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**Before the United States Senate  
Committee On Commerce, Science and Technology  
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It is with great appreciation that I thank Chairman Rockefeller for holding this hearing, for exposing and carefully examining this problem, and for his obvious commitment to protecting consumers from abuses in the marketplace. I have had the pleasure of working with Senator Klobuchar, from my home state of Minnesota, on consumer protection issues, and I know she also understands the inadequacy of current regulatory systems for protecting consumers in today's marketplace.

Unauthorized charges for membership clubs following consumer website purchases flow from internet retailers selling access to the financial accounts of their customers. This problem is part of a larger practice known as preacquired account marketing, which has festered largely unattended for more than a decade. Today's hearing is long overdue. The business practices that are being examined in this hearing drain the financial accounts of American consumers without legitimate purpose.

I first encountered the problem of unauthorized account charges resulting from preacquired account marketing as a public attorney enforcing consumer protection laws. Prior to joining the University of Minnesota Law School faculty in 2005, I worked as an Assistant Attorney General and Manager of the Consumer Enforcement Division in the Minnesota Attorney General's Office. I was involved in the prosecution of a series of cases against banks, mortgage companies, retailers, insurers and membership club sellers using preacquired account marketing.<sup>1</sup> For the last few years, I have studied and written about this practice, including its rapid growth as an internet marketing system.<sup>2</sup>

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<sup>1</sup> These cases included publicly filed consumer protection actions by the Minnesota Attorney General against Fleet Mortgage Corporation, Memberworks, Inc. (now known as Vertrue, Inc.), Damark International, Inc. (now known as Provell, Inc.) and U.S. Bancorp.

<sup>2</sup> An article examining this issue in more detail, including a proposed model law to control the problem, can be viewed at: <http://ssrn.com/abstract=1460963>. The article, entitled *The Invisible Hand of Preacquired Account Marketing*, will be published in June 2010 in Volume 47, Issue 2 of the *Harvard Journal on Legislation*.

Preacquired account marketing creates the same result in all of its modalities—massive consumer confusion and extraordinary numbers of consumer complaints about unauthorized charges to financial accounts. It accomplishes this result by acting as a sorting mechanism to identify vulnerable and distracted consumers unaware that their accounts have been charged. My testimony will focus on how this sorting occurs and why current laws are inadequate to control the problem. I will conclude by asking you to consider a law that bans e-retailers, other retailers and financial institutions from selling special access to their customers’ financial accounts. Further disclosure requirements will not solve the problem of consumer confusion and harm caused by preacquired account marketing.

## I. Preacquired Account Marketing Results In Unauthorized Account Charges

An internet retailer acquires an account number, such as a credit card number, when selling goods or services to a consumer. The consumer enters his or her account number on the e-retailer’s website when the consumer believes he or she understands and agrees to the terms of the transaction. Internet transactions mimic traditional retail transactions in this respect—consumers signal consent to a charge by providing an account number to the seller, much as a consumer swipes or hands over a debit or credit card to a physical retailer.

### A. How Preacquired Account Marketing Works

The flood of consumer complaints about unauthorized charges following website purchases is the predictable result of using preacquired account marketing techniques on the internet. The e-retailer agrees to sell the consumer’s account number it obtained, or sell the ability to charge its customer’s account, with a membership club seller. After the initial e-retailer transaction, the membership seller solicits the consumer for a free trial in a membership club or an insurance policy. If the marketing company determines the consumer consented, and the consumer fails to cancel in time, the marketing company charges the consumer’s account. The retailer who sold the consumer’s account number shares in the revenue.

This is the same process, with the same result, that occurs when preacquired account marketing is used in other contexts, including direct mail, outbound telemarketing and various forms of inbound call marketing.<sup>3</sup> Most of the nation’s largest financial

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<sup>3</sup> The Better Business Bureau, which rates Vertrue with a grade of “F”, describes consumer problems with the company’s business practice as follows: “Complaints reported to the Bureau primarily involve claims of

institutions also sell the right to charge their customers' accounts to membership club sellers and other companies employing preacquired account marketing.<sup>4</sup> Credit card, checking and mortgage accounts all are commonly accessed through preacquired marketing.

