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Caveat Emptor or Caveat Vendor? The Evolution of Unfairness in Federal Consumer Protection Law

*Jeffrey P. Naimon, Kirk D. Jensen, Caroline M. Stapleton,
and Sasha Leonhardt**

Under the Federal Trade Commission's original interpretation of unfair or deceptive acts or practices law, financial institutions could feel some sense of security that, if they provided a consumer with a clear understanding of a proposed transaction, the burden was on the consumer to determine whether the transaction was in his or her best interest. Recent actions taken by the Consumer Financial Protection Bureau and prudential regulators, however, suggest that regulators may be creating an expectation that institutions put some conception of consumers' interests first, even when there is no clear assumption of fiduciary or quasi-fiduciary responsibility. This move away from traditional arms-length dealing would place financial institutions in a difficult position: not only would they have to investigate and weigh aspects of a consumer's personal and financial life unrelated to the transaction, but they also may have to substitute their judgment for the consumer's in determining the consumer's best interest—a process almost certainly designed to lead to sub-optimal outcomes for all involved. The authors of this article explore the issues and advise financial institutions to carefully watch future regulatory guidance and enforcement actions for further signs that regulators are imposing quasi-fiduciary duties upon creditors.

"The strongest principle of growth lies in human choice."—GEORGE ELIOT¹

For centuries, two critical distinctions have helped parties to financial transactions understand their rights and obligations with respect to one another: whose money is the subject of the transaction, and what is the parties' relationship? For example, while consumer funds held in trust, or provided to a financial advisor for investment purposes, may impose upon the holder a heightened fiduciary duty of care to the consumer, standard consumer deposits and loans have long been subject to debtor-creditor law without any fiduciary

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¹ GEORGE ELIOT, DANIEL DERONDA 445 (Wordsworth ed. 1996) (1876).

duty to protect the borrower. The common law distinctions between fiduciary and non-fiduciary relationships provide both borrowers and creditors with a clear understanding of their legal obligations from the very beginning of a transaction.

Financial institutions are no strangers to fiduciary duties. They often serve as clients' trustees, executors, agents, or investment advisors, and in each circumstance are legally bound to act for their clients' benefit. By contrast, the principal business of banking—taking deposits and making loans—consists of arm's-length transactions, where the parties sit at opposite sides of the table and each party is free to pursue its own interests. Arm's-length transactions are not subject to fiduciary obligations; rather, these transactions, in addition to being subject to debtor-creditor law, are governed by centuries of common law, as well as federal and state consumer protection statutes, all aimed at ensuring that parties deal with one another fairly and honestly—but not necessarily in the best interests of the other party.

For decades, the primary statute empowering federal regulators to protect consumers from unfair or deceptive acts or practices was Section 5 of the Federal Trade Commission Act ("FTC Act"). Under Section 5, regulators can prevent financial institutions and other companies from engaging in unfair or deceptive acts or practices ("UDAP") with consumers in the absence of fiduciary obligations.² In the past, UDAP enforcement primarily focused on the "procedural" aspects of commerce—marketing, negotiations, and disclaimers—to ensure that consumers understood the terms of a bargain before signing any contract.³ If a financial institution's claims were true and, in context, did not mislead the consumer, the enduring rule was the same as it would be for any other arm's-length commercial transaction: *caveat emptor*, or "buyer beware."

In recent years, however, Congress and federal regulators have begun to ignore *caveat emptor* and procedural fairness in favor of a novel, outcome-driven approach to consumer protection law. Under this new regulatory regime, regulators no longer focus on encouraging free consumer choice but instead

² In addition, all 50 states have enacted their own "mini-UDAP" laws to protect consumers. Unlike the FTC Act, many of these mini-UDAP statutes permit individual consumers—rather than just a government entity—to initiate a private action against a company.

³ See, e.g., Blake D. Morant, *Saliency of Power in the Regulation of Bargains: Procedural Unconscionability and the Importance of Context*, 2006 MICH. ST. L. REV. 925 (2006); Paul Bennett Marrow, *Crafting a Remedy for the Naughtiness of Procedural Unconscionability*, 34 CUMB. L. REV. 11 (2003); Arthur Allen Left, *Unconscionability and the Code. The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967).

require financial institutions to guide consumers to the products and services that are best for them. Specifically, an expanded notion of the unfairness prong of UDAP law, coupled with new consumer protections in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), signal that financial institutions may be required for the first time to ensure that non-fiduciary consumers obtain the best possible outcome when engaging in routine financial transactions. While the government has stopped short of imposing an explicit fiduciary duty on financial institutions, regulators’ actions suggest that financial institutions may now have a *quasi*-fiduciary responsibility toward depositors, borrowers, and other arm’s-length consumers, in direct contrast to longstanding case law.⁴ Should this trend continue, financial institutions may have to expend significant effort and resources to comply with new regulatory expectations as the old rule of *caveat emptor* is cast aside for a more paternalistic model of consumer protection.

