*

Not only should "taking unreasonable advantage" be defined in relation to producer surplus, but supracompetitive producer surplus should be presumed whenever a situation outlined in section 1031(d)(2)(A)-(C) exists.[72] Such supracompetitive terms should be presumed because of the basic economic tenet that all firms will engage

[70] *See, e.g.*, Consent Order, *In the Matter of Zero Parallel, LLC,* No. 2017-CFPB-0017, Sept. 6, 2017, at ¶¶ 14-25.

[71] Complaint, *CFPB v. Aequitas Capital Management*, No. 3:17-cv-01278-MO, D. Ore., Aug. 17, 2017, at ¶¶ 111-126.

[72] I note the possibility that all covered persons offering a particular product are receiving supracompetitive terms. Such a situation might be elucidated through comparison with other substitute products or through comparison with a hypothetical of the revenue from offering the product without the act or practice in question. *See* 82 Fed. Reg. 54472, 54621, Nov. 17, 2017.

in profit-maximizing behavior and will take supracompetitive terms whenever possible.

6. Factors Mitigating Presumption of Supracompetitive Producer Surplus

Recognizing that perfectly competitive markets do not exist anywhere but the academic economist's imagination, it might appear that a producer surplus standard that looks to see whether a business is receiving supracompetitive terms relative to a perfect market proves too much, particularly when it is presumed to exist in all 1031(d)(2) situations. Certain factors mitigate it, however, such that it is a workable one.

First, it should be a rebuttable presumption. A firm might well defend itself by pointing out offsetting benefits from other terms—the entire economics of the transaction must be considered—but the burden of proof would be on the business, not the CFPB, to show the essential fairness of the transaction. That is, the firm might prevail by showing that there is not in fact a supracompetitive surplus when all the terms of a deal are considered. For example, a firm might note that it charges a much higher up-front fee than its competitors, but a much lower back-end, behaviorally contingent fee. Or vice-versa. If the firm can show that its practice is not supracompetitive when viewed in toto, then the presumption will have been rebutted, but the burden of proof should be on the firm given the fundamental economic tenet of profit-maximizing behavior.

Second, the likelihood of enforcement will correspond substantially to the extent of the supracompetitive benefits. The Bureau is unlikely to bring an enforcement action when there is only minimally supracompetitive pricing. Instead, enforcement attention will be focused on the more egregious cases.

And third, and most importantly, one of the three situations outlined in section 1031(d)(2)(A)-(C) must exist. Supracompetitive pricing alone is not "abusive." While there might be antitrust issues with supracompetitive pricing generally, the CFPB's writ is narrower and extends only to supracompetitive pricing in the situations enumerated by statute. A firm can thus readily avoid liability under section 1031(d)(2)(A) and 1031(d)(2)(C) by ensuring consumer understanding of risks, terms, and conditions or disavowing reliance on it to act in the consumer's interests. I now turn to those three situations.

7. Unjust Enrichment Also Includes Acts and Practices That Decrease Consumer Surplus More Than They Increase Producer Surplus

An act or practice that decreases consumer surplus more than it increases producer surplus might also constitute taking unfair advantage, even if it is a standard market practice and thus not a supracompetitive term. Thus, in the payments practices section of the Final Rule on Payday, Vehicle Title, and Certain Small-Dollar Loans, the Bureau found that payday lender payment practices were abusive under section 1031(d)(2)(B) because:

> Lenders take advantage by imposing financial harm on consumers when they make repeated efforts to extract funds from consumer accounts, and those actions are unreasonable in light of the low expected value of those re-presentments.[73]

In other words, the unreasonable advantage taking was because the benefit to the business from the practice was outweighed by the harm to consumers. This suggests an additional form of unjust enrichment, that can constitute taking unreasonable advantage, a sort of Kaldor-Hicks negative scenario in which an act or practice decreases total surplus, even as it increases producer surplus.

D. Situations In Which Taking Unreasonable Advantage Is Prohibited

1. Lack of Consumer Understanding

The first of the 1031(d)(2) prongs addresses taking unreasonable advantage of "a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service."[74] To the extent that a consumer does not understand the risks, costs, or conditions of a product, a consumer cannot exercise

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[73] *See* 82 Fed. Reg. 544472, 54744, Nov. 17, 2017. While the Bureau has proposed repealing other parts of the Final Rule, including on the basis of the Final Rule's legal analysis, the Bureau has not questioned its prior legal analysis in this instance.

