



Office of the Secretary

UNITED STATES OF AMERICA  
**FEDERAL TRADE COMMISSION**  
WASHINGTON, D.C. 20580

February 23, 2005

Sandra F. Braunstein, Director  
Division of Consumer and Community Affairs  
Board of Governors of the Federal Reserve System  
Washington, D.C. 20551

Dear Ms. Braunstein:

This letter responds to your request for information regarding the enforcement activities of the Federal Trade Commission ("Commission" or "FTC") under the Truth in Lending, Consumer Leasing, Equal Credit Opportunity, and Electronic Fund Transfer Acts ("Acts") during the 2004 calendar year, for use in preparing the Federal Reserve Board's ("Board") Annual Report to Congress. You have asked for information regarding the Commission's enforcement activities pursuant to those Acts, including methods of enforcement, and the extent to which compliance is achieved by entities subject to the Commission's enforcement authority.<sup>1</sup> Also, you have asked whether the Commission recommends any changes to these laws or their implementing regulations or wishes to provide other comments or observations.

## **I. THE COMMISSION'S 2004 ENFORCEMENT ACTIVITIES UNDER THE ACTS<sup>2</sup>**

### **Truth in Lending Act<sup>3</sup>**

In calendar year 2004, the Commission continued its enforcement activities to halt unlawful subprime lending practices. The Commission filed two federal district court actions (currently in litigation), and continued three ongoing litigations for alleged violations of the TILA,

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<sup>1</sup> The Commission is charged with enforcement of the Federal Trade Commission Act ("FTC Act") and various federal consumer financial laws and regulations, including the Truth in Lending Act ("TILA"), Consumer Leasing Act ("CLA"), Equal Credit Opportunity Act ("ECOA"), and Electronic Fund Transfer Act ("EFTA"), with respect to most nonbank entities in the United States. The Commission does not have data regarding the extent of compliance by these numerous nonbank entities with these mandates. As a result, this letter does not provide information on that issue.

<sup>2</sup> Information concerning the Commission's enforcement and other activities discussed in this report is also available at the Commission's Web site at <http://www.ftc.gov>.

<sup>3</sup> The Commission's enforcement actions under the TILA in 2004 pertained to credit violations. No enforcement actions alleging violations of the CLA, an amendment to the TILA, were issued.

Regulation Z, and the FTC Act. Other investigations of potential TILA violations are ongoing.

**A. Mortgage Cases Alleging TILA Violations**

The Commission filed a complaint in federal district court against Phillip W. Ranney and a group of Colorado-based mortgage brokers, and Kathleen A. Ranney as a relief defendant, for alleged violations of the FTC Act and the TILA, among other statutes.<sup>4</sup> The complaint alleged that the defendants deceptively claimed that they would refinance consumers' mortgages at the lowest rates available at no cost to the consumer. The complaint also alleged that the defendants represented that consumers would have to go through multiple refinances to get a "no-fee" loan, which would involve applying for two or more loans, one at a competitive rate and one at a higher-than-market rate. According to the complaint, the defendants deceptively represented that: 1) lenders on the higher interest loans would pay a premium to the mortgage broker that would be used to pay the fees for the low-interest loans, and 2) the low-interest loans would be used to pay off the higher interest loans, leaving consumers with a no-fee, low interest loan. The complaint alleged that instead of receiving a low-rate mortgage, many consumers received high-interest rate loans, had liens placed on their property because the defendants did not pay appraisal and other fees, incurred damage to their credit ratings, and in some instances, faced the beginning of foreclosure proceedings. In addition, according to the complaint, the defendants disseminated promotions for home mortgage refinancing at specific annual percentage rates that advertised credit terms other than those that actually are or will be offered by the creditor, in violation of Regulation Z and the TILA. The complaint seeks permanent injunctive and other equitable relief, including consumer redress. The court awarded a default judgment against the corporate defendants following their failure to answer the complaint;<sup>5</sup> litigation continues against the individual defendants.

