



Office of the Secretary

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

January 22, 2009

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 to help in preparing the Federal Reserve Board's 2008 Annual Report to Congress concerning compliance with the Truth in Lending ("TILA"), Consumer Leasing ("CLA"), Equal Credit Opportunity ("ECOA"), and Electronic Fund Transfer Acts ("EFTA") (collectively "the Acts"). The Federal Trade Commission ("Commission" or "FTC") enforces the Acts for most non-bank entities in the United States. You specifically have asked for information concerning the FTC's administration and enforcement of the Acts, as well as compliance with the Acts among entities within the FTC's jurisdiction.¹ You also have asked for any Commission suggestions and recommendations as to how the Acts and their implementing regulations should be changed. The FTC is pleased to provide you with the following information in response to your request.

**I. THE COMMISSION'S ENFORCEMENT ACTIVITIES IN 2008
UNDER THE ACTS ²**

Truth in Lending Act³

In 2008, the Commission used a variety of tools to protect consumers of financial services.⁴ The FTC has the authority to take law enforcement action against those who violate the TILA and Regulation Z. The Commission also issued or updated consumer and business education materials on a variety of topics related to financial services. The FTC further engaged

¹ The Commission does not collect data regarding the extent of compliance by those numerous non-bank entities. As a result, this letter does not provide information on that issue.

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

³ During 2008, the Commission did not initiate any enforcement actions alleging violations of the CLA, an amendment to the TILA.

⁴ A few of the cases discussed below were finalized in January of 2009.

in research and policy development activities concerning mortgage disclosures and mortgage practices.

A. Mortgage Cases Alleging TILA Violations

With the recent economic downturn, many consumers have become delinquent on their mortgages and may be subject to foreclosure. Some companies have sought to take advantage of these vulnerable consumers, promising for a fee to save their homes from foreclosure. To protect consumers from alleged mortgage foreclosure rescue scams, the Commission filed five law enforcement actions in 2008. Four alleged violations of the FTC Act (one of which settled),⁵ and one, the Safe Harbour Foundation case, alleged violations of the TILA and the Home Ownership and Equity Protection Act (“HOEPA”), in addition to the FTC Act.⁶

In Safe Harbour Foundation, several business entities and individuals allegedly targeted consumers facing foreclosure and promised to “save [their] home[s] from foreclosure. GUARANTEED!” To prevent foreclosure, the defendants allegedly offered consumers high-cost, interest-only, short-term balloon loans that were secured by second mortgages on their homes. Consumers purportedly were to use the proceeds from these loans to make payments on their first mortgage, to stop foreclosure. In February 2008, the FTC filed a complaint alleging that the defendants violated the FTC Act by significantly understating the annual percentage rate (“APR”) for the loans they offered. In addition, the complaint alleged that the defendants: (1) failed to accurately disclose the APR in violation of HOEPA and Regulation Z; (2) failed to provide other disclosures the TILA and HOEPA require; and (3) engaged in other practices HOEPA prohibits.⁷ The court has entered preliminary injunctions against some of the defendants prohibiting them from violating the FTC Act, the TILA, and HOEPA.⁸ Litigation in this case is ongoing.

⁵ *FTC v. National Hometeam Solutions, LLC*, No. 4:08-cv-00067 (E.D. Tex. Feb. 26, 2008) (complaint filed), available at <http://www.ftc.gov/opa/2008/09/uhsnfs.shtm>; *FTC v. Mortgage Foreclosure Solutions, Inc.*, No. 8:08-cv-00388 (M.D. Fla. Jan. 5, 2009) (stipulated final judgment and permanent injunction entered), (M.D. Fla. Feb. 5, 2008) (complaint filed), available at <http://www.ftc.gov/opa/2009/01/mfs.shtm>; *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv-01075 (N.D. Ohio Apr. 28, 2008) (complaint filed), available at <http://www2.ftc.gov/opa/2008/04/foresolutions.shtm>; *FTC v. United Home Savers, LLP*, No. 8:08-cv-01735 (M.D. Fla. Sept. 3, 2008) (complaint filed), available at <http://www.ftc.gov/opa/2008/09/uhsnfs.shtm>.

