The Federal Trade Commission and the Future Development of U.S. Consumer Protection Policy

by

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I. Introduction

As a nation, we derive vast economic benefits from competition in free markets. These benefits should not be taken for granted; they – and the competition that yields them – are not immutable. The nation's consumer protection policy can have profound effects on such benefits. The policy can enhance these benefits by strengthening the market. The policy can also reduce these benefits, however, by unduly intruding upon the market and hampering the competitive process. The Federal Trade Commission ("FTC" or "Commission") has a special responsibility to protect and speak for the competitive process, to combat practices that harm the market, and to advocate against policies that reduce competition's benefits to consumers.

The FTC protects consumers through its responsibility to prevent "unfair or deceptive acts or practices."[2] The FTC, and other public institutions, also operate against a backdrop of other consumer protection institutions, most notably the market and private contract and tort law. This paper seeks to provide a perspective on the rationale for how the agency should formulate

[1] Chairman, Federal Trade Commission. The views here are mine, not those of any other Commissioner. I would like to thank William E. Kovacic, Maureen K. Ohlhausen, Todd J. Zywicki, and the staff of the FTC's Bureau of Consumer Protection for their help in preparing this paper. I would also like to thank Thomas Krattenmaker for his helpful comments.

[2] 15 U.S.C. § 45.

consumer protection policy, identifying how the agency at the millennium fits in the scheme of institutions for consumer protection and its comparative advantages in carrying out this role.

The paper has three parts. The first describes the system of institutions for consumer protection in the American economy and how they interrelate. It begins with our market economy, in which producers compete to offer the most appealing mix of price and quality. This competition spurs producers to meet consumer expectations because the market generally imposes strict discipline on sellers who disappoint consumers and thus lose sales to producers who better meet consumer needs. These same competitive pressures also encourage producers to provide truthful information about their offerings. Market mechanisms cannot always effectively discipline deceptive sellers, however, such as when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, another institution can mitigate these problems. Private legal rights – property, contract, and tort law – provide a set of basic rules for interactions between producers and consumers. Government can also serve a useful role by providing default rules, which apply when parties do not specify rules. These rights and default rules alleviate some of the weaknesses in the market system by reducing the consequences to the buyer arising from a problematic exchange. Notwithstanding the strengths of private legal rights, in some circumstances – such as when court enforcement is impractical or economically infeasible – they may not be an effective deterrent .

The paper argues that when consumers are vulnerable because market forces are insufficient and the common law is ineffective, a public agency, such as the Federal Trade Commission, may shore up these other institutions by preserving competition and protecting

consumers. The FTC's consumer protection and competition missions naturally complement each other by protecting consumers from fraud or deception without restricting their market choices or their ability to obtain truthful information about products or services. The paper also describes the Commission's positive agenda which animates its principles for enhancing consumer welfare and makes the best use of the agency's institutional abilities. The bedrock principle of the FTC's positive agenda is that robust competition in a strong market is the primary bulwark of consumer protection. Thus, the Commission acts on two fronts: promoting competition and the free exchange of accurate and non-misleading information and taking aggressive enforcement against conduct that undermines competition and impedes the exchange of accurate information and poses the greatest threat to consumers.

The second section of the paper details how the FTC's proper place in this system of institutions for consumer protection guides the design of specific consumer protection initiatives. Starting with the agency's top priority – stopping conduct that causes the greatest threat to consumers – this section details the FTC's actions against fraud and then discusses the regulation of advertising, with an emphasis on matters involving health claims. It next illustrates how the agency uses its unique institutional capabilities to formulate new rules in response to changed situations by examining the FTC's initiatives on privacy and spam, including the recently-created national Do Not Call registry. Continuing the theme of adaption to change, this section concludes with examples of the Commission working to meet new challenges brought about by increasing globalization and e-commerce.

The paper concludes by discussing the critical importance to sensible policymaking of continuing efforts to increase the Commission's research and development function – the

systematic effort to improve the base of knowledge that informs the agency's diverse initiatives in the face of changes in the economic and policymaking environment at home and abroad. Using as examples the FTC's workshops on possible barriers to e-commerce and on the costs and benefits of the collection and use of consumer information, the paper examines how the Commission uses its distinctive institutional strengths to ensure that it understands new conditions and crafts appropriate responses.

