

**PREPARED STATEMENT  
OF THE FEDERAL TRADE COMMISSION**

**Before the**

**COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**Washington, D.C.**

**November 1, 2001**

## I. Introduction

Mr. Chairman and members of the Committee, I am Elaine Kolish, Associate Director of the Bureau of Consumer Protection's Division of Enforcement at the Federal Trade Commission.<sup>1</sup> I am pleased to have this opportunity to provide information concerning the Commission's recent enforcement action against Ira Smolev, Triad, and related parties.<sup>2</sup> That case was brought as part of the Commission's crackdown on deceptive negative option marketing programs that fail to disclose, or to disclose adequately, the terms of negative option or "free trial" offers. These practices have resulted in consumers being charged or billed for goods and services without authorization.<sup>3</sup> Negative option marketing is particularly troubling when marketers, as they did in the *Smolev* case, already have consumers' credit card or billing account information and can easily charge consumers' accounts without their permission or when marketers fail to disclose that consumers' credit card numbers will be transferred to another company and charged unless consumers call to cancel.

This testimony describes the *Smolev* case and other recent Commission actions involving deceptive negative option marketing and the deceptive sale of credit cards and credit card loss protection services. In addition, this statement describes FTC consumer education materials designed, for example, to help consumers understand negative option offers and minimize the risk of having their billing information transferred or used without their knowledge or consent.

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<sup>1</sup>The views expressed in this statement represent the views of the Commission. My oral statement and responses to any questions you may have are my own, and do not necessarily represent the views of the Commission or of any individual Commissioner.

<sup>2</sup>*FTC v. Ira Smolev*, No. 01-8922 CIV ZLOCH (S.D. Fla.) (filed Oct. 23, 2001).

<sup>3</sup>A negative option is any type of sales term, contract provision, or buying plan that requires an affirmative action on the consumer's part to prevent a sale from taking place. This type of marketing is legal as long as the seller clearly discloses all the material terms and conditions up front and the consumer accepts the offer.

## **II. Background**

The FTC is the federal government's primary consumer protection agency. Congress has directed the FTC, under the FTC Act, to take action against "unfair or deceptive acts or practices" in almost all sectors of our economy and to promote vigorous competition in the marketplace.<sup>4</sup> As part of our activity, the Commission monitors complaints about all types of negative option marketing. Although the number of complaints in this general area has been increasing, one of the specific segments with a particularly dramatic increase in complaints is buying clubs. Buying clubs provide members with specified benefits over a period of time, including, for example, discounts on goods, health services, and legal services. From 1998 to 2000, buying clubs jumped from the 26<sup>th</sup> to the 11<sup>th</sup> most frequently complained about subject in the FTC's Consumer Sentinel complaint database. Thus, this area has attracted increased FTC attention, as well as the attention of the State Attorneys General.

## **III. *Smolev/Triad* Case and Negative Option Marketing**

On October 24, 2001, the FTC announced that a group of buying clubs including Triad Discount Buying Service, Inc., its related companies and their operator, Ira Smolev, will pay more than \$9 million to settle charges brought by the FTC and State Attorneys General that the defendants misled consumers into accepting trial buying club memberships and obtained consumers' credit card account numbers without the consumers' knowledge or authorization

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<sup>4</sup>The FTC has broad law enforcement responsibilities under the FTC Act, 15 U.S.C. § 41 *et seq.* The statute provides the agency with jurisdiction over most of the economy. Certain entities, such as depository institutions and common carriers, are wholly or partially exempt from FTC jurisdiction, as is the business of insurance. In addition to the FTC Act, the FTC has enforcement responsibilities under more than 40 statutes.

from telemarketers pitching the buying clubs.<sup>5</sup> Consumers then were enrolled in the clubs and charged up to \$96 in yearly membership fees. Of the amount to be paid, \$8.3 million is earmarked for consumer restitution, and \$750,000 will cover state investigative costs. The multi-state investigation, which was led by Florida and Missouri, resulted in more than 40 states' entering into the settlement agreement.

