

Commissioner Elman dissenting, and Commissioner Nicholson not participating for the reason oral argument was heard prior to his appointment to the Commission.

IN THE MATTER OF
CONSOLIDATED MORTGAGE COMPANY ET AL.*

ORDER, OPINION, ETC., IN REGARD TO THE ALLEGED VIOLATION OF
THE FEDERAL TRADE COMMISSION ACT

Docket 8723. Complaint, Dec. 8, 1966—Decision, Feb. 19, 1968

Order requiring a Providence, R.I., mortgage loan company to cease misrepresenting the terms and conditions under which it makes loans and neglecting to disclose other material facts in connection with its lending operations.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Consolidated Mortgage Company, a corporation, and William F. Sullivan, individually and as an officer of said corporation, and Lester S. Cotherman, individually and as General Manager of said corporation, hereinafter referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect

*Order reopening and dismissing the complaint dated April 19, 1968, p. 711 herein.

thereof would be in the public interest, hereby issues its complaint stating its charges in that respect as follows:

PARAGRAPH 1. Respondent Consolidated Mortgage Company is a corporation organized, existing and doing business under and by virtue of the laws of the State of Rhode Island, with its principal office and place of business located at 236 Chapman Street, in the city of Providence, State of Rhode Island.

Respondent William F. Sullivan is an individual and an officer of the corporate respondent. Respondent Lester S. Cotherman is an individual and general manager of the corporate respondent. They formulate, direct and control the acts and practices hereinafter set forth. Their address is the same as that of the corporate respondent.

PAR. 2. Respondents are now, and for some time last past have been, engaged in the advertising and offering of lending services and the granting of loans to the general public some of which are secured by mortgages on property located in the States of Rhode Island and Massachusetts.

PAR. 3. In the course and conduct of their business, respondents place advertisements in newspapers with interstate circulation and advertise on Providence, Rhode Island, radio and television stations having sufficient power to carry such broadcasts across State lines. The purpose of such advertising is to induce persons residing in the States of Rhode Island and Massachusetts to obtain mortgage loans on real estate located in said States from respondents. As a result of such advertising, persons residing in the State of Massachusetts are induced to come into the State of Rhode Island for the purpose of conducting business with respondents at their place of business. Further, in the course and conduct of their business respondents place in the United States mails and cause to be placed therein for circulation between the States of Rhode Island and Massachusetts, mortgage instruments, correspondence and other documents and materials. Respondents are and have thereby engaged in substantial business intercourse in commerce and maintain and at all times mentioned herein have maintained a substantial course of trade in said lending services in commerce, as "commerce" is defined in the Federal Trade Commission Act.

PAR. 4. In the conduct of their business, and for the purpose of promoting the use and sale of their lending services, respondents have made numerous statements and representations in advertisements inserted in newspapers of general circulation and over the radio and television.

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Typical, but not all inclusive of said statements and representations, are the following:

Homeowners borrow \$2,000 for any worthwhile purpose; repay \$16.88 per month first, second, and third mortgages

<i>Borrow</i>	<i>Repay Per Month</i>
\$1,000 -----	\$8.44
1,500 -----	12.66
2,000 -----	16.88
3,000 -----	25.32
5,000 -----	42.20
10,000 -----	84.39

First mortgage repayment schedule

If you're a home owner (or are in the process of buying a home) you can consolidate all your bills and make one low monthly payment. Call 421-0116.

Consolidated Mortgage Co.,
605 Hospital Trust Bldg., Providence.

A \$3,000 loan from Consolidated will pay off all the bills, leave you with \$450 in cash, and your monthly payment could be a low \$25.32.

PAR. 5. Through the use of the aforesaid statements and representations, and others of similar import and meaning but not specifically set out herein, respondents have represented, directly or by implication that:

- a. Respondents will arrange loans on repayment schedules as shown in their advertised repayment schedules.
- b. Respondents will arrange loans at a six percent rate of interest.
- c. Respondents will arrange loans repayable over a period of fifteen years.

PAR. 6. In truth and in fact:

- a. Respondents do not arrange loans on repayment schedules as shown in their advertised repayment schedules. Respondents' repayment schedules require a substantially higher monthly payment.
- b. Respondents do not arrange loans at a six percent rate of interest. Respondents' usual rate of interest is either nine or twelve percent.
- c. Respondents do not arrange loans repayable over a period of fifteen years. Respondents' loans usually must be repaid over a five year period.

Therefore, the statements and representations as set forth in Paragraphs 4 and 5 hereof were and are false, misleading and deceptive.

PAR. 7. Respondents' advertisements and other statements and representations offering their lending services to the public of which

the above quoted advertisement is typical and illustrative, frequently state only one or more, but seldom if ever, all of the elements comprising the terms and conditions on which loans are made, such as the period of repayment, the number of payments required, finance charges, including interest, fees, service charges and discounts, and any other charges or expenses to be paid by the borrower to obtain such loans. By and through such omissions, respondents fail to reveal to the consuming public material facts with respect thereto. Such failure to reveal and disclose material facts has the tendency and capacity to induce substantial numbers of the members of the consuming public to believe that loans are made on terms and conditions different from those actually imposed by respondents so as thereby to be unfairly misled and deceived as to the extent of the financial obligation to be incurred by them.

PAR. 8. In the conduct of their business, and at all times mentioned herein, respondents have been in substantial competition, in commerce, with corporations, firms and individuals in the offering of lending services of the same general kind and nature as that offered by respondents.

PAR. 9. The use by respondents of the aforesaid false, misleading and deceptive statements, representations and practices has had, and now has, the capacity and tendency to mislead members of the purchasing public into the erroneous and mistaken belief that said statements and representations were and are true and into the purchase of substantial quantities of respondents' services by reason of said erroneous and mistaken belief.

PAR. 10. The aforesaid acts and practices of respondents, as herein alleged, were and are all to the prejudice and injury of the public and of respondents' competitors and constituted, and now constitute, unfair methods of competition in commerce and unfair and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

Mr. James A. Ryan supporting the complaint.

