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What FTC's 'Penalty Offense Notices' Mean For Companies

By **Joseph Reilly, Jonathan Joshua and Richard Gottlieb** (October 19, 2021, 5:59 PM EDT)



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Has the Federal Trade Commission gone too far with its latest actions? In recent weeks, the agency resurrected a long-dormant penalty enforcement scheme, by sending several hundred companies, including some of the nation's largest, what it describes as "notices of penalty offenses."

The notices contain zero accusations of any wrongdoing, but purport to put each company "on notice that engaging in conduct described [in the notice] could subject the company to civil penalties of up to $43,792 per violation."

What is this resurrected penalty scheme, which the FTC calls its penalty offense authority? What challenges may the FTC face in actually trying to penalize companies based on this authority? What lessons should be drawn by financial institutions and others that have not received a notice — and what's next? We attempt to answer these questions below.

Penalty Offense Authority: Based on Prior UDAP Determinations

The FTC is asserting its penalty offense authority in the wake of April's U.S. Supreme Court decision in AMG Capital Management v. FTC, in which the hight court held that Section13(b) of the FTC Act does not allow the FTC to obtain monetary relief, such as restitution or disgorgement.

For many years, Section 13(b) had been a principal basis for FTC actions seeking monetary relief. Without further action by Congress, the AMG decision is a devastating blow to FTC enforcement authority. Or is it?

Last year, anticipating a Supreme Court decision adverse to the FTC, then-FTC Commissioner (and now Consumer Financial Protection Bureau Director) Rohit Chopra coauthored with Samuel Levine (now the FTC's director of the Bureau of Consumer Protection) an article in the University of Pennsylvania Law Review that now appears to have been an influential road map on FTC penalty offense authority.[1] The authors advocated resurrection of that authority — exactly what the FTC has now attempted to do.

Created in 1975, this penalty authority is found in Section 5(m)(1)(B) of the FTC Act. Under that provision, the agency may, in some circumstances, take advantage of a prior administrative proceeding in which it determined, via a cease-and-desist order, other than a consent order, that any act or practice was unfair or deceptive, i.e., an unfair or deceptive act or practice, or UDAP.

After the cease-and-desist order is final, Section 5(m)(1)(B) allows the agency to sue a nonparty to the prior administrative proceeding in federal court, if the nonparty engages in the condemned act or practice "with actual knowledge that such act or practice is unfair or deceptive."

The court may award up to $10,000 — adjusted today to $43,792 — for each violation established by the FTC. In essence, the law authorizes the FTC to seek penalties based on some concepts of offensive collateral estoppel, but with due process protections for the defendant, as discussed further

below.

The Notices

The Education Notice

On Oct. 6, the FTC sent a notice of penalty offenses to 70 for-profit higher education institutions, explaining in an accompanying press release that it was cracking down on marketing practices in that industry.

The notice listed seven acts or practices previously determined to be unfair or deceptive, all of which generally relate to claims made by schools about their graduates' job and earnings prospects. For each of the seven acts or practices, the notice cited a prior administrative proceeding brought by the agency.

The Endorsements Notice

On Oct. 13, the FTC sent a different notice to over 700 businesses, described by the agency as "top advertisers, leading retailers, well-known consumer product companies, and major advertising agencies."

While following the form of the education notice, this notice focused on fake reviews and other deceptive endorsements. It listed seven acts or practices relating to reviews or endorsements that were previously determined across nine prior proceedings to be unfair or deceptive.

The agency, again, used striking language in its press release, asserting that it was "blanketing industry with a clear message that, if they use endorsements to deceive consumers, the FTC will be ready to hold them responsible with every tool at its disposal."

The FTC also explained that this notice was timely because, in its view, "[t]he rise of social media has blurred the line between authentic content and advertising."

Due Process and Other Challenges the FTC May Face

To establish that an entity had actual knowledge that an act or practice has been determined to be unfair or deceptive, the FTC evidently believes it is enough to send notices to nonparties of the prior administrative determinations. On this sole issue, the FTC appears to have some authority on its side.

In one of the only litigated cases under Section 5(m)(1)(B), discussed further below, the court agreed that the defendants were chargeable with knowledge of the content of prior FTC decisions, where the agency had provided defendants with copies of the decisions.[2]

Indeed, according to the Chopra-Levine law review article, the FTC actually followed this practice — sending notices to nonparties — for several years, following the 1975 enactment of the penalty offense authority. In the law's first five years, notifications evidently went to over 2,000 firms.