⁶ *FTC v. Safe Harbour Foundation of Florida, Inc.*, No. 1:08-cv-01185 (N.D. Ill. Feb. 27, 2008) (complaint filed), available at <http://www2.ftc.gov/opa/2008/02/rescue.shtm>.

⁷ Among other things, the complaint alleged that defendants violated HOEPA by extending credit without regard to repayment ability and by using prohibited negative amortization and balloon payment provisions.

⁸ *Safe Harbour Foundation*, No. 1:08-cv-01185 (N.D. Ill. Nov. 12, 2008) (preliminary injunctions entered).

The Commission's enforcement of the TILA in the mortgage lending context also has included challenging deceptive advertising for mortgages.⁹ The FTC issued three consent agreements for public comment, charging that the companies ran deceptive mortgage advertisements that, among other things, boldly promoted low rates or low monthly payment amounts, and failed to state or failed to state adequately the short time period for these terms, in violation of the FTC Act and the TILA. The FTC also alleged that the companies' promotions failed to disclose or failed to disclose adequately that the low monthly payment amount and/or low rate is less than what the consumer owes, with the difference added to the total amount due - causing "negative amortization." One of the companies also allegedly misrepresented that low "fixed" rates were for the full term of the loan, in violation of the FTC Act. Another of the companies allegedly failed to disclose adequately that the offer was made by itself, not the consumer's current lender, in violation of the FTC Act. The proposed orders prohibit each of the three companies from engaging in the deceptive practices that allegedly occurred in the promotions, in violation of the FTC Act, and from advertising specific credit terms without providing other key terms, in violation of the TILA and Regulation Z.¹⁰ The proposed orders also prohibit the three companies from failing to comply with the TILA and Regulation Z.

The FTC's enforcement activities under the TILA have also involved mortgage servicing. In 2008, the Commission settled charges that in servicing primarily subprime and Alt-A loans, EMC Mortgage Corporation and its parent Bear Stearns Companies, Inc. violated, among other things, the FTC Act, the TILA, and Regulation Z.¹¹ The complaint alleged that defendants charged borrowers a "loan modification fee" without authorization, and automatically included this fee (typically \$500) in the unpaid principal balance of the loan. The complaint alleged that in doing so, defendants caused the borrowers' loan balances to increase and created new transactions, without providing disclosures required by TILA and Regulation Z.¹² To resolve all of the complaint allegations, the settlement requires that defendants pay \$28 million for consumer redress, not misrepresent amounts consumers owe, and not charge unauthorized fees. In addition, the order prohibits defendants from: (1) failing to make required TILA disclosures

⁹ *In the Matter of American Nationwide Mortgage Co.*, Docket No. C-3168 (Fed. Trade Comm'n Jan. 8, 2009) (consent agreement accepted for public comment); *In the Matter of Michael Gendrolis d/b/a Good Life Funding*, Docket No. C-3034 (Fed. Trade Comm'n Jan. 8, 2009) (consent agreement accepted for public comment); *In the Matter of Shiva Venture Group, Inc. d/b/a Innova Financial Group*, Docket No. C-3032 (Fed. Trade Comm'n Jan. 8, 2009) (consent agreement accepted for public comment), available at <http://www.ftc.gov/opa/2009/01/anm.shtm>.

¹⁰ Specifically, each settlement prohibits each company from: (1) advertising a rate lower than the rate at which interest is accruing, regardless of whether the rate is referred to as an "effective rate," a "payment rate," a "qualifying rate," or any other term; (2) advertising the amount of any payment, the number of payments or the period of repayment, or the amount of any finance charge, without disclosing, clearly and conspicuously, all of the terms required by the TILA and Regulation Z, including the terms of repayment; the APR; and if the APR may be increased after consummation, that fact; and (3) stating a rate of finance charge without stating the rate as an APR, in violation of the TILA and Regulation Z.

¹¹ *FTC v. EMC Mortgage Corp.*, No. 4:08-cv-00338 (E.D. Tex. Sept. 9, 2008) (stipulated permanent injunction entered), available at <http://www2.ftc.gov/opa/2008/09/emc.shtm>.