The Commission filed a complaint in federal district court against a mortgage broker, Chase Financial Funding, and its principals, for alleged violations of the FTC Act, and the TILA and Regulation Z,<sup>6</sup> in connection with advertisements for extremely low mortgage rates. According to the complaint, the defendants sent consumers spam and direct mail falsely offering consumers a "3.5% fixed payment" loan, when, in fact, the loans advertised were actually adjustable rate mortgages, where the principal balance would increase if consumers made payments at the advertised rates. The complaint alleged that the defendants violated the FTC Act by deceptively claiming that they offered: 1) a fixed interest rate or fixed payment loan; 2) a loan in which payment of the minimum amount specified covers both interest and principal; 3) a loan with a specific payment schedule, interest rate, and/or APR; and 4) a loan with no prepayment penalty or a penalty that would not apply if the loan was refinanced through the defendant. The

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<sup>4</sup> Federal Trade Commission v. Phillip W. Ranney, No. 04-F-1065 (D. Colo. filed May 26, 2004).

<sup>5</sup> Id. (D. Colo. Aug. 13, 2004) (default judgment order).

<sup>6</sup> Federal Trade Commission v. Chase Financial Funding, Inc., No. SACV 04-549 GLT (ANx) (C.D. Cal. filed May 12, 2004).

complaint also alleged that the defendants misrepresented the “annual cash savings” that consumers would receive if they refinanced through the defendants and that the defendants failed to disclose or to disclose adequately that monthly payment of the specified amount would result in negative amortization, causing an increase in the total debt for periods during the loan. The complaint further alleged that the defendants violated the TILA and Regulation Z by:

1) advertising credit terms other than those that actually are or will be arranged or offered by the creditor; 2) stating a rate of finance charge without clearly and conspicuously disclosing the APR or the fact that the APR may increase after consummation; 3) advertising a “payment rate” without making other required disclosures; and 4) failing to disclose the terms of repayment or the APR, as required. The complaint seeks consumer redress and other permanent equitable relief. The court entered a stipulated preliminary injunction barring the defendants’ illegal business practices and prohibiting them from dissipating financial assets pending final resolution of the case.<sup>7</sup>

The Commission continued its litigation against Capital City Mortgage Corp. (“Capital City Mortgage”) and various relief defendants for violations of the TILA and Regulation Z and the FTC Act, among other federal statutes.<sup>8</sup> The complaint alleges that the defendants engaged in unfair or deceptive acts or practices in offering and extending financing and during the loans, resulting in many borrowers being overcharged on their loans and forced into default, losing their homes and equity. In 2004, the Court entered a consent decree with an individual defendant, Eric J. Sanne, the former general counsel of the company.<sup>9</sup> The settlement permanently barred Mr. Sanne from participating in any debt-collection business and required payment of \$20,000; he must pay an additional \$50,000 if he is found to have materially misrepresented his financial condition.

## **B. Other TILA Cases**

The Commission continued its litigation against Stewart Finance Company, its owner John Ben Stewart, Jr., and nine related companies (collectively, “Stewart Finance”) for alleged violations of the FTC Act and the TILA, among other statutes.<sup>10</sup> The complaint alleged that

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<sup>7</sup> Id. (C.D. Cal. May 28, 2004).

<sup>8</sup> Federal Trade Commission v. Capital City Mortgage Corp., No. 98CV-237 (D.D.C. filed Jan. 28, 1998).

<sup>9</sup> Id. (D.D.C. May 6, 2004).

<sup>10</sup> In addition, the Commission filed proofs of claim in the United States Bankruptcy Court for the Middle District of Georgia, where defendants Stewart Finance Company, Inc., Stewart National Finance Company, Inc., and D & E Acquisitions, filed for relief under Chapter 11 of the Bankruptcy Code. In re Stewart Finance Company, Nos. 03-30277 (RHF), 03-30278 (RHF), and 03-30398 (RHF) (Bankr. M.D. Ga. filed Feb. 10, 2003 and Feb. 27, 2003). The Commission also filed a proof of claim in defendant John Ben Stewart’s case for bankruptcy relief under Chapter 7 of the Bankruptcy Code. In re John Benjamin Stewart, Jr., No. 04-30528 (Bankr. M.D. Ga. filed March 24, 2004).

Stewart Finance, which provided small personal loans to consumers in the subprime market, engaged in deception and other illegal practices to induce consumers to unknowingly purchase expensive add-on products, such as insurance and car club memberships, to participate in a direct deposit program, and to repeatedly refinance their loans. The complaint also alleged that Stewart Finance failed to include the cost of its ancillary products in the finance charge and annual percentage rate disclosed to consumers. In 2004, the court held defendant John Ben Stewart, Jr. in contempt for violating the court's asset freeze, and his son, William Joseph Stewart, in contempt for aiding and abetting his father.<sup>11</sup> The Commission's summary judgment motion is pending before the court.