FIDUCIARY DUTIES AS THE EXCEPTION, NOT THE RULE

A fiduciary relationship exists when one party is required to act exclusively for the benefit of another party.⁵ Fiduciary relationships typically do not exist between parties transacting at arm’s-length.⁶ A fiduciary must show the other party honesty and confidentiality, and must act in the other party’s best interest, even if the fiduciary’s actions ultimately differ from the other party’s express wishes or instructions.⁷ Traditionally, financial institutions act as fiduciaries when they agree to become a consumer’s trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, or investment advisor.⁸ By contrast, courts have consistently held that absent some special form of trust agreement or other fiduciary arrangement, financial institutions which engage in other transactions with consumers do so at arm’s-length, rather than as parties to a fiduciary relationship.⁹ In an arm’s-length transaction, each party is

⁴ *E.g., N. Shipping Funds I, LLC v. Icon Capital Corp.*, 921 F. Supp. 2d 94, 104 (S.D.N.Y. 2013) (collecting cases).

⁵ See BLACK’S LAW DICTIONARY 290 (3d pocket ed. 2006).

⁶ *Trianco, LLC v. IBM Corp.*, 271 F. App’x 198, 203 (3rd Cir. 2008).

⁷ See *DOI v. Klamath Water Users Protective Ass’n*, 532 U.S. 1, 14 (2001).

⁸ The OCC has determined that national banks occupying these roles are acting in a fiduciary capacity. 12 C.F.R. § 9.2(e).

⁹ *Anstine v. Carl Zeiss Meditec AG*, 531 F.3d 1272, 1277 (10th Cir. 2008) (quoting BLACK’S LAW DICTIONARY 109 (6th ed. 1990)).

responsible for protecting his or her own interests.¹⁰ Courts have held that the relationships between a bank and a depositor,¹¹ a personal banker and a customer,¹² and a lender and borrower¹³ are all non-fiduciary in nature.

For example, in *Jackson v. Bank of America Corp.*, the Seventh Circuit held that a fiduciary relationship does not arise between a borrower and a lender unless “certain facts exist which establish a relationship of trust and confidence between the two.”¹⁴ According to the *Jackson* court, the “typical mortgagor-mortgagee relationship” does not impose fiduciary duties upon a lender.¹⁵ Similarly, in *Wigod v. Wells Fargo Bank, N.A.*,¹⁶ the Seventh Circuit held that no fiduciary relationship existed between a borrower and a mortgage servicer. The *Wigod* court noted:

To the extent Wells Fargo had a duty to service [the borrower’s] home loan responsibly and with competent personnel, that duty emerged solely out of its contractual obligations. As we recently noted, a mortgage contract itself “cannot give rise to an extra-contractual duty without some showing of a fiduciary relationship between the parties,” and no such relationship existed here.¹⁷

In all, courts have been reluctant to declare that fiduciary relationships exist in what would otherwise be arm’s-length scenarios—and for good reason, as such a relationship imposes serious costs and liabilities upon a fiduciary. As a general rule, courts only impose fiduciary relationships when both parties

¹⁰ *Morgan Stanley & Co. v. SEC*, 126 F.2d 325, 335 (2d Cir. 1942).

¹¹ *Geler v. Nat’l Westminster Bank*, 770 F. Supp. 210, 214 (S.D.N.Y. 1991) (“The relationship of a bank to its depositors is a contractual relation of a debtor to its creditors, and does not give rise to a fiduciary relation.”)

¹² *Manno v. BAC Home Loans Servicing, LP*, No. A-11-CA-347 LY, 2011 U.S. Dist. LEXIS 96067, at *17 (W.D. Tex. Aug. 26, 2011) (finding that no informal fiduciary relationship existed between a bank customer and his personal banker of approximately 35 years).

¹³ *Jackson v. Bank of Am. Corp.*, 711 F.3d 788, 792 (7th Cir. 2013) (holding that the “typical mortgagor-mortgagee relationship” is not a fiduciary one); *Farah v. Mafriqe & Kormanik, P.C.*, 927 S.W.2d 663, 675–76 (Tex. Ct. App. 1996) (“The relationship between a borrower and lender is usually neither a fiduciary relationship nor a special relationship.”); *but see Brass v. Am. Film Tech., Inc.*, 987 F.2d 142, 151 (2d Cir. 1993) (noting that in the past, scholarly commentators have identified the relationship between banks and depositors as an informal fiduciary relationship).

¹⁴ *Jackson*, 711 F.3d at 792 (quoting *Block v. Lake Mortg. Co.*, 601 N.E.2d 449, 452 (Ind. Ct. App. 1992)).

¹⁵ *Id.* (internal quotations omitted).

¹⁶ 673 F.3d 547 (7th Cir. 2012).