[74] 12 U.S.C. § 5531(d)(2)(A).

meaningful choice about whether to transact or not. Absent understanding, the consumer cannot avoid harm by avoiding a contract or by exiting a contract or by using a product more sparingly (or not enough). Lack of understanding thus impairs consumer autonomy.

The CFPB has brought 17 cases containing allegations under section 1031(d)(2)(A). In every one of these cases, the "abusive" violation was based upon taking unreasonable advantage of consumer lack of understanding caused either by (1) a misleading disclosure or (2) a material omission. In other words, section 1031(d)(2)(A) has thus far largely been used as "deception plus."

Indeed, in all but two cases with section 1031(d)(2)(A) allegations, the Bureau has also alleged "deception" based on related behavior. The two cases where it has not involve a payday loan lead generator or lead aggregator. While it is unclear why a deception charge was not brought against the lead generator, such a charge was not possible with the lead aggregator because it had no direct consumer contact, and thus could not make a deceptive statement or omission.

These two cases, however, show one way that section 1031(d)(2)(A) is broader than "deception." Because section 1031(d)(2)(A) does not require a material misstatement or omission by a covered person, it allows for the prosecution of parties that take unreasonable advantage of material misstatements and omissions made by other parties. Thus, a lead generator or a lead aggregator might take unreasonable advantage of consumers' misunderstanding of the legality of their loans based on material omissions by the lenders. If consumers understood that the loans were not enforceable, they might not repay them, which would in turn depress the price that lenders are willing to pay for leads. The lead generator or aggregator thus earns a surplus that it would not in a market with perfect information.

As an enforcement matter, it is important for the Bureau to be able to hold parties like lead generators and lead aggregators to account in such situations. The ultimate lenders are often hard to prosecute; they may be small and fly-by-night and can easily close shop and reopen under a different name. The lead generators and lead aggregators are a central node within on-line lending, and prosecution of such lead generators and aggregators has a force multiplier effect for the Bureau---if the lead generators and aggregators properly diligence their purchases, it ensures compliance more efficiently than having the Bureau sue dozens of lenders.

Section 1031(d)(2)(A) also differs from deception in three other important aspects, all of which flow from the statutory text.

a. Section 1031(d)(2)(A) Does Not Require a Material Misstatement or Omission

First, section 1031(d)(2)(A) differs from deception in that it does not require either a material misstatement or omission by the covered person or service provider. It simply requires that consumers not understand risks, costs or conditions of a financial product or service.

The cause of such misunderstanding could be anything. It could be a misstatement or omission from a third-party (as discussed above); it could be whatever preconceptions a consumer has coming into the transaction; it could be confusing terminology; it could be disclosure through a prolix contract that no consumer reads.

Put another way, no bad behavior is required under section 1031(d)(2)(A).[75] It is enough for a covered person or service provider to obtain an unjust benefit when there is lack of consumer understanding. Thus, section 1031(d)(2)(A) could conceivably be applied to situations where there is no contractual relationship between the consumer and the covered person, such as debt collection, credit reporting, loan servicing, or lead aggregation.

The point is that all section 1031(d)(2)(A) requires is a situation where the consumer does not understand the risks, costs or conditions of a transaction. This is a specific type of severe information asymmetry, as the covered person or service provider will surely have a better understanding than the consumer of the risks, costs or conditions.

The effect of such a severe information asymmetry is to impose a duty on covered persons and service providers: if a consumer does not understand a product's risks, costs or conditions, then the covered person or service provider must either (1) take steps to ensure that the consumer does understand or (2) not have any

[75] 82 Fed. Reg. 54472, 54619, 54624, Nov. 17, 2017.

supracompetitive terms in its dealings with consumers. Such an interpretation is consistent with well-established contract law on unilateral mistake: when one party has reason to know that the other party has made a mistake about a basic assumption on which the contract is founded, the contract is voidable, and the mistaken party can receive restitution.[76]

b. Consumers' Lack of Understanding of Risks, Terms, and Conditions Need Not Be Reasonable

Second, section 1031(d)(2)(A) does not require that the consumer's lack of understanding be reasonable. Contrast this with section 1031(d)(2)(C), where there is an express requirement that the consumer's reliance on a covered person to act in the consumer's interests be reasonable.

The lack of the word "reasonable" to modify "lack of understanding," in section 1031(d)(2)(A), particularly contrasted with its inclusion in section 1031(d)(2)(C), suggests that the "reasonable consumer" standard is inappropriate for section 1031(d)(2)(A). It is open to including a subjective lack of understanding.

c. Section 1031(d)(2)(A) Covers a Broader Range of Lack of Understanding than Section 1031(d)(1).