McKean & Whitehead, by *Mr. Thomas J. Whitehead* of Washington, D.C., for respondents.

INITIAL DECISION BY JOHN LEWIS, HEARING EXAMINER

MAY 31, 1967

STATEMENT OF PROCEEDINGS

The Federal Trade Commission issued its complaint against the above-named respondents on December 8, 1966, charging them with

engaging in unfair methods of competition and unfair and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act, by the use of false, misleading and deceptive statements, representations and practices in connection with the advertising and offering of their lending services and the granting of loans to the general public. After being served with said complaint, respondents appeared by counsel and filed their answer denying, in substance, having engaged in the illegal practices charged.

Pursuant to notice duly given, prehearing conferences were convened on February 9 and February 27, 1967, in Washington, D.C., before the undersigned hearing examiner, theretofore duly designated to act as hearing examiner in this proceeding. By agreement of counsel, the transcripts of said conferences were made a part of the record in this proceeding. Pursuant to prehearing orders of the undersigned, counsel exchanged lists of witnesses (including a brief description of the nature of the testimony of such witnesses) and copies of proposed documentary evidence. A number of the documents proposed to be offered by complaint counsel were marked for identification and received in evidence at the prehearing conference held February 27, 1967. A motion by respondents for the production, by complaint counsel, of certain correspondence and written statements of proposed witnesses and other persons was denied by order of the undersigned dated February 27, 1967.

Hearings on the charges set forth in the complaint were held in Providence, Rhode Island, from March 28 to March 30, 1967. At said hearings, testimony and other evidence were received in support of and in opposition to said charges, such evidence being duly recorded and filed in the office of the Commission. All parties were represented by counsel, participated in the hearings and were afforded full opportunity to be heard and to examine and cross-examine witnesses. At the close of all the evidence, and pursuant to leave granted by the undersigned, proposed findings of fact, conclusions of law and an order were filed by the parties on May 10, 1967. Included in respondents' proposed findings is a motion to reconvene the hearings for the purpose of affording them an opportunity to examine certain interview reports of a Commission investigator, and to further cross-examine certain witnesses. Said motion is hereby denied as without merit.¹

¹ Access to the interview reports (sought to be examined under the so-called *Jencks* Rule) was denied by the examiner at the hearings on the ground that such reports were not a substantially verbatim recital of any statement made by any of the witnesses interviewed. No further reason has been given by respondents why access should now be permitted. One of the witnesses sought to be recalled is alleged to be an expert witness. Respondents received timely notification of the calling of such witness under the examiner's prehearing orders, and they demonstrated no inability to cross-examine such witness. No

After having carefully reviewed the evidence in this proceeding and the proposed findings and conclusions submitted by the parties,² and based on the entire record, including his observation of the witnesses, the undersigned makes the following:

FINDINGS OF FACT³

I. The Respondents

A. Identity and Business

1. At all times material herein, respondent Consolidated Mortgage Company was a corporation organized, existing and doing business under and by virtue of the laws of the State of Rhode Island, with its principal office and place of business located at 236 Chapman Street, in the city of Providence, State of Rhode Island (PHO No. 1, par. A 1).

2. At all times material herein, the corporate respondent was engaged in the advertising and offering of lending services and the granting of loans to the general public, some of which loans were secured by mortgages on property located in the States of Rhode Island and Massachusetts (PHO No. 1, par. A 2).

3. The corporate respondent was organized and entered business in or about October 1963, and continued in business until on or about September 1, 1966. Said corporation was formed and operated with funds supplied by respondent Lester S. Cotherman who, prior to coming to Providence, was in the business of buying and rediscounting commercial paper in several other cities. The corporate respondent issued a note of \$30,000 to respondent Cotherman as evidence of the funds advanced to it by him. Respondent Cotherman hired respondent William F. Sullivan who, prior thereto, was employed in Providence by another company engaged in a similar line of business. Respondent Sullivan served as a director and as president and office manager of the corporate respondent from its inception until the latter part of 1965, when respondent Cotherman became president and respondent Sullivan as-

indication is given in their motion as to any subject matter concerning which further examination is necessary, nor as to why respondents were unable to cross-examine the witness at the hearings concerning such subject.

² Proposed findings not herein adopted, either in the form proposed or in substance, are rejected as not supported by the evidence or as involving immaterial matters. References to proposed findings are made with the following abbreviations: "CPF" (for complaint counsel's proposed findings); and "RPF" (for respondents' proposed findings).

³ References are hereinafter made to certain portions of the record in support of particular findings. Such references are to the principal portions of the record relied upon by the examiner, but are not intended as an exhaustive compendium of the portions of the record reviewed and relied upon by him. The following abbreviations are used in referring to the record: "Tr." (for the transcript of testimony), "CX" (for complaint counsel's exhibits), "RX" (for respondents' exhibits), and "PHO" (for the examiner's prehearing orders).

sumed the office of vice president. Respondent Sullivan owned 499 out of the 500 shares of stock issued by the corporate respondent. However, such shares were pledged to respondent Cotherman as security for a loan of \$5,000 made by the latter to finance the purchase of the stock by respondent Sullivan. Respondent Cotherman was chairman of the board and served as general manager of the corporation. As mentioned above, he was also elected president in the later part of 1965. As general manager of the corporation, he formulated its advertising program and approved loans submitted to him by respondent Sullivan. Respondent Sullivan did not share in the profits of the corporate respondent, but was paid a weekly salary, which was initially \$150 and was later raised to \$300. Respondent Cotherman also received a salary, but the amount thereof was based on the corporation's profits. His salary was initially \$25,000 a year and was later increased to \$35,000 (PHO No. 1, par. A 1: Tr. 98, 104-105, 116-128, 130-133, 320, 350, 358-359, 374-375; RX 58, 60, 61).

