What You Should Know About UDAP

Recently both the Federal Trade Commission (“Commission”) and the federal banking regulatory agencies have increasingly used a general consumer protection statute to address “unethical” or otherwise “bad” business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. The law of choice for enforcement against such business practices has been Section 5 of the FTC Act—the primary federal law that prohibits unfair or deceptive acts or practices and unfair methods of competition in or affecting commerce (“UDAP” or “FTC Act”).¹

Note that the Commission’s authority to take action against unfair or deceptive acts does not require clear-cut violations of a banking or consumer finance law, such as the Real Estate Settlement Procedures Act of 1974 or Truth in Lending Act.² Rather, the FTC Act empowers the Commission to pursue a refined enforcement regimen, enabling it to investigate practices by industry participants that could arguably comply with existing consumer finance laws, but still be considered unethical business practices used to compete in an increasingly competitive mortgage marketplace.³ The FTC Act also grants this same authority to the federal banking regulatory agencies, such as the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”), with respect to the entities they respectively regulate.⁴

One need only give a cursory review of recent cases brought by the Commission to glean the breadth of the UDAP law and its far-reaching implications. For example, in December 2005, the Commission entered into a consent agreement with DSW Warehouse Inc., a shoe warehouse retailer that had its customers’ personal information compromised, to settle privacy and security violations enforced under the FTC Act.⁵ In this case, the Commission used UDAP to address DSW’s flailing security information policies and lack of adequate protection for sensitive customer information. Another enforcement case brought by the Commission under the FTC Act involved a mortgage broker allegedly committing deceptive advertisements.⁶ The broker was accused of misrepresenting to consumers that it could provide low interest, no-fee mortgage loans.

Because of the breadth of the UDAP law, and the recent increased use of it by the Commission and the federal banking regulatory agencies to enforce good business practices, we thought it would be helpful to provide each of you with an overview of UDAP—what it is and what it should mean to each of you.

---

² Unfair or Deceptive Acts or Practices: Would You Recognize Them if You Saw Them?, by Paul F. Hancock, ABA Bank Compliance, p. 5 (May/June 2005).
³ Id.
⁵ File No. 0523096 http://www.ftc.gov/os/caselist/0523096/051201agree0523096.pdf
⁶ http://www.ftc.gov/opa/2005/03/pwrprocessing.htm
Primer on UDAP

Section 5 of the FTC Act is the primary federal law that prohibits unfair or deceptive acts or practices and unfair methods of competition in or affecting commerce. Unfortunately, the FTC provides minimal guidance on the parameters of what may be considered unfair or deceptive. In fact, the FTC has issued only two formal statements on the subject matter, both of which are dated more than twenty years ago. The first guidance, entitled FTC Policy Statement on Unfairness (“Unfairness Policy Statement”) was issued in 1980, and subsequently codified in 1994. The second guidance, entitled FTC Policy Statement on Deception (“Deception Policy Statement”) was issued in 1983. Together, these statements outline the factors that the FTC considers when determining whether a particular practice or act is either unfair or deceptive. A brief summary of is guidance is provided below.

In its Unfairness Policy Statement, the Commission outlines factors that convey the manner in which the FTC intends to enforce its mandate of protecting against consumer unfairness. Citing “unjustified consumer injury” as the principal focus of the FTC Act, the Commission considers three core elements to justify a finding of unfairness: the injury must be (1) substantial, (2) not outweighed by offsetting consumer or competitive benefits, and (3) not be one that consumers could have reasonably avoided. With respect to this last element, the Commission comments that the expectation is for the “marketplace to be self-correcting,” but that it recognizes that “certain types of sales techniques may prevent consumers from effectively making their own decisions, and that corrective action may then become necessary.”

In its Deception Policy Statement, the Commission addresses how it enforces its deception mandate. The Commission states that the following elements are always analyzed in any case involving deception: (1) whether the representation, omission or practice is likely to mislead, (2) the reasonableness of the practice from the perspective of a consumer or group of consumers, and (3) the materiality of the act or practice, which involves analyzing whether the act or practice is likely to influence or otherwise “affect the consumer’s conduct or decision with regard to a product or service,” thereby resulting in likely injury.

Beyond these two formal statements and public enforcement actions, there is no additional formal guidance that can provide insight as to the purpose and intent of, and parameters for, compliance with the UDAP law. But this vagueness and breadth of the law is most likely the value of UDAP—it can be molded and used to address a host of various consumer protection issues that may cross the line of good business practice or ethics as they evolve. In this fashion, the FTC, as well as the federal banking regulatory agencies, can use the UDAP law to address a multitude of consumer, such as abusive lending practices.

---

9 FTC Policy Statement on Unfairness (December 17, 1980).
10 FTC Policy Statement on Deception, p. 3 (October 14, 1983).
12 Hancock, p. 5-6.
You should also be aware that almost every state has some type of UDAP law, many of which are patterned after Section 5 of the FTC Act and referred to as “mini-FTC Acts.” Similar to Section 5 of the FTC Act, the core purpose for many of the state UDAP laws is to provide consumer protection. Unlike Section 5 of the FTC Act, however, many of the state “mini-FTC Acts” also specifically grant consumers a private right of action. For example, in Florida, consumers may bring suit against a business entity that engages in unfair or unconscionable acts or practices, or unfair methods of competition.13

In today’s competitive mortgage marketplace, each of you should take care to examine your marketing materials and sales techniques, as well as business arrangements, to ensure compliance not only with current banking and consumer finance laws, but also pertinent consumer protection laws such as UDAP, both federal and state. To review the FTC’s Statements on Unfairness and Deception, visit http://www.ftc.gov/bcp/policystmt/ad-unfair.htm and http://www.ftc.gov/bcp/policystmt/ad-decept.htm, respectively. For guidance issued by the banking regulatory agencies on UDAP, visit http://www.occ.treas.gov/ftp/advisory/2002-3.doc (OCC) and http://www.fdic.gov/news/news/financial/2004/fil2604a.html (FDIC).

This article is for informational purposes only and does not constitute legal advice. Readers should not rely on it as such. No one should attempt to interpret or apply any law without the aid of an attorney.