

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



Bureau of Consumer Protection

December 12, 2007

John E. Bowman  
Chief Counsel  
Regulation Comments, Chief Counsel's Office  
Office of Thrift Supervision  
1700 G Street, NW  
Washington, DC 20552

Re: Public Comment, OTS-2007-0015

Dear Mr. Bowman:

The staff of the Bureau of Consumer Protection at the Federal Trade Commission ("FTC" or "Commission") appreciates the opportunity to comment on the Office of Thrift Supervision ("OTS")'s advance notice of proposed rulemaking regarding unfair or deceptive acts or practices (the "OTS ANPR").<sup>1</sup>

In its notice, the OTS has requested information to help it assess whether it should expand its current prohibitions against unfair or deceptive acts or practices.<sup>2</sup> One legal basis for the potential rulemaking is the FTC Act.<sup>3</sup> The FTC Act provides that the OTS has the authority to prescribe regulations to prevent unfair or deceptive acts or practices by savings associations.<sup>4</sup> The OTS ANPR states that the agency is considering a variety of approaches to address "unfair or deceptive acts or practices," including adopting FTC guidance as an OTS regulation,

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<sup>1</sup> Unfair or Deceptive Acts or Practices, 72 Fed. Reg. 43,570 (advance notice of proposed rulemaking Aug. 6, 2007).

<sup>2</sup> Unfair or Deceptive Acts or Practices, 72 Fed. Reg. at 43,570-71.

<sup>3</sup> 15 U.S.C. § 57a(f)(1). The OTS also can exercise its authority under the Home Owners' Loan Act ("HOLA") to prohibit unfair or deceptive acts or practices by savings associations and certain affiliated entities, as well as certain service providers. 12 U.S.C. §§ 1461-1470. The OTS ANPR states that this would be consistent with HOLA's mandate that the OTS ensure safety and soundness, since engaging in unfair or deceptive acts or practices can pose significant reputation risk, compliance risk, and legal risk. Unfair or Deceptive Acts or Practices, 72 Fed. Reg. at 43,573.

<sup>4</sup> 15 U.S.C. § 57a(f)(1).

converting past OTS guidance into rules, adopting additional OTS guidance, or prohibiting specific unfair or deceptive practices. The OTS is considering taking action to curtail certain practices in credit card lending, residential mortgage lending, gift cards, and deposit accounts.<sup>5</sup>

As the OTS ANPR notes, the agency could incorporate the FTC's standards for unfairness and deception under Section 5 of the FTC Act into an OTS regulation.<sup>6</sup> As the OTS considers whether to do so, the Commission submits this comment describing its extensive experience addressing unfair and deceptive practices under the FTC Act. First, the comment summarizes the FTC's interest and experience with respect to financial services. Second, the comment describes how the Commission has used its unfairness authority in rulemaking and law enforcement actions to prevent financial services providers from harming consumers. Third, the comment discusses how the FTC has used its deception authority in law enforcement actions to prevent financial service providers from injuring consumers. The Commission staff recommends that the OTS consider the FTC's experience applying the current legal standards in determining whether to impose rules prohibiting or restricting particular acts and practices of financial institutions.

## **I. The FTC's Interest and Experience**

The Commission enforces Section 5 of the Federal Trade Commission Act ("FTC Act"), prohibiting unfair or deceptive acts or practices, as to most entities engaged in commercial activities, including nonbank financial companies.<sup>7</sup> The FTC also enforces statutes that address specific consumer credit practices, including the Truth in Lending Act,<sup>8</sup> the Home Ownership and Equity Protection Act,<sup>9</sup> the Consumer Leasing Act,<sup>10</sup> the Fair Debt Collection Practices

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<sup>5</sup> Unfair or Deceptive Acts or Practices, 72 Fed. Reg. at 43,573-74.

<sup>6</sup> *Id.* at 43,573.

<sup>7</sup> 15 U.S.C. § 45(a). Nonbank financial companies include nonbank mortgage companies, mortgage brokers, finance companies, and units of bank holding companies.

<sup>8</sup> 15 U.S.C. §§ 1601-1666j (requiring disclosures and establishing other requirements in connection with consumer credit transactions).

<sup>9</sup> 15 U.S.C. § 1639 (providing additional protections for consumers who enter into certain high-cost refinance mortgage loans).

<sup>10</sup> 15 U.S.C. § 1667-1667f (requiring disclosures, limiting balloon payments, and regulating advertising in connection with consumer lease transactions).

Act,<sup>11</sup> the Fair Credit Reporting Act,<sup>12</sup> the Equal Credit Opportunity Act,<sup>13</sup> and the Credit Repair Organizations Act.<sup>14</sup> In addition, the Commission conducts research on consumer credit matters,<sup>15</sup> develops consumer and business education materials related to consumer credit,<sup>16</sup> responds to inquiries about these matters from consumers, industry and the media, and works with other federal and state law enforcement entities to protect consumers from unfair, deceptive, or other unlawful practices.

## **II. FTC Use of Unfairness Authority for Financial Goods and Services**

### **A. Overview of Unfairness Principles**

When it was enacted in 1914, Section 5 of the FTC Act prohibited “unfair methods of competition in commerce.” Through the use of this authority, the Commission was able to challenge acts and practices that were harmful to consumers to the extent that the agency could prove that they were harmful to competition. The concept of “unfair methods of competition”

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<sup>11</sup> 15 U.S.C. §§ 1692-1692o (prohibiting abusive, deceptive, and unfair debt collection practices by third-party debt collectors).

<sup>12</sup> 15 U.S.C. §§ 1681-1681x (imposing standards for consumer reporting agencies and information furnishers in connection with the credit reporting system and placing restrictions on the use of credit reporting information). The Fair and Accurate Credit Transactions Act of 2003 amended the Fair Credit Reporting Act.

<sup>13</sup> 15 U.S.C. §§ 1691-1691f (prohibiting creditor practices that discriminate on the basis of race, color, religion, national origin, sex, marital status, age [provided the applicant has the capacity to contract], receipt of public assistance, and exercise of certain legal rights).

<sup>14</sup> 15 U.S.C. §1679-1679j (prohibiting untrue or misleading representations and requiring certain affirmative disclosures in the offering or sale of “credit repair” services).

<sup>15</sup> *E.g.*, FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO AND JANIS K. PAPPALARDO, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (June 2007) (finding that the current federally required mortgage disclosures fail to convey key mortgage costs to many consumers and better disclosures can significantly improve consumer recognition of mortgage costs).

<sup>16</sup> Materials on credit topics are available at the Commission’s For Consumers Credit web page, at <http://www.ftc.gov/bcp/menus/consumer/credit.shtm> (last visited Dec. 10, 2007). The web page includes consumer education materials such as “Mortgage Payments Sending You Reeling? Here’s What to Do,” “High-Rate, High-Fee Loans (HOEPA/Section 32 Mortgages),” and “Reverse Mortgages: Get the Facts Before Cashing In On Your Home’s Equity.”

was “understood as reaching most of the conduct now characterized as consumer unfairness.”<sup>17</sup>

In 1938, Congress amended Section 5 of the FTC Act to also prohibit “unfair or deceptive acts or practices” in commerce.<sup>18</sup> The purpose of this amendment was to make “the consumer, who may be injured by an unfair trade practice, of equal concern before the law, with the merchant or manufacturer injured by the unfair methods of a dishonest competitor.”<sup>19</sup>

Congress deliberately chose to frame Section 5 of the FTC Act in general terms because it recognized that defining the terms “unfair” and “deceptive” with specificity would create the risk that the acts and practices described would become outdated or easily evaded. From 1938 until 1964, the Commission often brought cases simply alleging that respondents violated the law by engaging in “unfair or deceptive acts or practices,” without attempting to distinguish between the concepts of unfairness and deception.<sup>20</sup>

In 1964, in the Statement of Basis and Purpose for the rule entitled Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking (the “Cigarette Rule”), the Commission first articulated distinct principles for determining whether an act or practice is unfair. The FTC explained that in making this determination, it would consider: (1) whether the practice “offends public policy,” as set forth in statutes, the common law, or otherwise; (2) “whether it is immoral, unethical, oppressive, or unscrupulous; [and] (3) whether it causes substantial injury to consumers (or competitors or other businessmen).”<sup>21</sup> In the subsequent decade, the Commission rarely used its unfairness authority.<sup>22</sup>

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<sup>17</sup> Letter from the FTC to Hon. Wendell Ford and Hon. John Danforth, Committee on Commerce, Science and Transportation, United States Senate, Commission Statement of Policy on the Scope of Consumer Unfairness Jurisdiction (December 17, 1980), reprinted in *In re Int'l Harvester Co.*, 104 F.T.C. 949, 1070, 1074 n.3 (1984) (“Unfairness Policy Statement”).