But the practice fell into disuse in the 1980s, a development the authors ascribe to a broader turn by the agency, during the Reagan Administration, "away from systemic market problems and toward small-time scams."

The real challenges the FTC will face in obtaining penalties based on the notices relate to due process principles and the passage of time since the prior UDAP determinations now at issue.

In Section 5(m)(2) of the FTC Act, Congress addressed the due process issues raised by seeking to penalize nonparties to prior determinations. In particular, the law entitles any nonparty to the prior administrative proceeding(s) to both:

- A de novo trial of issues of fact, including whether the nonparty's conduct is sufficiently similar to that which was previously condemned; and

- A review, by the court in which the penalty is sought, of the agency's prior determination that a particular act or practice is, in fact, unfair or deceptive.[3]

In evaluating the FTC's ability to withstand the challenges posed by such a trial or review, it is worth noting just how long ago it made the prior determinations now relied on by the agency. The endorsements notice cites nine prior determinations, but none since 1984.

More than half of those determinations, in fact, were made in 1960 or earlier. Similarly, the three determinations in the education notice were made in 1980, 1971 and 1952. Much has changed in the decades since those prior determinations.

For example, the rise of social media — which, according to the agency, is a major driver behind its decision to send the endorsements notice — is obviously a much more recent phenomenon. In the event the FTC seeks penalties, the agency therefore may struggle in a de novo trial to establish that the defendant's conduct was sufficiently similar to what was condemned so long ago.

Indeed, in one of the very few cases litigated under what is now Section 5(m)(1)(B), the U.S. Court of Appeals for the Eighth Circuit determined — even before the de novo trial provision was added to the law — that no penalty was warranted, because the defendants in fact never utilized the previously condemned practice; i.e., their practice was not sufficiently similar to the one in the prior decision.[4]

The Chopra-Levine article argues that this case is "worth nothing," but having reviewed it, we disagree. Further, each prior determination of unfairness or deception cited in the recent notices should be studied closely to determine whether it would stand up if reviewed by a court today.

Impact on Financial Institutions and Other Companies

Most of corporate America is subject to the FTC's jurisdiction to enforce UDAPs. Banks and other depository institutions are a notable exception, but the agency's jurisdiction over bank service providers makes the FTC's enforcement activity relevant to them as well.

Likewise, banks may be subject to secondary, contract-based indemnity liability with respect to bank partnerships and other banking-related activity. So what do these recent notices mean for companies that may receive them in the future?

In a blog post on the education notice, the FTC specifically warned other companies — those outside the education marketplace — "that the FTC will use every tool at its disposal to protect consumers from deceptive and unfair practices." Thus, anyone subject to FTC jurisdiction should recognize that factual and statistical claims — in advertising, consumer disclosures and even by sales representatives — may be carefully scrutinized.

If the FTC's record in challenging the education industry is any guide, companies should carefully review marketing materials — both their own and those used by their service providers — to ensure that any factual claims are both demonstrably true and derived using justifiable methodologies.[5] The underlying data used to substantiate marketing claims should be retained as well, rather than just the results of any analysis.

Regarding the endorsements notice, one of the FTC's blog posts warned all companies that use endorsements — beyond the 700 or so receiving the notice — to take the "opportunity to reconsider the internal checks they have in place to ensure that endorsements in their ads comply with the law" as described in the FTC's prior, cited determinations.

Financial institutions that use third-party service providers, in particular, should also be aware of the FTC's interest in fintech providers, debt collectors, lead aggregators and service providers who use machine learning or artificial intelligence-based models for use in underwriting or servicing. Financial institutions' client relationships may also be subject to scrutiny.

In addition to the possibility of a renewed Operation Chokepoint,[6] the FTC may also directly target companies for the acts of their clients. For example, in one recent FTC action, a payment processor was the target of an enforcement action for allegedly ignoring "clear red flags of illegal conduct" when processing payments on behalf of various alleged perpetrators of fraudulent activities.

Likewise, unlike the CFPB, the FTC has jurisdiction over auto dealers, including with respect to their financing activities.[7] As a result, indirect auto financing relationships with auto dealerships may be an additional cause for concern. This is particularly true with respect to fair lending concerns regarding dealer markup.[8]

While the CFPB brought actions against individual financial institutions with respect to alleged fair lending disparities from dealer markup, such actions did not bring about industrywide changes. In contrast, the FTC has enforced fair lending laws against auto dealers, and likely intends to bring more such actions.

