

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

FEDERAL TRADE COMMISSION,

Plaintiff,

VS.

STEVEN L. KENNEDY,

Defendants.

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CIVIL ACTION NO. H-06-1980

MEMORANDUM OPINION AND ORDER

I. INTRODUCTION

The Federal Trade Commission ("FTC") the plaintiff, filed this suit against Websource Media LLC ("WSM"), Websource Media, L.P. ("WSM LP"), BizSitePro, LLC ("BSP"), Eversites, LLC ("Eversites"), Telsource Solutions, Inc. ("TSS") and Telsource International ("TSI") as defendants. In addition, the FTC named as defendants six individuals: Steven L. Kennedy, Marc R. Smith, Kathleen A. Smalley, Keith Hendrick, John O. Ring and James E. McCubbin, Jr.¹ This suit was brought pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. §§ 53(b) and 45(a) and 5(a) ("the Act"). The Court received testimonial and documentary evidence concerning the conduct of the defendants, and particularly Steven L. Kennedy, and determines that the FTC should prevail on its claims.

¹ The defendants, WSM, BSP, Eversites, WSM LP, TSI, TSS, Marc R. Smith, Kathleen A. Smalley, Keith Hendrick, John O. Ring, and James E. McCubbin have reached settlement with the FTC and; therefore, are no longer parties to this suit.

II. FACTUAL BACKGROUND

The evidence is substantial and shows that Smith f

product name "WebPointUSA"². In the same time frame, Ring and McCubbin incorporated TSI and TII to provide telemarketing services through domestic and international call centers particularly for WSM and its entities. In this regard, TSI and TII contracted with WSM to provide telemarketing services to WebPointUSA, BSP and Eversites. Even though BSP and Eversites were not "owned" by WSM or Kennedy, the evidence shows that he contracted and paid for the private mailbox that BSP used as its business address. He also completed a form entitled, "USPS Application for Delivery of Mail Through An Agent" for BSP's private mailbox. Kennedy performed a similar service for Eversites and US Web Network ("USWN"). Hence, BSP, Eversites and USWN were created in order that WSM could continue billing its customers through Local Exchange Carriers ("LECs") when the LECs refused to accept further billing requests from TSS and TSI.³

Eventually, USWN was purchased by WSM and WSM products were sold under the product name USWN. In May of 2006, WSM was sold to Web.Com, Incorporated. WSM LP survived the sale and continued to sell WebPoint USA, BSP and Eversites products in behalf of Web.Com. WSM LP was operated by Kennedy, Smith, Smalley and Hendrick, the same management team that was in place before the sale. An injunction was entered against the defendants and Web.Com, Inc., in June of 2006.

III. THE SUIT AND PARTY CONTENTIONS

A. The FTC's Claims and Contentions

The FTC filed this suit against the defendants in June of 2006, in connection with the marketing and sale practices associated with WSM's website services. The FTC claims that the

² See FTC Exhibit 15 which shows that Kenneds tSMtt

defendants and WSM engaged in a practice called cramming, or web cramming, in violation of Section 5 of the Act. Cramming is a practice by which the telemarketer bills a consumer for a product or service without first obtaining the consumer's informed consent, a practice prohibited by the Act. Hence, it was the script and the salespersons' departures from the script that came to the attention of the LECs and, eventually, the FTC. The FTC also contends that Kennedy, through the various entities, participated with others in controlling the marketing and billing activities of the various entities through a common enterprise. The FTC asserts that through this common enterprise, Kennedy repeatedly violated the Act by engaging in unfair and deceptive acts and practices.

Specifically, the FTC charges that all defendants engaged in unfair acts and practices by charging consumers' telephone accounts without previously obtaining the consumers' informed consent. Secondly, the FTC alleges that they falsely represented that if a consumer agreed to a free trial website, the website would be cancelled automatically after a trial period unless the

This is _____ calling from EverSites. How are you doing? The purpose of my call is I'm sending over some information on a website offer for your business . . .

Can I fax it or mail it out?

Who would I direct it too? Is he/she the Owner or the Manager? And who am I speaking with?