II. General Principles

A. Economic and legal underpinnings and the role of the FTC

How do competition, consumer protection, and the Federal Trade Commission fit into the larger picture of the American economy? In turn, this raises two subsidiary issues. First, why is it desirable to have a government agency as part of this system, instead of just relying on markets and the common law? Second, why should this be a *federal* competition and consumer protection agency? It *is* obvious that any society must first make the fundamental choice of an economic system, whether it be competition through free enterprise and open markets, command-and-control regulation, or public or collective ownership. The United States has largely chosen free enterprise and markets as the organizing principle of our economy. Free enterprise, however, does not mean a system without rules. Any market economy also needs a well-specified structure of property rights, contract law, and other rules of conduct.[3]

One can envision the American system of consumer protection as a three-legged stool: a first leg of competition based on free enterprise with a second leg the legal structure of contract,

[3] *See* William E. Kovacic, *Institutional Foundations for Economic Legal Reform in Transition Economics: The Case of Competition Policy and Antitrust Enforcement*, 77 CHI.-KENT L. REV. 265, 269-70 (2001) (describing views of commentators concerning necessary legal framework for a market economy).

property, and other private law that largely focuses on the relative rights of particular parties. A two-legged stool will not be very stable. Likewise, markets and private legal rights, while indispensable to the American economic system, may falter in key respects. These legs can better support the American economic system when buttressed by a third leg.[4] Public agencies – entrusted to promote consumer welfare by preserving competition and protecting consumers – work as this third leg, reinforcing the other two. This paper will elaborate on the strengths and limitations of the first two legs, competition and private law, and how agencies, like the Federal Trade Commission, function as a third leg to complement these strengths and compensate for the limitations of these other institutions.[5] This paper will also discuss how the agency has, at times, failed to realize its limitations and, instead of complementing these other legs, worked against them by interfering with robust competition and consumer choice. At other times, the FTC has been too passive, failing to recognize unique capabilities and the need to supplement the other legs.

B. Leg 1: Competition and its limits

Competition presses producers to offer the most attractive array of price and quality options possible. In competitive industries, the imperative to gain new sales by satisfying consumer needs increases the choices available. Consumers can often determine whether a product will satisfy their needs by direct inspection of the product before purchase or by past

[4] The analogy of the three-legged stool is drawn from Todd J. Zywicki, *Bankruptcy Law as Social Legislation*, 5 TEX. REV. OF L. & POL. 393, 400 (2001), which applies it in a different context.

[5] As discussed throughout this paper, besides the FTC, other agencies exist to pursue these priorities, including the Antitrust Division of the Department of Justice, parts of the Food and Drug Administration, many state attorneys general, and local, state, and federal criminal enforcement agencies.

experience with the product.[6] In competitive markets, when consumers dislike the offerings of one seller, they can turn to others. This ability to shift expenditures imposes a rigorous discipline on each seller to satisfy consumer preferences. Competition does more than simply increase choices for consumers, however. It motivates sellers to provide truthful, useful information about their products[7] and drives them to fulfill promises concerning price, quality, and other terms of sale.[8] Consumers can punish a seller's deceit or failure to fulfill a promise by voting with their feet – and their pocketbooks. This punishment is usually swift for sellers of products purchased frequently whose qualities purchasers can readily evaluate.[9]

For products purchased infrequently, for which an individual consumer cannot usually rely on personal experience to evaluate a seller's truthfulness, private institutions can help provide the information that augments or substitutes for such experience. For example, third-party evaluations, such as Consumer Reports magazine, provide information on cars and

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[6] *See, e.g.*, J. Howard Beales, III, et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. 491, 501 (1981).

[7] *See, e.g.*, Paul H. Rubin, *Regulating Deception*, 10 CATO J. 667, 679 (1991) ("There is much support in the recent literature for the proposition that, as long as deception is not allowed, there are incentives for sellers to disclose even the negative attributes of their products. This is because consumers will rationally assume that any advertisement which omits a critical piece of information (say, the durability of a product) will imply that the value of that attribute for that product is at the lowest level.") *See also* Beales, et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. at 502.

[8] *See, e.g.*, Lester G. Telser, *A Theory of Self-Enforcing Agreements*, 53 J. BUS. 27 (1980) (noting that when a stream of benefits from repeated interaction is promised, and that stream of benefits would be lost by acting opportunistically, it is in a party's self interest to forego the one-time gain of opportunism in favor of preserving the prospect of a future stream of benefits.)