¹⁷ *Id.* at 568.

consent to the creation of a fiduciary relationship. The Eighth Circuit’s opinion in *Southern Trust Co. v. Lucas*¹⁸ has been a leading case for nearly a century to support the proposition that no fiduciary relationship exists between a bank and consumers absent evidence of an agreement to the contrary. In *Southern Trust*, a widow engaged a trust company to exchange her apartment house for a farm and then to sell the farm, with a promise to provide her with the profits minus the trust company’s commission.¹⁹ Unbeknownst to the widow, the trust company was also acting as the agent for the owner of the farm in question, and had already unsuccessfully attempted to sell the farm for an amount far less than the value of the widow’s apartment house.²⁰ The widow ultimately lost nearly \$15,000 in connection with the transaction and sued the trust company for damages.²¹

In discussing whether or not a fiduciary relationship existed between the trust company and the widow, the Eighth Circuit emphasized that “one party cannot create a legal obligation or status by pleading ignorance and inexperience to an opposing party in a business transaction.”²² A fiduciary duty, according to the court, can only be created if both parties consent “by word or deed to an alteration” of their default status as arm’s-length negotiators.²³ However, the Eighth Circuit noted that given the trust company’s “full knowledge of [the widow’s] inexperience, desires, and reliance upon their protection, *and their representation of her interests*,” the company’s decision to proceed “under conditions which would have justified her in believing they were caring for her interests” effectively created a fiduciary relationship.²⁴ Thus, the Eighth Circuit found that in this limited circumstance, the trust company held itself out as a fiduciary and therefore assumed a fiduciary obligation to the widow, including the duty to act in her best interest.²⁵

Although the unique facts in *Southern Trust*—a vulnerable widow, a company aware of that vulnerability, and, most importantly, a company which “assumed” the responsibility to act on the widow’s behalf—ultimately led the court to conclude that there was a fiduciary relationship, courts generally cite *Southern*

¹⁸ 245 F. 286 (8th Cir. 1917).

¹⁹ *Id.* at 287.

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 288.

²³ *Id.*

²⁴ *Id.* (emphasis added).

²⁵ *Id.*

Trust for the principle that a consumer's decision to do business with a financial institution, standing alone, cannot create a fiduciary relationship. In other words, according to the *Southern Trust* court, *both* parties must acquiesce to entering into a fiduciary relationship—either by word or deed—for fiduciary duties to be imposed upon a financial institution. For example, the Virginia Supreme Court cited *Southern Trust* to hold that no fiduciary duty was owed by a banker to his customer:

We trust most men with whom we deal. There must be something reciprocal in the relationship before [fiduciary responsibility] can be invoked [. . .] We do not for a moment doubt the fact that Miss Anderson trusted this bank and its cashier, Hancock, just as she trusted two other Richmond Banks from which she bought bonds. But that is not enough [. . .] The presumption is that people who deal with each other, grown men and women, deal with each other as such[.]²⁶

In other words, a fiduciary relationship does not arise between a financial institution and a consumer merely because the consumer makes a bad bargain.²⁷

More recently, courts have relied on another Illinois state court case, *Santa Claus Industries, Inc. v. First National Bank*,²⁸ to illustrate a narrow exception to the *caveat emptor* rule. In *Santa Claus Industries*, the court held that while the relationship between a bank and a borrower is not automatically fiduciary in nature, a fiduciary relationship may be created if a consumer places trust and confidence in the bank, and the bank thereby gains influence and superiority over the consumer.²⁹ The court noted that the degree of trust and confidence necessary to create this type of fiduciary relationship could be shown through a variety of factors, including “degree of kinship, age disparity, health, mental condition, education, business experience, [and] extent of reliance.”³⁰

Although the *Santa Claus Industries* court did not address whether consent was required to create a fiduciary relationship, the Seventh Circuit reaffirmed the need for both parties—fiduciary and beneficiary—to consent to a fiduciary relationship. One year after *Santa Claus Industries*, in *Pommier v. Peoples Bank Marycrest*,³¹ Pommier sued his lender bank for breach of fiduciary duty. The

²⁶ *Hancock v. Anderson*, 160 Va. 225, 240–41 (1933).

²⁷ *De Witt Cnty. Pub. Bldg. Comm'n v. Cnty. Of De Witt*, 128 Ill. App. 3d 11, 27 (1984).

²⁸ 216 Ill. App. 3d 231 (1991).

²⁹ *Id.* at 238.

³⁰ *Id.*

³¹ 967 F.2d 1115 (7th Cir. 1992).

Seventh Circuit held that the default relationship between a bank and a borrower is not a fiduciary one, and noted that the borrower had failed to establish that any of the *Santa Claus* factors applied in his case.³² Specifically, the Seventh Circuit found that the borrower in *Pommier* was:

neither so young and naïve as to be necessarily dominated by the bank, nor was he so very old that there could be even an inference that he was *no longer in possession of his faculties*. There has been no allegation of *failing health*, or any *mental condition which would leave [the borrower] unable to conduct his own affairs* [. . .] While the bank officers may have had more business experience than [the borrower], he was not a novice in the business world.³³

In addition to looking to the *Santa Claus Industries* factors, the Seventh Circuit also held that “the dominant party must accept the responsibility, accept the trust of the other party before a court can find a fiduciary relationship.”³⁴ The *Pommier* court did not find any evidence that the lender had accepted such a responsibility.³⁵ The Seventh Circuit moreover noted that no fiduciary duty could exist if the bank’s position was only “slightly dominant”—a requirement that was not mentioned by the state court in *Santa Claus Industries*.³⁶ As the borrower had failed to establish an implied fiduciary relationship between himself and his lender, the court rejected his claim of breach of fiduciary duty.³⁷

As cases like *Pommier* illustrate, the basic principle articulated in *Southern Trust*—that financial institutions do not have a fiduciary duty to consumers absent an agreement to the contrary—has been the default rule for nearly a century. While some consumers may trust a financial institution to provide the consumer with products and services that are in the consumer’s best interests, a consumer’s trust alone does not a trustee make.³⁸ Thus, in the absence of an agreement to elevate an ordinary business transaction to a fiduciary relationship, the well-established default rule has been *caveat emptor*.