This will arrive in a few days and it can be reviewed it [sic] at that time. It will include a pass code that allows them to go in and look at the site. If a decision is made to purchase the website it is only \$49.99 per month, but there is no cost or obligation by looking it over. [emphasis supplied]

Now can you grab a pen for me, please?

Now I will give you a five-digit confirmation number, that's going to remove your business from the computer so my co-workers won't keep calling you repeatedly about the offer, OK?

We use an automated system that will verify four quick questions: First name, Last name, Company's name, Address -that's it. The last question is basically -- are you over 18 and authorized to make decisions? I know that's a strange question, but the reason we ask that is because it involves the Internet and we're not allowed to send anything to a minor.

to transfer the customer to the automated system to create a Third Party Verification ("TPV"). However, while the TPV was being recorded, the telemarketer would often remain on the phone line and coached the customer through the verification process. The following is an example of the TPV's automated questions:

Sir/Ma'am? I'm entering your phone number, Ok?

Ok, the next four questions are for you and I'll push the buttons to speed it up. I'm not going anywhere, I'll be right here.

You have reached EverSites' automated verification system and this call is being recorded to confirm your understanding of our offer. Let's begin . . .

I need to know who I am speaking with, please say your first and last name?

What's the name of your company?

Thank you for agreeing to try a website from EverSites. Your new Website will be activated within 24 hours and is free for 15 days. You will incur no charges at this time, but if you decide to keep the Website,

That's all the information that I need. Congratulations on your site and welcome to EverSites. If you have any questions, you may reach us toll free at 866-558-7483.

Your confirmation number is . . . [GET NUMBER].

After a TPV was created the defendants and WSM would place a charge for a set-up fee on the consumer's telephone bill in spite of their representations to the contrary. And, unless the consumer called in to cancel the service, a monthly hosting fee would be automatically charged to the consumer's account each month thereafter.

unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful." See [§ 45(a)(1)]. Section 53 permits the FTC to seek and obtain injunctions against persons and entities who violate any provision of the Act. Likewise, 13(b) authorizes the FTC to seek and obtain temporary restraining orders and preliminary injunctions for violations or threatened violations of the Act.

The FTC contends that Kennedy and others under their control unfairly caused unauthorized charges to be billed on the telephone service of individuals and businesses, particularly small businesses and non-profit organizations. This practice, it argues, violated the Act. To establish this contention, the FTC must establish that Kennedy engaged in a practice that was likely to cause substantial injury to consumers; that the injury was not reasonably avoidable by the consumers; and, that the injury suffered was not outweighed by countervailing benefits to consumers or the competition. *See Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1363-66 (11th Cir. 1988).

A. Practice Likely Caused Injury

The first element of the burden of proof requires the FTC to prove that numerous consumers' telephone bills reflected billings for services that they did not want. Kennedy denies that the FTC has proven this element against him. He contends that he resigned as manager and president of WSM in September of 2001. Afterward, WSM was managed by Smith and Smalley. And, although he remained an employee of WSM and held an interest, he contends that he played no role in marketing and selling of website products. Instead, he contends that he was responsible for marketing and selling a product called Globenetix, unrelated to WSM's website business.

As well, Kennedy asserts, he was never a manager, member, officer, director or employee of BSP, TSS, or TSI. As such, he did not participate in or have authority to control the business practices of those entities, Smith, Smalley, Hendrick or the telemarketing activities of WSM's subsidiaries. It was Smith, Smalley and Hendrick, he contends, who negotiated the telemarketing agreements; managed, supervised, trained, employed and terminated the services of the telemarketing companies and their employees. Finally, Kennedy points out that WSM required that scripts used be used and that the scripts were lawful. After a sale, each new customer received a "Welcome Letter" confirming the transaction. As well, quality control personnel were hired to police the telemarketers' activities. When violations of WSM's protocols were detected and verified, penalties were assessed against sales representatives and they were subject to termination.

The facts show otherwise. In spite of the WSM protocols, the sales representatives charged consumers for the website setup fee even though the consumers were told that they would not be billed during the trial period. Nor were customers warned of the "negative option" built into the telephone script -- the practice of requiring the consumer to call back and cancel a service that was allegedly free for 15 days. Instead, WSM required the consumer to contact WSM during the trial period to effect a cancellation in spite of its "no cost" representation. This practice shifted the burden to the consumer.