[9] Each year, tens of thousands of new products are introduced, many of which fail. An famous example was the Coca Cola Company's introduction of its "New Coke". Introduced with great fanfare, the product fizzled and has virtually disappeared from the market.

appliances, which an average consumer may buy once every five, ten, or even twenty years.[10] Moreover, sellers may well have an incentive to disclose information to consumers if the mere fact that they disseminate information distinguishes them from lower-quality rivals and consumers perceive that the average quality of a nondisclosing seller is lower.[11] In addition, rivals may emphasize the gap between a competitor's promises and the product it delivers. Reputation is also important to sellers,[12] and items like company brands and logos implicitly convey quality and other important product information.[13]

Sometimes robust competition alone will not punish or deter seller dishonesty or reneging. For products called "credence goods," consumers cannot readily use their own experiences to assess whether the seller's quality claims are true.[14] Typical consumers know

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[10] *See, e.g.*, Consumer Reports magazine, online version available at <http://www.consumerreports.org/main/home.jsp>; Cnet Product Reviews available at <http://www.cnet.com/>.

[11] *See* Beales, et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. at 502.

[12] *See* Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 527 (1981) (concluding that reputation is the main constraint on opportunistic behavior).

[13] *See* Paul H. Rubin, *Regulating Deception*, 10 CATO J. 667, 675 (1991) ("Investments in non-salvageable firm-specific capital (capital that would become worthless if the firm were to shut down) would serve to guarantee quality since the firm would lose the value of these investments if consumers dissatisfied with low-quality products forced it to shut down by withdrawing patronage. In addition to advertising, including endorsements by celebrities, such capital includes investments in establishing trademarks and brand names, and investments in physical assets such as signs and decor.")

[14] *See* Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16(1) J. OF L. & ECON., 67, 68-69 (Apr. 1973) ("Credence qualities are those which, although worthwhile, cannot be evaluated in normal use. Instead the assessment of their value requires additional costly information. An example would be the claimed advantages of the removal of an appendix, which will be correct or not according to whether the organ is diseased. The purchaser will have no different experience after the operation whether or not the organ was

whether a food product "tastes great;" they cannot judge whether consuming the same product reduces the risk of cancer or whether the cost of a car repair included items not necessary to restore the vehicle to its full capacity. Private rating systems help, as do the creation of regional or national firms with established reputations that would be severely damaged through exposure of deceit or fraud. Nevertheless, when information is costly to produce and to use or when the costs of producing the information are difficult for the information provider to recoup because of free-rider problems,[15] these market mechanisms will not correct all problems. Moreover, in certain circumstances, competing firms may not have strong incentives to identify their rivals' misrepresentations if it would highlight a deficiency common to all such products.[16]

For credence goods, the market may not identify and discipline a deceptive seller because the product's qualities are so difficult to measure.[17] Moreover, a product market with

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diseased. A similar example would apply to replacement of a television tube, certain automobile repairs and the like. The line between experience and credence qualities of a good may not always be sharp, particularly if they will be discerned in use, but only after the lapse of a considerable period of time.")

[15] *See, e.g.*, Beales, et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. at 503-4.

[16] In part for this reason industries often acquiesce to private restraints on comparative advertising claims, particularly restraints on truthful claims that "disparage" competitors' products. *See* 16 C.F.R. § 14.15 and discussion, *infra,* at notes 63-64 and accompanying text. This reluctance also justifies certain government actions to require disclosures of health or safety risks that are common to a class of products, for example requiring health warnings on tobacco products. *See, e.g.*, Federal Cigarette Labeling and Advertising Act, 15 U.S.C. §§ 1331- 1340, *as amended.*

[17] *See* Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16(1) J. OF L. & ECON. 67, 68 (Apr. 1973) ("Hence, the contention that competitive markets are sufficient to prevent fraud by, at least, established firms, because of the effect on future sales of the eventual discovery of the fraud, does not hold in this case. The provision of joint diagnosis and repair implies that some fraud can be successful because of the high, if not prohibitive, costs of discovery of the fraud.")

special attributes – consumers cannot determine quality before purchase, higher quality products cost more to produce than lower quality products, and firms cannot credibly guarantee quality – may become a "lemons market" in which only low-quality products are sold.[18] Under these circumstances, the market mechanism may break down because, in the presence of information asymmetries, no seller can convince consumers that it is offering a high-quality product. Consumers would pay higher prices for better quality products if they could readily identify them; because they cannot, producers cannot recoup the additional costs of manufacture. Fortunately, these markets appear to be virtually nonexistent.[19]

Legitimate companies care about how consumers regard them. They count on repeat business and word-of-mouth endorsements to increase sales. By contrast, the commercial thief loses no sleep over its standing in the community and is unconcerned about repeat business. These fraudsters cheat consumers, grab the revenues, and disappear from sight, often to re-emerge in another guise to steal again.