These are not trivial charges. Membership clubs now routinely charge about \$100 or more per year. Membership club sellers claim tens of millions of members. Affinion alone asserts that it adds one million members per year through internet solicitations alone.

#### B. The Deception Problem with Preacquired Account Marketing

Consumers are confused and misled by this marketing system for three reasons. First, this type of selling process circumvents the short-hand methods used by consumers to indicate consent to a transaction. In an internet transaction, the entry of an account number, and perhaps CVV code, alerts consumers that they are providing that authorization. When e-retailers sell the right to charge their customer accounts, membership club sellers can defeat consumer expectations that withholding this information prevents consent to a charge for the transaction.

Second, membership club sellers and other preacquired account marketing companies layer multiple sales practices with deceptive potential. These sellers invariably provide a "free trial offer" or similar inducement to begin the solicitation, suggesting a lack of commitment required of the consumer. This is consistent with the consumer's expectation that he or she has not provided an account number authorizing a charge. These sellers then employ a "negative option" method to charge the consumer's account without further action by the consumer if he or she fails to cancel during the trial period. Finally, agreements purportedly entered into through preacquired account marketing typically include an "automatic renewal" provision so that the charge is re-assessed periodically, often at a higher rate on later charges, until cancelled by the consumer. Combining the circumvention of short-hand consent signals and the layering of multiple

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unauthorized charges by the Company's affiliates. In such cases, customers reported no recollection of having agreed to the programs that were billed to their credit card, debit card or bank account. In some of the cases, consumers reported being charged for two or three years."

<sup>4</sup> Affinion, one of the largest preacquired marketing seller of membership clubs, lists its "affinity partners" as including "18 of the top 20 U.S. credit card issuers, 17 of the top 20 U.S. debit card issuers, 5 of the top 5 U.S. mortgage companies."

suspect sales methods makes it inevitable that many consumers will not understand the complicated solicitation terms.

Third, preacquired account marketing raises special concerns for deception of vulnerable consumers. The elderly who have substantial mental diminishment, those with mental impairment from illness and non-native English speakers are more susceptible to the deception potential with this form of marketing. It is one thing to have individuals in these groups read or enter an account number, but quite a different experience to allow vulnerable populations to be charged for failing to notice and comprehend complicated disclosures when they have not provided an account number to the seller.

### C. The Sorting of Distracted and Vulnerable Consumers

Membership club sellers will respond that the entire transaction sequence is fully disclosed to the consumer. This assertion generally is true, especially on the internet where human deviation from script is not possible. Are we left with a debate about whether these disclosures are adequate to overcome the problems with consumer deception described above? No. The fundamentally corrupt business model that drives this form of marketing gains focus if we shift perspective from the various experiences of millions of individual consumers during the solicitation process to the net effect of this system on consumer account charges.

This result occurs because preacquired account marketing acts as a sorting system to identify consumers who will have their financial accounts charged without their full understanding. Preacquired account marketers (and the enabling e-retailers, banks and other companies that sell account access) rely on a combination of consumers who never understand the solicitation and consumers who grasp it at the time of solicitation but fail to remember the terms of the transaction through the trial period. For consumers in these groups who notice the charge on their account statement, the sellers take a pro-rated amount of the charge. The bulk of revenue lies in those consumers who do not notice the charge and are assessed the full amount, and who later suffer automatic renewal charges at higher rates, sometimes for years, before cancelling. These consumers not only pay all of the cost of the membership club, but do not demand anything of value from the service because they do not even know they are members.