B. *Commerce*

4. In the course and conduct of its business, the corporate respondent regularly placed advertisements in newspapers circulating in the States of Rhode Island and Massachusetts, and advertised on Providence radio and television stations whose broadcasts were heard in the States of Rhode Island and Massachusetts. The purpose of such advertising was to induce persons residing in the States of Rhode Island and Massachusetts to obtain loans from said respondent, most of which loans were secured by mortgages on real estate located in said States. As a result of such advertising, many persons residing in the State of Massachusetts were induced to come into the State of Rhode Island for the purpose of conducting business with the corporate respondent at its place of business. Between one-third and one-half of the loans made by said respondent were made to persons residing in the State of Massachusetts (PHO No. 1, par. A 3: Tr. 100-104, 128-129, 360). Further, in the course and conduct of its business, the corporate respondent placed in the mails and caused to be placed therein, for circulation between the States of Rhode Island and Massachusetts, mortgage instruments, correspondence and other documents and material (Tr. 113-115).

C. *Competition*

5. It is admitted by respondents and is, accordingly, found that in the conduct of its business and at all times mentioned herein, the corporate respondent was in substantial competition, in commerce, with

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other corporations, firms and individuals in the offering of lending services of the same general kind and nature as that offered by said respondent (PHO No. 1, par. A 8).

II. The Alleged Illegal Practices

A. *The Challenged Advertising*

6. The charges in the complaint are based on (a) the making of certain allegedly false, misleading and deceptive statements in newspapers, and in radio and television advertising, concerning the terms and conditions on which the corporate respondent will make loans to prospective borrowers; and (b) the failure to reveal in such advertising certain material facts. There is no dispute as to the fact that the corporate respondent did advertise its lending services in newspapers and on radio and television in the manner alleged in the complaint. However, respondents contend that such advertising was not "typical," as alleged, since it used other types of advertisements (RPF at 12). While it may be that other types of advertisements were used, those referred to in the complaint were used with sufficient frequency and regularity that they may be regarded as typical of the advertising used by the corporate respondent.⁴

7. Typical of the advertising by the corporate respondent in newspapers is the following (CX 1, 2, 4-10 A) :

Homeowners borrow \$2,000 for any worthwhile purpose : repay \$16.88 per month
first, second, and third mortgages

<i>Borrow</i>	<i>Repay</i> <i>(Per Month)</i>
\$1,000 -----	\$8. 44
1,500 -----	12. 66
2,000 -----	16. 88
3,000 -----	25. 32
5,000 -----	42. 20
10,000 -----	84. 39

First mortgage repayment schedule

If you're a home owner (or are in the process of buying a home) you can consolidate all your bills and make one low monthly payment. Call 421-0116.

Consolidated Mortgage Co.,
605 Hospital Trust Bldg., Providence.

⁴ The record discloses that the advertisements challenged by the complaint (CX 1-10A) were extensively used from at least June to November 1964 (Tr. 68). There is no indication that respondents ever discontinued this type of advertisement. The other advertisements which respondents claim were used (RX 30-33) involve only the period of May 1964 (Tr. 342).

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8. Typical of the advertising used by the corporate respondent in television broadcasts is a program in which the video portion disclosed a blackboard with a "Typical Family Problem" chart thereon, showing obligations for various items totaling \$2,550 and monthly payments owing of \$183. The announcer, referring to the blackboard chart, makes the following statement (CX 3 A) :

Homeowners, it doesn't take too much imagination to see that this family is in a financial jam. . . .

As you can see, all these bills add up to \$2,550.00 and means that this family has to make a regular monthly payment of \$183.00. \$183.00 is a lot of money—sometimes it is too much, sometimes far more than a family can make.

What can be done to lower this high figure?

Come to Consolidated Mortgage Company first :

Now watch this :

A \$3,000.00 loan from Consolidated will pay off all the bills, leave you with \$450.00 in cash—and your monthly payment could be a low \$25.32.

B. The Representations

9. The complaint alleges that through the use of statements in advertising such as those set forth above, respondents have represented, directly or by implication, that they will (a) arrange loans on repayment schedules as shown in the advertised repayment schedules, (b) arrange loans at a six percent rate of interest, and (c) arrange loans repayable over a period of 15 years. Respondents concede that the above-quoted statements do constitute a representation by the corporate respondent that it will arrange loans on the repayment schedules advertised, but only "to borrowers who qualify for such loans." Complaint counsel have accepted the qualification proposed by respondents, and the complaint is deemed amended accordingly. Respondents deny, however, that the advertisements can be interpreted as representing that the loans will be made at a six-percent rate of interest or will be repayable over a term of 15 years. While the above-quoted advertisements do not expressly state that the loans will be repayable over a period of 15 years at a six-percent rate of interest, complaint counsel contend that the advertised repayment schedule is based on the FHA amortization schedule for loans repayable over 15 years at six percent interest, and would be so interpreted by members of the public (PHO No. 1, par. A 5).

10. There is no dispute as to the fact that the above-quoted repayment schedules are based on the FHA-approved schedule of loans repayable over a 15-year term at interest of six percent (CX 10 A-B, 25; Tr. 328, 139-144). The only issue raised in this respect is whether members of the public who read the advertisements were aware of this

association (RPF at 10-11). Most of the borrower-witnesses called in support of the complaint emphasized that it was the low amount of the advertised monthly payments which caught their attention, but gave no indication in their testimony that they had received any impression from the advertisements concerning the actual time-period for repayment of the loan or the rate of interest they would be charged (Tr. 154, 163-164, 183-184, 204, 209, 243, 301). However, several of the borrowers did indicate that they were familiar with the fact that FHA-approved loans were repayable over a long term at a low rate of interest, and testified that they assumed from the low amount of the monthly payments advertised that the loan would be "like an FHA approved loan," repayable over a period of 15 years or a similar long term, and would carry interest of six percent or a similar low rate (Tr. 255-257, 264, 271, 289-290). Respondents suggest that the testimony of the latter witnesses should not be accepted because they were confused or mistaken concerning the duration of, or method of computing interest under, FHA-approved mortgage loans (RPF at 19-21). However, respondents' argument overlooks the fact that such witnesses were not offered as experts on the technicalities of FHA loans, but as indicative of the confusion which the challenged advertising can give rise to in the minds of members of the public.