The third important textual point about section 1031(d)(2)(A) is that it covers understanding of "risks, costs, or conditions" of a product or service. This is broader language than that of section 1031(d)(1), which refers merely to understanding of "a term or condition" of a product or service. The lack of parallel language in two consecutive clauses is unlikely to be a matter of careless drafting. Instead, section 1031(d)(2)(A) covers a broader range of understanding than 1031(d)(1). Whereas section 1031(d)(1) is limited to the actual product terms, section 1031(d)(2)(A) covers not just product terms ("costs or conditions"), but also indirect costs ("costs") and general risks ("risks") associated with the product.

The Bureau has interpreted "costs or conditions" broadly. The most common "abusive" fact pattern are cases involving small-dollar, short-term lenders whose loans allegedly violate state usury and

[76] Restatement (2d) of the Law, Contracts, §§ 153, 158, 211(3); Restatement (3d) of the Law, Restitution and Unjust Enrichment § 5.

licensing laws. The Bureau has alleged in such cases that a consumer's "legal obligation to repay is a material term, cost and condition of a loan," and because the lender did not disclose that the loans are void under state law the defendants took unreasonable advantage of consumer's understanding about their rights and obligations.[77] Thus, as the Bureau has repeatedly alleged under different Directors, legality of an obligation is a "cost or condition."

Likewise, "costs or conditions" readily encompasses product features such as payment allocation rules.[78] It should also extend to things like credit card grace periods, which are virtually impossible for even consumer finance experts to understand, and to amortization schedules.[79]

"Risks" is broader category that covers not just the contractual terms of a transaction, but broader hazards associated with the transaction things. The has not yet brought any actions focused on lack of consumer understanding of broader risks, but one could imagine it including items such as data security and data privacy. Likewise, it could include risks relating to creditors' remedies (*e.g.*, recourse status of a loan), credit reporting (*e.g.*, a misunderstanding about whether a creditor engages in credit reporting and to which agencies), or the consumer's ability to stop payment (*e.g.*, a consumer might not understand that a stop payment order on a check is of limited time duration).

"Risks" might also, for example, cover consumer lack of understanding of the ability to refinance a loan. Consider a consumer

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[77] Complaint, *CFPB v. Golden Valley Lending, Inc.*, No. 1:17-cv-03155, N.D. Ill., April 27, 2017, at ¶¶ 149-152. *See also* First Amended Complaint, *CFPB v. CashCall, Inc.*, 1:13-cv-13167-GAO, Mar. 21, 2014, at ¶¶ 68-71; Consent Order, *In the Matter of Colefax Capital Corporation*, No. 2014-CFPB-0009, July 29, 2014, at ¶¶ 41-43; First Amended Complaint, *CFPB v. NDG Financial Corp.*, No. 1:15-cv-05211-CM, S.D.N.Y. Dec. 11, 2015, at ¶¶ 291-295; Consent Order, *In the Matter of Zero Parallel, LLC,* No. 2017-CFPB-0017, Sept. 6, 2017, at ¶¶ 14-25; First Amended Complaint, *CFPB v. Think Finance, LLC*, No. 4:17-cv-00127-BMM, D. Mont., Mar. 28, 2018, at ¶¶ 152-156. In *Think Finance*, the Bureau changed its formulation to track the statutory language of "risks, costs, or conditions".

[78] Complaint, *CFPB v. PayPal, Inc. & Bill Me Later, Inc.*, No. 1:15-cv-01426, D. Md. May 19, 2015, at ¶¶ 71-75. *See also Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (1965).

[79] *See Consumer Fin. Prot. Bureau v. Nationwide Biweekly Admin., Inc.*, 2017 U.S. Dist. LEXIS 145923, 2017 WL 3948396 (N.D. Cal. Sept. 8, 2017).

with poor credit who gets a very high loan-to-value ratio adjustable-rate mortgage loan, say 97% LTV. There can be clear and perfect disclosure of the loan terms, including of the fact that the loan is of 97% of the appraised value of the property. In that sense, the consumer might well understand the "terms and conditions" of the loan, such as the requirement of repayment and the amount, etc. But the consumer might not understand the risks associated with the product. For example, the consumer might not understand that if the property's value falls, the consumer will not be able to refinance the mortgage should rates go up.[80]

The point here is not what situations necessarily fall into section 1031(d)(2)(A), but that its coverage of lack of understanding of "risks" in particular makes it substantially broader than "deception."

d. Understanding Is of the Nature, Magnitude, and Likelihood of Risks, Terms, and Conditions

Separate and apart from the question of objective vs. subjective lack of understanding, is the level of understanding necessary, specifically of "risks." The Bureau has addressed this in both its Final Rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans (for both the ability-to-repay rule and the payment practices rule) and the Notice of Proposed Rulemaking to repeal the ability-to-repay sections of the Final Rule.