This situation could present a difficult public policy problem if a substantial number of consumers were charged for membership services of which they were unaware, but where most members understood the process and happily paid for the service. Mounting evidence, however, shows this latter group is almost non-existent-- that almost every

consumer charged through preacquired account marketing is unaware of or did not want the membership service they allegedly agreed to purchase. This evidence includes the following:

\* The Iowa Attorney General sued Vertrue, a preacquired seller, in 2006. As part of the investigation, Attorney General Tom Miller surveyed consumers that Vertrue had identified as paying for one of its membership programs. Of the 88 club members who returned surveys, 59 (or 67.0%) were unaware of the membership and stated that the charge was totally unauthorized, 24 (or 27.3%) stated that they were aware of the club but they never used it and believed they had already cancelled, 6 (or 6.8%) stated generally that the charges were “unauthorized,” and 3 (or 3.4%) gave unclear answers that indicated some awareness of the club but dissatisfaction with the service, including one member who “felt coerced” into paying for the membership.<sup>5</sup>

\* In 2004, Illinois Attorney General Lisa Madigan surveyed by telephone customers of a national bank that had cashed “live check” direct mail offers for a free trial offer in membership programs solicited under a preacquired account marketing arrangement. Of the 56 bank customers who were listed as active members of a membership program, 37 indicated no awareness that they were club members. None of the 56 customers stated that they were both aware of the charge and intended to sign up for the program by cashing the live check.

\* When Minnesota Attorney General Mike Hatch sued the mortgage subsidiary of Fleet National Bank in 2001 for preacquired marketing, he presented evidence that Fleet’s own customer service agents overwhelmingly objected to these charges, calling them “unethical,” “a scam,” and “a fraud” based on their conversations with homeowners whose mortgage accounts were charged for membership clubs and insurance policies through preacquired marketing.

The data collected so far strongly supports the conclusion that there appears to be few, perhaps almost no, consumers among the club members who are aware they are paying

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<sup>5</sup> The Iowa Attorney General action against Vertrue was recently tried before the trial judge and the parties currently are submitting post-trial briefs.

for the service.<sup>6</sup> This situation makes irrelevant the issue of whether some or even most of the consumers accepting the free trial offer understood the disclosures at the time of solicitation. The evidence indicates that the business model underlying preacquired account marketing works as a sorting scheme that results in account charges to consumers who do not know they have been charged and do not want the purported service.

After a decade of observing the membership club industry develop on the foundation of preacquired account marketing, I have little doubt that this business sector would cease to exist almost overnight if it had to sell its products like every other retailer. In other words, these membership clubs could not survive if they had to get consumers to give them a credit card number to purchase the services the membership clubs are selling.

## II. Failure of Existing Law to Control These Unauthorized Charges

Current law does not control the problem of preacquired account marketing, particularly in the context of e-retailers selling customer account access in post-transaction offers. Neither laws of general application nor specific rules in consumer protection statutes or regulations contain adequate tools to stop this unfair practice.<sup>7</sup>

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<sup>6</sup> This data does not include usage information for these membership programs. It would be instructive to know how many consumers charged for these membership clubs actually use the service, which would be evidence of awareness of the charge. For example, many of these membership clubs offer to their members as a primary benefit reimbursements for certain types of purchases. If a majority of members are taking advantage of this offer, one could infer awareness of at least club membership, although not necessarily awareness of the account charge.

<sup>7</sup> It is worth a brief word about why the market fails to control preacquired account marketing. The most obvious market correction for the problem is the adverse reputational consequences for the companies involved in a practice that generates angry, voluminous complaints of account theft by consumers. In fact, membership club sellers routinely change their trade names (Memberworks became Vertrue; Damark became Provell; Trilegiant became Affinion; etc.), which might suggest some concern of this sort. Yet reputational problems are lessened when consumers just respond to a direct marketing solicitation rather than making affirmative choices to seek out the seller and because the primary initial brand presentation with preacquired marketing is the name of the retailer or financial institution, not the membership club seller. This leads to the more promising possibility of financial institutions and referring retailers who sell access to their customers' accounts abandoning preacquired marketing because of substantial reputational interests. Unfortunately, adverse reputational consequences for the account issuers and referring retailers are mitigated by the structure of the free trial offer. The solicitation is usually closely tied to the reputation of the account issuer or referring seller, but when consumers discover weeks or months later the account charges on their statements that they believe are unauthorized, the preacquired seller typically is listed as the initiator of the charge. As the consumer is likely to have no idea how this charge appeared