³² *Id.* at 1116.

³³ *Id.* at 1119 (emphasis added).

³⁴ *Id.* (emphasis added) (citing *De Witt*, 128 Ill. App. 3d at 25).

³⁵ *Id.* at 1120.

³⁶ *Id.* at 1119 (citing *Mid-Am. Nat’l Bank v. First Savings & Loan*, 161 Ill. App. 3d 531, 538 (1987)); see also *Avila v. Citimortgage, Inc.*, No. 13 C 3566, 2013 U.S. Dist. LEXIS 142259, at *5 (N.D. Ill. Oct. 2, 2013).

³⁷ *Pommier*, 967 F.2d at 1120.

³⁸ *Farab*, 927 S.W.2d at 676 (“[s]ubjective trust is not enough to transform arms-length dealing into a fiduciary relationship.”).

TRADITIONAL INTERPRETATIONS OF FEDERAL UDAP LAW

Although borrowers and depositors have generally been unable to rely on common law fiduciary relationships with financial institutions for routine transactions, federal statutes prohibit financial institutions from engaging in unfair or deceptive conduct in connection with arm's-length consumer transactions. At the federal level, financial institutions are barred from "unfair or deceptive acts or practices in or affecting commerce" under Section 5 of the FTC Act.³⁹ Although Congress drafted Section 5 broadly, the Federal Trade Commission ("FTC")—which has administrative authority over non-bank entities—and the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC")—which have administrative authority over national and state-chartered banks and thrifts—have provided guidance regarding acts that may be deemed violations of UDAP law. Yet none of this guidance suggests that UDAP law imposes any sort of fiduciary or *quasi*-fiduciary duty on financial institutions or otherwise requires them to provide products or services that are in the consumers' best interests in arm's-length transactions. Rather, regulators viewed UDAP law as ensuring that financial institutions did not limit consumers' ability to decide which products are in their own best interest.

In 1980 the FTC issued its seminal Policy Statement on Unfairness ("Policy Statement"), in which it outlined the three essential factors in determining whether a practice is unfair to consumers:

- (a) whether the practice injures consumers;
- (b) whether the practice violates public policy; or
- (c) whether the practice is unethical or unscrupulous.⁴⁰

In the Policy Statement, the FTC acknowledged that the first of these factors—consumer injury—was the most important and consequently the primary focus of the FTC's enforcement efforts.⁴¹ The FTC further explained that to establish unfairness, the injury had to be (a) substantial, (b) not outweighed by countervailing benefits to consumers or competition, and (c)

³⁹ 15 U.S.C. § 45(a)(1). For a brief history of UDAP law, see Jeffrey P. Naimon & Kirk D. Jensen, *The UDAP-ification of Consumer Financial Services Law*, 128 BANKING L.J. 22, 23–25 (2011).

⁴⁰ FTC Policy Statement on Unfairness, appended to *Int'l Harvester Co.*, 104 F.T.C. 949, 1070 (Dec. 17, 1984).

⁴¹ *Id.*

not reasonably avoidable by consumers themselves.⁴²

While the FTC did not explicitly mention fiduciary relationships in its Policy Statement, it nonetheless emphatically rejected the idea that UDAP's unfairness prong somehow limited consumers' responsibility for their own decisions in arm's-length transactions:

Normally we expect the marketplace to be self-correcting, and *we rely on consumer choice*—the ability of individual consumers to make their own private purchasing decisions without regulatory intervention—to *govern the market*. We anticipate that consumers will survey the available alternatives [when purchasing products, entering into financial services transactions, or evaluating loss mitigation options from a mortgage servicer], choose those that are most desirable, and avoid those that are inadequate or unsatisfactory. However, it has long been recognized that certain types of sales techniques may prevent consumers from effectively making their own decisions, and that corrective action may then become necessary. Most of the Commission's unfairness matters are brought under these circumstances.⁴³

This language is acutely incompatible with the existence of a fiduciary or *quasi*-fiduciary duty between financial institutions and consumers. As stated here, a fiduciary duty would have required the financial institution, not the individual consumer, to choose with care among available alternatives on the consumer's behalf, thereby robbing the consumers of the freedom—indeed, the responsibility—to make this decision on their own. Moreover, the FTC's Policy Statement contained no indication that financial institutions were required to advise consumers based upon an analysis of what was in consumers' best interests; in fact, as the opposing party to the transaction, it would be inappropriate for a financial institution to do so. The FTC further acknowledged that, consistent with empowering consumers to take responsibility for their own choices, UDAP enforcement actions exist 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.”⁴⁴ In other words, a financial institution's decision to offer, and a consumer's free decision to purchase, a product would not be considered unfair; regulators would not second-guess the decisions of informed consumers under UDAP law. To be considered unfair, the practice

⁴² *Id.*

⁴³ *Id.* (emphasis added).

