

Emerging Issues in UDAP: Preemption

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One of the broadest tools in a plaintiffs attorneys' arsenal, and that of public prosecutors as well, is state unfair and deceptive acts and practices laws, or "UDAP." Every state has enacted some form of UDAP law, sometimes called "little FTC Acts" after similar language found in Section 5 of the Federal Trade Commission Act: "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."² This article shall discuss some of the approaches that states have taken to UDAP legislation, and the application of preemption principals to UDAP cases.

Overview

Each state's UDAP statute contains its own variants on the federal model, with provisions for private rights of action, enforcement by state officials, and exclusions. For example, the Maryland Consumer Protection Act contains fourteen enumerated unfair or deceptive practices including making "false, falsely disparaging, or misleading oral or written statement, visual description, or other representation of any kind which has the capacity, tendency, or effect of deceiving or misleading consumers," and "deception, fraud, false pretense, false premise, misrepresentation, or knowing concealment, suppression, or omission of any material fact with the intent that the consumer rely on the same in connection with . . . the promotion or sale of any consumer goods[.]"³

New Jersey's Consumer Fraud Act provides:

The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby, is declared to be an unlawful practice; provided, however, that nothing herein contained shall apply to the owner or publisher of newspapers, magazines, publications or printed matter wherein such advertisement appears, or to the owner or operator of a radio or television station which disseminates such advertisement when the owner, publisher, or operator has no knowledge of the intent, design or purpose of the advertiser.⁴

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² 15 U.S.C. § 45(a)(1).

³ Md. Code, Commercial Law Article § 13-301.

⁴ N.J.S.A. § 56:8-2. The term "merchandise" for purposes of the Act "include[s] any objects, wares, goods, commodities, services or anything offered, directly or indirectly to the public for sale." N.J.S.A. § 56:8-1(c).

Pennsylvania's Unfair Trade Practices and Consumer Protection Law ("UTPCPL") provides twenty-one illustrative examples of unfair or deceptive acts or practices, with the twenty-first being a catch-all provision prohibiting: "Engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding."

The epicenter of UDAP activity in the nation of late has been California's Unfair Competition Law, or "UCL,"⁵ more commonly referred to as "§ 17200." The UCL prohibits "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising," and carries a range of remedial tools, including enforcement by the state and by private individuals, and the ability to sue for injunctive and restitutionary relief.

Preemption

One of the most debated areas of UDAP law in recent months has been the application of federal preemption principals to the California UCL.

The most recent round of preemption battles began in December 2007, when a federal district court in California ruled, in *Jefferson v. Chase Home Finance (Jefferson)*,⁶ that the UCL is not preempted by the National Bank Act (NBA).

At issue in this case was the practice of an operating subsidiary of Chase, a national bank, of applying additional mortgage payments received after the full monthly payment to principal only if the payments are specifically designated as principal prepayments. As explained by Chase, if it receives extra funds in the same check as the regular monthly payment, Chase automatically applies the extra funds directly to the prepayment of principal. If, however, Chase receives undesignated funds after the borrower has made a regular monthly payment, Chase places the funds in "suspense," and requests the borrower to specify how those funds should be applied in the next monthly statement (e.g., to the following month's payment, to principal, to unpaid fees, or to escrow).

The reasoning for this practice, according to Chase, is that many borrowers send in multiple undesignated partial payments each month to make up a regular monthly payment, if Chase were to process partial payments as prepayments of principal those borrowers might not have sufficient funds to make up a regular mortgage payment at the end of the month, and inappropriately incur a late fee.

The plaintiff in this case argued that Chase's practice was inconsistent with the stated terms of its contract with borrowers, and that as such Chase engaged in "unfair, fraudulent, and unlawful practices in violation of the UCL. The plaintiff based its UCL claim on alleged violations, including (1) California's prohibition on false advertising, (2) misrepresentation theories, specifically that the contractual misrepresentations were "fraudulent" because they are likely to deceive the public, and (3) that the representations were "unfair" insofar as they constituted a systemic breach of contract.

⁵ Cal. Bus. & Prof. Code § 17200

⁶ No. C 06-6510 TEH, 2007 WL 4374410 (N.D. Cal. Dec. 14, 2007).

California state courts have held that under the UCL even a “perfectly true statement couched in such a manner that it is likely to mislead or deceive the consumer” is actionable. The defendant argued, among other things, that the plaintiff’s state law claims were preempted because they were either expressly preempted by or in conflict with the NBA and implementing regulations promulgated by the Office of the Comptroller of the Currency (OCC).

In ruling that federal law does not preempt the UCL claim at issue in this case, the Jefferson court stated that “laws of general application, which merely require all businesses (including banks) to refrain from misrepresentations and abide by contracts and representations to customers do not impair a bank’s ability to exercise its lending powers. They only ‘incidentally affect’ the exercise of a Bank’s powers, do not fall into the enumerated categories of [OCC preemption regulations], and are therefore not preempted.” “The core issue in this case,” according to the Court, “will be not whether or when Chase is permitted to place payments in suspense accounts, but whether Chase misrepresented to customers what it would do with their payments.”