<sup>18</sup> In 1975, Congress expanded FTC jurisdiction to reach activities “affecting commerce.” Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, Pub. L. No. 93-637, § 201(a), 88 Stat. 2193, 2200 (1975).

<sup>19</sup> H.R. Rep. No. 1613, 75<sup>th</sup> Cong., 1<sup>st</sup> Sess. 3 (1977).

<sup>20</sup> J. HOWARD BEALES, FEDERAL TRADE COMMISSION, THE FTC’S USE OF UNFAIRNESS AUTHORITY, ITS RISE, FALL, AND RESURRECTION §II.A. (2003), <http://www.ftc.gov/speeches/beales/unfair0603.shtm>.

<sup>21</sup> Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, Statement of Basis and Purpose, 29 Fed. Reg. 8324, 8355 (1964).

<sup>22</sup> Beales, *supra* note 20, at §II.A.

In 1972, in *FTC v. Sperry & Hutchinson Co.*,<sup>23</sup> the Supreme Court addressed the FTC’s articulation of unfairness in the Cigarette Rule.<sup>24</sup> The Court stated that, in determining if acts or practices are unfair, the Commission, “like a court of equity, considers public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws.”<sup>25</sup> The Supreme Court’s dicta approving the FTC’s use of broad equitable considerations in concluding that acts and practices are unfair encouraged the agency to use its unfairness authority more frequently during the 1970’s.<sup>26</sup> Specifically, the Commission commenced a series of rulemakings, sometimes relying on broad unfairness theories to try to regulate entire industries.<sup>27</sup> The rulemakings often failed to consider properly the cost-benefit tradeoffs of the proposed rules, and many in Congress opposed the Commission’s broad rulemaking agenda.<sup>28</sup> Congress eventually responded by passing legislation restricting the FTC’s authority.<sup>29</sup>

In the late 1970s, the FTC recognized that it needed an approach to unfairness that was more systematic and rigorous than its broad equitable approach. On December 17, 1980, the Commission therefore issued its Unfairness Policy Statement, declaring that “[un]justified consumer injury is the primary focus of the FTC Act.”<sup>30</sup> The statement articulated a three-part test to determine whether the consumer injury that an act or practice causes, or is likely to cause, renders a practice “unfair:”

The injury must be substantial; it must not be outweighed by countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided.<sup>31</sup>

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<sup>23</sup> 405 U.S. 233, 244 (1972).

<sup>24</sup> *Am. Fin. Servs. Ass’n v. FTC*, 767 F.2d 957, 971 (D.C. Cir. 1985); *Sperry & Hutchinson Co.*, 405 U.S. at 244 n.5.

<sup>25</sup> *Sperry & Hutchinson Co.*, 405 U.S. at 244.

<sup>26</sup> *E.g.*, FEDERAL TRADE COMMISSION, FTC STAFF REPORT ON TELEVISION ADVERTISING TO CHILDREN 189 (1978) (“FTC STAFF REPORT ON TELEVISION ADVERTISING TO CHILDREN”).

<sup>27</sup> *Am. Fin. Servs. Ass’n*, 767 F.2d at 969.

<sup>28</sup> Beales, *supra* note 20, at §II.A.

<sup>29</sup> FTC Improvements Act, Pub. L. No. 96-252 (May 1980); Beales, *supra* note 20, at §II.C.

<sup>30</sup> Unfairness Policy Statement at 1073.

<sup>31</sup> *Id.*

The Unfairness Policy Statement also explained that, in most instances, the proper role of “public policy” is as evidence to be considered in determining the balance of costs and benefits.<sup>32</sup>

During the 1980’s and the early 1990’s, the Commission used the analytical framework set forth in its Unfairness Policy Statement. The Commission found that tying its analysis to the concept of consumer injury resulted in a more effective and objective use of its unfairness authority. In 1994, Congress enacted Section 5(n) of the FTC Act, which codified the three-part unfairness test from the FTC’s Unfairness Policy Statement and rejected public policy as an independent basis for finding unfairness.<sup>33</sup>

Today the FTC uses a well-reasoned three-part test to determine whether an act or practice is “unfair:” it must cause, or be likely to cause, substantial consumer injury; the injury must not be outweighed by countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided.<sup>34</sup> In analyzing whether injury is substantial, the Commission is not concerned with trivial or merely speculative harms, although the substantial injury test may be met by small harm to a large number of consumers.<sup>35</sup> “In most cases a substantial injury involves monetary harm . . . Unwarranted health and safety risks may also support a finding of unfairness. Emotional impact and other more subjective types of harm, on the other hand, will not ordinarily make a practice unfair.”<sup>36</sup> Once it is determined that there is substantial consumer injury, the next step is to determine whether the harm is outweighed by countervailing benefits to consumers or competition. Generally, it is important to consider both the costs of imposing a remedy and any benefits that consumers enjoy as a result of the practice.<sup>37</sup> Finally, a practice is only unfair if the injury is not one that a consumer can reasonably avoid. If consumers could reasonably have made a different choice, but did not, the practice is not unfair under the statute.<sup>38</sup>

The Commission takes the approach that well-informed consumers generally are capable of making choices for themselves. However, the agency may prohibit or restrict acts and

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<sup>32</sup> *Id.*

<sup>33</sup> 15 U.S.C. § 45(n). Section 5(n) of the FTC Act, however, also provides that “[i]n determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence.”

<sup>34</sup> Unfairness Policy Statement at 1073.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* (footnotes omitted).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

practices as unfair, through rulemaking or law enforcement, if they unreasonably create or take advantage of an obstacle to the ability of consumers to make informed choices, thus causing, or being likely to cause, consumer injury. The Commission’s current focus on “substantial net harm” is the best way to ensure that it uses its resources wisely.<sup>39</sup> When used appropriately, unfairness is an important tool to address practices that, although not deceptive, cause substantial and unjustified net harm.

## **B. FTC Use of Unfairness in Financial Services Rules**

The Commission may issue rules pursuant to Section 18 of the FTC Act to define acts or practices that are unfair or deceptive.<sup>40</sup> In appropriate circumstances, the FTC promulgates rules to prevent and prohibit unfair practices. The Commission has issued the Holder in Due Course Rule (“HDC Rule”) and the Credit Practices Rule (“CPR”) in the consumer credit area. In addition, pursuant to the Telemarketing and Consumer Fraud and Abuse Prevention Act,<sup>41</sup> the Commission has issued the Telemarketing Sales Rule, which prohibits certain unfair credit-related practices.

### **1. Holder in Due Course Rule**

In 1975, the Commission issued the HDC Rule.<sup>42</sup> The holder-in-due-course doctrine may immunize the subsequent holder of a negotiable instrument from the claims or defenses that the consumer could have asserted against the original holder. The subsequent holder is entitled to such immunity if it takes the instrument for value, in good faith, and without notice of any claims or defenses against it. For example, if a consumer purchased a defective refrigerator from a department store on an installment plan and the department store sold the installment contract to a creditor, the holder-in-due course doctrine would prevent the consumer from raising the claims that the refrigerator is defective when the creditor seeks to obtain payment under the installment contract.

In its rulemaking, the Commission determined that the use of the holder-in-due-course

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<sup>39</sup> Unfairness Policy Statement at 1076.