The payment practices section of the Final Rule (which the Bureau has not proposed to repeal), found that:

> a generalized understanding does not suffice to establish that consumers understand the material costs and risks of a product or service. Rather, the Bureau determined that it is reasonable to interpret "lack of understanding" in this context to mean more than mere awareness that it is within the realm of possibility that a particular negative consequence may follow or a particular cost may be incurred as a result of using the product.[81]

Thus, the Bureau noted that:

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[80] *See Commonwealth v. Fremont Investment & Loan*, 452 Mass. 733 (Mass. 2008).
[81] 82 Fed. Reg. 54472, 54740, Nov. 17, 2017.

> Consumers' general understanding that granting authorization can sometimes lead to fees does not prepare them for the substantial likelihood that, in the event their account becomes severely distressed, the lender will continue making payment withdrawal attempts even after the lender should be on notice (from two consecutive failed attempts) of the account's distressed condition. Nor does it prepare them for the result that thereby they will be exposed to substantially higher overall loan costs in the form of cumulative NSF or overdraft fees from their account-holding institution and returned-item fees from their lender, as well as the increased risk of account closure. Moreover, this general understanding does not prepare consumers for the array of significant challenges they will encounter if, upon discovering that their lender is still attempting to withdraw payment after their account has become severely distressed, they take steps to try to stop the lender from using their authorizations to make any additional attempts.[82]

In contrast, in the Notice of Proposed Rulemaking regarding a repeal of the ability-to-repay provisions of the Final Rule, the Bureau took the position that the level of understanding necessary is one of:

> the likelihood and magnitude of risks of harm associated with payday loans sufficient for [a consumer] to anticipate those harms and understand the necessity of taking reasonable steps to prevent resulting injury. Specifically, this means consumers need only to understand that a significant portion of payday borrowers experience difficulty repaying and that if such borrowers do not make other arrangements they either end up in extended loan sequences, default, or struggle to pay other bills after repaying their payday loan.[83]

[82] *Id.*
[83] 84 Fed. Reg. 4252, 4270, Feb. 14, 2019.

There is arguably a tension between the Bureau's positions in the unchallenged part of the Final Rule and in the Notice of Proposed Rulemaking, but the ultimate touchstone is that the level of understanding must be sufficient for a consumer to know to avoid the harm. That would seem, at a minimum to require consumer awareness not just that there are risks, but an understanding of the particular nature of the risks, their magnitude, and likelihood.

2. Inability of Consumer to Protect Her Interests

Section 1031(d)(2)(B) deals with taking unreasonable advantage of "[t]he inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service." As an initial matter, "inability of the consumer to protect," is of course not limited to complete "inability," but also covers situations in which it is impracticable for the consumer to protect her interests in selecting or using a consumer financial product or service.[84]

Several situations would seem to be covered by this section, many of which related in some way to grossly unequal bargaining power or informational asymmetries, but which may extend beyond that.

a. Lack of Consumer Choice: Undertaking a Transaction

First, "inability to protect one's interests" covers situations where the consumer does not choose to use a financial product or service. When a consumer cannot choose whether to use a financial product or service, the consumer is deprived of the ability to protect her interests by declining to use the service. Credit reporting and debt collection both fall into this category. Likewise, creation of accounts or provision of services without consumer consent would fall into this category.[85]

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[84] 82 Fed. Reg. 54472, 54743, Nov. 17, 2017 (addressing payment practices). I note that the Bureau has not proposed a repeal of this portion of the Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule.