¹² These disclosures include, but are not limited to: the APR; the amount financed; and the number, amount, and timing of payments.

before consummating a consumer transaction, and (2) failing to comply in any other respect with the TILA and Regulation Z.¹³

B. Other TILA Cases

The FTC also has taken enforcement actions related to the TILA and Regulation Z to deter payday loan advertisers from failing to disclose the APRs for their loans, which makes it harder for consumers to comparison shop for credit. In June 2008, the FTC settled charges against three payday lenders, alleging that their Internet advertising violated the TILA and Regulation Z by stating the amount of finance charges (such as a \$20 fee for a \$100 loan) but failing to disclose the APRs.¹⁴ According to the complaints, the companies offered payday loans to consumers for a 14-day period, with APRs ranging from 460 percent to 782 percent. All three companies entered into administrative consent orders prohibiting them from advertising credit offers without providing consumers with key disclosures, such as the APRs, required by the TILA and Regulation Z.

In September 2008, the FTC also settled charges that two payday loan lead generators violated the TILA and Regulation Z by failing to disclose in their ads the APRs for the loans offered.¹⁵ The FTC's complaints charged that the lead generators advertised payday loans on their websites and collected information from consumers through online applications. The respondents allegedly sold this "lead" information to lenders who ultimately offered payday loans to consumers. The FTC's complaints alleged that the respondents violated the TILA and Regulation Z by stating the amount of finance charges on their websites but failing to disclose the APRs. According to the complaints, the companies offered payday loans to consumers for a 14-day period. For a typical 14-day pay period, the APRs ranged from 260 percent to 782 percent. The settlements require the respondents to disclose the APRs in similar advertisements and to comply in all other respects with the TILA and Regulation Z.

The FTC's enforcement of the TILA and Regulation Z in the online payday loan context also included challenging a lender's failure to provide required written disclosures to consumers. In November 2008, the FTC and the State of Nevada charged ten related Internet payday lenders and their principals, based mainly in the United Kingdom, with violations of federal and state

¹³ In addition, the Commission continues litigation challenging advertising claims made by Chase Financial Funding, Inc., a mortgage broker. The FTC filed its action in 2004, and the ongoing litigation was discussed in last year's and prior years' letters. See *FTC v. Chase Financial Funding, Inc.*, No. 8:04-cv-00549 (C.D. Cal. May 12, 2004) (complaint filed), available at <http://www.ftc.gov/opa/2004/06/chasefinancial.shtm>.

¹⁴ *In the Matter of CashPro*, Docket No. C-4220 (Fed. Trade Comm'n June 6, 2008) (final consent order); *In the Matter of American Cash Market, Inc.*, Docket No. C-4221 (Fed. Trade Comm'n June 6, 2008) (final consent order); *In the Matter of Anderson Payday Loans*, Docket No. C-4222 (Fed. Trade Comm'n June 6, 2008) (final consent order), available at <http://www.ftc.gov/opa/2008/02/amercash.shtm>.

¹⁵ *In the Matter of We Give Loans, Inc.*, Docket No. C-4232 (Sept. 5, 2008) (final consent order); *In the Matter of Aliyah Associates, LLC d/b/a American Advance*, Docket No. C-4229 (Sept. 5, 2008) (final consent order), available at <http://www.ftc.gov/opa/2008/06/wegiveloans.shtm>.

law.¹⁶ The FTC's charges were filed under the FTC Act, the TILA, and Regulation Z. The complaint alleged that the defendants called applicants in the United States and told them that they qualified for a loan, typically in an amount around \$200, that would have to be repaid by their next payday, with a fee ranging from \$35 to \$80. The defendants purportedly told consumers that they would receive written disclosures about the loans following the call, but consumers never received them. In addition to allegations that the defendants violated the FTC Act, the complaint alleged that they violated the TILA and Regulation Z by failing to disclose in writing to consumers key terms of their loans, including the APR, the payment schedule, the amount financed, the total number of payments, and any late payment fees. This litigation is ongoing.