From 1996 to 2000, the Triad companies contracted with numerous independent telemarketers to "upsell"<sup>6</sup> the Triad buying clubs. The telemarketers generally marketed their own products and services through outbound calls or inbound calls in response to advertising, direct mail, or infomercials. After customers purchased products or services from these telemarketers and provided their credit card numbers for payment, the telemarketers promoted a 30-day free trial in the Triad buying club as a thank-you for purchasing the telemarketers' products or services. The Commission's complaint alleges that the telemarketing scripts did not disclose or disclose sufficiently that consumers had to call the defendants and cancel their

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<sup>5</sup>The press release and related documents are available at [www.ftc.gov/opa/2001/10/triad.htm](http://www.ftc.gov/opa/2001/10/triad.htm). Specifically, the complaint alleges that defendants misrepresented that: (1) consumers who agree to the offer of a 30-day trial membership incur no obligation to take any action to avoid having their credit cards charged for the membership; (2) consumers agreed to accept the trial memberships, or agreed to purchase memberships, for which defendants charged them; and (3) only the cost of the products purchased from defendants' third-party telemarketers would be charged to the consumers' credit card accounts and no other charges to the accounts would be made without the consumers' further express authorization. The complaint also alleges that defendants failed to disclose or to disclose adequately that a consumer who fails to contact defendants within 30 days and cancel the membership is automatically enrolled as a member and charged an annual fee, and that the member is charged a renewal fee each subsequent year unless the member cancels the membership. In addition, it alleges that defendants, directly and through their third-party telemarketers, failed to disclose that the consumers' financial information is turned over to defendants, who charge the consumer's credit card for the membership. Finally, the complaint alleges that defendants violated the Telemarketing Sales Rule ("TSR") by not disclosing material terms and conditions of the offers up front.

<sup>6</sup>Upselling is the practice of marketing additional products after a consumer has agreed to purchase a different product. In this case, for example, two sellers entered into a joint marketing agreement to offer products or services during the same telephone call. The first seller telemarketed its own products or services. After consumers provided financial information to pay for their orders, the first seller offered the second seller's products or services.

membership before the end of the trial period to avoid being automatically enrolled as a member and charged an annual fee. In addition, consumers were unaware that their credit card numbers were being transferred from the telemarketer they called to Triad.

In addition to providing monetary relief, the Triad Order requires Ira Smolev and the Triad companies to drastically revise their marketing practices to prevent future deception. The Order prohibits them from misrepresenting “free” offers of goods or services and from failing to disclose any obligations placed on consumers who accept trial offers. The Order also prohibits them from: (1) obtaining consumers’ billing information, including credit card account numbers and unique identifying information, from third parties without the consumers’ express authorization; (2) disseminating the information (with a few narrow exceptions, such as to process an authorized charge); and (3) signing up new members or renewing existing memberships without express, verifiable authorization from the consumer.<sup>7</sup>

In addition to the FTC and state actions against Triad, since 1999 several states have taken enforcement action against three other buying club marketers, Damark International,<sup>8</sup>

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<sup>7</sup>The Order also enjoins violations of the Telemarketing Sales Rule, and requires Ira Smolev and the Triad companies to retain a third party monitor to oversee their future business operations and report to the FTC. Finally, the Order requires Ira Smolev to maintain a \$1.5 million escrow account before he markets goods or services to the general public or assists others engaging in telemarketing.

<sup>8</sup>In 1999, Minnesota obtained an Assurance of Discontinuance from Damark International to resolve allegations that it deceived consumers by offering a free trial membership in its buying clubs without disclosing that consumers must affirmatively act to cancel the membership within 30 days to avoid a credit card charge.

MemberWorks<sup>9</sup> and Brand Direct Marketing (“BDM”),<sup>10</sup> based on their marketing practices.

These matters involved alleged practices like those at issue in the *Smolev* matter.

The FTC and State Attorneys General are continuing to investigate other companies that are engaged in negative option marketing, including offers for buying clubs, that may be misleading to consumers. Past FTC cases have involved book offers,<sup>11</sup> website services,<sup>12</sup> and Internet services,<sup>13</sup> among others. On October 4, during remarks at the 2001 Privacy Conference

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<sup>9</sup>At least four states -- Minnesota, New York, Nebraska, and California -- have obtained either an Assurance of Voluntary Compliance (“AVC”) or a court settlement with MemberWorks. Nebraska obtained an AVC in February 2001 that applies nationwide. The AVC requires MemberWorks to provide refunds to consumers alleging unauthorized charges and includes detailed conduct provisions applicable to MemberWorks’ marketing of membership programs.