[85] Consent Order, *In the Matter of Wells Fargo Bank, N.A.*, 2016-CFPB-0015, Sept. 8, 2016, at ¶¶ 16-37.

b. Lack of Consumer Choice: Selecting a Financial Product or Service Provider

Similarly, it covers situations where the consumer cannot choose the provider of the financial product or service. If the consumer cannot choose the provider of the financial product or service, the consumer cannot avoid a harm by taking her business elsewhere, and the normal protective forces of competition do not work. Third-party loan servicing would fall into this category, as well as problems with service providers to covered persons.[86] Similarly, indorsement of a check presented for cashing prior to the consumer's authorization of the transaction fits into this situation as it effectively precludes the consumer from cashing the check elsewhere.[87]

c. High Switching Costs: Transaction Costs

Third, "inability of the consumer to protect [her] interests" covers situations where there are high switching costs for consumers that result in consumer "lock-in". That is even if the consumer can switch consumer financial products or services, it might be impracticable to do so because of the switching costs. In particular, switching costs are often an up-front, unavoidable cost, whereas the benefits from switching may be uncertain and materialize in the future if ever. In such a situation, consumers might rationally be hesitant to switch product relationships, even if doing so would ultimately be welfare enhancing. Yet the effect of such a situation is that the consumer cannot utilize "exit" as a means to protect her interests.

For example, switching deposit accounts can have high costs for consumers because of the need to rearrange direct deposit and automatic bill payments. At the same time, the benefits are uncertain because of deposit account terms can be changed prospectively with minimal notice, such that a consumer might switch for an offer of a good deal only to subsequently lose a good deal.

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[86] Prepared Remarks by Richard Cordray, Director of the Consumer Financial Protection Bureau, Consumer Advisory Board Meeting, Feb. 20, 2013.

[87] Complaint*, CFPB v. All American Check Cashing, Inc.*, No. 3:16-cv-00356-WHB-JCG, S.D. Miss., May 11, 2016, at ¶¶ 70-71.

d. High Switching Costs: Behavioral Impediments

Beyond situations with high switching costs, there are also situations in which a suboptimal level of switching may be observed, perhaps for some behavioral reason. For example, consumers fail to efficiently refinance their mortgages.[88] While the mechanism explaining consumer behavior may not be perfectly understood, observation of consumer behavior indicates that consumers are unable to protect their interests through exit, and such a situation might well fall into the scope of section 1031(d)(2)(B).

The point here is not that the CFPB need embrace behavioral economics. Instead, it need merely observe that consumers fail to behave as would be rationally predicted. In such a situation, it is apparent that for whatever reason consumers lack the ability to protect their interests in selecting or using a financial product or service.[89]

e. High Switching Costs: Forfeitures

Related to high switching costs is also a situation involving forfeiture. Switching consumer financial relationships may result in a forfeiture separate and apart from transaction costs. For example, in *ITT Educational Services*, the Bureau alleged that consumers were unable to protect their interests in part because their educational credits at ITT were essentially non-transferrable, so if they decided not to take ITT's offer of private student loans, they would forfeit their past educational investment at ITT.[90] Likewise in *Freedom Debt Relief*, the Bureau alleged that the defendant failed to disclose to consumers that they would get their funds back if they withdrew from its debt relief program.[91]

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[88] *See, e.g.*, K. Jeremy Ko & Yoon-Ho Alex Lee, *Consumer Mistakes in the Mortgage Market: Choosing Unwisely Versus Not Switching Wisely*, 14 U. PA. BUS. L.J. 417 (2012).

[89] I read "selecting" to encompass not just initial selection, but also the decision to refinancing or not, that is to select a new financial product or service.

[90] Complaint, *CFPB v. ITT Educational Services, Inc.*, No. 14-cv-292, S.D. Ind., Feb. 26, 2014, at ¶¶ 140, 171.

[91] Complaint, *CFPB v. Freedom Debt Relief, LLC*, No. 3:17-cv-06484, N.D. Cal., Nov. 8, 2017, at ¶¶ 16, 73. The Bureau did not predicate an "abusive" charge on this behavior, but a violation of the Telemarketing Sales Rule and thus of the Consumer Financial Protection Act. Nevertheless, the forfeiture concept remains in the factual background to the abusive charge.

Similarly, in *All American Check Cashing*, the Bureau alleged that consumers were locked into a check cashing transaction with the defendant because the defendant's unauthorized indorsement of the check effectively precluded cashing the check elsewhere.[92] The consumer would thus risk forfeiting the check by choosing a different provider of check cashing services.