The evidence also shows that consumers were in fact billed immediately or shortly after the sale and that the "Welcome Letter" may not issue and, when it did, was not always timely⁴. In innumerable instances, the consumers were billed for the monthly service unaware that there was in fact, no trial period. When consumers requested refunds, they did not immediately receive them. Tens of thousands of consumers never obtained refunds. Therefore, as to t

element, injury to consumers for services that they did not subscribe, the Court is of the OPINION, and FINDS, that the element is proved by a preponderance of the evidence.

B. Consumer Could Not Avoid Injury

Next, the FTC contends that consumers were not given a true "free and informed choice that would enable them to avoid the unfair practice." Kennedy contends that WSM adopted policies that complied with the FTC's telemarketing guidelines. In addition to the guidelines, he

C. Does Injury Outweigh Benefits

Lastly, the FTC contends that the injury suffered by the consumer was not outweighed by benefits to the consumer or to the competition. Kennedy ar.842ret thet th1

V. FALSE REPRESENTATIONS TO CONSUMERS

The FTC also contends that Kennedy violated § 5 of the Act by falsely representing that if a consumer agreed to a "free" trial offer, the website would be cancelled automatically if the consumer did not approve of the website during the trial period. Again, Kennedy relies on the argument that his relationship with WSM was at best tangential. He contends that he was not an officer or member of WSM management although he was an employee and holder of a minority interest.

The evidence shows that even though Kennedy resigned as president and manager of WSM in 2001, he continued as a manager of WSM. He was an officer of WSM's parent company, NetStrategy, and he was president of Globenetics, a subsidiary of WSM. Hence, the Court concludes that, while Kennedy resigned from WSM, he maintained a control position directly with WSM and indirectly through the parent corporation. More importantly, he

being used⁸

In order to prove that the defendants acted as a common enterprise, the FTC must establish facts showing that there was a common control group, that business was transacted through a member of interrelated companies, commingling of corporate funds, unified advertising, and/or other facts that reveals that there was no real distinction exists between WSM, TSS, TSI and the other entities that ultimately reported to WSM. *See FTC v. Ameridebt, Inc.*, 343 F. Supp. 2d 451, 462 (D. Md. 2004). It is not necessary that the FTC prove any particular number of entity connections and any specific connection. Instead, it must be proved that the defendants maintained an "unholy" alliance. *Id.*

The evidence shows that the managers and principal

of fraudulent sales. And, in January and February 2003, he became aware that WSM had exceeded the threshold of consumer complaints and was facing cancellation of the LEC account. He advised that the FTC could hold the individuals liable for the sales representatives' conduct. As well, he knew that other entities were formed so that WSM could continue its billing practices. According to Smalley, Kennedy was fully aware of the scripts used and the customer service complaints while serving as one of the four managers of WSM. Also, he was WSM's technical support person, and for an indeterminate period of time, received consumer complaints through WSM's website. Kennedy, Smith, Smalley and Hendricks went on to take offices with WSM.com when WSM was purchased. The defendant served as vice-president of Web.Com.

Therefore, the Court need not determine whether the elements of a common enterprise were established by the FTC because the Court determines that Kennedy was an owner, officer and employee of WSM. He participated in WSM management decisions. While he did not directly manage TSS and TSI, the evidence shows that he was an undisclosed participant in their activities as management and ownership in WSM. Thus, he knew or should have known of the fraudulent activities of the sales representatives with whom WSM had entered into contract. As an officer and owner and a person in the "management loop" Kennedy had a duty to know and a responsibility to correct the fraudulent conduct of WSM, and through WSM, its subsidiaries or operatives. Hence, the Court FINDS and CONCLUDES that Kennedy had authority to control and did, in fact, control WSM and, through WSM, its subsidiaries and operatives.

VII. RESTITUTION AND CONSUMER INJURY

Because Kennedy and the officers of WSM acted in concert to violate § 5(a) of the Act and 15 U.S.C. § 45(a), an appropriate remedy must be fashioned for Kennedy's unlawful conduct. Presently, an Agreed Permanent Injunction has been entered against all corporate

acts and the acts of the individual and corporate defendants. The Court finds that Kennedy had actual or constructive knowledge that the telemarketers were making and did make false