<sup>10</sup>In August 2000, BDM agreed to be bound by a federal court order resolving allegations that BDM violated the TSR and state consumer protection laws. *State of Connecticut and State of Washington v. Brand Direct Marketing, Inc.*, No. 300CV1456-GLG (D. Conn., Aug. 9, 2000). The states filed this action in federal court to enforce the TSR pursuant to the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §6101 *et seq.* The states have authority to bring such TSR enforcement actions under 15 U.S.C. § 6103(a). Pursuant to this Order, BDM paid \$1.9 million in penalties, fees and consumer education funds, and about \$11 million in restitution. In addition, BDM is required to make specific disclosures about its ability to directly charge consumers’ credit cards. Finally, the order requires BDM to improve its cancellation, automatic renewal, and refund procedures.

<sup>11</sup>For example, the Commission recently obtained a consent decree against a book company for allegedly violating the Prenotification Plan Negative Option Rule, 16 C.F.R. Part 425, the TSR, and the Unordered Merchandise Statute, 39 U.S.C. § 3009. *FTC v. Creative Publishing Int’l, Inc.*, No. 01-945 (DWF/AJB) (D. Minn. May 30, 2001). That case involved allegations that consumers were not told all the terms and conditions of the plan they were unwittingly signed up for when they agreed to receive a book on a free preview basis. Those consumers who paid for the book were sent notices, without their authorization, that other books would be sent to them unless they cancelled.

<sup>12</sup>*See e.g., FTC v. Shared Network Services, LLC*, No. CIV. S-99-1087 WBS JFM (E.D. Cal.); *FTC v. Wazzu Corp.*, No. SACV-99-762-AHS (C.D. Cal.); and *FTC v. U.S. Republic Communications, Inc.*, No. 4:99-CV-3657 (S.D. Tex.). The defendants in these cases represented that small businesses would have an opportunity to review website services for a 30-day trial period before being charged for the services. The defendants made it nearly impossible for businesses to cancel, however, by failing to provide information about how to contact the defendants or by providing that information weeks after the telemarketing call.

<sup>13</sup>In 1998, the Commission challenged the free trial-period marketing practices of three Internet Service Providers (“ISPs”). The Commission alleged that the ISPs failed to disclose adequately that consumers who do not cancel free Internet services during a 30-day trial period would incur charges on their credit cards (the consumers provided their credit card numbers to the ISPs to initiate the free trial periods). The consent orders require the ISPs to disclose clearly and prominently any obligation to cancel the service in order to avoid being charged, and to provide at least one reasonable means of canceling. *See America Online, Inc.*, No. C-3787, *Prodigy Servs. Corp.*,  
(continued...)

in Cleveland, Ohio,<sup>14</sup> FTC Chairman Muris announced that, as part of the FTC's review of the Telemarketing Sales Rule, he will recommend consideration of amendments to address abuses concerning pre-acquired account information to ensure that this type of information is not used to bill consumers for goods or services they did not want.<sup>15</sup>

#### **IV. Actions Involving Credit Card Sales and Credit Card Loss Protection Services**

The FTC has aggressively challenged deceptive marketing of credit and credit card-related services. Most recently, on October 18, 2001, the FTC announced the filing of nine cases, most of which involve the alleged deceptive telemarketing of "guaranteed loans," worthless credit card protection services, and "protection" from identity theft.<sup>16</sup>

The FTC has brought cases challenging the deceptive marketing by telemarketers of major credit cards, such as VISA and MasterCard. For example, in January 2001, the Commission obtained a settlement with American Consumer Membership Services, Inc. and its principal resolving charges that they deceptively telemarketed offers of pre-approved, guaranteed VISA or MasterCard credit cards for a \$69 fee to consumers with credit problems. Instead of the promised cards, consumers received vouchers, coupons, and other offers, and occasionally credit card applications with lists of banks to which they could apply for a credit card. Applying for these credit cards often required additional bank fees of as much as \$150. The settlement bans the defendants from engaging in any telemarketing, or in the advertising,

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<sup>13</sup>(...continued)  
No. C-3788, and *CompuServe, Inc.*, No. C-3789 (Mar. 16, 1998).