In February 2008, the Commission settled charges that BlueHippo Funding, LLC violated, among other things, the FTC Act and the TILA in advertising and offering financing of high-end electronics to consumers with poor credit.¹⁷ Consumers allegedly paid for the companies' goods by making a down payment and agreeing to allow the companies to deduct payments directly from their bank accounts.¹⁸ The companies allegedly failed to deliver merchandise as promised, causing many consumers to cancel their contracts. The companies purportedly often failed to disclose to consumers until after they had debited one or more of the payments from consumers' bank accounts that, even if the consumers never received the merchandise, the companies would not refund the payments made. The complaint alleged that the companies violated the TILA and Regulation Z by failing to make required written disclosures.¹⁹ To resolve the complaint allegations, the defendants entered into a settlement agreement which requires that they pay between \$3.5 million and \$5 million for consumer redress and bars them from: (1) making misrepresentations in marketing any consumer electronics product and any other product for which defendants require four or more periodic payments before shipping the product, and (2) failing to disclose material terms and conditions regarding refunds, cancellations, exchanges, or repurchases. The settlement also prohibits the defendants from violating the TILA and Regulation Z.

¹⁶ *FTC and State of Nevada v. Cash Today, Ltd.*, No. 3:08-cv-00590 (D. Nev. Nov. 6, 2008) (complaint filed), available at <http://www1.ftc.gov/opa/2008/11/cashtoday.shtm>.

¹⁷ *FTC v. BlueHippo Funding, LLC*, No. 1:08-cv-1819 (S.D.N.Y. Apr. 10, 2008) (stipulated permanent injunction entered), available at <http://www2.ftc.gov/opa/2008/02/bluehippo.shtm>.

¹⁸ *Id.*, No. 1:08-cv-1819 (S.D.N.Y. filed Feb. 22, 2008) (complaint filed).

¹⁹ These disclosures include, but are not limited to, the conditions under which a finance charge may be imposed, methods for computing the finance charge, identification of other charges which may be imposed, and a statement of billing rights.

C. TILA Consumer and Business Education

The Commission's consumer and business education activities are vital to protecting purchasers of financial goods and services. In 2008, the FTC released a number of consumer education pieces addressing financial services topics related to consumer credit, including "Choosing a Credit Card: The Deal is in the Disclosures," and an article entitled "How to Recognize a Foreclosure Rescue Scam."²⁰ The Commission also issued updates to other publications, including "Foreclosure Rescue Scams: Another Potential Stress for Homeowners in Distress," "Payday Loans Equal Very Costly Cash: Consumers Urged to Consider the Alternatives," "Mortgage Servicing: Making Sure Your Payments Count," and "Looking for the Best Mortgage."²¹ As part of its Hispanic Outreach Program, the Commission published Spanish-language versions of certain publications: "Estafas de Rescate de Ejecución Hipotecaria: Otro Posible Estrés para los Propietarios en Riesgo de Perder su Vivienda" (Foreclosure Rescue Scams: Another Potential Stress for Homeowners in Distress), and "Como reconocer un rescate hipotecario" (How to Recognize a Foreclosure Rescue Scam).²² All of the Commission's consumer education materials are available on the FTC's website.²³

D. Research and Policy Development Initiatives

In addition to its other activities related to administering and enforcing the TILA, the FTC engages in research and policy development to inform its own decisions and to make recommendations to other policymakers. In April 2008, staff from the Commission's Bureau of Consumer Protection, Bureau of Economics, and Office of Policy Planning filed a public comment addressing the Board's proposed rules to restrict certain mortgage practices under the

²⁰ See FEDERAL TRADE COMM'N, CHOOSING A CREDIT CARD: THE DEAL IS IN THE DISCLOSURES, at <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre05.pdf>, FEDERAL TRADE COMM'N, HOW TO RECOGNIZE A FORECLOSURE RESCUE SCAM, at <http://www.ftc.gov/bcp/edu/pubs/articles/naps31.pdf>.

²¹ See FEDERAL TRADE COMM'N, FORECLOSURE RESCUE SCAMS: ANOTHER POTENTIAL STRESS FOR HOMEOWNERS IN DISTRESS, at <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre42.pdf>, FEDERAL TRADE COMM'N, PAYDAY LOANS EQUAL VERY COSTLY CASH: CONSUMERS URGED TO CONSIDER THE ALTERNATIVES, at <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt060.pdf>, FEDERAL TRADE COMM'N, MORTGAGE SERVICING: MAKING SURE YOUR PAYMENTS COUNT, at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea10.pdf>, FEDERAL TRADE COMM'N, LOOKING FOR THE BEST MORTGAGE, at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea09.pdf>.