⁴⁴ *Id.*

would have to cause unjustified consumer harm that the consumers could not avoid—perhaps because of a financial institution’s coercive, misleading, or manipulative sales tactics.⁴⁵

In fact, the FTC’s UDAP enforcement actions favor consumer choice so strongly that they could be considered almost “anti-fiduciary.” For example, in a 1971 UDAP complaint, the FTC alleged that a publisher engaged in an unfair practice when it decided to offer consumers a renewal option that the publisher believed was in their best interests without informing the customers that other options were available.⁴⁶ “The position of [the publisher] appears to be that they were acting in the best interest of subscribers,” the FTC stated in its complaint. “This excuse is without merit since *subscribers were entitled to determine their own best interests.*”⁴⁷ Thus, not only were companies not required to protect the best interests of consumers, but an institution’s decision to act as a *de facto* fiduciary was itself an unfair practice since it restricted consumers’ freedom of choice. The FTC confirmed this approach in a 1984 enforcement action when it stated that UDAP’s purpose was not to “mandate specific conduct or specific social outcomes, but rather [. . .] to ensure simply that markets operate freely, so that consumers can make their own decisions.”⁴⁸

Historically, the federal banking regulators have embraced the FTC’s pro-consumer choice interpretation of federal UDAP law. In 2002, the OCC issued its own UDAP guidance for national banks that focused on the lending and marketing contexts.⁴⁹ This guidance, based primarily on the FTC’s 1980 Policy Statement, noted that the OCC would not find a practice to be unfair

solely on the grounds that a consumer could have obtained a more appropriate or satisfactory product or service elsewhere. Rather, consumer harm caused by a practice that is coercive or that otherwise effectively inhibits the consumer from making an informed choice would be considered not reasonably avoidable [and thus an unfair or deceptive act or practice].⁵⁰

The Board and the FDIC followed suit in 2004 by adopting the FTC’s Policy

⁴⁵ *Id.*

⁴⁶ *In re Curtis Publ’g Co.*, 78 F.T.C. 1472 (1971).

⁴⁷ *Id.* at *36 (emphasis added).

⁴⁸ *In re Int’l Harvester Co.*, 104 F.T.C. 949, at *310 (1984).

⁴⁹ Guidance on Unfair or Deceptive Acts or Practices, OCC Advisory Letter 2002-3 (Mar. 22, 2002).

⁵⁰ *Id.*

Statement on unfairness in their jointly-issued UDAP guidance.⁵¹ Their statement largely echoed the FTC’s language regarding unfairness and noted that it was not the purpose of federal UDAP law to ensure that fully-informed consumers made wise decisions in the marketplace.⁵² The joint Board/FDIC guidance did differ, however, from the statements issued by the OCC and FTC when it suggested that “banks should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who are not financially sophisticated.”⁵³ In retrospect, this “particular care” requirement could be viewed as an early harbinger of the changing regulatory approach to UDAP law from a focus on defending consumer choice towards an outcome-based analysis.

RECENT TRENDS: FINANCIAL INSTITUTIONS AND *QUASI-FIDUCIARY* DUTIES

In the years since the 2008 economic crisis, Congress and federal regulators have shifted the way they view relationships between financial institutions and consumers. Regulators no longer appear to consider routine consumer financial transactions to be traditional arm’s-length transactions. Rather, the message from federal regulatory agencies—principally through enforcement complaints and consent orders—is that lenders are at least partially responsible for ensuring that consumers receive the best possible outcome even in arm’s-length transactions. If this pattern continues, lenders may be required to act almost as *quasi*-fiduciaries for consumers, notwithstanding the absence of any actual fiduciary relationship under the law.

Is there Anything Fair about Unfairness Anymore?

Recently, federal regulators have begun to expand their interpretation of unfairness under UDAP law. As discussed above, traditional unfairness encompassed those acts and practices that prevented consumers from freely making decisions in their own best interests. Yet the new concept of “unfairness” appears to have shifted the burden of deciding what is in a consumer’s best interest from consumers themselves to financial institutions.

In 2008, for example, the OCC based one UDAP enforcement action in part on a claim that the bank had engaged in “a pattern or practice of disregard of

⁵¹ Statement on Unfair or Deceptive Acts or Practices by State-Chartered Banks, jointly issued by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (Mar. 11, 2004).

⁵² *Id.*

⁵³ *Id.*

the interests of consumers involved in transactions with the payment processors and direct telemarketers.”⁵⁴ Although the language may sound innocuous, this nonetheless signaled a major shift in UDAP enforcement—neither the FTC’s Policy Statement on unfairness nor the OCC’s own UDAP guidance ever required a lender to protect consumers’ interests in an arm’s-length sale. The OCC never explained its basis for claiming that a bank had any responsibility, let alone one which resembles a *quasi*-fiduciary duty, to take consumers’ interests into account.