11. While the advertisements in question did not expressly refer to the duration of the loan or the rate of interest, the corporate respondent's use of a repayment schedule similar to that provided for under an FHA-approved 15-year-term-6%-interest loan was obviously calculated to create an association in the minds of prospective borrowers between the advertised terms and those of FHA loans. The testimony of several of the witnesses indicates that respondent was successful in this respect.⁵ While most of the witnesses indicated no familiarity with the terms of FHA loans, they were impressed with the low monthly repayment schedule advertised, which schedule was admittedly based on the FHA schedule for a 15-year loan bearing interest at six percent. Since loans in the advertised amounts could be amortized at the indicated monthly repayment rates only if they were repayable over a 15-year term with interest at six percent, it was implicit in the ad-

⁵ In establishing the deceptive character of an advertisement it is not necessary to prove that any particular number of persons were misled thereby. Since the Federal Trade Commission Act was intended to "protect the public—that vast multitude which includes the ignorant, the unthinking and the credulous" (*Positive Products Co. v. FTC*, 132 F. 2d 165, 167, 7 Cir., 1942), it is sufficient to establish that there would be some members of the public who would be misled by an advertisement (*Prima Products, Inc. v. FTC*, 209 F. 2d 405, 409, 2d Cir., 1954).

vertised repayment schedule that the loans made would be repayable over a 15-year term at interest of six percent.

12. It is, accordingly, concluded and found that through the use of the statements and representations in the above-quoted advertisements and others of similar import and meaning, the corporate respondent has represented, directly or by implication, that it will arrange loans to qualified borrowers. (a) on repayment schedules as shown in its advertised repayment schedules. (b) at a six percent rate of interest, and (c) repayable over a 15-year term or a similar extended period of time.

C. Alleged Falsity of Representations

13. The evidence introduced by complaint counsel involved 14 loan transactions by the corporate respondent with 13 borrowers. In each instance, the amount of the monthly payments provided for in the loan documents was two to three times that called for in the advertised repayment schedules; the loans were for a term of five years (except for three which were for terms of four, six and seven years, respectively); and the rate of interest provided for ranged from eight percent compound interest (*i.e.*, interest computed annually on the entire amount borrowed) to 18 percent simple interest (*i.e.*, interest computed at the monthly rate of 1½ percent on the unpaid balance). In no case did the repayment schedule conform to that in the advertisements, nor was the term of repayment 15 years, nor was the rate of interest six percent simple interest (CX 14-23: Tr. 157, 162, 244, 306).

14. Eight of the borrowers were called to testify by counsel supporting the complaint. In each instance the witness had applied for a loan after seeing or hearing one of respondent's advertisements in a newspaper or on radio or television. In each instance the loan, as granted, required substantially larger monthly payments than the witness had anticipated having to pay on the basis of the advertised repayment schedules. Illustrative of such transactions are the following: One witness who had expected to pay \$16.88 a month for a \$2,000 loan, pursuant to the advertised schedule, was required to pay \$53.59 a month; another, who expected to pay somewhere between \$8.44 and \$16.88 a month for a \$1,600 loan, was required to pay \$41.90 a month; another, who expected to pay \$20 to \$25 a month for a \$2,500 loan, was required to pay \$63 a month; and another, who expected to pay about \$25 a month for a \$3,000 loan, was required to pay \$44 a month for a loan repayable over seven years, but was advised this was a mistake since the term should have been five years, and the payments were increased to \$72.82 a month (Tr. 153, 157, 165, 171, 207, 213-214, 243-244, 255, 259, 282, 289, 301, 306).

15. Despite such testimony and evidence, respondents contend that complaint counsel has not sustained the burden of proof, since the reason none of the above-mentioned borrowers was granted a loan in accordance with the advertised schedules was because he or she was not qualified for such a loan due to a preexisting mortgage on his or her property or an otherwise unsatisfactory debt situation (RPF at 15-22). In the opinion of the examiner, respondents' explanation (based on the testimony of respondent (Otherman) as to why the various borrower-witnesses were not granted loans in accordance with the advertised schedule represents an exercise in *ex post facto* rationalization. It presupposes that the corporate respondent did ordinarily make loans on such terms to qualified borrowers, and merely turned down the individuals in question because they failed to qualify. However, as will be hereafter more fully indicated, the corporate respondent did not make such loans to anyone, irrespective of qualification, and it used the advertised schedules merely as a bait mechanism to induce applications from prospective borrowers, without any intention of making loans in accordance with such schedules.

16. As previously found, the advertised repayment schedule was based on the schedule of monthly payments provided for under the FHA-approved amortization schedule for a 15-year loan at simple interest of six percent. Respondents regarded such terms as appropriate for use only in the case of relatively long-term first mortgage loans. However, the corporate respondent did not ordinarily make such loans because it considered them not to be sufficiently profitable. Its business was primarily that of secondary mortgage financing, and its loans were generally made for a five-year term (with a small proportion being made for a term of seven years), and at rates of interest substantially in excess of six percent. Where an applicant for a loan was considered eligible for a first-mortgage loan, the corporate respondent did not ordinarily make the loan, but would refer the individual to a financial institution making such loans, in return for which it received a forwarding fee (Tr. 99, 328-330, 355-357, 360-361).

17. During the time it was in business, from October 1963 to September 1966, the corporate respondent made approximately 1,200 loans (Tr. 129). Except for a few loans made in February 1965, after it had come under investigation by the Commission, respondent made no loans which provided for monthly payments in accordance with the advertised repayment schedule, or for a 15-year term, or for simple

interest of six percent.⁶ The handful of loans made at the advertised rates were admittedly made for the purpose of providing respondents with a possible defense in the event of the bringing of a proceeding against them by the Commission.⁷ In the light of these undisputed facts, respondents now concede that "they rarely made loans at the [advertised] repayment schedules." However, in apparent justification of their advertising, they cite the fact that they "often arranged for loans to be made at the [advertised] repayment schedules" (RPF at 14). In the opinion of the examiner, the fact that the corporate respondent may have referred some customers to other institutions for first-mortgage loans is irrelevant to any issue in this proceeding. The statements made in its advertisements constituted representations as to the terms on which it, and not some other institution, was offering to make loans. It cannot be seriously argued that the corporate respondent was spending its good money for advertising, in order to obtain business for other lending institutions in return for the incidental payment of some referral fees. It seems evident, therefore, that the truth or falsity of the representations made in its advertising must be determined in the light of the corporate respondent's own performance.