The Commission continued its litigation in federal district court against National Audit Defense Network, Inc., Tax Coach, Inc. (doing business as Tax Ready), and various officers of both companies.<sup>12</sup> The company ceased business operations in May 2004, under Chapter 7 of the Bankruptcy Code. Discovery is closed; a trial date has not yet been set.

### **C. Consumer and Business Education**

The Commission's consumer and business education efforts for consumer credit and consumer leasing are vital to achieving its mission and enforcement goals. All of the Commission's consumer protection materials are made available to the public through the Commission's Web site.<sup>13</sup>

#### **Equal Credit Opportunity Act**

In calendar year 2004, the Commission entered into one settlement, and continued its litigation against a mortgage lender, for alleged violations of the ECOA and Regulation B. This case seeks an order awarding equitable relief and/or civil penalties. Other enforcement efforts continue.

The Commission settled charges filed in federal district court against Sprint Corporation and various subsidiary corporations ("Sprint") for alleged violations of the ECOA and Regulation

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<sup>11</sup> Id. (N.D. Ga. Apr. 16, 2004) (contempt order). Thereafter, Mr. John Ben Stewart, Jr. died.

<sup>12</sup> The complaint alleged the defendants violated the FTC Act and the TILA and Regulation Z regarding misrepresentations about merchandise refunds and by failing to timely credit consumers' credit card accounts after accepting the return of tax-information products or otherwise acknowledging that refunds were owed. Federal Trade Commission v. National Audit Defense Network, Inc., No. CV-S-02-0131 (D. Nev. filed Jan. 30, 2002).

<sup>13</sup> See, e.g., FEDERAL TRADE COMM'N, HIGH-RATE, HIGH-FEE LOANS (HOEPA/SECTION 32 MORTGAGES), at <http://www.ftc.gov/bcp/conline/pubs/homes/32mortgs.htm> (for credit) and FEDERAL TRADE COMM'N, LOOK BEFORE YOU LEASE, at <http://www.ftc.gov/bcp/conline/pubs/alerts/lease.pdf> (for leases).

B, among other statutes.<sup>14</sup> The complaint alleged, among other things, that Sprint failed to provide notices mandated by the ECOA in connection with consumers' applications for telephone service. The complaint further alleged that Sprint denied applicants phone service or required them to make a deposit or advance payment to obtain service, but failed to provide applicants with timely notices of adverse action or provided notices that lacked mandatory information, such as the explanation that it is unlawful to discriminate against an applicant with respect to any aspect of a credit transaction. The settlement required the defendants to pay civil penalties of \$1.125 million and provided for injunctive relief.<sup>15</sup>

The Commission's complaint against Capital City Mortgage, discussed above, alleged, among other things, that the company and its owner, Thomas K. Nash, violated the ECOA and Regulation B by: 1) failing to take written applications for mortgage loans; 2) failing to collect required information about the race or national origin, sex, marital status, and age of applicants; 3) failing to provide rejected applicants with written notice of adverse action; and 4) when providing notice of adverse action, failing to provide applicants with the correct name and address of the Commission, the federal agency that administers compliance with the ECOA with respect to the defendants.

The Commission continued its consumer and business education efforts, including efforts to increase awareness of and compliance with the ECOA. The Commission also continued its participation in the Interagency Task Force on Fair Lending. In 2004, the Commission updated its publication "Utility Credit" to provide additional current information to consumers.<sup>16</sup>

### **Electronic Fund Transfer Act**

In 2004, the Commission entered into two settlements involving the EFTA.

The Commission settled a federal district court action against Mantra Films, Inc. ("Mantra") and its sole officer and director, Joseph R. Francis (Francis), the marketers and sellers of "Girls Gone Wild" videos and DVDs.<sup>17</sup> The complaint alleged violations of the FTC Act and the EFTA, among other statutes. The complaint charged that, among other things, Mantra and

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<sup>14</sup> United States of America v. Sprint Corp., No. 4:04 CV 361 (N.D. Fla filed Sept. 9, 2004); Id. (N.D. Fla. Sept. 10, 2004) (consent decree entered).