<sup>40</sup> 15 U.S.C. § 57a(a)(1)(B); rulemaking procedures are set forth at 15 U.S.C. § 57a(b).

<sup>41</sup> 15 U.S.C. §§ 6101-6108.

<sup>42</sup> Preservation of Consumers’ Claims and Defenses, Statement of Basis and Purpose, 40 Fed. Reg. 53,506 (Nov. 18, 1975) (codified at 16 C.F.R. § 433). The Commission promulgated this rule before it issued the Unfairness Policy Statement.

doctrine in consumer credit disputes was unfair.<sup>43</sup> The FTC considered the impact of this doctrine in an environment of extensive breaches of contract, breaches of warranty, misrepresentation, and fraud in credit sale transactions. The Commission's primary concern was that the system wholly allocated costs arising from the seller's practices to the consumer, because creditors demanded payment as "holders in due course," even though the creditor was in a better position to prevent the seller's harmful practices.<sup>44</sup> The FTC found that consumers were "clearly injured" by a system that "force[d] them to bear the full risk and burden of sales related abuses."<sup>45</sup> In promulgating the HDC Rule, the Commission found that sellers or creditors imposed adhesive contracts upon consumers.<sup>46</sup> The FTC also determined that consumer injury was not "off-set by a reasonable measure of value received in return."<sup>47</sup> Indeed, the Commission found that readily available credit from a "fly-by-night" salesperson who does not perform as promised does not benefit consumers.<sup>48</sup> And the FTC determined that consumers and honest merchants would benefit as prices came to reflect actual transaction costs, and honest merchants no longer needed to compete with those who relied on abusive sales practices.<sup>49</sup>

Therefore, the Commission concluded that the use of certain credit transactions to foreclose consumer claims and defenses arising from credit sale transactions was an unfair practice.<sup>50</sup> To remedy the unfair practice, the HDC Rule requires sellers to include a specific contract provision in the text of certain consumer credit contracts, rendering the contract ineligible for treatment as a negotiable instrument under state contract law.<sup>51</sup> Thus, the HDC Rule allows consumers to bring claims related to the sale of the goods or services against the

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<sup>43</sup> *Id.* at 53,522. Specifically, the Commission stated that it is an unfair practice "for a seller to employ procedures in the course of arranging the financing of a consumer sale which separate the buyer's duty to pay for goods or services from the seller's reciprocal duty to perform as promised." *Id.*

<sup>44</sup> *Id.* at 53,522-23.

<sup>45</sup> *Id.* at 53,523.

<sup>46</sup> *Id.* at 53,523-24.

<sup>47</sup> *Id.* at 53,524.

<sup>48</sup> *Id.* at 53,520.

<sup>49</sup> *Id.* at 53,523.

<sup>50</sup> *Id.*

<sup>51</sup> 16 C.F.R. § 433.2. The notice states: "Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder."



creditor, with monetary recovery limited to the amount the consumer paid under the contract.<sup>52</sup>

## 2. Credit Practices Rule

The Commission issued the CPR in 1985.<sup>53</sup> In the CPR, the FTC determined that certain remedies that creditors frequently included in credit contracts for use when consumers defaulted on the loans were unfair: confessions of judgment (or other waiver of the right to notice and the opportunity to be heard); wage assignments; security interests in household goods; waivers of exemption; pyramiding of late charges; and cosigner liability.<sup>54</sup>

The Commission found that substantial economic injury to consumers resulted from the use of these remedies by creditors. For example, confessions of judgment deprived consumers of notice of a lawsuit and the opportunity to present defenses, potentially leading to unjust loss of property.<sup>55</sup> Evidence in the record also showed that consumers frequently paid disputed debts that were not in fact owed when threatened with execution or garnishment based on confessions of judgment.<sup>56</sup> Wage assignments also occurred without a hearing or other due process and often led to job loss or severely reduced income.<sup>57</sup>

The FTC also determined that consumers could not reasonably avoid harm from these practices. The record showed that, because creditor remedies were relevant only in the event of default and default was relatively infrequent, in looking for credit consumers reasonably

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<sup>52</sup> Almost twenty years later, a House of Representatives report stated that the Holder in Due Course rule has not had a significant impact on credit availability. H.R. REP. NO. 103-652, at 163 (1994) (Conf. Rep.), *reprinted in* 1994 U.S.C.C.A.N. 1993.

<sup>53</sup> FTC Credit Practices Rule, 49 Fed. Reg. 7740 (March 1, 1984) (codified at 16 C.F.R. § 444).

<sup>54</sup> FTC Credit Practices Rule, 16 C.F.R. § 444.

<sup>55</sup> FTC Credit Practices Rule, 49 Fed. Reg. at 7743; 7749; 7753.

<sup>56</sup> *Id.* at 7753.

<sup>57</sup> *Id.* at 7744. Consumers likewise faced destitution where the creditor took security interests in necessary household goods. *Id.* at 7743. Moreover, waiver of exemption clauses potentially resulted in consumers losing possessions deemed basic necessities by state law. *Id.* at 7744. Pyramiding of late charges, that is, the assessment of a late charge where the creditor applied a payment to an outstanding late charge before the monthly payment due, caused a subsequent payment to be treated as late even when it was timely. Treating such payment as late resulted in the consumer being unknowingly assessed multiple late charges for a single late payment, even though subsequent payments were made on time. *Id.* at 7744.

concentrated their search on other factors, such as interest rates and payment terms.<sup>58</sup> Furthermore, consumers could not bargain over the boilerplate contract terms specifying creditor remedies.<sup>59</sup> Shopping for credit contracts was difficult already, because contracts were written in technical language and sometimes were not provided until the transaction was consummated.<sup>60</sup> Moreover, individual creditors had little incentive to provide better terms and explain their benefits to consumers, because a costly education effort would be required with all creditors sharing the benefits.<sup>61</sup> Such a campaign also may have attracted primarily the riskiest borrowers.<sup>62</sup>

The Commission also examined empirical evidence concerning the causes of default, and concluded that these are usually circumstances or events beyond the debtor's immediate control.<sup>63</sup> Moreover, although certain actions could reduce the consumer's risk of default, no reasonable level of precautions could eliminate the risk.<sup>64</sup> Thus, consumers could not reasonably avoid the harsh consequences of creditors' remedies by avoiding default.

The Commission carefully considered potential costs of its proposed credit practice restrictions, such as increased collection costs, increased screening costs, larger legal costs, and increases in bad debt losses.<sup>65</sup> For example, the FTC considered assertions that banning confessions of judgment might decrease credit supply, increase credit cost, or result in heightened security requirements for loans.<sup>66</sup> It found that empirical evidence instead showed that where certain states had prohibited or restricted confessions of judgment, there had been no significant effect on the cost or availability of credit.<sup>67</sup> In fact, the record showed that about ninety-one percent of debtors failed to appear and defend when creditors sued them; thus, although creditors may have experienced a slight delay in collection activities with a ban on

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<sup>58</sup> *Id.* at 7744; 7746.

<sup>59</sup> *Id.* at 7745.

<sup>60</sup> *Id.* at 7744; 7746-47.

<sup>61</sup> *Id.* at 7744.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.* at 7748.

<sup>65</sup> *Id.* at 7744.

<sup>66</sup> *Id.* at 7754.

<sup>67</sup> *Id.*

confessions of judgment, it was unlikely that any significant additional costs would be incurred in the vast majority of cases.<sup>68</sup>

The Commission also evaluated claims regarding the benefits of wage assignments. Some commenters argued that wage assignments allowed consumers with no other collateral to obtain a secured loan, but record evidence indicated that in a substantial number of loans secured by wage assignments, other security was also provided.<sup>69</sup> Other commenters argued that wage assignments spared creditors the cost of going to court.<sup>70</sup> The FTC found that court costs would be moderate in an undisputed case, and the rights were extremely valuable to consumers when they have defenses.<sup>71</sup> The Commission also cited a study finding that wage assignment restrictions had no statistically significant effects on credit costs.<sup>72</sup>

Indeed, in the CPR rulemaking process, the Commission considered several other proposed rule provisions and found that the costs to consumers and competition outweighed the injury caused by the practices. For example, the FTC rejected proposed provisions prohibiting creditors from requiring debtors to pay creditors' attorneys' fees in debt collection.<sup>73</sup> The Commission determined that creditors already have an incentive to minimize attorneys' fees, as most defaulted borrowers do not actually pay the full amount owed for attorneys' fees. Moreover, any benefit that such a prohibition would provide to debtors would be offset by losses to creditors. Further, such a provision might increase total legal costs by encouraging debtors to raise additional defenses.<sup>74</sup> Thus, the Commission carefully considered the evidence in the record to determine whether each regulatory proposal met the unfairness standard.