18. The record is clear that although not in the business of making first-mortgage loans, the corporate respondent made extensive use of the repayment amortization schedule of such loans in its advertising. While some of the advertisements contained the apparently cautionary statement, "1st Mortgage Repayment Schedule," beneath the schedule of monthly payments,⁸ such statement appeared in much smaller print than the balance of the advertisement. Moreover, the repayment schedule itself was preceded by the heading "1st, 2nd & 3rd Mortgages." The significance of the cautionary note would be lost on all but the most discerning readers as, indeed, the evidence in the record demonstrates it was. Although the corporate respondent did not make first-mortgage loans and was aware that 90% of the people who applied to it for loans were not eligible for first-mortgage loans (Tr. 360), it nevertheless sought to pitch its appeal to the public on the basis of

⁶ Respondent Cotherman at first testified that respondent had made six to ten loans at the advertised rates during 1963 and 1964. However, he later conceded that these were not made in 1963 and 1964, and that respondent itself had made only six loans, the other four being made by other institutions to which the borrower had been referred (Tr. 379-381). The documentary evidence reflecting the loans made by respondent at the advertised rates involved only four transactions, all in February 1965 (RX 54-57).

⁷ When respondent Cotherman was asked why such loans had been made, in view of the company's policy of not making first-mortgage loans and of referring qualified applicants to other institutions, he gave the following response (Tr. 390):

"I think you will find that those were made shortly after the investigation and I wanted to be able to show that I actually had purchased and held some of these loans."

⁸ No such cautionary statement appeared in respondent's television advertisements.

the low monthly repayment schedule of first-mortgage loans. It is clear from the testimony of its own officials that it used such schedule merely as bait to procure applications from borrowers to whom it could make loans on the more profitable terms of secondary mortgages.⁹ While it may have referred a small portion of applicants to other lending institutions for first-mortgage loans, after culling out the cream of the more profitable secondary mortgage loans for itself, this was merely incidental to its basic purpose in advertising, which was to secure business for itself.

19. It is accordingly concluded and found that the statements and representations set forth in paragraphs 7, 8, and 12 hereof were false, misleading and deceptive since, in truth and in fact, the corporate respondent did not, irrespective of the qualifications of prospective borrowers:

a. Arrange loans on repayment schedules as shown in their advertised repayment schedules, but used repayment schedules requiring substantially higher monthly payments.

b. Arrange loans at a six-percent rate of interest, but charged rates of interest which were substantially higher.

c. Arrange loans repayable over a term of 15 years, but usually required repayment over a five-year term, with seven years being the maximum term granted.

D. Alleged Failure to Disclose Material Terms

20. The complaint alleges that respondents' advertisements failed to disclose a number of the material terms and conditions on which their loans were made, such as the period of repayment, the number of payments required, and various finance charges, including service charges, fees and other expenses which the borrower was required to pay. It is further alleged that the failure to disclose such material facts has a tendency and capacity to induce members of the public to believe that loans are made on terms and conditions different from those actually imposed, thereby misleading and deceiving them as to the extent of the financial obligation which will be incurred by them.

21. As has been found above, a number of the advertisements used by the corporate respondent referred only to the monthly payments which would be required for the repayment of a loan in a given amount. There was no reference to the duration of the loan, the amount of

⁹ According to the testimony of a Commission attorney-investigator who interviewed respondent Sullivan, the latter stated that the advertised repayment schedule was "just a lure to get the customer on the phone or into the office" (Tr. 330). Respondent Sullivan denied using the word "lure," and testified that he had told the investigator respondent used such advertising "in order to attract or draw business" (Tr. 352). In the opinion of the examiner, it is unnecessary to resolve this semantic dispute since, whichever expression was used, it is clear that respondent used the advertisement as a form of bait to obtain loan business.

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interest to be paid, or to any charges or fees which would be imposed. While, as previously found, some prospective borrowers assumed from the advertisements that they would be receiving a long-term loan at six percent interest, most had no idea until the time of closing as to the duration of the loan or the rate of interest to be charged. Nor were any of the borrowers aware, prior to the time of closing, that they would have to pay various closing expenses, such as legal fees and searching of title. Such expenses ran from a minimum of \$110 to as much as \$450 (CX 14-D, 15-C, 16-C, 17-D, 18-C, 19-E, 20-C, 21-C, 22-C; Tr. 112-113, 157, 162, 166-167, 183-185, 193, 258-260, 288-289, 298-299, 383).

22. Respondents contend that there is nothing about the advertisements which would lead prospective borrowers to believe that loans would be made on terms and conditions different from those actually imposed. They further contend that the record is lacking in evidence as to what terms and conditions prospective borrowers believed they would be getting after reading the advertisements, or to otherwise indicate they were misled. To the contrary, respondents contend that the record indicates many of the borrowers were "chronic debtors" who showed themselves to be "sophisticated in the area of which the complaint speaks." Respondents also note that the terms and conditions of the loans were fully explained to borrowers at the time of closing (RPF at 23-28).