## A. Legislative and Regulatory History

The most promising avenue for controlling preacquired account marketing in the last decade was the prohibition against financial institutions sharing customer account numbers enacted in 1999 as section 502(d) of Title V of the Gramm Leach Bliley Act (codified at 15 U.S.C. § 6802(d)). Unfortunately, this Act gave federal regulators the authority to promulgate rules for the implementation of section 502(d), and the resulting regulations essentially made section 502(d) meaningless as a limit on preacquired marketing.<sup>8</sup> Even if this prohibition had not been undermined by federal regulators, it would not have prevented retailers that are not financial institutions from engaging in preacquired account marketing.

The Federal Trade Commission promulgated amendments to the Telemarketing Sales Rule in 2003 that put some limits on the use of preacquired account marketing in the telemarketing context, 16 C.F.R. § 310.4(a)(6). The amendment proposed in the initial rule-making notice would have prevented the practice entirely, but the FTC substantially limited the reach of the final rule while noting that it would continue to watch the evolution of this suspect marketing practice. Again, these rules do not apply to internet transactions and thus would have no impact on e-retailers selling account access.

## B. Legal Actions

Lawsuits brought by state attorney generals, the FTC and private attorneys have had some impact on preacquired account marketing, but so far have been of limited value in addressing the underlying issues driving the consumer complaints of unauthorized charges. State attorneys general and FTC actions alleging consumer deception and misunderstanding have been successful, but the cases against the largest membership club sellers by state attorneys general have so far mostly yielded only modest reforms in the

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on his or her account, there is less risk of harm to the reputation of the financial institution or retailer that obtains revenue from selling the access to its customers' accounts.

<sup>8</sup> See 12 C.F.R. § 40.12 . Regulation P was adopted jointly by the federal banking regulators, the Federal Reserve Board and the Federal Trade Commission. Regulation P allows the sharing of encrypted account numbers. Financial institutions, therefore, can sell access to their customers' accounts to direct marketers as long as they encrypt the numbers given to the marketers, which does nothing to control the problem of account charges unknown to the consumer.

form of improved disclosures.<sup>9</sup> This outcome is consistent with the theory of these cases, which is that the solicitation process misled or deceived consumers.<sup>10</sup>

Private legal actions have had less success. Of particular interest to the subject matter of this hearing is a multi-district litigation case recently dismissed in the United States District Court for the Southern District of Texas, *In Re VistaPrint Corp. Marketing and Sales Practice Litigation*.<sup>11</sup> Plaintiffs alleged that the post-transaction sale of membership clubs following sales of business cards on the VistaPrint website were deceptive and violated numerous state and federal laws. The court granted the defendants' motion to dismiss on the substance of the plaintiffs' legal claims, but denied defendant VistaPrint's attempt to have the case dismissed because the VistaPrint form contract required that all actions by its customers be filed in Bermuda courts. The trial court judge held that consumers ordering business cards on the VistaPrint website had a duty to read all of the disclosures about the free trial offer. The judge concluded that the disclosures were sufficient to make the website post-transaction solicitation not deceptive to the "reasonable" consumer as a matter of law. The case is on appeal.

### C. Consumer Misunderstanding and Abuse Is What Matters

The *VistaPrint* decision presents the fault line in a part of the legal debate associated with preacquired account marketing. Sellers who employ and profit from the practice stress the obligation of consumers to search and read website disclosures that set forth this unusual procedure leading to account charges. Consumer advocates assert that the disclosures are insufficient to overcome the misleading overall impression of the solicitation. While this makes for an interesting legal theory dispute that explores the current state of the law of deception, this argument is utterly misplaced for considering the public policy issue presented by preacquired account marketing. It is a red herring.

