BEFORE THE FEDERAL TRADE COMMISSION
WASHINGTON, D.C.

Telemarketing Sales Rule Review

SUPPLEMENTAL COMMENTS OF THE MINNESOTA ATTORNEY GENERAL'S OFFICE

FTC File No. R411001

At the Telemarketing Sales Rule ("TSR") Forum on June 6, 2002, Federal Trade Commission staff stated that Supplemental Comments should focus on issues not discussed in previous submissions and that participants were encouraged to include detailed data supporting their arguments. Accordingly, the Minnesota Attorney General's Office submits these Supplemental Comments on the following three points: (1) the ineffectiveness of relying on credit card system chargeback controls with preacquired account telemarketing; (2) quantitative data supporting the States' position that consumers regularly misunderstand preacquired account sales pitches; and (3) the need to clarify the exception provision in part 310.4(a)(5) as it relates to internal inbound upsells.

1. <u>The limits placed on chargebacks by the major credit card systems do not provide an effective control on preacquired account telemarketing</u>.

At the TSR Forum, industry representatives suggested that the credit card systems effectively monitor abuses with preacquired account telemarketing by disciplining or expelling merchants who exceed credit card system limits on the allowable percentage of account chargebacks. Our investigations have shown that the credit card systems record as chargebacks only a minute percentage of the consumers who call to cancel unauthorized charges as a result of preacquired account telemarketing. The overwhelming majority of credit card holders who have their accounts credited for unauthorized charges obtain voluntary refunds that are not processed as a chargeback.

We obtained data on Minnesota customers of a major financial institution whose credit cards were charged during a three year period for membership clubs by one preacquired account seller. Of the 12,300 customers who canceled their membership during the first year and obtained a refund, over 99.8% of these refunds, 12,278 of the 12,300, were processed as a voluntary credit. Only 22 of the 12,300 refunds, or about .18%, were identified to the credit card systems as a chargeback.

There are at least two reasons for this discrepancy between extraordinarily high charge reversal rates and undetectable chargeback levels with general use credit cards. First, preacquired account sellers typically have a toll-free phone number on the line describing the charge that appears on the credit card bill. Some credit card issuers affiliated with preacquired account sellers have required in contracts with preacquired account sellers that the sellers include a toll-free number on all billing descriptors. Consumers are likely to call that number when they

dispute the charge. A refund issued by the seller is a voluntary credit that is not counted in the chargeback rate.

Second, the same result occurs when the customer contacts the financial institution rather than the seller. Our investigations have revealed that financial institutions regularly enter into agreements with preacquired account sellers that provide for the financial institution to refer to the seller all customer calls about charges by the seller. In some cases, financial institutions have expressly agreed not to initiate chargeback procedures prior to such referrals. The following contract provisions are examples of contract terms between various credit card issuers and preacquired account sellers:

> [Bank] will not unilaterally charge back [seller] or credit the account of any member when there is an inquiry involving the Services, unless [Bank] has first notified the [seller] Customer Service Department and has given that department the opportunity to resolve the problem directly with the member.
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> [Bank] will not unilaterally charge back [seller] or its vendors or credit the account of any purchasing [Bank] cardholder when there is an inquiry or disagreement involving merchandise or services provided through the SERVICE unless it has first given either [seller's] membership services representative or the customer service department of the vendor providing the above merchandise and/or services the opportunity to resolve the problem directly with the member, subject to the requirements of the Fair Credit Billing Act, other applicable federal, state and local laws, and/or under MasterCard and Visa rules and regulations.
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> [Bank] shall make every effort to refer Cardmembers who have billing disputes directly to [Insurance Company] within thirty (30) days of the receipt of such dispute, and shall specifically direct such disputes either in writing to Vice President of Customer Service, [Insurance Company] [address], or by telephone at 1-800-[XXX-XXXX]. However, in the event any Cardmember with a dispute does not wish to contact [Insurance Company] concerning said dispute, [Bank] shall provide to [Insurance Company] on a daily basis information concerning said dispute as mutually agreed upon by the parties. [Bank] agrees to utilize its best efforts to resolve billing disputes without initiating Chargebacks, but reserves the right to exercise any and all of its Chargeback and compliance rights as so defined by VISA and Mastercard operating regulations, or Regulation Z.

Some financial institutions have a "hotline" system so that consumer calls can be transferred directly from the customer service center at the financial institution to the retention department of the preacquired account seller. As one bank told its customer service representatives:

> We prefer that cardmembers contact the Business Partner directly when attempting to cancel. However, when a call comes into [Bank], we will attempt to re-route the call to the Business Partner via an abbreviated warm transfer, i.e., we introduce the caller and then the Business Partner handles the call.