Forfeiture situations might also arise with loss of accrued rewards program balances, such as with programs that allow redemption only in increments of $50, which might take require $5,000 of consumer spending to accrue. Thus, a consumer who closes an account when having a $49.99 rewards balance will forfeit that entire balance.

f. Value-Extractive Hold-Up Techniques

Also related to forfeiture are situations in which a business uses its situational leverage to hold-up a transaction to extract additional, unbargained-for compensation. For example, a lender that refuses to close a mortgage unless the borrower pays additional, previously undisclosed closing fees would be taking unreasonable advantage of its situational leverage to hold up the transaction unless it is paid off. The consumer cannot avoid the harm here without surrendering the benefit of his previous agreed-to bargain. This is a classic scenario that would constitute unjust enrichment, and thus taking unreasonable advantage of the consumer's inability to protect his interests.[93]

g. Inability to Bargain Over Contract Terms: Contracts of Adhesion

"Inability to protect interests" also seems to include situations where the consumer cannot bargain over a contract term. For example, in *Freedom Stores*, the Bureau alleged that a forum selection clause took unreasonable advantage of consumers' inability to protect their interests because the consumers could not negotiate the clause.[94] Similarly, in *Security National Automotive Acceptance Corporation*, the

[92] Complaint*, CFPB v. All American Check Cashing, Inc.*, No. 3:16-cv-00356-WHB-JCG, S.D. Miss., May 11, 2016, at ¶¶ 70-71.

[93] Restatement (3d) of the Law, Restitution and Unjust Enrichment, § 14, Illustrations 13, 18, 19.

[94] Complaint, *CFPB v. Freedom Stores, Inc.*, No. 2:14-cv-643, E.D. Va., Dec. 18, 2014*,* at ¶¶ 65-66, 75-76.

Bureau alleged that a clause purporting to allow the lender to contact servicemember borrowers' commanding officers if the borrower defaulted took unreasonable advantage of consumers' inability to protect their interests because the consumers could not negotiate the clause.[95]

h. Inability to Bargain Over Contract Terms: Consumer Financial Distress

Relatedly, there are situations where the consumer is under such acute financial distress that the consumer does not care about product terms (at least up to some reservation price). For example, many borrowers on payday loans, vehicle title loans and refund anticipation loans have acute and immediate needs for cash to cover various expenses.[96] The same goes for consumers seeking to obtain structured settlement advances.[97] These consumers are focused on getting cash and getting it fast. The cost and consequences of the borrowing are a secondary concern that are postponed for another day. Such consumers for all purposes lack the ability to protect their interests in selecting a consumer financial product. Similarly, consumers who are facing an immediate threat of debt collection activities may fall into these groups.[98]) Consumers facing a potential forfeiture might also fall into this category.[99] Again, it is well-established that knowing third-party beneficiaries of consumers'

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[95] Complaint, *CFPB v. Security National Automotive Acceptance Company, LLC*, No. 15-cv-401, S.D.Ohio, June 17, 2015, at ¶¶ 12-13, 25-26. *See also* Complaint, *CFPB v. Freedom Stores, Inc.*, No. 2:14-cv-643, E.D. Va., Dec. 18, 2014, at ¶¶ 46-49, 84-87 (unfairness claim predicated on disclosed right to contact commanding officers).

[96] Complaint, *CFPB & Navajo Nation v. S/W Tax Loans, Inc. et al.*, No. 15-cv-00299, D.N.M., April 14, 2015, at ¶ 44; 82 Fed. Reg. 54472, 54616, 54618, Nov. 17, 2017.

[97] Complaint, *CFPB v. Access Funding, LLC*, No. 16-cv-03758-JFM, D. Md., Nov. 21, 2016, at

[98] Consent Order, *In the Matter of ACE Cash Express, Inc.*, No.2014-CFPB-0008, July 10, 2014, at ¶¶ 15, 29-31; Complaint, *CFPB v. College Education Services LLC*, No. 8:14-cv-3078, M.D. Fla., Dec. 11, 2014 at ¶¶ 10, 13, 21, 56.

[99] *See* Complaint, *CFPB v. ITT Educational Services, Inc.*, No. 14-cv-292, S.D. Ind., Feb. 26, 2014, at ¶¶ 140, 171.

financial distress are subject to rescission of their gains for unjust enrichment.[100]

i. Vulnerable Consumers Populations

To the extent that a consumer has unique situational vulnerabilities that constrain her ability to protect her financial interests, section 1031(d)(2)(B) might also be applicable. A consumer who is hospitalized or incarcerated, a servicemember who has been deployed abroad on active duty,[101] a consumer with cognitive impairments[102] or brain injuries,[103] or a consumer with a limited educational background may all lack the ability to protect their interests in selecting (including switching) or using a financial product or service. The hospitalized consumer, the incarcerated consumer and the servicemember may not be able to respond in time for deadlines, and the consumer with the limited educational background might not understand deadlines or choices.