²² See FEDERAL TRADE COMM'N, ESTAFAS DE RESCATE DE EJECUCIÓN HIPOTECARIA: OTRO POSIBLE ESTRÉS PARA LOS PROPIETARIOS EN RIESGO DE PERDER SU VIVIENDA, at <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/scrc42.pdf>, FEDERAL TRADE COMM'N, COMO RECONOCER UN RESCATE HIPOTECARIO FRAUDULENTO, at <http://www.ftc.gov/bcp/edu/pubs/articles/snaps31.pdf>, FEDERAL TRADE COMM'N, LOS ANUNCIOS QUE LE PROMETEN ALIVIAR SUS DEUDAS PUEDEN ESTAR OFRECIENDO BANCARROTA, at <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/salt015.pdf>. Numerous additional materials for Hispanic consumers are also available. See <http://www.ftc.gov/ojo>.

²³ See <http://www.ftc.gov/bcp/consumer.shtm>.

TILA and HOEPA.²⁴ The FTC staff comment concluded that, while the Board's proposed restrictions on a new category of higher-cost loans appeared to strike a reasonable balance, it should continue to weigh their potential benefits and costs, including considering any empirical evidence submitted in public comments. The FTC staff comment also concluded that the Board's proposed restrictions on appraisal, servicing, and advertising practices, and the revised timing requirement for TILA disclosures, would be beneficial for consumers. Finally, the FTC staff comment raised concerns that proposed mortgage broker compensation disclosures might not be beneficial for consumers and therefore recommended that the Board consider alternative approaches based on additional empirical research. The Board issued its new rules pursuant to the TILA and HOEPA in July 2008,²⁵ and most of these rules take effect in October of 2009.

In June 2008, staff from the Commission's Bureau of Consumer Protection, Bureau of Economics, and Office of Policy Planning also filed a public comment with the U.S. Department of Housing and Urban Development (HUD) concerning proposed amendments to regulations implementing the Real Estate Settlement Procedures Act (RESPA).²⁶ Among other things, RESPA requires that consumers receive disclosures during the mortgage process, including the Good Faith Estimate (GFE) within three days of the loan application and the HUD-1 Settlement Statement (HUD-1) at closing. The FTC staff comment stated that some of the proposed modifications could help consumers better understand and compare loan terms and closing costs. The FTC staff comment also raised the concern that some proposals also may have the unintended consequence of further complicating the already complex mortgage process. In addition to addressing many specific issues related to the proposed amendments,²⁷ the FTC staff comment emphasized that consumers would benefit most if the federal government commenced

²⁴ See FEDERAL TRADE COMM'N, IN THE MATTER OF REQUEST FOR COMMENTS ON TRUTH IN LENDING, PROPOSED RULE, DOCKET NO. R-1305, COMMENTS OF THE STAFF OF THE BUREAU OF CONSUMER PROTECTION, THE BUREAU OF ECONOMICS, AND THE OFFICE OF POLICY PLANNING OF THE FEDERAL TRADE COMMISSION, at <http://www.ftc.gov/os/2008/04/V080008frb.pdf>.

²⁵ Truth in Lending; Final Rule, 73 Fed. Reg. 44,522 (July 30, 2008), available at http://www.federalreserve.gov/reportforms/formsreview/RegC_20081024_ffr.pdf.

²⁶ See IN THE MATTER OF REQUEST FOR COMMENT ON PROPOSED AMENDMENTS TO THE REGULATIONS IMPLEMENTING THE REAL ESTATE SETTLEMENT PROCEDURES ACT, DOCKET NO. FR-5180-P-01, COMMENTS OF THE STAFF OF THE BUREAU OF CONSUMER PROTECTION, THE BUREAU OF ECONOMICS, AND THE OFFICE OF POLICY PLANNING OF THE FEDERAL TRADE COMMISSION, at <http://www.ftc.gov/os/2008/06/V080012respa.pdf>.