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<sup>9</sup> See, e.g., Assurance of Discontinuance, In re Citibank (NYS Dept. of Law filed Feb. 22, 2002) (multistate settlement), available at [http://www.oag.state.ny.us/media\\_center/2002/feb/feb27b\\_02\\_attach.pdf](http://www.oag.state.ny.us/media_center/2002/feb/feb27b_02_attach.pdf); Press Release, Office of the Washington Attorney General, *Settlement with Discount Buying Club Highlights Privacy Concerns* (August 4, 2000), available at <http://www.atg.wa.gov/pressrelease.aspx?&id=5010>; Assurance of Discontinuance, *Minnesota ex rel. Hatch v. Damark Int'l, Inc.*, No. C8-99-10638 (Ramsey County Dist. Ct. Dec. 3, 1999).

<sup>10</sup> The lawsuit filed by Iowa Attorney General Tom Miller against Vertrue, Inc. was based in part on a broader theory that encompassed the assertion that consumers who pay for Vertrue membership clubs rarely know they are members whose accounts have been charged for the service. See *Iowa ex rel. Miller v. Vertrue, Inc.*, Equity No. EQ53486 (Polk Co. Dis. Ct. May 15, 2006), available at [http://www.state.ia.us/government/ag/latest\\_news/releases/may\\_2006/MemberWorks\\_Vertrue\\_PETITION](http://www.state.ia.us/government/ag/latest_news/releases/may_2006/MemberWorks_Vertrue_PETITION).

<sup>11</sup> No. MDL 4:08-md-1994 (S.D.Tex 8/31/09), available at 2009 WL 2884727.



If the net effect of this business practice is that the overwhelming numbers of consumers paying for a service are unaware that their accounts are being charged year after year, we should explore how to stop this real-world result from occurring. It should not matter whether this result occurs because the consumer failed in his or her alleged “duty” to closely read all website disclosures and thus misunderstood the solicitation terms, because the consumer does not speak English well and could not really understand the dense disclosures, because the consumer understood the disclosures when using the website but forget about the solicitation and thus failed to exercise the negative option during the attenuated free trial offer period, or because of any other such reason. No one should want a practice to continue that amounts to a predacious sorting out of consumers to have their financial accounts charged without their awareness.

### III. Prohibit Preacquired Account Marketing

Unlike the complex regulatory trade-offs typical when drafting consumer protection regulations, an obvious solution exists for the problem motivating this hearing. A retailer should be required to obtain from the consumer his or her account number before charging the account. Most consumers think this is the state of law now.<sup>12</sup>

There is no legitimate commercial purpose supporting preacquired account marketing. A seller can always avoid a preacquired account marketing transaction by having the consumer provide his or her account number. This, of course, is how the referring e-retailer got the account number from the consumer that it later sold to the membership club. Put another way, a seller that has the consent of the consumer to be charged for a transaction can obtain payment by acquiring the account number it would otherwise charge through the preacquired account method. Therefore, the only benefit in allowing such conduct derives from the seller avoiding the act of acquiring the account number from the consumer who owns the account.

The companies employing this practice have given few reasons for allowing the circumvention of this routine, but critical, part of a typical consumer transaction. In amending the Telemarketing Sales Rule, the Federal Trade Commission expressly sought

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<sup>12</sup> See, e.g., Supplemental Comments of the Vermont Attorney General’s Office, *Telemarketing Sales Rule Review Forum Before the Federal Trade Commission*, FTC File No. R411001, available at: <http://www.ftc.gov/os/comments/dncpapercomments/supplement/vtag.pdf> (describing AARP study showing a plurality (46%) of consumers thought that a telemarketer could not charge a credit or debit card without obtaining the account number from the consumer, while a majority (51%) didn’t think a bank account could be charged in this manner, and another 15% and 13%, respectively, didn’t know if this type of charge was possible).