When market forces cannot overcome these threats to consumer welfare, *e.g.*, because some sellers are unconcerned about repeat business and reputation or because deception is difficult to detect because of information asymmetries, there are other ways to regulate exchanges. The second leg of the stool, private legal rights, not only complements the competitive market, it can also overcome, or at least mitigate, some of these market problems.

C. Leg 2: Private legal rights and their limits

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[18] George A. Ackerlof, *The Market for Lemons: Qualitative Uncertainty and the Market Mechanism*, 84 Q. J. OF ECON. 488-500 (Aug. 1970).

[19] *See* Timothy J. Muris, *California Dental Association v. FTC: The Revenge of Footnote 17*, 8 S. CT. ECON. REV. 265, 288-89 (2000) (discussing rarity of lemons markets).

One of the crucial roles for government is to define and allocate property rights. Courts – and government agencies – can both be useful in defining and protecting those rights. The triad of property, contract, and tort law provide a basic set of legal rules permitting ownership, voluntary transference, and protection from involuntary transactions. David Hume's treatise on human nature specifies "three fundamental rules of nature, that of the stability of possession, of its transference by consent, and of the performance of promises."[20]

If parties could breach without legal consequence, the voluntary exchange of promises of future performance would not disappear, however.[21] Indeed, before the rise of formal contract law, an active system of voluntary exchanges existed, in which people used credit bureaus, bonding, reliance on experience from past dealings, and similar devices to ensure performance.[22] Nevertheless, compared to the system of contract law that developed, the alternative system was probably inefficient because it was almost certainly more costly.[23] Credit bureaus and bonding,

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[20] 3 DAVID HUME, A TREATISE OF HUMAN NATURE § VI (L.A. Selby-Bigge ed., 1888).

[21] *See, e.g.*, Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. OF POL. ECON. 615 (1981) (examining the repeat-purchase, contract-enforcement mechanism of private arrangements).

[22] *See, e.g.*, Todd J. Zywicki, BANKRUPTCY AND RECIPROCITY: AN EVOLUTIONARY ANALYSIS OF PROMISE-KEEPING NORMS, AND BANKRUPTCY LAW 28 (Geo. Mason Univ. Sch. of Law, Working Paper, 2001) ("For centuries commerce [based largely on promise-keeping] existed outside of the jurisdiction of any political authority . . . Modern commercial law was invented and enforced not by governments, but by merchants themselves."); Daniel B. Klein, *Promise Keeping in the Great Society: A Model of Credit Information Sharing, from* REPUTATION: STUDIES IN THE VOLUNTARY ELICITATION OF GOOD CONDUCT (Daniel B. Klein, ed., Univ. of Mich. Press 1997); Avner Greif, *Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition*, 83 AM. ECON. REV. 525, 530 (1993).

[23] For certain industries, the system of contract rules can itself be inefficient. *See* Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) (concluding in study of diamond industry "extralegal contracts are more likely to become an industry norm in situations where traditional contract

for example, increase the cost of contracting, at least by the fact that the parties need another contract to protect themselves from the consequences of breach. In some cases – those economists like to call "at the margin" – the costs would be so high that certain exchanges would not be made at all.

One of the most useful roles for the government is to provide what are called default rules – terms that apply when the parties do not explicitly specify otherwise. The more efficient these rules, the greater the scope for exchange and thus the greater the gain in consumer welfare. When contracts are formed, even in the most complex transactions, parties do not find it useful to define the terms for every contingency possible. Instead, courts, legislatures, and agencies have developed default rules that are like buying off-the-rack clothing rather than specially tailored clothes. Rather than writing your own contract, you get it "off the rack," as it has come down in the judicial and legislative pronouncements.[24] Many of these rules of exchange are so basic – for example, rules against fraud, breach of contract, and deceptive advertising – that we do not even think about them as rules at all. In this way, a vast and increasingly sophisticated common law has evolved to govern consumer and other commercial transactions.