²⁷ The FTC staff comment stated that HUD should: (1) re-evaluate its proposal to improve and standardize the GFE form; (2) clarify or modify several aspects of the revised HUD-1 form, Closing Script, and Comparison chart of GFE and HUD-1 terms; (3) re-evaluate its proposed broker compensation disclosures; (4) assess whether pricing restrictions on the resale of settlement service components and prohibitions on referral fees may inadvertently decrease competition and efficiency in the settlement services market; (5) re-assess the proposed expansion of the definition of "required use" of affiliated business services; and (6) continue its commendable use of consumer testing to minimize consumer misunderstanding. *Id.*

a comprehensive effort to reform federal mortgage disclosures under RESPA and the TILA. In November 2008, HUD announced its amended regulations to implement RESPA.²⁸

In addition to filing comments with other policymakers related to the TILA, the FTC's Bureau of Economics, in May 2008, hosted a conference to analyze mortgage market product developments, market outcomes, and the role of information (especially disclosures) in consumer choice and on consumer welfare.²⁹ The conference gathered experts from many relevant specialties to examine these topics. Commission economists and other experts presented and discussed research results, including evaluating how current mortgage disclosures could be improved to assist consumers in making better-informed decisions.

Equal Credit Opportunity Act

The FTC enforces the ECOA and Regulation B against entities within its jurisdiction that, among other things, unlawfully discriminate against members of protected classes in connection with extending credit. The Commission has a strong commitment to enforcing fair lending laws and will pursue vigorously violations revealed by its investigations. The Commission filed one ECOA enforcement action in 2008 and continues to investigate mortgage lenders for possible discrimination in both the pricing and approval of loans.

In December 2008, the Commission announced the complaint and settlement in a fair lending matter involving both prime and subprime home mortgage loans. The FTC resolved allegations that Gateway Funding Diversified Mortgage Services, L.P., and its general partner Gateway Funding Inc. (collectively "Gateway"), charged African-American and Hispanic consumers higher prices than non-Hispanic white consumers for purchase and refinance mortgage loans in violation of the ECOA, Regulation B, and the FTC Act.³⁰ The Commission's complaint alleged that the defendants gave their loan officers nearly complete discretion to charge, in addition to the risk-based price, overages that included higher interest rates and higher up-front charges. The Commission alleged that Gateway paid loan officers a percentage of these overages and failed to monitor whether African-American and Hispanic consumers were paying higher overages than non-Hispanic white consumers. According to the complaint, the exercise of discretion by loan officers resulted in African-American and Hispanic applicants being charged higher prices because of their race or ethnicity -- price disparities that were substantial, statistically significant, and could not be explained by factors related to underwriting risk or credit characteristics of the applicants. The settlement bars the defendants from discriminatory lending practices and requires them to implement fair lending training and monitoring programs

²⁸ Real Estate Settlement Procedures Act (RESPA): Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs; Final Rule, 73 Fed. Reg. 68,204 (Nov. 17, 2008), available at <http://www.hud.gov/offices/hsg/sfh/res/finalrule.pdf>.

²⁹ See CONSUMER INFORMATION AND THE MORTGAGE MARKET, at <http://www.ftc.gov/be/workshops/mortgage/index.shtml>.

³⁰ *FTC v. Gateway Funding Diversified Mortgage Services, L.P.*, No. 2:08-05805 (E.D. Pa. Dec. 17, 2008) (stipulated permanent injunction entered), available at <http://www1.ftc.gov/opa/2008/12/gateway.shtm>.

and a comprehensive data integrity program. The settlement imposes a judgment of \$2.9 million, all but \$200,000 of which is suspended based on the defendants' inability to pay.

Electronic Fund Transfer Act

The Commission enforces EFTA and Regulation E with regard to most non-bank entities in the United States. EFTA and Regulation E provide a framework of rights, liabilities, and responsibilities of participants in electronic fund transfer systems. For example, they mandate that preauthorized debits can only be drawn from a consumer's account if the consumer provides a written, signed or similarly authenticated authorization. In 2008, the Commission was involved in six cases charging violations of EFTA and Regulation E, to protect consumers from harm in connection with negative option plans for health care products, especially dietary supplements.