industry input on this issue and asked in its Notice of Proposed Rule-Making: “What specific, quantifiable benefits to sellers or telemarketers result from preacquired account telemarketing?”<sup>13</sup> In its comments accompanying the final rule changes, the FTC characterized the industry’s failure to provide a satisfactory response to this question as follows:

[A]lthough business and industry representatives acknowledged during the Rule Review that the practice of preacquired account telemarketing was quite common, maintaining that it was "very important" to them, they provided scant information that would help to quantify the benefits conferred by this practice or better explain how these benefits might outweigh the substantial consumer harm it can cause.<sup>14</sup>

The two arguments most commonly asserted in favor of permitting preacquired marketing are that it better protects consumer privacy and that it lowers the costs of transaction. Both arguments are patently wrong.

The privacy argument is that preacquired account marketing allows fewer employees to see personal financial information because the information is electronically transmitted from seller to seller. Whether or not this is true, one need only reflect for a few moments to see the irony in this position. In the archetype situation presented by an e-retailer collaborating with a membership club seller in a post-transaction free trial offer, the e-retailer sells the consumer’s account number, or the ability to charge the consumer’s account, to the membership club without the consumer’s consent to this transaction. Any negligible benefit from the membership club’s employees not seeing the consumer’s account number, if this is even the case, must be compared to the violation of the consumer’s privacy right and trust by the e-retailer selling access to the consumer’s account without the consumer’s permission. Furthermore, in situations where the actual account number is transferred by the e-retailer, the privacy concerns are multiplied rather than reduced.

The argument about lowering costs is equally wrong and ironic. There is no meaningful reduction in cost to the membership club in an internet preacquired account transaction because it is the consumer that has to enter his account information. The costs of handling this information cannot be materially less than the costs of coordinating with the

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<sup>13</sup> 67 Fed. Reg. at 4538.

<sup>14</sup> 68 Fed. Reg. at 4617.

e-retailer to obtain the information needed to charge the consumer's account at the end of the trial period. In any case, these costs are truly negligible compared to all the work that the membership club must incur to implement this complex system. Just the costs of handling tens of thousands of consumers complaining about unauthorized charges must exceed many fold any purported savings from not having a web system that allows consumers to enter account information.

Finally, the discussion about preacquired account marketing often gets confused with the more difficult question of customer account data retained by sellers. There are legitimate commercial reasons for a seller to retain and re-use customer account numbers. For instance, the customer may regularly order merchandise from that seller. Sellers retaining account information can use that data in ways that are beneficial to and within the expectations of the consumer, or they can use the data in ways that mimic the deception problems of reacquired marketing.<sup>15</sup> This situation, therefore, presents the more usual consumer protection regulatory quandary of how to proscribe the abusive conduct without needlessly burdening legitimate commerce.

The mixed character of seller retained account information does not mean the preacquired account marketing practices at issue in this hearing ever create public benefit. There is a clear line between the following two situations: (1) a consumer voluntarily gives retailer A his account number and retailer A uses that data in a later transaction with the same consumer (seller-retained data); and (2) a consumer voluntarily gives retailer A his account number and retailer A sells to membership club seller B the right to charge the consumer's account without the consumer providing his or her account number to membership club seller B. The former situation may (or may not) be with the reasonable expectations of the consumer, and may (or may not) cause consumer confusion and misunderstanding. The latter situation, preacquired account marketing, probably is not within the reasonable expectations of many people, and definitely causes mass and nearly universal consumer confusion and misunderstanding as to the legitimacy of account charges for membership clubs.

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<sup>15</sup> Statement of Basis and Purpose, Telemarketing Sales Rule, 68 Fed. Reg. at 4598 (citing to public enforcement actions resulting from sellers using retained account information in ways that mimic the abuses of preacquired account marketing).

## Conclusion

Preacquired account marketing has no legitimate commercial reason to exist yet drains the wealth of consumers who are unaware their accounts are being charged. Consumers are exposed to these charges for unwanted services when e-retailers, other retailers and financial institutions sell special access to their customers' accounts in return for a share of the gain. Congress should enact legislation to protect American consumers from such abuse.