<sup>15</sup> This relief also addressed alleged violations of the Fair Credit Reporting Act ("FCRA"), settling charges that the defendants took "adverse action" by placing conditions or restrictions on consumers' telephone service based on their credit reports without disclosing information required by the FCRA.

<sup>16</sup> See <http://www.ftc.gov/bcp/online/pubs/credit/utility.pdf>. For other ECOA publications, see, e.g., FEDERAL TRADE COMM'N, EQUAL CREDIT OPPORTUNITY, at <http://www.ftc.gov/bcp/online/pubs/credit/ecoa.htm>.

<sup>17</sup> United States of America v. Mantra Films, Inc. and Joseph R. Francis, No. CV03-9184 (C.D. Cal. filed Dec. 16, 2003). Id. (C.D. Cal. Aug. 4, 2004) (stipulated court order).

Francis deceptively marketed Girls Gone Wild videos and DVDs to consumers and deceptively enrolled consumers in continuity programs advertised on the Internet and television. The complaint also alleged that consumers' checking accounts were debited on a recurring basis without obtaining consumers' written authorization for preauthorized electronic fund transfers from the accounts as required by the EFTA. The stipulated court order required the defendants to pay approximately \$1.1 million in combined consumer redress and civil penalties and barred the defendants from a range of unlawful activities.

The Commission also filed and settled a case in federal district court against a group of corporate defendants, collectively known as "Promenade."<sup>18</sup> The complaint alleged that the defendants violated the FTC Act and the EFTA, among other things, through the sale of discount buying services, health services, and other membership services, which offered a "free trial" period. The complaint also charged that the defendants deceptively placed recurring automatic charges on consumers' accounts at the conclusion of the trial period unless those consumers canceled before the end of the trial period. Further, the complaint alleged, the defendants, in some instances, failed to disclose their cancellation policy to consumers, among other things. According to the complaint, the defendants debited consumers' bank accounts for the memberships on a recurrent basis without obtaining consumers' written authorization. The stipulated court order barred the defendants and two principals, Michael Reinstein and Brian Kelly, from various illegal conduct, included injunctive relief, and required payment of \$2.4 million; the order allowed the defendants and these principals to pay \$113,000, if remitted within five days of the judgments' entry, and suspended the balance, based on their ability to pay.<sup>19</sup>

In 2004, the Commission continued its consumer and business education efforts in this area. Its publications provide consumers with information on how to safely utilize new forms of electronic banking and are available to the public through the Commission's website.<sup>20</sup>

## **II. ANY SUGGESTIONS FOR CHANGES IN THE ACTS OR THEIR IMPLEMENTING REGULATIONS**

In 2004, the Commission issued no recommendations for changes in the Acts or their implementing Regulations.<sup>21</sup>

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<sup>18</sup> Federal Trade Commission v. Promenade Communications LLC, No. CV-04-6657 (C.D. Cal. Aug. 11, 2004).

<sup>19</sup> At the time of entry of the judgment, defendants had ceased all business operations.

<sup>20</sup> See, e.g., FEDERAL TRADE COMM'N, ELECTRONIC CHECK CONVERSION, at <http://www.ftc.gov/bcp/online/pubs/credit/echeck.htm>.

<sup>21</sup> On February 4, 2005, the Commission filed a comment with the Board on proposed amendments to Regulation E and its Commentary. The comment is available at <http://www.ftc.gov>.

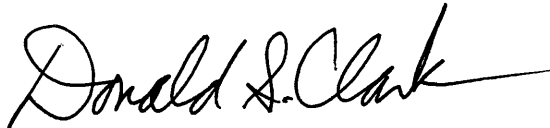
Sandra F. Braunstein, Director

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The Commission hopes that the information contained in this letter responds to your inquiry and will assist in preparation of the Board's Annual Report to Congress. If any other information would be useful or if you wish to request additional assistance, please contact Joel Winston, Associate Director, Division of Financial Practices, at (202) 326-3224.

By direction of the Commission.

A handwritten signature in black ink that reads "Donald S. Clark". The signature is written in a cursive style with a long horizontal stroke extending to the right.

Donald S. Clark  
Secretary