A. Negative Option Cases Alleging EFTA Violations

In 2008, the FTC brought four cases against companies for alleged violations of the EFTA, Regulation E, and the FTC Act, regarding their negative option plans (also referred to as "continuity programs"). Three cases have settled and one is in litigation. Generally, in negative option plans, a consumer agrees to receive products or services from a company for a trial period at no charge or at a reduced price. The company obtains the consumer's credit card or debit card number,³¹ sometimes by falsely stating that it will be debited only to pay for shipping and handling. If the consumer does not cancel before the end of the trial period, the product shipments continue, with the consumer incurring recurrent charges.

First, in JAB Ventures, LLC ("JAB"), the Commission's complaint alleged that defendants offered consumers "free" samples of their dietary supplements and required that the consumer provide a credit card or debit card number to pay for shipping and handling.³² The complaint alleged, among other things, that the defendants debited consumers' accounts without fully disclosing the terms or obtaining consumers' authorization for preauthorized electronic fund transfers, in violation of the EFTA and Regulation E. The FTC also alleged that JAB did not adequately disclose to consumers that they would be sent additional product shipments and charged approximately \$100 every two or three months. The stipulated final order requires that defendants pay approximately \$7.8 million for consumer redress.³³ The defendants paid \$466,000 of the monetary judgment, with the remainder of the judgment suspended based on their demonstrated inability to pay more. The order requires that defendants clearly and conspicuously disclose all material facts regarding offers for any dietary supplement, food, drug, device, or health-related program or service, or any product or service with a negative option feature. It also incorporates Regulation E's prohibition on failing to obtain written authorization for preauthorized electronic fund transfers from a consumer's account.

³¹ EFTA and Regulation E apply to debit cards; TILA and Regulation Z apply to credit cards.

³² *FTC v. JAB Ventures, LLC*, No. 2:08-cv-04648 (C.D. Cal. Jul. 16, 2008) (complaint filed).

³³ *Id.*, No. 2:08-cv-04648 (C.D. Cal. Aug. 20, 2008) (stipulated permanent injunction entered).

Second, in *Complete Weightloss Center, Inc.*, defendants offered on their website “free” samples of their dietary supplements, requiring consumers to provide their debit or credit card numbers.³⁴ The defendants allegedly failed to adequately disclose that the consumers would be automatically enrolled in a negative option program, and that credit and debit card accounts would be debited approximately \$30 on a recurring basis.³⁵ The complaint also alleged that defendants debited consumers’ bank accounts without obtaining written authorization for preauthorized electronic fund transfers, as required by Regulation E. The stipulated final order requires that defendants pay approximately \$2.5 million for consumer redress.³⁶ The defendants paid \$3,000 of the monetary judgment, with the remainder of the judgment suspended based on a demonstrated inability to pay more. The settlement agreement requires that defendants clearly and conspicuously disclose all material terms and conditions of offers for any dietary supplement, food, drug, device, or health-related product or service, or any product or service with a negative option feature. It also incorporates Regulation E’s prohibition on failing to obtain written authorization for preauthorized electronic fund transfers from a consumer’s account.

Third, in *Ultralife Fitness, Inc.* (“Ultralife”), customers allegedly provided their credit or debit card information to Ultralife with the understanding that it would be used only to cover shipping and handling costs of free samples of dietary supplements.³⁷ According to the FTC’s complaint, customers later discovered that the defendants had enrolled them, without their consent, into continuity programs.³⁸ The complaint states that Ultralife withdrew funds or assessed fees before the consumer received the product, after the product was received but before the trial period ended, and even when the consumer never received the product. The complaint also alleged that Ultralife debited consumers’ bank accounts without obtaining written, signed or similarly authenticated authorization for preauthorized transfers from their accounts. The stipulated final judgment and order include a monetary judgment of approximately \$9.9 million for consumer redress.³⁹ The defendants have paid \$150,000 of the monetary judgment, with the remainder of the judgment suspended based on a demonstrated inability to pay more, and are required to pay approximately \$200,000 to the Internal Revenue Service. The settlement agreement requires that defendants clearly and conspicuously disclose all material terms and conditions of any offer with a negative option feature. It also incorporates Regulation E’s prohibition on failing to obtain written authorization for preauthorized electronic fund transfers from a consumer’s account.