In a court challenge to two of the CPR's provisions, an association of consumer finance companies argued that in the absence of seller deception or coercion, the FTC may not intercede in the market to obtain "better bargains" for consumers.<sup>75</sup> The court reviewed the Commission's

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<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 7759.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 7784.

<sup>74</sup> *Id.*

<sup>75</sup> *Am. Fin. Servs. Ass'n*, 767 F.2d at 964.

record establishing that the practices caused substantial injury;<sup>76</sup> that the marginal cost to industry was clearly overshadowed by the much greater risks to consumers;<sup>77</sup> and that the injury was not reasonably avoidable by consumers.<sup>78</sup> As to the balancing of costs and countervailing benefits, the court cited favorably the Commission's determination that the CPR would have only a marginal impact on the cost or availability of credit, and that this marginal cost was clearly overshadowed by the much greater risks to consumers resulting from the use of the challenged remedies.<sup>79</sup>

In determining whether the FTC correctly concluded that the harm from the practices was not reasonably avoidable, the court relied on the Commission's findings that (1) consumers are not, as a practical matter, able to shop and bargain over alternative collection provisions; and (2) default is ordinarily the product of forces beyond a borrower's control.<sup>80</sup> Specifically, the FTC had found that contracts offered by creditors serving higher-risk borrowers were often substantially identical. The Commission also had found that consumers' ability to shop and bargain was further limited by the technical language and fine print used in the contracts.<sup>81</sup> And it found that in some cases, comparison was impossible because the creditor refused to provide the contract until the borrower was ready to sign it.<sup>82</sup> Moreover, relying principally on two large survey studies of the causes of default, the Commission concluded that because default was both unforeseeable and unavoidable, the creditors' use of the challenged remedies was not reasonably avoidable.<sup>83</sup> Based on all of these findings, the court held that the Commission's decision to prohibit the use of certain security interests and wage assignments was supported by substantial evidence in the record.<sup>84</sup>

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<sup>76</sup> *Id.* at 972-75.

<sup>77</sup> *Id.* at 975-76, 986.

<sup>78</sup> *Id.* at 976-78.

<sup>79</sup> *Id.* at 976.

<sup>80</sup> *Id.* at 977.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 977-78.

<sup>84</sup> *Id.* at 989. The Federal Home Loan Bank Board (OTS's predecessor agency), the Federal Reserve Board, and the National Credit Union Association issued substantially similar rules applicable to their supervised institutions. 12 C.F.R. § 535; 12 C.F.R. § 227; 12 C.F.R. § 706.

### 3. Telemarketing Sales Rule

In 1994, the Telemarketing and Consumer Fraud and Abuse Prevention Act directed the Commission to issue a rule prohibiting “deceptive and abusive” telemarketing acts or practices.<sup>85</sup> In the resulting Telemarketing Sales Rule (“TSR”), the FTC prohibited specific “abusive” practices that either were “directly consistent with the Act’s emphasis on privacy protection, and with the intent, made explicit in the legislative history, that the TSR address these particular practices,” or satisfied the FTC’s traditional unfairness test.<sup>86</sup> The TSR generally applies broadly to telemarketing of all types of products and services, including financial services, and specifically prohibits certain financial-related practices<sup>87</sup> because they are *unfair*. For example, the TSR bans (a) requesting or receiving payment for “credit repair” services prior to delivery and proof that such services have been rendered;<sup>88</sup> (b) requesting or receiving payment for “recovery services” prior to delivery and proof that such services have been rendered,<sup>89</sup> and (c) requesting or receiving payment for a loan when a seller or telemarketer has guaranteed or represented a high likelihood of success in obtaining or arranging a loan or other extension of credit (sometimes called “advance fee loan”).<sup>90</sup>

With respect to credit repair, recovery services, and advance fee loans, in many instances, telemarketers take consumers’ money for services that the seller has no intention of providing and in fact does not provide.<sup>91</sup> Each of these practices had been the subject of large numbers of consumer complaints and enforcement actions, and in each case caused substantial injury to

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<sup>85</sup> 15 U.S.C. § 6102(a).

<sup>86</sup> Telemarketing Sales Rule; Final Rule, 68 Fed. Reg. 4580, 4614 (Jan. 29, 2003) (codified at 16 C.F.R. §310) (citing H.R. REP. NO. 103-20 at 8 (1993)).

<sup>87</sup> The TSR prohibits disclosing or receiving, for consideration, unencrypted consumer account numbers for use in telemarketing, causing billing information to be submitted for payment without the express informed consent of the customer or donor, and failing to follow specified steps for obtaining express informed consent of the customer or donor in any telemarketing transaction involving preacquired account information and a free-to-pay conversion feature. 16 C.F.R. §310.4(a)(5-6).

<sup>88</sup> “Credit repair” refers to claims that one can remove negative information from consumers’ credit reports, even if the information is accurate and timely.

<sup>89</sup> “Recovery services” refers to claims that purport to recover money consumers lost to investment fraud.

<sup>90</sup> Telemarketing Sales Rule; Final Rule, 68 Fed. Reg. 4580, 4613-14 (Jan. 29, 2003) (codified at 16 C.F.R. §310).

<sup>91</sup> *Id.* at 4614.

consumers.<sup>92</sup> Taking money without providing anything in return caused substantial harm to consumers without any countervailing benefits to consumers or competition.<sup>93</sup> Finally, having no way to know these offered services were illusory, consumers had no reasonable means to avoid the harm that resulted from accepting the offers.<sup>94</sup> Thus, these practices met the statutory criteria for unfairness. The Commission determined that consumer injury could be avoided by a rule prohibiting telemarketers from requesting or receiving payment for these services until after performance of the services was completed.<sup>95</sup>

### **C. Law Enforcement Actions Regarding Unfairness**

In the last decade, the Commission also has used case-by-case law enforcement to challenge certain acts and practices as unfair. The acts and practices challenged include a range of practices that cause widespread and significant consumer harm. In bringing these cases, the Commission has weighed the costs and benefits of the acts and practices being evaluated. This comment will provide examples in the areas of processing payments, unilateral contract modifications, and loan servicing.

#### **1. Processing Payments**

In a number of cases, the FTC has found that companies have assessed charges on consumers or debited their bank accounts without any contact with the consumers at all, simply by obtaining their telephone billing information or bank account numbers and sending charges through a payment system.<sup>96</sup> These practices clearly result in significant consumer injury, and there are no countervailing benefits to consumers or competition.<sup>97</sup> Consumers also cannot reasonably avoid the practice because they never had contact with the company billing or debiting their accounts.<sup>98</sup> Thus, imposing charges on consumers in these circumstances is an

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<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *E.g., FTC v. EdebitPay LLC*, No. 07-4880 (C.D. Cal. 2007); *FTC v. PharmacyCards*, No. 04-0712 (D. Nev. 2004); *FTC v. Verity Int'l Ltd.*, No. 00-7422 (S.D.N.Y. 2000); *FTC v. J.K Publications, Inc.*, No. 99-00044 (C.D. Cal. 1999); *FTC v. Hold Billing Serv., Ltd.*, No. 98-0629 (W.D. Tex. 1998).

<sup>97</sup> *FTC v. J.K Publ'ns, Inc.*, 99 F. Supp.2d 1176, 1201-03 (C.D. Cal. 2000).