Contractual terms, such as warranties and money-back guarantees, may alleviate some of the problems that would otherwise exist, such as information asymmetries.[25] There are

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remedies are likely to lead to inefficiently high levels of breach of contract and the market is organized in a way that makes other methods of enforcing these agreements possible.")

[24] *See* Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Default Rules*, 101 YALE L.J. 729 (1992); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261 (1985).

[25] *See, e.g.*, Howard Beales, et al., *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. at 511-12 (noting that such contractual terms may partially indemnify the buyer

transaction costs involved in negotiating, forming, and enforcing contracts, however. Moreover, as is well known, resort to courts for enforcement of consumer transactions is often economically infeasible. When disputes involve small losses to consumers, private lawsuits are not a rational economic option for most because the costs, including non-pecuniary ones, associated with suing far outweigh any likely redress. Class actions also suffer from structural problems that increase the risk of outcomes – such as inadequate consumer redress and excessive attorneys fees – that fail to protect consumer welfare adequately.[26] Further, small claims courts often do not sufficiently reduce the costs of litigation.[27]

Market factors, such as a business's concerns about repeat business and reputation, can augment the effectiveness of common law and overcome some of the incentives a seller might otherwise have to dishonor its agreements. In return, common law can complement the operation of the market. For example, having a judicial remedy reduces the risk of engaging in a transaction with a new entrant to a market, allowing the transaction to take place at lower cost.[28]

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against making a wrong decision based on a lack of information and may act as a signal of the product's quality since warranties are cheaper to provide if the products seldom fails).

[26] *See* Thomas B. Leary, Commissioner, FTC, *The FTC and Class Actions* (June 26, 2003) (identifying flaws in the class action system arising from the lack of an actual plaintiff, which increases the risk of collusive settlements between class counsel and defendant's counsel, inadequate consumer redress, excessive attorneys fees, and the prosecution of meritless cases that harm consumers indirectly), *available at*, <http://www.ftc.gov/speeches/leary/classactionsummit.htm>

[27] *See, e.g.*, Arthur Best et al., *Peace, Wealth, Happiness, and Small Claims Courts: A Case Study*, 21 FORDHAM URB. L.J. 343, 367 (1994) ("The complexity of the existing apparatus for collection in Denver forces many small claims judgment creditors to go to an attorney for assistance in collecting a judgment. These additional costs can severely undercut the otherwise low cost of winning the judgment.").

[28] *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.1(6th ed. 2003); Todd J. Zywicki, THE PAST, PRESENT, AND FUTURE OF CONTRACT GOVERNANCE: AN ECONOMIC THEORY OF CONTRACT GOVERNANCE 65 (Working Paper, 2003) (noting that with reduced

This remedy encourages market participants to patronize new entrants, with whom they have not previously transacted business, who have no prior pattern of repeat dealing, and who have not yet established a reputation.

In some cases, even market forces and common law together may be insufficient to discipline bad actors. One can easily imagine sellers unconcerned about repeat customers or reputation, or who make product claims that are difficult to verify, and who rely on the fact that few injured consumers will undertake the often difficult task of suing to vindicate their rights.

D. Leg 3: Government agencies, including the Federal Trade Commission

When the ability of common law to protect consumers' rights falters, as when injury claims are small individually but significant in the aggregate, and market forces are ineffective for the reasons discussed earlier, another institution may overcome these weaknesses and thereby reinforce the effectiveness of competitive markets and common law. Public agencies – entrusted to promote consumer welfare by preserving competition and protecting consumers – work as a third leg of the stool, reinforcing these other two legs in support of the market economy.[29]

How the FTC supports competition (leg 1)

Our faith in the market is firmly grounded in the principle that free enterprise and competition best guarantee commercial freedom, economic efficiency, and consumer welfare.

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information about a potential trading partner, parties will be less willing to enter into contracts and trades that would be consummated if promises could be made more enforceable. "Thus, at some point, the overall costs of relying on informal norms becomes sufficiently high that it becomes efficient to create institutions to enforce promises, despite the administrative costs of doing so.")

[29] Although other agencies are crucial to this task, see note 5 supra, the focus here is on the FTC. Of course, government has its own limits, which must be considered when developing public policies.