The OCC is not alone in expanding the scope of UDAP. Indeed, recent FTC complaints filed against Apple, Inc. (“Apple”) and Amazon.com, Inc. (“Amazon”) suggest that the FTC is equally as willing to expand the notion of what constitutes unfairness. In *In re Apple Inc.*, a majority of FTC Commissioners found that Apple engaged in an unfair act or practice by allowing users to purchase apps on the iPhone for fifteen minutes after their first purchase without reentering their password.⁵⁵ This practice enabled children to make unauthorized purchases using their parents’ iPhones and resulted in undesired charges on the parents’ credit cards.⁵⁶ The FTC’s complaint claimed that Apple’s failure to obtain express, informed consent for these charges was an unfair practice under Section 5 of the FTC Act.⁵⁷

In a dissenting statement, FTC Commissioner Joshua Wright argued that the majority had incorrectly relied upon a more expansive interpretation of UDAP law than described in its 1980 Policy Statement when it found that Apple’s conduct constituted an unfair act or practice.⁵⁸ As Commissioner Wright stated, “The test the Commission uses to evaluate whether an unfair act or practice is unfair used to be different . . . I do not believe the Commission has met its burden to satisfy all three requirements in the unfairness analysis.”⁵⁹ He noted that Apple’s case was distinguishable from all prior FTC unfairness actions because it concerned an act or practice “that results in some injury to one group of consumers but that generates benefits for another group.”⁶⁰ Commissioner Wright believed that the FTC should have conducted a more robust analysis of the net harm caused by Apple’s practices given the benefits

⁵⁴ OCC Consent Order for a Civil Money Penalty, No. 2008-027 (Apr. 24, 2008).

⁵⁵ *In re Apple Inc.*, No. 112-3108 (Jan. 15, 2014).

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.* (Wright, J.D., dissenting).

⁵⁹ *Id.* at 2.

⁶⁰ *Id.* at 3.

that it provided to some consumers. “The Commission,” he wrote, “under the rubric of ‘unfair acts and practices,’ substitutes its own judgment for a private firm’s decisions as to how to design its product to satisfy as many users as possible”⁶¹ In all, the *Apple* complaint demonstrates that the FTC and other federal regulatory agencies may well be reversing decades of UDAP law by finding unfairness where the regulator believes that the conduct is not in some consumers’ interests, even if the conduct unequivocally generates benefits for other consumers.

In a similar action against Amazon,⁶² the FTC alleged that Amazon engaged in unfair acts or practices by failing to require consumers using Amazon apps to enter a password in order to make “in-app” purchases, particularly for apps that were likely to be used by children making in-app purchases without parental authorization.⁶³ The FTC claimed that charges to consumers resulting from in-app purchases had caused, or were likely to cause, substantial injury that could not be reasonably avoided⁶⁴—this, despite Amazon’s statement that it provided consumers with “prominent notice of in-app purchasing, effective parental controls, real-time notice of every in-app purchase, and world-class customer service.”⁶⁵

The *Amazon* action further illustrates the FTC’s view that consumers are unable to take action on their own behalf to avoid financial injury even when they received prior notice of the potential for in-app charges and had access to preventative measures such as parental controls to avoid undesired costs. Moreover, as in *Apple*, the FTC’s complaint in *Amazon* failed to consider that many consumers would benefit from—and may prefer—Amazon’s existing in-app purchase practices. Instead, the FTC appears to be relying on its UDAP authority to require companies to make decisions based on what the FTC perceives to be in consumers’ best interests, rather than what the companies themselves determine is best for their businesses and their relationships with consumers, or even to allow consumers to make these decisions themselves.

Prohibition of UDAAPs

In addition to the regulatory expansion of UDAP law, Congress’ enactment

⁶¹ *Id.* at 1.

⁶² *FTC v. Amazon.com, Inc.*, No. 2:14-cv-01038 (W.D. Wash. filed Jul. 10, 2014).

⁶³ *Id.*

⁶⁴ *Id.* at 11.

⁶⁵ Letter from Andrew C. Devore, Vice President and Associate General Counsel, Amazon, to the Honorable Edith Ramirez, Chairwoman, Federal Trade Commission (Jul. 1, 2014) (*available at* <http://www.scribd.com/doc/233383359/Amazon-letter-to-FTC>).

of the Dodd-Frank Act created a new prohibition on unfair, deceptive, *and abusive* acts and practices (“UDAAPs”) that is distinct from the requirements under Section 5 of the FTC Act. While the Dodd-Frank Act’s explanation of “unfair” and “deceptive” acts and practices reflects the FTC’s previous interpretations of those terms, the novel and largely untested concept of abusiveness is amorphously defined as covering any act or practice that:

- (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- (2) takes unreasonable advantage of—
 - (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or 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.⁶⁶

This definition—and the last provision in particular—has raised concern among financial institutions that the Consumer Financial Protection Bureau (“CFPB”) will use UDAAP law to impose *quasi*-fiduciary responsibilities on financial institutions by taking an expansive view of the definition of “reasonable reliance.”⁶⁷ Under such a *quasi*-fiduciary view, there is risk that the CFPB might go so far as to require financial institutions to go beyond the requirements applicable to all other industries by (1) evaluating each individual consumer’s expectations to determine whether the consumer is “reasonably relying” upon the institution to act in the consumer’s interests, and (2) if so, ensuring that the transaction does not take “unreasonable advantage” of the consumer’s belief. These requirements are contrary to the norms of a standard arm’s-length transaction, in which the only criterion in determining whether an institution acted fairly is an objective evaluation of whether the institution uses coercive tactics or conceals material information—not the subjective impressions of the consumer or the consumer’s mistaken beliefs.