<sup>98</sup> *Id.*

unfair act or practice.<sup>99</sup> Moreover, the Commission has sued payment processors that submitted unauthorized charges to be debited from consumers' accounts.<sup>100</sup> In *FTC v. Windward Marketing*, for example, the court, in determining that a payment processor had engaged in unfair practices, found that the processor had notice that it was processing payments for which consumers had not given their consent.<sup>101</sup> Processing charges in these circumstances causes substantial injury to consumers, has no offsetting benefits to consumers and competition, and cannot be reasonably avoided.

## 2. Unilateral Contract Modification

Unilaterally modifying contracts also was found to be an unfair practice in *In re Orkin Exterminating Co.*<sup>102</sup> There, the Orkin termite and pest control company offered consumers "lifetime" guarantees for the continued protection of a treated house or other structure. During a particular time period, the company's contracts provided that a customer could renew the coverage of its "lifetime" guarantee by paying a specific annual renewal fee.<sup>103</sup> Subsequently, the company raised the annual renewal fee for customers with those contracts.<sup>104</sup>

The promise to consumers in this case was made and honored for years before the company modified the contract unilaterally to increase its fee. However, consumers were harmed when the company later decided to break its promise through unilaterally modifying the contract. To address the consumer injury from the unilateral contract modification, the Commission issued an administrative complaint alleging that it was unfair in violation of Section

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<sup>99</sup> *Id.*

<sup>100</sup> *E.g., FTC v. Interbill Ltd.*, No. 06-01644 (D. Nev. 2006); *FTC v. Global Marketing Group, Inc.*, No. 06-02272 (M.D. Fla. 2006); *FTC v. Universal Processing, Inc.*, No. 05-6054 (C.D. Cal. 2005); *FTC v. First Am. Payment Processing, Inc.*, No. 04-0074 (D. Ariz. 2004); *FTC v. Elec. Fin. Group*, No. 03-211 (W.D. Tex. 2003); *FTC v. Windward Mktg., Ltd.*, No. 96-615 (N.D. Ga. 1997).

<sup>101</sup> *FTC v. Windward Mktg., Ltd.*, No. 96-615, 1997 U.S. Dist. LEXIS 17114, at \*37-38 (N.D. Ga. Oct. 1, 1997).

<sup>102</sup> *In re Orkin Exterminating Co.*, 108 F.T.C. 263 (1986), *aff'd*, *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354 (11<sup>th</sup> Cir. 1988); *see also Gateway Learning Corp.*, FTC Docket No. C-4120 (July 7, 2004) (consent order) (retroactive application of a materially changed privacy policy to information that the respondent had previously collected from consumers was an unfair practice).

<sup>103</sup> *Orkin Exterminating Co.*, 849 F.2d at 1356.

<sup>104</sup> *Id.* at 1358.

5 of the FTC Act.<sup>105</sup> After an administrative proceeding, the Commission concluded that Orkin had engaged in an unfair practice through raising its fee, and the company appealed.<sup>106</sup>

On appeal, the court held that there was sufficient evidence in the record to support the Commission determination that Orkin's fee increase was unfair. The court affirmed the Commission's finding of "substantial injury," emphasizing that the FTC had found that Orkin's breach of these contracts generated more than \$7 million in renewal fees over a four year period of time.<sup>107</sup> The court also affirmed the Commission's determination that the fee increase did not provide a benefit to consumers or competition, noting that the FTC had found that there was no improvement in the amount or quality of the service provided when the fee was increased.<sup>108</sup> Finally, the court affirmed the Commission's finding that consumers could not reasonably avoid the injury from the fee increase, as the contracts gave no indication that the company would raise the renewal fees for any reason.<sup>109</sup>

### 3. Loan Servicing

The Commission also has challenged allegedly unfair practices in the servicing of

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<sup>105</sup> Beales, *supra* note 20 at §IV.A. In the financial services context, the FTC has sued companies selling payment processing services to small business clients for unilaterally modifying the contracts. *FTC v. Merchant Processing, Inc.*, No. 07-00533 (D. Ore. 2007); *FTC v. Certified Merchant Serv. Ltd.*, No. 02-44 (E.D. Tex. 2002).

<sup>106</sup> Note that, "[a]lthough all breaches of contract cause injury, not all breaches necessarily constitute unfair practices." Timothy J. Muris and J. Howard Beales, III, *The Limits of Unfairness Under the Federal Trade Commission Act* 37 (Association of National Advertisers, Inc. 1991). Under the common law, the damages available in a private action for breach of contract usually provide an incentive not to breach contracts. In ordinary circumstances, private enforcement of contracts therefore is sufficient to prevent consumer injury. However, if the prospect of liability for damages in private action is not sufficient to deter a company from breaching consumer contracts, treating breaches in these circumstances as unfair may be necessary to prevent them from injuring consumers. *See Orkin*, 108 F.T.C. at 375 and 379-80 (separate statement of Chairman Oliver) ("some, perhaps many, Orkin customers were unable or unwilling to avail themselves of their private remedies because the individual losses are so small," thus eliminating the company's incentive not to breach its fixed fee service contacts with consumers).

<sup>107</sup> *Orkin*, 849 F.2d at 1365.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 1365.



subprime mortgage loans.<sup>110</sup> For example, in November 2003, the Commission, along with the Department of Housing and Urban Development, announced a settlement with Fairbanks Capital Corp. (now called Select Portfolio Servicing, Inc.). The Commission alleged that Fairbanks engaged in several unfair practices. In particular, the FTC alleged that Fairbanks failed to timely or properly post payments received from borrowers, and then assessed late fees and other charges as a result. The injury caused by improper posting was substantial, including significant delinquency fees and possibly improper foreclosures when the borrower could not pay the sometimes hundreds of dollars of fees imposed by Fairbanks. The injury was not reasonably avoidable by consumers because, even if they sent their payments on time, the servicer did not credit payments to their accounts on time. Finally, there was no increase in services or benefits to consumers from improper posting of payments, nor any benefits to competition. Thus, the Commission alleged that Fairbanks' conduct constituted an unfair practice under Section 5.

In addition, the FTC alleged that Fairbanks' practice of placing casualty insurance on consumers' homes when such insurance was already in place, while failing to disclose adequately to consumers that their mortgage accounts would be assessed for such insurance, was an unfair practice. The practice caused substantial injury. Consumers who refused to pay for the duplicative insurance incurred significant delinquency fees that put them at risk of foreclosure. Consumers could not reasonably avoid this injury because, even if they provided proof of their insurance coverage to Fairbanks, the company allegedly did not remove the insurance charges from their accounts.

The Commission also alleged unfair loan servicing practices in litigation against Capital City Mortgage Corp. ("Capital City"), which both originated and serviced subprime mortgage loans.<sup>111</sup> According to the Commission's complaint, Capital City required borrowers to pay money not owed or suffer impairment of title to the property securing their loan, refusing to release liens in many instances where borrowers paid all amounts due under the loan. This practice clearly caused substantial injury to consumers. The injury was not reasonably avoidable by consumers, as even when they paid the amounts due under their loans, Capital City refused to release the lien without additional payments. Finally, these practices were not outweighed by countervailing benefits to consumers or competition.

As stated in the Unfairness Policy Statement, a wide variety of business practices can be unfair if they unreasonably create or take advantage of an obstacle to consumer decision-making in a "well-functioning market."<sup>112</sup> The Commission has used its unfairness authority carefully to prevent practices that cause or are likely to cause substantial injury not reasonably avoidable by

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<sup>110</sup> *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Capital City Mortgage Corp.*, No. 98-00237 (D.D.C. 1998).

<sup>111</sup> *FTC v. Capital City Mortgage Corp.*, No. 98-00237 (D.D.C. 1998).