23. Even without consumer-type testimony, it is clear from the advertisements themselves that the impression sought to be created is one which is contrary to the realities of the corporate respondent's loan program. They seek to minimize the loan amounts and monthly payment amounts, and to maximize the amount of the borrower's take-home. Thus, in addition to the low monthly schedules set forth, the newspaper advertisements advise the borrower that "you can consolidate all your bills and make one low monthly payment" (CX 1, 5-7). The television advertisements advise the borrower that he can reduce his monthly payments on existing obligations of \$2,550 from \$183.00 to "a low \$25.83" by borrowing \$3,000 and at the same time "leave you with \$450.00 in cash" (CX 3 A-B). There is no suggestion in these advertisements that, through compression of the term of the loan from the 15-year period contemplated by the advertised schedule to five years, through the payment of interest rates of as much as 18 percent instead of the six-percent on which the schedule was based, and through the addition of attorneys' and other closing fees of as much as \$450, the amount of the borrower's monthly payments may triple, the amount

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of his loan may have to be increased to take care of such additional costs and his take-home from the loan may be eliminated or considerably minimized.¹⁰ Contrary to respondents' contention, there is ample borrower-testimony in the record to establish that the terms and conditions on which the loans were granted were not what the borrowers had been led to expect from reading or viewing the advertisements.¹¹

24. The fact that the borrowers were advised as to the terms and conditions of the loan at the time of closing is immaterial since it does not cure the initial deception.¹² Moreover, the record discloses that the terms and conditions were not fully explained at the time of closing or were not fully understood in some instances.¹³ While some of the borrowers may have been "chronic debtors," as respondents contend, they can hardly be called "sophisticated in the area of which the complaint speaks." Most of the borrower witnesses were on a relatively low level of the economic and social ladder in terms of income, employment and educational attainments, and impressed the examiner as anything but knowledgeable or sophisticated. The kind of advertising used by the corporate respondent was particularly calculated to mislead persons of this type, who were eager to grasp at any straw in an effort to extricate themselves from the burden of debt in which they were engulfed.

25. It is, accordingly, concluded and found that the corporate respondent has failed to reveal to the members of the consuming public,

¹⁰ It may be noted that the television schedule of payments contains no reference to any closing fees in its illustration of how the borrower may have a take-home of \$450 from a \$3,000 loan.

¹¹ One borrower testified: "I read the ad in the paper and I figured that you get a low payment each month and that was it. I didn't think I was going to pay so much interest and fees and I can't explain it" (Tr. 183). The witness had contemplated borrowing about \$2,500 to consolidate debts of around \$2,000. As a result of closing fees of \$450.00 and additional interest, the amount of the loan was increased to \$3,809.60 (CX 21). Another witness, who wanted to borrow \$1,000 at the advertised rate of \$8.44 a month, was told "the laws were different in Massachusetts and I couldn't get that particular loan." In order to cover the additional interest and the closing charges, he had to borrow \$1,600 instead of \$1,000 (Tr. 247, 253-254). Another witness, who expected to make a loan which would net him \$5,000 from which to pay certain obligations, received a net amount of \$3,700 and had to sign a note for \$5,637.60 as a result of the additional interest and closing fees (CX 20; Tr. 258-260).

¹² "The law is violated if the first contact or interview is secured by deception (*FTC v. Standard Education Society, et al.*, 302 U.S. 112, 115), even though the true facts are made known to the buyer before he enters into the contract of purchase (*Progress Tailoring Co. v. FTC*, 7 Cir., 153 F. 2d 103, 104, 105)."
Carter Products, Inc. v. FTC, 186 F. 2d 821, 824, 7 Cir., 1951.

¹³ Some of the witnesses indicated that there was a brief or hurried explanation at the time of closing, which they did not understand, and some indicated that they didn't realize what they would have to pay until they received the coupon-payment booklet in the mail following the closing (Tr. 156, 162-167, 184-185, 239-240, 258).

in its advertising, material facts with respect to the terms and conditions on which loans are made. Such failure to reveal and disclose material facts has the tendency and capacity to induce substantial numbers of members of the consuming public to believe that loans are made on terms and conditions different from those actually imposed by the respondent, so as thereby to be unfairly misled and deceived as to the extent of the financial obligation to be incurred by them.

E. Effect of Practices

26. It is concluded and found from the record as a whole that the use by the corporate respondent of the aforesaid false, misleading and deceptive statements, representations and practices had the capacity and tendency to mislead members of the purchasing public into the erroneous and mistaken belief that said statements and representations were true, and into the purchase of substantial quantities of said respondent's services by reason of said erroneous and mistaken belief.

F. Responsibility of Individual Respondents

27. The complaint alleges that the individual respondents, Sullivan and Cotherman, formulated, directed and controlled the acts and practices of the corporate respondent, and complaint counsel contends that the individual respondents are therefore responsible for such acts and practices (CPF at 2). Respondents concede that respondent Cotherman formulated, directed and controlled the policies of the corporate respondent, but contend that there is no basis in the record for holding respondent Sullivan accountable therefor (RPF at 4; PHO No. 1, par. A 1).

28. As has been previously found, the corporate respondent was organized and financed by respondent Cotherman. While respondent Sullivan was its nominal president and principal stockholder, he was merely a front for respondent Cotherman, who loaned him the money to purchase the stock and held such stock as security for repayment of the loan. According to Cotherman's uncontradicted and credited testimony, he formulated the corporate respondent's advertising program and approved loans made by it (Tr. 128, 359, 364). Under such circumstances, it is the opinion of the examiner that there is no basis for holding respondent Sullivan individually responsible for the acts and practices of the corporate respondent herein challenged. It is concluded and found, however, that since respondent Cotherman formulated, directed and controlled such acts and practices, he should be considered to have participated therein and be held individually accountable therefor.

CONCLUSIONS OF LAW

1. The respondents Consolidated Mortgage Company and Lester S. Cotherman were, at all times material herein, engaged in substantial business intercourse in commerce and maintained a substantial course of trade in commerce, as "commerce" is defined in the Federal Trade Commission Act.

2. Said respondents were, at all times material herein, in substantial competition with other corporations, firms and individuals in commerce, as "commerce" is defined in the Federal Trade Commission Act.

3. The acts and practices of respondents Consolidated Mortgage Company and Lester S. Cotherman, as hereinabove found, were all to the prejudice and injury of the public and of said respondents' competitors, and constituted unfair methods of competition in commerce and unfair and deceptive acts and practices in commerce, in violation of Section 5 of the Federal Trade Commission Act.