j. Misinformed Consumers

Finally, consumers' will necessarily lack the ability to protect their interests if they are misinformed.[104] The most obvious of such situations is where a business has engaged in deceptive statements or omissions. The Bureau has alleged section 1031(d)(2)(B) violations in such instances.[105]

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[100] Restatement (3d) of the Law, Restitution and Unjust Enrichment, § 14, illustration 26 ("Lender forecloses a mortgage on Blackacre, the property of Owner, although the mortgage debt has already been paid. The resulting financial pressure obliges Owner to sell Whiteacre. Buyer acquires Whiteacre from Owner with notice of the coercion exercised by Lender. Owner is entitled to rescind the conveyance to Buyer.").

[101] While the Servicemembers Civil Relief Act provides some protection for the servicemember, a SCRA violation might also be an "abusive" act or practice.

[102] Complaint, *CFPB v. Access Funding, LLC*, No. 16-cv-03758-JFM, D. Md., Nov. 21, 2016, at ¶ 28 (lead-poisoning victims).

[103] Complaint, *CFPB v. RD Legal Funding, LLC*, No. 1:17-cv-00890, S.D.N.Y., Feb. 7, 2017, at ¶¶ 23 (NFL football player brain injuries).

[104] *See* 82 Fed. Reg. 54472, 54619, Nov. 17, 2017 (noting that consumers who lack an understanding of the material risks and costs of a product cannot protect their interests).

[105] *See, e.g.,* Complaint, *CFPB v. RD Legal Funding, LLC*, No. 1:17-cv-00890, S.D.N.Y., Feb. 7, 2017, at ¶¶ 72-75 (defendant allegedly misrepresented that product was an assignment of structured settlement, not credit secured by structured

Additionally, "inability of the consumer to protect [her] interests" might cover situations where disclosures are ineffective at affecting consumer behavior. There is little evidence of the efficacy of disclosures in shaping consumer financial behavior outside of the context of the simplest of transactions, such as ATM fee disclosures. Whether this is because of consumers do not understand the disclosures, do not reading the disclosures or discounting the disclosures in some way is immaterial. When disclosures do not register with consumers, consumers lack the ability to protect their interests in selecting or using a financial product or service because they cannot rationally know whether they in fact wish to transact at all or with which particular product or provider.

The problem with disclosures is particularly an issue with boilerplate terms, as distinct from the core economic terms of a deal. For example, consumers may simply not understand the importance of class action waivers and binding mandatory arbitration clauses and thus would be unable to protect their interests in eschewing contracts with such terms if they do not understand their importance. In this regarding section 1031(d)(2)(B) intertwines with section 1031(d)(2)(A).

But even if a consumer understands such boilerplate, it may not matter. If most credit card issuers, for example, have arbitration clauses, the consumer cannot readily avoid such clauses and thus lacks the ability to protect her interests. As the FTC has noted:

> If 80 percent of creditors include a certain clause in their contracts, for example, even the consumer who examines contract[s] from three different sellers has a less than even chance of finding a contract without the clause. In such circumstances relatively few consumers are likely to find the effort worthwhile, particularly given the difficulties of searching for contract terms…[106]

The disincentive to search is particularly acute, the FTC has noted when terms related to default because of its infrequence.[107] The same

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settlement); Consent Order, *In the Matter of Y King S Corp., d/b/a Herbies Auto Sales*, No. 2016-CFPB-0001, Jan. 21, 2016, at ¶¶ 71-76; Complaint, *CFPB v. Pension Funding, LLC*, No. 8:15-cv-1329, C.D. Cal., Aug. 20, 2015, at ¶¶ 79, 83-87.

[106] FTC Credit Practices Rule, 49 Fed. Reg. 7746, Mar. 1, 1984.

[107] *Id.*

might be said of any terms related to debt collection or dispute resolution. Thus, if a supracompetitive contract term is widespread, a consumer may not have reasonable ability to avoid it.

The Bureau has already embraced this approach. For example, in *Security National Automotive Acceptance Corporation*, the Bureau alleged that a contract clause purporting to allow a lender to contact servicemembers' commanding officers upon default took unreasonable advantage of the consumers' inability to protect their interests in part because consumers were unaware of this clause buried in their contracts.[108] Moreover, in *Security National*, the Bureau alleged that even if consumers were aware of the contract clause, it would still have taken unreasonable advantage of the consumers' inability to protect their interests because consumers could not anticipate the nature and frequency of the creditor's threatened and actual contacts with their commanding officers.