<sup>112</sup> Unfairness Policy Statement at 1073.

consumers, and are not outweighed by countervailing benefits to consumers and competition.<sup>113</sup>

### III. FTC Use of Deception Authority

#### A. Overview of Deception Principles

As with unfairness, since 1938 the Commission has had the authority under Section 5 of the FTC Act to bring cases to prevent deceptive acts or practices. Deceptive acts and practices under the FTC Act are a subset of unfair acts and practices.<sup>114</sup> A full analysis of the three elements of the unfairness test are not necessary when considering a deceptive act or practice because: (1) deception is very unlikely to benefit consumers or competition, and (2) consumers cannot reasonably avoid being harmed by deception.<sup>115</sup> Consequently, the Commission employs a truncated analytical framework for deception in which a finding of false or misleading material statement or omissions is presumed to injure consumers.<sup>116</sup>

In 1984, the FTC issued its Deception Policy Statement, setting forth the elements of deception. An act or practice is deceptive if (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that representation is material to consumers.<sup>117</sup> Injury is likely if inaccurate or omitted

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<sup>113</sup> Even if consumers do not take away a claim from a seller's silence in the circumstances, the Commission nevertheless may challenge such "pure omissions" as unfair. Such pure omissions are likely to be considered unfair if they concern: (1) core aspects of the transaction that virtually all consumers would consider essential to an informed decision, or (2) the basic characteristics of common law merchantability, such as information bearing on the fitness of a product for its intended use and information bearing on significant hidden safety standards. *In re International Harvester*, 104 F.T.C. 949, 1062 (1984). For example, in *International Harvester*, a tractor manufacturer did not inform farmers that if they removed or loosened a fuel cap on a hot or running tractor to check fuel levels, it could cause fuel geysering. The Commission concluded that the manufacturer's silence was unfair in these circumstances because: (1) it caused farmers to suffer fatal and serious burns, (2) consumers and competition received no benefits from the manufacturer's silence, and (3) farmers could not reasonably avoid injury, because, although they understood generally they should not remove a fuel cap from a hot or running engine, they did not appreciate that something as dangerous as fuel geysering could occur. *Id.* at 1064-67.

<sup>114</sup> *Id.* at 1060.

<sup>115</sup> *Id.* at 1056.

<sup>116</sup> *Id.*

<sup>117</sup> Federal Trade Commission Policy Statement on Deception, *appended to In re Cliffdale Assocs.*, 103 F.T.C. 110, 174-83 (1984) ("Deception Policy Statement"); *see also FTC v. Tashman*, 318 F.3d 1273, 1277 (11<sup>th</sup> Cir. 2003); *FTC v. Gill*, 265 F.3d 944, 950 (9<sup>th</sup> Cir. 2001); *FTC v. QT, Inc.*, 448 F.

information is material.<sup>118</sup>

A claim may be deceptive by either misrepresenting or omitting a material fact that causes consumers to be misled.<sup>119</sup> There are two types of claims: express and implied. Express claims directly represent the fact at issue, while implied claims do so in an oblique or indirect way.<sup>120</sup> The Commission may rely on its own reasoned analysis to determine what claims, including implied ones, are conveyed in a challenged advertisement, so long as those claims are reasonably clear from the face of the advertisement.<sup>121</sup> If, after a facial analysis, the Commission cannot conclude that a particular advertisement can reasonably be read to contain a particular implied message, it needs extrinsic evidence to determine whether such a reading is reasonable.<sup>122</sup> Extrinsic evidence may include, but is not limited to, results from consumer surveys.<sup>123</sup>

A claim is deceptive if the overall net impression that consumers take away based on all of the elements (language, pictures, graphics, etc.) in an advertisement is likely to mislead them.<sup>124</sup> The FTC evaluates whether the consumer's impression or interpretation of a

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Supp. 2d 908, 957 (N.D. Ill. 2006); *FTC v. Think Achievement*, 144 F. Supp. 2d 993, 1009 (N.D. Ind. 2000); *FTC v. Minuteman Press*, 53 F. Supp. 2d 248, 258 (E.D.N.Y. 1998).

<sup>118</sup> Deception Policy Statement at 171.

<sup>119</sup> *FTC v. Simeon Mgmt. Corp.*, 532 F.2d 708, 716 (9<sup>th</sup> Cir. 1976); *FTC v. Pharmtech Research, Inc.*, 576 F. Supp. 294, 300 (D.D.C. 1983).

In some circumstances, silence also may be deceptive. Silence associated with the appearance of a particular product, the circumstances of a specific transaction, or ordinary consumer expectations represents that the product is reasonably fit for its intended purpose. Deception Policy Statement at 170. For example, in connection with sale of a car, consumers assume in the absence of other information that the car can go fast enough for ordinary use on a freeway. If the car cannot, the seller's silence on this point may have been deceptive.

<sup>120</sup> *FTC v. QT, Inc.*, 448 F. Supp. 2d 908, 957 (N.D. Ill. 2006).

<sup>121</sup> *FTC v. Kraft, Inc.*, 970 F.2d 311, 319 (7<sup>th</sup> Cir. 1992); *QT, Inc.*, 448 F. Supp. 2d at 958.

<sup>122</sup> *In re Kraft, Inc.*, 114 F.T.C. 40, 121, *aff'd*, 970 F.2d 311 (7<sup>th</sup> Cir. 1992).

<sup>123</sup> *Id.* at 122.

<sup>124</sup> *FTC v. Cyberspace.com*, 453 F.3d 1196, 1200 (9<sup>th</sup> Cir. 2006) (“A solicitation may be likely to mislead by virtue of the net impression it creates even though the solicitation also contains truthful disclosures”); *FTC v. Gill*, 265 F.3d 944, 956 (9<sup>th</sup> Cir. 2001) (affirming deception finding based on “overall ‘net impression’” of statements); *Removatron Int'l Corp. v. FTC*, 884 F.2d 1489, 1497 (1<sup>st</sup> Cir. 1989) (advertisement was deceptive despite written qualification); *Thompson Medical Co. v. FTC*,

representation or omission is reasonable. Reasonableness is evaluated based on the sophistication and understanding of consumers in the group to whom the act or practice is targeted, which may be a general audience or a specific audience, such as children or the elderly.<sup>125</sup> A claim may be susceptible to more than one reasonable interpretation, and if one such interpretation is misleading, then the ad is deceptive, even if other, non-deceptive interpretations are possible.<sup>126</sup>

Disclaimers or qualifying statements can be very important to the deception analysis. Once an affirmative representation is made, the Commission carefully examines any disclaimers to make sure that they are sufficiently clear and prominent to convey the qualifying information effectively to consumers. Qualifications are only effective if they are both noticed and understood by consumers. “[I]n many circumstances, reasonable consumers do not read the entirety of an ad or are directed away from the importance of the qualifying phrase by the acts or statements of the seller;”<sup>127</sup> thus, a fine print disclosure at the bottom of a print advertisement or a brief video superscript in a television advertisement therefore is unlikely to qualify a claim effectively.<sup>128</sup> Similarly, because consumers “may glance only at the headline” of an advertisement, “accurate information in the text may not remedy a false headline.”<sup>129</sup>

The FTC has provided extensive guidance to businesses on what constitutes a clear and prominent disclosure of information. The agency’s guidance focuses on the impact on consumers of specific elements such as clarity of language, relative type size and proximity to the claim being qualified, and an absence of contrary claims, inconsistent statements, or other distracting elements that could undercut the disclosure.<sup>130</sup>

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791 F.2d 189, 197 (D.C. Cir. 1986) (literally true statements may nonetheless be deceptive); *FTC v. QT, Inc.*, 448 F. Supp. 2d 908, 958 (N.D. Ill. 2006).

<sup>125</sup> Deception Policy Statement at 177.

<sup>126</sup> *Id.* at 178.

<sup>127</sup> *Id.* at 184.

<sup>128</sup> *E.g., id.* at 183; *In re Haagen Dazs Co.*, 119 F.T.C. 762 (1995); *Stouffer Food Corp.*, 118 F.T.C. 746 (1994); *In re Kraft, Inc.*, 114 F.T.C. 40, 124 (1991), *aff’d*, 970 F.2d 311 (7<sup>th</sup> Cir. 1992).

<sup>129</sup> Deception Policy Statement at 183.