At this same national bank, this process of avoiding chargebacks applies even if the customer expressly states that the reason for the request is that the charge was made without authorization:

> **Unauthorized Enrollment**
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> Marketing and Third Party vendors have expressed their concern that we are telling Cardmembers that we tape telemarketing calls. We should **NOT** disclose this information, but **INSTEAD** refer the call to the vendor if the Cardmember mentions the tape or other security verifications.
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> Please tell the caller that we apologize for the unauthorized billing to their account. Have them call [Club] at 1-800-[XXX-XXXX] (7 days a week, 24 hours a day, closed Christmas Day) to inquire about this, and to have a credit issued.

Even when the credit card issuer handles the calls itself rather than refers the call to the seller, credit card issuers routinely process the charge reversal as a voluntary refund rather than as a charge back. As one financial institution told its customer sales representatives: "If the customer does not wish to cancel through the vendor, it may then be appropriate to cancel the membership ourselves. Additionally, **Third Party programs must never be coded into dispute**" (emphasis added).

These practices effectively circumvent the chargeback system for preacquired account sellers affiliated with the card issuer. For example, if a consumer calls a credit card issuer complaining of an unauthorized charge by a local department store, the consumer likely will be directed to fill out the form on the back of his or her credit card statement (or will be sent written materials) that initiate the chargeback process. If the consumer calls about an unauthorized charge by a preacquired account seller affiliated with the credit card issuer, he or she likely will be referred to the seller or perhaps issued a direct refund not processed as a chargeback. In this manner, preacquired account sellers are able to suffer extremely high cancellation rates from consumers complaining of unauthorized charges, yet often avoid incurring unacceptably high chargeback rates.

Even if the chargeback system were effective to control unfairness and deception with preacquired account charges on general use credit cards, which it plainly is not, proposed section 310.4(a)(5) still would be necessary because of the limited scope of the general use credit card system chargeback limits. These limits are a voluntary system applicable only to the major credit card networks, such as Visa and MasterCard.[1] Our experience is that a significant share of

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[1] It is not clear that the Visa and MasterCard rules would apply to many or most preacquired account telemarketing in any case. The credit card system chargeback rules generally contemplate a four party transaction: a card holder, a card-issuing financial institution, a merchant, and an acquiring financial institution. The merchant processes the transaction through the acquiring institution, which in turn transmits the charge to the card holder through the issuer. Preacquired account charges often involve the same institution acting as the acquirer and the issuer, which may render any potential chargeback limits irrelevant to such a transaction. In the (Footnote Continued on Next Page)

the preacquired account charges is made on proprietary credit cards that can be used only at the issuing store or company. In particular, we have seen substantial preacquired account charges associated with credit cards issued by major gasoline sellers and other retailers. There is no evidence that these credit cards are subject to any chargeback limits. Furthermore, none of the preacquired account charges to checking or savings accounts, mortgage accounts, utility accounts or the like are subject to any comparable chargeback system.

2. Data supporting consumer misunderstanding with preacquired account charges.

At the TSR Forum, the FTC staff requested additional information from all interested parties in the form of specific data supporting the assertions made by the parties. Prior NAAG comments submitted by all 50 states summarized the universal experience of state Attorneys General that preacquired account telemarketing leads to consumer deception and misunderstanding. This Supplement Comment focuses only on quantitative data evidencing consumer confusion and misunderstanding that was collected as part of investigations of preacquired account telemarketing undertaken by this Office.

a. Unauthorized billing is the dominant reason for membership cancellation.

The data we have reviewed in our investigations uniformly supports our impression that underlying the high cancellation rates with preacquired account telemarketing is consumer sentiment that the charges were unauthorized. In addition to the survey of Fleet Mortgage Corporation customer service representatives presented in the prior NAAG Comments, an investigation of a subsidiary of another of the nation's largest banks revealed a similar pattern. During a thirteen month period, this bank processed 173,543 cancellations of membership clubs and insurance policies sold by preacquired account sellers. Of this number of cancellations, 95,573, or 55%, of the consumers stated "unauthorized bill" as the reason for the request to remove the charge. The other primary reason given for cancelling (by 56,794 customers, or 32% of the total) was a general "request to cancel" code that may have also included many consumers claiming unauthorized charges.

b. Cancellation patterns relative to enrollment with 30 day free trial offers.