3. Reasonable Reliance to Act in the Consumer's Interests

Section 1031(d)(2)(C) covers taking unreasonable advantage of "[t]he *reasonable reliance by the consumer on a covered person to act in the interests of the* consumer." This section was most likely drafted in response to concerns about mortgage brokers steering consumers into higher cost mortgages. While mortgage brokers are not in fact agents of the borrower, borrowers frequently assumed that they were, and thus that they had a duty to get the borrower the best priced mortgage.[109]

The statutory language, however, readily extends to any situation in which there is an undisclosed conflict of interest that might reasonably surprise a consumer. For example, it might extend to consumer financial products and services provided by educational institutions that consumers expect to stand *in loco parentis*;[110] loan servicers whom consumers might (depending on circumstances) believe have an obligation to steer them to the best repayment

[108] Complaint, *CFPB v. Security National Automotive Acceptance Company, LLC*, No. 15-cv-401, S.D. Ohio, June 17, 2015, at ¶¶ 12-13, 25-26.

[109] *See* Laurie Burlingame & Howell E. Jackson, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J. L. BUS. & FIN. 289 (2007).

[110] *See, e.g.*, Complaint, *CFPB v. ITT Educational Services, Inc.*, No. 14-cv-292, S.D. Ind., Feb. 26, 2014, at ¶¶ 180-82.

options;[111] loan brokers, origination agents, and lead generators that imply that they will match the consumer with the lowest-cost lender;[112] conflicted consumer financial advisors;[113] deed of trust trustees (whose name implies a fiduciary relationship); and debt settlement services, which function as an agent of the consumer vis-à-vis creditors.[114] In all of these situations, disclosures could potentially serve as a defense to section 1031(d)(2)(C) as they would affect the reasonableness of the consumer's reliance.

CONCLUSION

In the preceding discussion, I outlined a broad range of situations that can plausibly be fit into the statutory language of section 1031(d). My point here is not to say definitively whether any of these situations is "abusive," much less worthy of an enforcement action. Instead, it is to illustrate that there are myriad situations readily encompassed by the statutory language, including as shown by the Bureau's past enforcement activities.

I do not believe that I have come anywhere close to anticipating all possible situations, however. This is not because of a lack of clarity in the statutory language regarding the limitations on the Bureau's power to proscribe acts and practices as "abusive." Instead, it is because the concept of "abusive," sounding largely in unjust enrichment, is inherently a fact-and-circumstances specific analysis, and it is hard to anticipate such future situations.

Indeed, it would be an act of regulatory hubris for the Bureau to believe that it could anticipate all of the situations that might arise in the future and whether these situations would, when considering all of the facts and circumstances, be fairly said to be "abusive." The consumer finance world is changing too fast, with too many new

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[111] *See, e.g.*, Complaint, *CFPB v. Navient Corp.*, No. 3:17-cv-00101-RDM, M.D. Pa., Jan. 18, 2017 at ¶¶ 139-142.

[112] *See, e.g.*, Consent Order, *In the Matter of Zero Parallel, LLC,* No. 2017-CFPB-0017, Sept. 6, 2017, at ¶¶ 14-25.

[113] *See, e.g.*, Complaint, *CFPB v. Access Funding, LLC*, No. 16-cv-03758-JFM, D. Md., Nov. 21, 2016, at ¶¶ 57-65; Complaint, *CFPB v. College Education Services LLC*, No. 8:14-cv-3078, M.D. Fla., Dec. 11, 2014 at ¶¶ 56-61.

[114] Debt settlement services are governed by the Telemarketing Sales Rule, but could still also be "abusive" under the Consumer Financial Protection Act.

business models, uses of data, and ways of communication to anticipate what issues might arise in five or ten years, much less in twenty-five.

Given the Bureau's inability to completely anticipate future products and situations, the Bureau should not tie its hands unnecessarily by defining "abusive" in a way that in any way narrows the term. Instead, the Bureau should, like the FTC, rely on the common lawmaking process. The good faith of the Bureau's civil service staff, combined with limited enforcement resources and rights of judicial review, will necessarily constrain any possible zealotry in overusing "abusive."

Whether zealotry in terms of underenforcement can be similarly constrained remains to be seen in terms of how the Bureau deals with a possible rulemaking. Specifically, it remains to be seen whether the Bureau truly seeks to clarify the term "abusive" or whether "clarification" is merely cover for a deliberate narrowing of the Bureau's statutory authority by those who because of ideological priors against regulation do not believe in its mission of consumer protection.