<sup>130</sup> *Id.*; FEDERAL TRADE COMMISSION, DOT COM DISCLOSURES: INFORMATION ABOUT ONLINE ADVERTISING, <http://www.ftc.gov/bcp/online/pubs/buspubs/dotcom/index.shtml>; FEDERAL TRADE COMMISSION, DIETARY SUPPLEMENTS: AN ADVERTISING GUIDE FOR INDUSTRY 1988 at Section A.3; *In re Kent & Spiegel Direct, Inc.*, 124 F.T.C. 300 (1997); *In re Synchronal Corp.*, 116 F.T.C. 1189 (1993) (consent orders requiring disclosures to be repeated during television infomercials); *In re Nutri/System, Inc.*, 116 F.T.C. 1408 (1993) (consent order requiring a shorter disclosure for 15 second

A representation or omission is material if it is likely to affect a consumer's choice of or conduct regarding a product.<sup>131</sup> If consumers are likely to have chosen differently but for the claim, the claim is likely to have caused consumer injury.<sup>132</sup> Express claims are presumed material.<sup>133</sup> Similarly, information regarding the cost of a product or service is presumed material.<sup>134</sup> Intentional claims,<sup>135</sup> and claims about the purpose and efficacy of a product or service,<sup>136</sup> are also presumed material.

Most of the FTC's consumer protection efforts in connection with financial services concern deceptive claims. In addition, case-by-case law enforcement actions are the main tool that the Commission uses to prevent these deceptive claims.<sup>137</sup> Combining its broad deception authority under Section 5 of the FTC Act with case-by-case law enforcement results in the Commission being able to move swiftly to combat deception. The Commission can challenge deceptive claims regardless of the medium or format used, including direct mail solicitations,<sup>138</sup> email solicitations,<sup>139</sup> oral representations,<sup>140</sup> television and radio advertising,<sup>141</sup>

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television ads).

<sup>131</sup> *Kraft, Inc. v. FTC*, 970 F.2d 311, 322 (7<sup>th</sup> Cir. 1992); *In re Cliffdale Assocs., Inc.*, 103 F.T.C. 110, 165 (1984); *see also FTC v. SlimAmerica, Inc.*, 77 F. Supp.2d 1263, 1272 (S.D. Fla. 1999) (citations omitted).

<sup>132</sup> Deception Policy Statement at 171.

<sup>133</sup> *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1095-1096 (9<sup>th</sup> Cir. 1994).

<sup>134</sup> *In re Peacock Buick*, 86 F.T.C. 1532, 1562 (1975), *aff'd*, 553 F.2d 97 (4<sup>th</sup> Cir. 1977); Deception Policy Statement at 190.

<sup>135</sup> *Am. Home Prod.*, 98 F.T.C. 136, 368 (1981), *aff'd*, 695 F.2d 681 (3rd Cir. 1982).

<sup>136</sup> *Novartis Corp. v. FTC*, 223 F.3d 783, 786-87 (D.C. Cir. 2000).

<sup>137</sup> The Commission also uses a variety of other means to identify and prevent deceptive claims, such as legislative rules, interpretive rules, guides, policy statements, informal business guidance, and public workshops.

<sup>138</sup> *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *In re First Plus Fin. Group, Inc.*, FTC Docket No. C-3984 (2000).

<sup>139</sup> *FTC v. EdebitPay LLC*, No. 07-4880 (C.D. Cal. 2007); *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004).

<sup>140</sup> *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. 2006); *FTC v. Stewart Fin. Company Holdings, Inc.*, No. 03-2648 (N.D. Ga. 2003); *FTC v. First Alliance Mortgage Co.*, No. 00-964 (C.D. Cal. 2002); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *United States v. Mercantile*

and Web sites.<sup>142</sup> The FTC can challenge deceptive claims for all types of financial goods and services, from mortgage and personal lending, to credit counseling services,<sup>143</sup> to automobile leasing.<sup>144</sup>

The FTC has targeted deception relating to various financial services products and services, including those identified in the OTS ANPR: credit card and payment card lending, residential mortgage lending, gift cards, and deposit accounts. This comment will describe selected cases in which the FTC has challenged deceptive acts and practices in those areas.

## **B. Law Enforcement Actions Regarding Deception**

### **1. Credit Cards and Other Payment Cards**

The Commission frequently has taken action to protect consumers from deceptive representations in the marketing of credit cards and other payment cards.<sup>145</sup> As a recent example,

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*Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002).

<sup>141</sup> *FTC v. DebtSet*, No. 07-558, (D. Colo. 2007); *FTC v. AmeriDebt*, No. 03-3317 (D. Md. 2003).

<sup>142</sup> *FTC v. EdebitPay LLC*, No. 07-4880 (C.D. Cal. 2007); *FTC v. DebtSet*, No. 07-558, (D. Colo. 2007); *FTC v. AmeriDebt*, No. 03-3317 (D. Md. 2003).

<sup>143</sup> *FTC v. AmeriDebt*, No. 03-3317 (D. Md. 2003).

<sup>144</sup> *In re R.N. Motors, Inc.*, FTC Docket No. C-3947 (Apr. 27, 2000); *In re Simmons Rockwell Ford Mercury, Inc.*, FTC Docket No. C-3950 (Apr. 27, 2000); *In re Chrysler Corp.*, FTC Docket No. C-3847 (Jan. 13, 1999); *In re Martin Advertising*, FTC Docket No. C-3846 (Jan. 13, 1999); *In re Frank Bommarito Oldsmobile, Inc.*, FTC Docket No. C-3774 (Jan. 9, 1998); *In re Toyota Motor Sales, U.S.A., Inc.*, FTC Docket No. C-3776 (Jan. 9, 1998); *In re Beuckman Ford, Inc.*, FTC Docket No. C-3777 (Jan. 9, 1998); *In re Volkswagen of America, Inc.*, FTC Docket No. C-3778 (Jan. 9, 1998); *In re Suntrup Ford, Inc.*, FTC Docket No. C-3779 (Jan. 9, 1998); *In re Lou Fusz Automotive Network, Inc.*, FTC Docket No. C-3780 (Jan. 9, 1998).

<sup>145</sup> The FTC has sued over 55 companies since 1998 alleging that they charged advance fees for credit cards but never provided the cards. *E.g.*, *FTC v. Remote Response Corp.*, No. 06-20168 (S.D. Fla. 2006); *FTC v. Centurion Fin. Benefits LLC*, No. 05-5442 (N.D. Ill. 2005); *FTC v. 3RBancorp*, No. 04-7177 (N.D. Ill. 2004); *FTC v. SunSpectrum Commc'ns Org., Inc.*, No. 03-81105 (S.D. Fla. 2003); *FTC v. Platinum Universal, LLC*, No. 03-61987 (S.D. Fla. 2003); *FTC v. Assail, Inc.*, No. 03-007 (W.D. Tex. 2003); *FTC v. Star Credit Servs., Inc.*, No. 02-4500 (E.D.N.Y. 2002); *FTC v. Capital Choice Consumer Credit, Inc.*, No. 02-21050 (S.D. Fla. 2002); *FTC v. Bay Area Business Council, Inc.*, No. 02-5762 (N.D. Ill. 2002); *FTC v. 1st Beneficial Credit Servs. LLC*, No. 02-1591 (N.D. Ohio 2002); *FTC v. Membership Servs., Inc.*, No. 01-1868 (S.D. Cal. 2001); *FTC v. Am. Consumer Membership Servs.*, No. 99-1206 (N.D.N.Y. 1999).

the FTC sued prepaid stored-value card seller EDebitPay, LLC and its affiliates (“EDebitPay”) in July 2007.<sup>146</sup> Defendants’ email and Internet advertisements stated that there were “No Annual Fees” and “No Security Deposit” associated with the card. In fact, defendants allegedly debited a \$159.95 fee from the consumer’s bank account for “application and processing.” Providing consumers with some information about a characteristic, feature, or other attribute of a good or service but failing to provide other material information related to it is a deceptive act or practice if consumers are left with a false or misleading impression. The FTC alleges that consumers reasonably understood from EdebitPay’s statements that there were no substantial fees imposed to obtain and use the card. The claim that there were no “annual fees” or “security deposit” therefore left a misleading impression. Information concerning the cost of a product, such as substantial fees, is presumed material to consumers in making decisions.