4. The Commission has jurisdiction over the subject matter of this proceeding¹⁴ and of the respondents, and this proceeding is in the public interest.

ORDER

It is ordered, That respondents Consolidated Mortgage Company, a corporation, and its officers, and Lester S. Cotherman, individually and as general manager of said corporation, and said respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering of or the sale or granting of lending services, or of any similar or related services, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

(a) Representing, directly or by implication, that loans are made to customers at a six-percent rate of interest;

(b) Representing, directly or by implication, that loans made or arranged by respondents are repayable over a fifteen-year period;

¹⁴ Respondents contend that the Commission has no jurisdiction over lending services under Section 5 of the Federal Trade Commission Act, citing the testimony of Chairman Dixon at congressional hearings on the Truth in Lending Act, to the effect that if Congress should substitute the Commission for the Federal Reserve Board as the enforcing agency for the bill, it should be given jurisdiction under the "money" clause of the Constitution (RPF at 5-S, 2S). Respondents have obviously misread the Chairman's testimony. There is no suggestion therein that the Commission does not now have jurisdiction over such practices under the "commerce" clause, but merely a request to broaden such jurisdiction so that it would be coextensive with that which the Board would have under the "money" clause, thereby covering acts and practices which do not occur in commerce.

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(c) Representing, directly or by implication, that loans are made at any stated repayment schedule, interest rates, period of repayment or under other stated terms or conditions; *Provided, however*, That it shall be a defense in any enforcement proceeding instituted hereunder for respondents to establish that loans are readily and in the regular course of business made available to customers under the stated repayment schedule, interest rates, period of repayment or other terms or conditions as stated;

(d) Misrepresenting in any manner the monthly repayment schedules, interest rates, periods of repayment or other terms or conditions under which respondents' loans are made.

It is further ordered, That respondents Consolidated Mortgage Company, a corporation, and its officers, and Lester S. Cotherman, individually and as general manager of said corporation, and said respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering of or the sale or granting of lending services, or of any similar or related services, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist, in those cases where representations are made as to the terms and conditions of respondents' loans, from failing, clearly and conspicuously, to reveal in advertising:

- (a) The period of repayment;
- (b) The number of payments required;
- (c) The finance charges expressed in terms of dollars and cents;
- (d) The simple annual percentage rate or rates at which the finance charge has been imposed on the monthly balance;
- (e) Any other charges or expenses which are to be incurred or paid by the borrower to obtain such loans.

It is further ordered, That the complaint be, and the same hereby is, dismissed as to respondent William F. Sullivan in his individual capacity.

OPINION OF THE COMMISSION

By MACINTYRE, *Commissioner*:

This matter is before the Commission upon the cross-appeals of counsel supporting the complaint and the respondents from the hearing examiner's initial decision filed May 31, 1967, holding that respondents, except for William F. Sullivan, had violated Section 5 of the Federal Trade Commission Act as charged. The complaint alleges that such Act was violated by the use of false, misleading and deceptive statements, representations and practices in connection with the advertising and offering of respondents' lending services and the granting of loans to the general public. The hearing examiner entered an order against the

respondents, except William F. Sullivan, to cease and desist the practices he found unlawful. The issues raised on the respective appeals will be considered below.

There is no question about the deceptive nature of respondents' advertising and the unfairness of their practices. It is unnecessary to relate the details here, since the examiner has fully covered them in his initial decision. The gist of the challenged representations was that respondents would arrange low-interest loans payable over a long period of time. Such representations were false and wrongful in that they induced or tended to induce the general public to apply to respondents for loans, which they might not have done had they known the truth. The examiner found that the borrower witnesses who testified were on a relatively low level of the economic and social ladder in terms of income, employment and educational attainments. The representations were particularly calculated to mislead persons of this type, who, as the examiner further found, were eager to grasp at any straw in an effort to extricate themselves from the burden of debt in which they were engulfed.

Respondents have made no appeal from the examiner's findings and conclusions as to the falsity and misleading character of their advertisements and the deception of the public. Rather, they argue that the complaint should be dismissed on the grounds it is no longer in the public interest to issue an order to cease and desist. First they seek dismissal of the complaint against the corporate respondent because of the claim that it no longer exists. The assertion is that two months before the issuance of the complaint Consolidated Mortgage Company ceased doing business, closed its office, and that dissolution proceedings were instituted.

The Commission has determined on this that the corporate respondent has not yet been dissolved under the laws of the State of Rhode Island, the jurisdiction in which it was organized and given a corporate charter, and, accordingly, that it is appropriate to prohibit such corporation from engaging in the acts and practices found to be unlawful. During the course of the oral argument respondents' attorney requested permission to file information showing the fact and the date of asserted "forfeiture" under the laws of the State of Rhode Island, which, it was claimed, would demonstrate that Consolidated Mortgage Company has been dissolved.¹

¹ Respondents, on December 18, 1967, filed a paper designated "Motion To Suspend Proceedings," which was a motion to suspend for 30 days for the purpose of inserting into the record information and data regarding the asserted dissolution of respondent Consolidated Mortgage Company. Complaint counsel filed an answer in opposition to the request. Respondents have since filed certain information in this connection. Their request for a 30-day time extension is now moot and need not be further acted upon.

The respondents, on January 12, 1968, submitted certain materials, which include, among other things, a letter from the Chief Tax Examiner for Corporations for the State of Rhode Island, acknowledging the receipt of the tax return filed and the request for forfeiture and stating in part as follows: "The effective date of forfeiture for failure to pay tax would be December 31, 1969 as provided for by statute."² As we understand it, the corporate respondent is in the process of being dissolved under the laws of the State of Rhode Island and that under the procedures mentioned dissolution would occur on December 31, 1969. We believe it is clear, in the circumstances, that there is an existing corporation and that it is wholly appropriate to enter a cease and desist order against it for the violations of law found in this proceeding.