Providers of noncredit consumer financial products, and financial institutions that work with them, should also consider the potential impact of the aggressive stance the FTC is now taking. Many providers of such products, such as income share agreements, home coinvestments, early wage access and the like, assert that because the products are not credit, the CFPB lacks jurisdiction.

To the extent that such providers are correct, the FTC will still have jurisdiction. The FTC's recent actions indicate that the FTC will act if it perceives that providers of these alternatives to credit are engaging in any UDAPs.

What May Be Next

In looking for clues about which industry may be the next to receive penalty offense notices, look no further than the Chopra-Levine law review article again. That article not only advocated for use of the penalty authority the FTC has now invoked, it even listed "for-profit college fraud" as the first area where the authority could prove useful — in line with the FTC's choice last week to make for-profit education providers the very first recipients of a notice.

The article also suggested that notices be directed at "online disinformation," specifically the problem of fake reviews and deceptive endorsements that the FTC addressed this week. The other areas listed by the article's authors were:

- "False earnings claims targeting workers," i.e., claims made to workers about how much they can earn;

- "Deceptive data harvesting," i.e., whether a company's actual use of data accords with its representations; and

- "Illegal targeted marketing," which is generally referring to the practice of social media and other companies of selling access to lists of consumers based on behavioral data about the consumers without a permissible purpose for such sale under the Fair Credit Reporting Act, or FCRA. Chopra and Levine admit that penalty offense authority requires a prior UDAP — not FCRA — determination, but point to language in the FCRA itself as a solution to that problem. The language provides that "[f]or the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of any requirement or prohibition imposed under [the FCRA] shall constitute an unfair or deceptive act or practice in commerce."

The argument that a prior FCRA determination may count as a prior UDAP finding raises the question of whether the agency will seek to extend that argument to prior determinations under the many other consumer protection statutes the FTC enforces. We have not seen that argument yet, but we would not be surprised if the issue arises in the near future.

Further, these notices make clear we can expect a newly emboldened and active FTC, seeking to stretch the limits of its authority to target established industry participants in connection with what may have formerly been considered business as usual. Stay tuned.

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[1] Rohit Chopra and Samuel A.A. Levine, The Case for Resurrecting the FTC Act's Penalty Offense Authority, U.Penn. L. Rev. (forthcoming), available at https://ssrn.com/abstract=3721256. An unpublished version can be viewed by logging into SSRN if you have an account, creating a new account, or by clicking on the "Download This Paper" option, then choosing the "Download Without Registration" option.

[2] U.S. v. Hopkins Dodge Sales , 849 F.2d 311, 315 (8th Cir. 1988).

[3] Congress codified this second right — to judicial review of the agency's prior determination — only in 1994, though it had been recognized in a litigated case under the statute several years before. U.S. v. Allied Publishers Serv. , 1982-83 Trade Cas. (CCH) ¶64,983 (E.D. Ca. 1982).

[4] U.S. v. Hopkins Dodge Sales, 849 F.2d 311, 314 (8th Cir. 1988).

[5] See https://www.ftc.gov/news-events/press-releases/2019/12/ftc-obtains-record-191-million-settlement-university-phoenix ($191 million settlement with the University of Phoenix regarding allegedly false advertisements touting relationships with employers); https://www.ftc.gov/news-events/press-releases/2016/12/devry-university-agrees-100-million-settlement-ftc ($100 million FTC settlement with DeVry University regarding allegedly false advertising relating to graduates' employment rates and increased incomes); and https://www.ftc.gov/news-events/blogs/business-blog/2018/10/law-averages-ftc-challenges-sofis-student-loan-refinancing (settlement with a student loan provider regarding allegedly methodologically inappropriate determinations behind "average savings claim" for student loan refinance product).

[6] Operation Chokepoint was the name used by the U.S. Department of Justice for an initiative by which various financial regulatory agencies pressured financial institutions to limit the ability of various types of business to access the financial system. The various businesses subject to Operation Chokepoint included payday lenders, firearms manufacturers and retailers, credit card scammers, and pornography providers. See, generally, https://www.prnewswire.com/news-releases/federal-deposit-insurance-corporation-agrees-to-settlement-in-operation-choke-point-lawsuit-300855421.html.

[7] 12 U.S.C.A. § 5519.

[8] Congress used the Congressional Review Act to reject the CFPB's guidance relating to "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act." Public Law 115–172 (2018).

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