This case presents an example of the on-going debate surrounding the seemingly unlimited reach of the UCL. One of the key issues has been whether the UCL can stand alone as a cause of action, or whether it must be tethered to an independent substantive, statutory protection or prohibition. In this case, the plaintiff presented its UCL claim as a stand alone claim, as well as part of a violation of the California Consumer Legal Remedies Act (CLRA). However, the CLRA does not contain technical requirements or prohibitions, but rather prohibits conduct that is “likely to deceive” a reasonable consumer. As this case blesses both “tethered” and “untethered” theories, it does not bring clarity to this debate.

Another important and related issue that this cases raises, and which has been a topic of debate for practitioners, is the applicable preemption principles. If the UCL claim was based on a substantive statute that purported to impose technical restrictions on the activities of national banks, such as a prohibition on collecting certain non-interest charges, or limiting credit terms, then that substantive statute, and any claims based on that statute, such as a UCL claim, would likely be preempted. As for a general claim that a lender’s practice is “unfair,” the Court acknowledged in dicta that such a claim “may well be preempted.” However, the Court declined to engage in that analysis.

By allowing the plaintiff to proceed under the UCL for practices that are entirely truthful and technically compliant with all applicable disclosure laws, the California courts have created the distinct possibility that California consumers may attempt an end-run around federal preemption by arguing that substantively compliant disclosures or documents are nonetheless “unfair or deceptive.” This will frustrate the purpose of the preemption doctrine as contained in the NBA and present operational headaches and added costs particularly for banks’ compliance departments, who will be forced to determine not only that their products and disclosures are technically compliant with disclosure laws such as the Truth-in-Lending Act, but also that they are compliant with UCL-type claims.

It remains to be seen how the preemption analysis of state UCL laws may be affected by federal rulemaking on UDAP currently being contemplated by the Federal Reserve Board and the Office of Thrift Supervision (OTS). It is conceivable, particularly for OTS UDAP regulations, that such federal regulations may be viewed as displacing state UDAP laws.

Just over a month after *Jefferson*, the U.S. Court of Appeals for the Ninth Circuit issued its ruling in *Rose v. Chase Bank USA, N.A. (Rose)*.⁷ The plaintiffs in this case alleged that Chase, a national bank chartered by the OCC, sent its customers convenience checks that failed to contain certain disclosures required under California law. The plaintiffs asserted three theories of liability under § 17200.

First, the plaintiffs alleged that the failure to provide the required disclosures violated substantive disclosure requirements under California law and therefore constituted an “unlawful” practice. Second, the plaintiffs argued that the failure to provide the disclosures (regardless of whether the defendant’s actions violated substantive disclosure law) constituted a “fraudulent” business practice, or was “deceptive or misleading advertising.” Third, they argued that the failure to provide the disclosures at issue was an “unfair” business practice, again regardless of whether a technical violation of law occurred).

The court rejected all of the plaintiffs’ theories. The court found that requiring a national bank to observe the state disclosure law would hamper the federally permitted activities of a national bank, and therefore are preempted by the NBA. As to the more general alleged “unfair” and “deceptive” practices, the Court found that regardless of the exact state law claim alleged, the legal duties underlying the plaintiffs’ UCL claims were the same purported duties to disclose imposed by the technical disclosure provision. In other words, the more abstract unfairness and deception allegations were so close to the violation of the state’s technical disclosure requirement that those state law claims must also fail as preempted under the NBA.

One of the crucial points of the *Rose* decision, and what will likely emerge as the basis for citing to *Rose* in subsequent decisions, is the following passage:

Regardless of the nature of the state law claim alleged, however, the proper inquiry is whether the “legal duty that is the predicate of” Plaintiffs’ state law claim falls within the preemptive power of the NBA or regulations promulgated thereunder. Here, from the face of Plaintiffs’ complaint, the district court correctly found that Defendants’ alleged legal duties that underlie Plaintiffs’ UCL claims for “deceptive” or “unfair” business practices are the same purported duties to disclose imposed by Cal. Civ. Code § 1748.9, and that are preempted by the NBA and OCC regulations.⁸

This language has striking, and perhaps fatal, implications for the so-called “teathered” use of § 17200 claims, wherein the violation of some substantive statute (e.g., a statute requiring certain technical disclosures) is used as the basis for a UCL claim.⁹ As the excerpted passage indicates, where the substantive statute is preempted, then so is application of the state UDAP law.

What neither of these cases addresses, and what may be the next topic to be examined under California’s UCL, is whether the NBA shields national banks from UCL claims that are wholly unrelated to any substantive law, and instead merely allege that a national bank’s conduct, while

⁷ 2008 WL 185491 (9th Cir. Jan. 23, 2008).

⁸ *Id.*

⁹ Notably, this teathering approach is often used where the remedies available under the UCL are more favorable than those available under the substantive statute, if any.

fully consistent with the NBA and OCC regulations, is simply “unfair” or “deceptive” (possibly under Federal Trade Commission Act precedent).

Conclusion

The above cases beg the question as to whether it is possible for a national bank to act in full compliance with federal law and yet act in an unfair or deceptive manner under state law. Given the structure of our federal system, it seems unlikely that a state UDAP statute will be successfully applied against a federally-chartered institute that is otherwise in full compliance with technical requirements of federal law as well as its own representations, but we will await the next legal decision on the issue.