## 2. Mortgage Lending

In many cases, the Commission has alleged that mortgage lenders have misrepresented material terms related to their loans.<sup>147</sup> For instance, the FTC’s complaint against Associates First Capital Corporation and Associates Corporation of North America (“The Associates”) alleged that the defendants made false and misleading statements about subprime home equity loan costs and single-premium credit insurance.<sup>148</sup> According to the Commission complaint, The Associates engaged in a course of conduct through which they represented that consumers could pay off their current unsecured debts with a home equity loan for the same amount. The Associates made this claim in advertisements for home equity loans that contained charts showing that the “solution” to unsecured debt of \$24,000 was a home equity loan of \$24,000, as well as in custom-tailored written proposals provided to consumers. In fact, the complaint alleged, consumers could not pay off their current debts with a home equity loan for the same amount, because The Associates’ home equity loan also (a) required the payment of substantial loan fees and closing costs, and (b) in some instances, mandated that consumers purchase single-premium credit insurance. Thus, the “loan amount” listed in the credit advertisements

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<sup>146</sup> *FTC v. EDebitPay LLC*, No. 07-4880 (C.D. Cal. 2007).

<sup>147</sup> *United States v. Mercantile Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002) (misrepresentations regarding balloon payments and other loan terms); *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortgage Co.*, No. 00-964 (C.D. Cal. 2000) (misrepresentations regarding up-front fees and other loan costs); *FTC v. CLS Fin. Serv., Inc.*, No. 99-1215 (W.D. Wash. 1999) (misrepresentations that credit was open-end credit); *FTC v. Wasatch Credit Corp.*, No. 99-579 (D. Utah 1999) (same); *In re First Plus Fin. Group, Inc.*, FTC Docket No. C-3984 (2000) (misrepresentations regarding the amount of money consumers would save by obtaining its loans); *FTC v. Capital City Mortgage Corp.*, No. 98-00237 (D.D.C. 1998) (misrepresentations regarding various loan terms).

<sup>148</sup> *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001).

misrepresented the true cost of the loan.<sup>149</sup> A higher loan amount imposed higher fee and interest costs on consumers, and information regarding the cost of a product is presumed material.<sup>150</sup>

Moreover, the Commission has brought several enforcement actions against mortgage brokers for allegedly deceiving consumers about key loan terms, such as the existence of a prepayment penalty<sup>151</sup> or a large balloon payment due at the end of the loan.<sup>152</sup> Similarly, the Commission has charged brokers with falsely promising consumers low fixed payments and rates on their mortgage loans.<sup>153</sup> In June 2004, the Commission sued Chase Financial Funding (“CFF”), a California mortgage broker, and its principals, in connection with sending unsolicited email and direct mail promising a “3.5% fixed payment” loan.<sup>154</sup> The FTC alleged that CFF did not offer any such loan and that the loan CFF falsely advertised was actually a “payment option” adjustable rate mortgage. With this mortgage, interest accrued at a higher rate, the principal balance would increase if consumers made payments at the advertised rates, and payments were not “fixed.” CFF’s alleged misrepresentations regarding mortgage rates involved facts that a reasonable person likely would have considered important in choosing a loan, and were therefore material.

### 3. Gift Cards

The Commission has used the same deception principles to challenge deception in relatively new financial products, such as gift cards. Specifically, the FTC has brought cases against sellers of gift cards that carried concealed fees or expiration dates. The Commission alleged that the companies represented, expressly or by implication, that consumers could

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<sup>149</sup> Indeed, as several banking agencies have recognized, an advertisement or transaction that is in technical compliance with the Truth in Lending Act may nevertheless violate the FTC Act. Board of Governors of Federal Reserve System and Federal Deposit Insurance Corporation, *Unfair or Deceptive Acts or Practices by State Chartered Banks* (March 11, 2004), at 5-6, available at [www.federalreserve.gov/BoardDocs/press/bcreg/2004/20040311/attachment.pdf](http://www.federalreserve.gov/BoardDocs/press/bcreg/2004/20040311/attachment.pdf); OCC Advisory Letter 2002-3, *Guidance on Unfair or Deceptive Acts or Practices* (March 22, 2002), at 6, available at [www.occ.gov/ftp/advisory/2002-3.doc](http://www.occ.gov/ftp/advisory/2002-3.doc).

<sup>150</sup> *Peacock Buick*, 86 F.T.C. 1532, 1562 (1975), *aff'd*, 553 F.2d 97 (4<sup>th</sup> Cir. 1977).

<sup>151</sup> *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

<sup>152</sup> *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

<sup>153</sup> *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *FTC v. Ranney*, No. 04-1065 (D. Colo. 2004); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. 2006).

<sup>154</sup> *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004).



redeem their gift cards for goods or services of an equal value to the monetary amount of the card. However, these gift cards charged consumers “dormancy” fees—fees imposed against the cards during periods of non-use—or imposed expiration dates. The FTC settled separate cases against two such gift card retailers, Kmart Corporation and Darden Restaurants, Inc., alleging that they failed to disclose adequately to consumers the dormancy fees associated with their cards.<sup>155</sup> The Commission charged that the failure to disclose adequately the fees, in light of the representations made about the value of the cards, resulted in consumers being misled. The FTC also alleged that the claim on the Kmart gift card that it “never expire[s]” was deceptive because in fact, defendants’ application of a dormancy fee caused the card to expire.

#### 4. Deposit Accounts

Although the nonbank companies over which the FTC has jurisdiction generally do not offer deposit accounts, the Commission has challenged certain representations about deposit account services. For example, the FTC charged a regional subprime lending company, Stewart Finance, and its affiliates with making deceptive claims in selling small personal loans and inducing consumers to participate in a “direct deposit” program.<sup>156</sup> In particular, the complaint alleged that Stewart Finance actively solicited Social Security recipients by offering loans of \$150 if they agreed to have their Social Security or other government benefits automatically deposited into bank accounts with financial institutions that Stewart Finance designated. Stewart Finance allegedly trained employees to tell customers that the direct deposit was a “free service” that would “not cost you any extra money.” In fact, the Commission alleged that Stewart Finance deducted monthly fees of \$4 to \$6 from the customer’s account. In addition, if the consumer wished to withdraw money from his account, he allegedly had to do so using an automated teller machine and often incurred a fee. As discussed above, information regarding the cost of a product is presumed material.<sup>157</sup>

In sum, the FTC has challenged a wide variety of deceptive representations and omissions related to financial goods and services. The Commission staff believes that these efforts to combat false and misleading information in the marketplace has helped consumers make better-informed decisions.

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<sup>155</sup> *In re Kmart Corp.*, FTC Docket No. C-4197 (Aug. 14, 2007) (final order); *In re Darden Restaurants, Inc.*, FTC Docket No. C-4189 (May 7, 2007) (final order).

<sup>156</sup> *FTC v. Stewart Fin. Co. Holdings, Inc.*, No. 03-2648 (N.D. Ga. 2003).

<sup>157</sup> *In re Peacock Buick*, 86 F.T.C. 1532, 1562 (1975), *aff’d*, 553 F.2d 97 (4<sup>th</sup> Cir. 1977).

#### **IV. Conclusion**

In sum, the Commission's activities are focused primarily on ensuring that consumers obtain the truthful, non-misleading information they need to make informed financial decisions, and on protecting them from unlawful acts and practices that are likely to cause them harm. The FTC uses case-by-case enforcement and carefully crafted rules to accomplish these goals. The Commission staff recommends that the OTS consider the FTC's experience applying its current legal standards in determining whether to impose rules prohibiting or restricting particular acts and practices of financial institutions.

The FTC staff appreciates your consideration of this information. If any other information would be useful regarding these matters, please contact Peggy L. Twohig, Associate Director for Financial Practices, at (202) 326-3224.

Sincerely,

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