Preacquired account selling often is accompanied by a free trial offer. In such cases, an indicator of consumer understanding of the transaction is temporal cancellation patterns. Consumers canceling within the 30 day free trial period likely indicate that he or she understood (either during the phone call, with the follow-up mailing, or both) the terms of the deal. If all consumers understood the free trial offer, one would expect to see a significant cancellation rate

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case of the proprietary credit cards, such as gasoline company cards, the transaction is essentially a two-party system, with the issuer, the merchant and acquired being the same. There is no credit card system through which to process a chargeback, but rather all charge reversals would be with the card issuer crediting the account and presumably directly recouping the loss from the preacquired seller.

within the 30 day free trial offer period followed by a scattered pattern of later cancellations.

The data we have reviewed suggest this is not the typical pattern. Below are charts showing cancellation dates relative to date of enrollment for Minnesota consumers who were charged by their financial institution as a result of preacquired account sales with a 30 day free trial offer:

Financial Institution A

Days From Enrollment	# of Cancellations	% of Total Cancellations
0-30	369	22
31-60	455	27
61-90	252	15
91-120	150	9
Greater than 120	459	27

Financial Institution B

Days From Enrollment	# of Cancellations	% of Total Cancellations
0-30	552	26
31-60	737	35
61-90	420	20
91-180	330	16
Greater than 180	46	2

The overall pattern of these two sets of data is strikingly similar. The largest concentration of cancellations occurs immediately after the free trial period but coincident with the first account charge for the service. The cancellation rate in the free trial period is less than half the cancellation rate in the 31-90 day period, when consumers have been billed for the service. This result is consistent with the pattern of consumer complaints alleging unauthorized charges received by Attorneys General and with the data suggesting that most consumers cancel these charges because they believe they are unauthorized.

c. Consumers currently charged for the program are unaware of the charges.

As part of a settlement in our action against Fleet Mortgage Corporation, on June 12, 2002 this Office sent a letter offering reimbursement of membership club fees paid by Fleet (and now Washington Mutual) customers. To obtain the restitution, the homeowner is required to sign a statement that: "I did not expressly authorize the charges on my mortgage account for a membership program." Our office has already received signed restitution request forms from 1,314 of the 2,914 homeowners sent such a form; a return rate of over 45% in just two weeks.[2] Of the 2,914 restitution offers sent to homeowners, 650 were sent to homeowners currently being

[2] The response rates are even higher than 43% when considering the fact that a percentage of such mailings are to invalid addresses and thus never received by the intended recipient.

charged for such a program. Of these 650 homeowners, 305, or over 46%, have requested reimbursement of past charges, that the membership be canceled and that all future charges be terminated. Thus, even among consumers who are currently charged for such programs, almost half promptly returned a form stating that they did not authorize the charge and do not want the service.

3. The exception provision in 310.4(a)(5) should be clarified as it relates to inbound internal upsells.

In the initial NAAG Comments on the proposed Rule, the Attorneys General suggested that the Commission clarify the exception provision to section 310.4(a)(5). (NAAG Comments, pp. # 36-37). Industry comments to the proposed Rule and at the TSR Forum argued that the preacquired account prohibition as applied to inbound internal calls (i.e., inbound upsells that are handled by the same telemarketer and not transferred to a second telemarketer) would result in consumer annoyance from having to repeat the credit card number. This is not a proper interpretation of the proposed Rule, and this Office urges a further clarifying comment on the matter.

Several industry commentators used the example of a travel agent booking a flight, a car rental and hotel accommodations as part of a single trip. These commentators suggested that the travel agent would have to obtain the consumer's credit card number for each of these travel arrangements. Even if the various reservations by the travel agent were within the scope of the Rule, section 310.4(a)(5) would not require that the consumer read his or her number several times to make a series of travel arrangements. The travel agent would be transferring billing information "pursuant to a transaction" in which the consumer disclosed his or her information, and thus come within the exception to the provision. This Office suggests that the Commission expressly state that "transaction" is defined by consumer expectation as to the purpose of the call.

The travel agent example is misplaced because it is not the type of upsell within the scope of section 310.4(a)(5). An upsell that falls within the proposed section 310.4(a)(5) occurs when the telemarketer-recipient of the call completes the transaction for which the consumer calls and then initiates a new transaction. In the travel agent situation, the consumer called to arrange a trip, including perhaps multiple reservations. If the calls end with the travel arrangements, the arrangements were made "pursuant to a transaction" in which the consumer disclosed his or her billing information, and the Rule is not invoked. But if the travel agent attempts to sell the consumer a different product or service, such as a magazine or a membership club, the agent creates a new transaction and the consumer must provide his or her billing information for that transaction. This latter re-disclosure is appropriate to ensure that the consumer provides meaningful consent to a purchase that he or she did not intend to make when calling to make travel accommodations.

Conclusion

The Minnesota Attorney General's Office appreciates the opportunity to be heard in these Supplemental Comments and at the TSR Forum.

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