<sup>14</sup>Chairman Muris' remarks can be found at [www.ftc.gov/speeches/muris/privisp1002.htm](http://www.ftc.gov/speeches/muris/privisp1002.htm).

<sup>15</sup>16 C.F.R. Part 310. As with any rulemaking, the Commission will carefully consider the record developed during the proceeding before making a final decision.

<sup>16</sup>The press release announcing the "Ditch the Pitch" cases is at [www.ftc.gov/opa/2001/10/ditch.htm](http://www.ftc.gov/opa/2001/10/ditch.htm).

marketing, or sale of credit cards, loans or other extensions of credit. In addition, it requires the payment of over \$40,000 in consumer redress.<sup>17</sup> In other similar cases, the FTC alleged that the companies misrepresented that consumers whose credit cards are lost or stolen are at risk for unlimited charges, when in fact under the Truth-in-Lending Act consumers are not responsible for any unauthorized credit card charges over \$50, and major credit card companies typically waive this fee too.

## **V. Consumer Education**

To help consumers protect themselves, the Commission has widely disseminated numerous consumer education publications.<sup>18</sup> To help consumers understand negative option and trial offers and reduce the risk of having their credit card numbers transferred or charged without authorization, the Commission has issued two publications – “Prenotification Negative Option Plans” and “Trial Offers: The Deal is in the Details.” The FTC also has issued consumer education materials addressing the deceptive marketing of gold credit cards and credit card loss protection programs, including “Gold and Platinum Cards;” “Secured Credit Card Marketing Scams;” and “FTC Consumer Alert! Credit Card Loss Protection Offers: They’re the Real Steal.” We hope that consumers who may have had their credit card numbers transferred or charged without their knowledge or consent will report their experiences by filing a complaint with the FTC. Consumers who feel that they have been defrauded can file complaints with the FTC in writing, online at [www.ftc.gov](http://www.ftc.gov), or by calling the FTC’s toll-free number, 1-877- FTC HELP. Information about where such practices are occurring and which companies are engaging

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<sup>17</sup>*FTC v. American Consumer Membership Services, Inc.*, No. 99 CV 1206 (N.D.N.Y.) (complaint filed Aug. 5, 1999).

<sup>18</sup>These publications are available at [www.ftc.gov/bcp/online/pubs](http://www.ftc.gov/bcp/online/pubs).

in them is critical to effective state and federal law enforcement efforts.<sup>19</sup>

## **VI. Conclusion**

The Commission appreciates the opportunity provided by the Subcommittee to describe our efforts to tackle the deceptive marketing of negative option and free trial offers and the improper transfer or misuse of consumers' billing information, as well as other deceptive practices involving the sale of credit cards and credit card loss protection services.

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<sup>19</sup>Recently issued voluntary self-regulatory guidelines also may help address and prevent deception and consumer confusion over negative option marketing practices, as well as the use of pre-acquired account information. On October 14, 2001, the Electronic Retailing Association's board approved industry self-regulatory guidelines that address negative option marketing (called advance consent marketing by the industry), made compliance with them a condition of membership, and advised members not to do business with other companies not adhering to the guidelines. In addition, the Magazine Publishers Association and companies such as Time-Life have formally adopted the guidelines, and it appears that other companies and associations also may do so. These guidelines explain the disclosures that are required for various types of negative option marketing (*e.g.*, automatic renewals, free trial offers) and advise sellers "to be sensitive to the privacy concerns of consumers and regulators in connection with the use and disclosure of consumers' account billing information." The guidelines further provide that "sellers and their agents and their service providers should not transfer a consumer's account billing information to any unaffiliated third party other than a billing or processing agent without the consumer's express authorization." We are hopeful that as the self-regulatory guidelines become more widely known and adopted, they will have a significant impact on industry practices and reduce consumer confusion and complaints about negative option marketing techniques. The guidelines are available at [www.retailing.org](http://www.retailing.org).