³⁴ *FTC v. Complete Weightloss Center, Inc.*, No. 1:08-cv-00053 (D. N.D., May 13, 2008) (complaint filed).

³⁵ *Id.*

³⁶ *Id.*, No. 1:08-cv-00053 (D.N.D. May 14, 2008) (stipulated permanent injunction entered).

³⁷ *FTC v. Ultralife Fitness, Inc.*, No. 2:08-cv-07655 (C.D. Cal. Nov. 20, 2008) (complaint filed), available at <http://www1.ftc.gov/opa/2008/12/ultralife.shtm>.

³⁸ One continuity program was for periodic shipments of the dietary supplement (at a cost of approximately \$50 a month) and another for fitness instruction (at a cost of approximately \$30 a month).

³⁹ *Id.*, No. 2:08-cv-07655 (C.D. Cal. Dec. 1, 2008) (stipulated permanent injunction entered).

In addition to the three settlements, the FTC brought a fourth case involving a negative option plan used to sell dietary supplements. In this case, NextClick Media advertised “free” samples of herbal products, allegedly claiming consumers would only pay for shipping and handling.⁴⁰ It allegedly sent consumers a 30-day supply of the products which consumers had to pay for if kept, automatically enrolled consumers in a continuity program in which their credit cards or debit cards were charged monthly, and made it difficult or impossible for consumers to cancel the subscription. The Commission filed a complaint alleging, among other things, that NextClick Media debited consumers’ accounts on a recurring basis without obtaining written authorization, in violation of the EFTA and Regulation E. The complaint also alleged that NextClick Media made misrepresentations about the costs associated with a “free” trial, failed to disclose material facts, billed consumers’ credit or debit cards, and made false claims about smoking cessation patches. A court issued a preliminary injunction that incorporates Regulation E’s prohibition on failing to obtain written authorization for preauthorized electronic funds transfers from consumers’ accounts.⁴¹ Litigation continues in this case.

In addition to commencing the new cases discussed above, in 2008 the Commission continued its litigation in federal district court against Berkeley Premium Nutraceuticals, Inc. and other corporate and individual defendants for alleged violations of, among other things, the FTC Act, EFTA, and Regulation E.⁴² According to the complaint, the defendants offered consumers “free” samples of their dietary supplements, then automatically billed them on a recurring basis without obtaining their authorization for the recurring debits in violation of the EFTA and Regulation E. The complaint seeks permanent injunctive relief, including consumer redress. Some of the defendants were convicted of fraud charges in a related criminal trial, after which a stay that had been imposed on the FTC’s civil case was lifted.⁴³ The FTC’s case is now proceeding.

B. Other EFTA Cases

Finally, as noted above, the FTC alleged that BlueHippo Funding violated EFTA and Regulation E in connection with offering to finance purchases of high-end electronics by consumers with poor credit.⁴⁴ Among other things, the complaint alleged that defendants conditioned the extension of credit to consumers on repayment by preauthorized electronic debits. The settlement between the Commission and the defendants prohibits them from conditioning extension of credit on mandatory preauthorized transfers in violation of the EFTA and Regulation E.

⁴⁰ *FTC v. NextClick Media, LLC*, No. 3:08-cv-01718 (N.D. Cal. Mar. 31, 2008) (complaint filed), available at <http://www2.ftc.gov/opa/2008/05/nextclick3.shtm>.

⁴¹ *Id.*, No. 3:08-cv-01718 (N.D. Cal. Apr. 23, 2008) (preliminary injunction entered).

⁴² *FTC v. Warshak*, No. 1:06-cv-00051 (S.D. Ohio Jan. 30, 2006) (complaint filed), available at <http://www.ftc.gov/opa/2006/02/avlimil.shtm>.

⁴³ *Id.*, No. 1:06-cv-00051 (S.D. Ohio Mar. 5, 2008) (court order lifting stay entered).

⁴⁴ See *supra* at 5, *FTC v. BlueHippo Funding, LLC*.

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

The Commission has no suggestions for changes in the Acts or their implementing regulations at this time beyond the staff comments referenced above.

The FTC 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 Peggy Twohig, Associate Director, Division of Financial Practices, at (202) 326-3224.

By direction of the Commission.

Donald S. Clark
Secretary