The CFPB has thus far only initiated a handful of UDAAP enforcement

⁶⁶ 12 U.S.C. § 5531(d).

⁶⁷ See e.g. Tiffany S. Lee, *No More Abuse: The Dodd-Frank and Consumer Financial Protection Act’s “Abusive” Standard*, 14 J. CONSUMER & COM. L. 118, 122 (2011) (“Though the Bureau has yet to define what constitutes ‘unreasonable advantage,’ the language could be construed to establish a quasi-duty of care owed by lenders to borrowers, limiting the amount that a lender could profit when one of the three prohibited conditions described in section 1031 exist.”).

actions based upon allegations of abusive acts or practices. In 2013 the CFPB alleged that American Debt Settlement Solutions, Inc. (“ADSS”) had engaged in abusive practices with respect to consumers who enrolled in its debt-relief programs.⁶⁸ Specifically, the CFPB found that ADSS’ actions were abusive because consumers reasonably relied on ADSS “to act in their interest by enrolling them in a debt relief program that they can reasonably be expected to complete, and which will therefore result in the negotiation, settlement, or alteration of the terms of their debts”; in fact, according to the CFPB, ADSS knew that the likelihood that these programs would be successful was very small.⁶⁹ However, the CFPB’s complaint did not explain why the consumers’ belief that ADSS was working in their interest was reasonable, nor how ADSS took advantage of the consumers’ belief.

The CFPB’s expansive interpretation of abusive conduct may also include requiring financial institutions to anticipate consumers’ legal defenses to the institutions’ claims. In a recent enforcement action against CashCall, Inc. (“CashCall”), a purchaser and servicer of consumer installment loans, the CFPB claimed that CashCall engaged in abusive acts or practices when it sought to collect on loans that were fully or partially void under state usury or licensing laws.⁷⁰ In addition to any potential issues raised by state law, the CFPB found that CashCall’s conduct was abusive because

[c]onsumers generally do not know or understand the impact that [usury and licensing laws] have on their loans. Consumers who obtained [loans] in [states] where usury laws or consumer-licensing regimes rendered those loans void, or otherwise limited the consumer’s obligation to repay them, typically lacked an understanding that those state laws vitiated Defendants’ collection rights on all or part of the consumers’ repayment obligations By nevertheless taking, or attempting to take, the full loan balance from those consumers, Defendants took unreasonable advantage of consumers’ lack of understanding about the impact of applicable state laws on the parties’ rights and obligations[.]⁷¹

The *CashCall* action demonstrates that under the CFPB’s interpretation of UDAP, the burden of protecting consumers’ own legal rights is shifting to

⁶⁸ Complaint, *CFPB v. ADSS, Inc.*, No. 9:13-cv-80548-DMM, ECF No. 1 (S.D. Fla. filed May 30, 2013).

⁶⁹ *Id.* at 15.

⁷⁰ Complaint, *CFPB v. CashCall Inc.*, No. 1:13-cv-13167, ECF No. 1 (D. Mass. Dec. 16, 2013).

⁷¹ *Id.* at 21–22.

financial institutions. Not only does this effectively impose fiduciary duties where none exist, but it creates significant practical problems as well. If a debt collector cannot collect a debt when a consumer could assert an affirmative defense, then the debt collector will have to analyze every debt collection action from the consumer's point of view and act accordingly. This is an impossible task—in most cases only the consumer has the facts to determine whether there is a proper defense to collection, and thus only the consumer should have the burden of raising such defenses. For generations, and for good reasons, the burden has been on consumers to raise their own defenses to legal actions.⁷² There is no evidence that in enacting Dodd-Frank, Congress intended to overturn decades of settled law when it enacted the “abusive” prong of UDAAP.⁷³

IMPACT ON CONSUMERS AND INSTITUTIONS

Implicit in the new *quasi*-fiduciary duty imposed by UDAP and UDAAP law is an assumption that financial institutions are in a better position than many consumers to know what is in each consumer's interest. This idea is contrary to the arm's-length paradigm under which banks and borrowers have conducted business for centuries.⁷⁴ Requiring financial institutions to defend consumers' interests in arm's-length transactions—even when it is to the detriment of the financial institution—effectively substitutes the institution's judgment for that of individual consumers regarding important financial decisions. This outcome is inconsistent with the original intention behind UDAP⁷⁵ and ultimately harms consumers, as a bank may choose to deny consumers access to products or services that they rightly believe could benefit them, all so the bank can comply with UDAP/UDAAP.

One example may illustrate this point. Assume a consumer applies for a cash-out refinance loan that results in a higher outstanding principal balance, higher interest rate, and higher monthly payment. Would this transaction be unfair to the consumer? Based on these facts, one could argue that this transaction is not in the consumer's best interests, potentially even harms the

⁷² See, e.g., *Conn v. Gabbert*, 526 U.S. 286, 292–93 (1999) (“The plaintiff generally must assert his own legal rights and interests[.]”) (quoting *Warth v. Seldin*, 422 U.S. 490, 499 (1975)).