Respondents next request dismissal as to both the individual respondents (though the examiner, in his initial decision, did dismiss as to respondent Sullivan) on the ground that the individuals are no longer in the business and that they have no intention to reenter the type of business conducted by respondent Consolidated Mortgage Company. We believe an order is justified in this case against the individual respondents in spite of the declared present intention of each not to reenter such business at any future date. Here the respondents, in a calculated fashion, misled and deceived the unknowledgeable and unsophisticated. They continued these practices until after the Commission had opened its investigation against them. Both individual respondents have in the past been associated with the lending business in other connections. Respondent Cotherman, in Erie, Pennsylvania, had previously operated the Great Lakes Discount Corporation, which he described as a business similar to that of the corporate respondent (Tr. 376). Respondent Sullivan had previously been the manager of Domestic Credit Corporation in Providence, Rhode Island. The Commission cannot be assured, in all such circumstances, that the individuals will not again engage in the practices. Where there is doubt, as here, an order to cease and desist is fully justified.

One further point has been raised, and that concerns the examiner's dismissal of the complaint as against individual respondent Sullivan. Complaint counsel has appealed from this dismissal. The examiner believed there was no basis for holding this respondent individually responsible for the acts and practices found unlawful since the testimony indicated that the corporate respondent was organized and financed by respondent Cotherman and that the latter made the decisions in the business. Although Mr. Sullivan was the corporation pres-

² Complaint counsel filed a motion to reject the information submitted by respondents, and respondents thereafter filed a reply.

ident and principal stockholder, the examiner found that he was merely a front for respondent Cotherman.

We do not agree with the dismissal of the complaint as to respondent Sullivan. Though his position as president of the corporation may have been to an extent a formality, he was part and parcel of the daily business operation. He was the "front" man. It was respondent Sullivan who first saw the applicants and who accepted and processed the loans of applicants. In passing himself off as president (which he in fact was), respondent Sullivan, we have no doubt, was benefiting himself (*e.g.*, his employment) as well as Mr. Cotherman, and having allowed himself to be used in this manner cannot now be heard to deny his responsibility for the results. Accordingly, we will overrule the examiner on this point and hold respondent Sullivan liable in his individual capacity.

The appeal of complaint counsel will be granted and that of the respondents denied. The initial decision will be modified to conform with the views expressed herein and as so modified will be adopted as the decision of the Commission. An appropriate order will be entered.

Commissioner Nicholson did not participate for the reason that oral argument was heard prior to his taking the oath of office.

FINAL ORDER

This matter having come on to be heard upon the cross-appeals of complaint counsel and the respondents, and the Commission having determined, for the reasons appearing in the accompanying opinion, that the appeal of complaint counsel should be granted and that of respondents denied; and the Commission having further directed that the initial decision be modified in conformity with the views of the Commission expressed in its opinion and as so modified adopted as the decision of the Commission:

It is ordered, That the appeal of complaint counsel be, and it hereby is, granted and that the appeal of respondents be, and it hereby is, denied.

It is further ordered, That Finding 28 of the initial decision be, and it hereby is, modified by substituting for the last two sentences thereof the following:

It is concluded and found, therefore, that respondent Cotherman, who formulated, directed and controlled the acts and practices herein involved, did participate therein and is individually accountable for them. Respondent Sullivan was the "front" man in the daily operation of the business. It was he who first saw the ap-

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plicants and who accepted and processed the loan applications. In passing himself off as the president of the corporation, respondent Sullivan was benefiting himself (*e.g.*, employment), as well as Mr. Cotherman, and having allowed himself to be used in this manner, cannot now be heard to deny his responsibility for the results. It is concluded and found that respondent Sullivan, in the circumstances presented, is likewise accountable for the challenged acts and practices.

It is further ordered, That the following order to cease and desist be substituted for the order contained in the initial decision:

ORDER

It is ordered, That respondents Consolidated Mortgage Company, a corporation, and its officers, Lester S. Cotherman, individually and as General Manager of said corporation, and William F. Sullivan, individually and as an officer of said corporation, and said respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering of or the sale or granting of lending services, or of any similar or related services, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forthwith cease and desist from:

(a) Representing, directly or by implication, that loans are made to customers at a six-percent rate of interest;

(b) Representing, directly or by implication, that loans made or arranged by respondents are repayable over a fifteen-year period;

(c) Representing, directly or by implication, that loans are made at any stated repayment schedule, interest rates, period of repayment or under other stated terms or conditions: *Provided, however*, That, except for the terms and conditions covered by subparagraphs (a) and (b) above, it shall be a defense in any enforcement proceeding instituted hereunder for respondents to establish that loans are readily and in the regular course of business made available to customers under the stated repayment schedule, interest rates, period of repayment or other terms or conditions as stated;

(d) Misrepresenting in any manner the monthly repayment schedules, interest rates, periods of repayment or other terms or conditions under which respondents' loans are made.

It is further ordered, That respondents Consolidated Mortgage Company, a corporation, and its officers, Lester S. Cotherman, individually and as General Manager of said corporation, and William F. Sullivan, individually and as an officer of said corporation, and said respondents' agents, representatives and employees, directly or through any corporate or other device, in connection with the offering of or the sale or granting of lending services, or of any similar or related services, in commerce, as "commerce" is defined in the Federal Trade Commission Act, do forth with cease and desist, in those cases where representations are made as to the terms and conditions of respondents' loans, from failing, clearly and conspicuously, to reveal in advertising:

- (a) The period of repayment:
- (b) The number of payments required:
- (c) The finance charges expressed in terms of dollars and cents;
- (d) The simple annual percentage rate or rates at which the finance charge has been imposed on the monthly balance;
- (e) Any other charges or expenses which are to be incurred or paid by the borrower to obtain such loans.

It is further ordered, That the initial decision as modified by this order be, and it hereby is, adopted as the decision of the Commission.

It is further ordered, That respondents shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order to cease and desist set forth herein.

Commissioner Nicholson not participating for the reason oral argument was heard prior to his taking the oath of office.