⁷³ See, e.g., *Robert C. Herd & Co. v. Krawill Mach. Corp.*, 359 U.S. 297, 304 (1959).

⁷⁴ For centuries, merchants and buyers have known that they are on different sides of a transaction, and history is replete with (sometimes stark) examples of this relationship. See, e.g., William Shakespeare, *THE MERCHANT OF VENICE* (c. 1597).

⁷⁵ See *In re Curtis Publ'g Co.*, 78 F.T.C. 1472 (1971) (see discussion *supra* accompanying n.47).

consumer, and arguably is unfair. Now assume that the consumer wants the cash to pay for an extravagant vacation that the consumer has long dreamed of taking. Does this fact change the analysis, or does a more narrow focus on the consumer's financial well-being trump the fulfillment of the consumer's dream? What if we change the hypothetical and assume that the consumer wanted the funds from the cash-out refinance to help pay down an even higher-interest credit card balance? Or to cover tuition for a child's college education? Or to pay medical expenses? Or to care for aging parents? Would this transaction now be in the consumer's best interests? This hypothetical illustrates the difficulties financial institutions may face in substituting their judgment for the consumer's regarding the consumer's best interests, and why financial institutions have not, until very recently, been asked to make these choices.

This expanded interpretation of consumer protection law imposes a cost on financial institutions that is not outweighed by any real benefit to consumers, and may in fact cost consumers more. The time and effort for a consumer to decide what is in his or her own interest is far less than the cost an institution would incur to make the same determination. Financial institutions would have to supplement the research they already perform on their customers with inquiries into each customer's future plans, personal and family circumstances,⁷⁶ savings habits, risk appetite, and so forth—"many different factors—including . . . the situation of the borrower, determine whether a loan is in a borrower's best interest."⁷⁷ The institution would then have to convert these qualitative characteristics into quantitative data to determine whether a given product would be in the customer's interest. Performing this analysis for every transaction would be prohibitively expensive and generate costs that likely would be passed on to consumers in the form of higher fees or interest rates. More troubling, however, is that all of this time, effort, and expense would generate little benefit for consumers, given the likelihood that the institution could miss a pertinent piece of consumer-specific information and provide the

⁷⁶ To show just one example of the absurdity of such a standard, consider the fact that statistical evidence—and common sense—strongly indicate that divorce is a "trigger event" for mortgage default. See Yonheng Deng, *et al.*, *Mortgage Terminations, Heterogeneity and the Exercise of Mortgage Options*, 68 *ECONOMETRICA* 2, 280 (2000). Thus, a creditor acting as a fiduciary could arguably be required to ask a mortgage loan applicant whether he or she is happily married. Indeed, as lenders have been criticized for failing to verify borrowers' undocumented statements about their financial situation, creditors could potentially be obligated to seek out detailed facts about a couple's marital union before approving a mortgage loan.

⁷⁷ U.S. General Accounting Office, *Consumer Prot., Fed. and State Agencies Face Challenges in Combating Predatory Lending: Testimony Before the Senate Special Comm. on Aging*, 108th Cong. (2004) (prepared statement of David G. Wood, Dir. Fin. Mkts. & Cmty. Inv.), available at <http://www.gao.gov/new.items/d04412t.pdf>.

consumer with a less-than-optimal product. Far better to leave the burden for protecting the consumer's interests with the party that has the greatest knowledge and incentive to protect the consumer—the consumer himself.

Finally, regulators' broad reading of UDAP and UDAAP law likely conflicts with financial institutions' obligations under other laws. For example, a financial institution has a well-established legal duty to act in the interests of its shareholders, yet this duty may conflict with a new *quasi*-fiduciary duty to act in the interests of consumers. Similarly, fair lending laws require financial institutions to make credit available to underserved populations, which may be at odds with UDAP and UDAAP interpretations that would require financial institutions to deny certain financial products when those products are not in the consumers' financial interests. It remains unclear how federal regulators expect financial institutions to resolve these conflicts.

CONCLUSION

Under the FTC's original interpretation of UDAP law, financial institutions could feel some sense of security that, if they provided a consumer with a clear understanding of a proposed transaction, the burden was on the consumer to determine whether the transaction was in his best interest. Recent actions taken by the CFPB and prudential regulators, however, suggest that regulators may be creating an expectation that institutions put some conception of consumers' interests first, even when there is no clear assumption of fiduciary or quasi-fiduciary responsibility. This move away from traditional arm's-length dealing would place financial institutions in a difficult position: not only would they have to investigate and weigh aspects of a consumer's personal and financial life unrelated to the transaction, but they also may have to substitute their judgment for the consumer's in determining the consumer's best interest—a process almost certainly designed to lead to sub-optimal outcomes for all involved. As regulators further develop their expectations regarding UDAP and UDAAP law, financial institutions should carefully watch future regulatory guidance and enforcement actions for further signs that regulators are imposing quasi-fiduciary duties upon creditors.