The United States has chosen antitrust law to provide the governing rules for competition in most sectors of the economy. Competition policy protects consumers, not competitors.[30] Antitrust law helps maintain effective competition by prohibiting conduct that unreasonably restricts markets. Antitrust law is really "a form of regulation that competes with other regulatory structures"[31] and, in most instances, makes direct regulation unnecessary. The other option for addressing market imperfections is comprehensive sectoral regulation, which ordinarily entails strict controls on prices, entry, and conduct. For various segments of our economy, state and federal governments have adopted this latter strategy, often at great costs.

Consumer protection policy also has a vital role in supporting markets. It helps ensure that consumers can make well-informed decisions about their choices and that sellers will fulfill their promises and not increase sales by lying about their products. Thus, prevention of deception helps consumers in two ways: first, most obviously, by deterring deceptive sellers; and second by making it easier for honest sellers to make credible claims about their products.

Thus, loss of sales to a dishonest competitor is not the only harm the dishonest inflict on legitimate businesses. If many sellers lie about their products, a pernicious atmosphere of consumer distrust may develop. Such an atmosphere harms society in several ways. Deceit by one group of sellers may lead consumers to doubt the integrity of an entire industry or to distrust

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[30] *See, e.g., Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (noting that federal antitrust laws are designed "for the protection of competition, not competitors." (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962))).

[31] Timothy J. Muris, *Antitrust's Next Decade, in* BETTY BOCK, IS ANTITRUST DEAD? 55 (1989).

markets generally.[32] Deception by Internet sellers, for example, could discourage consumers from using the Internet to gather information and make purchases. In such a world, truthful sellers must resort to extraordinary measures to persuade consumers of their honesty. Even if honest suppliers take such precautions to show their trustworthiness, some consumers may avoid purchases that otherwise would improve their well-being. A real-world example of this phenomenon is the effect of spam on consumer confidence in the Internet.

Not surprisingly, the FTC focuses heavily on preventing fraud and deceptive advertising. By striving to keep sellers honest, consumer protection policy does more than safeguard the interests of the individual victim– it serves the interest of *consumers* generally and facilitates competition.

How the FTC supports the common law (leg 2)

Under the FTC Act, the Commission seeks to stop unfair or deceptive acts or practices, thereby helping to reinforce the common law rules of exchange. Simply stated, the core of modern consumer protection policy is to protect consumer sovereignty by attacking practices that impede consumers' ability to make informed choices, such as fraud, unilateral breach of contract, and unauthorized billing.[33] As discussed above, resort to courts for enforcement for consumer

[32] Of course, some level of consumer awareness of potential deception is an important part of consumer self-protection and is why the FTC has an active consumer education program. *See* discussion of consumer education, *infra,* at note 41 and accompanying text.

[33] After a long struggle with the extent of its unfairness jurisdiction, the Commission adopted a benefit cost analysis for unfairness, which was subsequently codified. *See* 15 U.S.C. § 45(n). *See* J. Howard Beales III, *The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection,* Wash., DC (May 30, 2003) (presenting remarks before the Marketing and Public Policy Conference) for the history and current use of the FTC's unfairness jurisdiction. Consumer sovereignty may be frustrated *ex ante*if, for example, important information is not provided. *See* Labeling and Advertising of Home Insulation, Statement of Basis and Purpose, 44 Fed. Reg. 50218 (1979). It may be frustrated *ex post* if sellers do not honor their contracts with consumers. *See Orkin Exterminating Co.,* 108 F.T.C. 263 (1986), *aff'd sub nom, FTC v. Orkin,*

transactions often does not work well when many consumers suffer small injury. While private class actions can provide some relief for class members, the FTC can act in the interest of all consumers, free from the conflicting incentives in current class actions. In addition, administrative agencies, like the FTC, have developed areas of expertise, such as interpreting implied claims in advertising,[34] that provide an advantage over courts when ruling on consumer matters involving certain complex issues.

The Commission also can go beyond enforcing a particular contract provision to provide "rules of the game" that reduce consumer harm in the future. The Commission can establish new default rules and procedures for transference of rights when it is otherwise difficult to do so. While seeking to facilitate the exercise of consumer choice, the agency is also highly cognizant of the need to avoid unduly shackling market forces. For example, this balance undergirds the FTC's approach to unsolicited telemarketing calls, through which consumers decide whether or not they wish to receive such calls and express their preferences effectively through the Do Not Call registry.[35] Once these new rules of exchange are established, if transaction costs are low, parties can more easily transfer these rights.[36]

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849 F.2d 1354 (11th Cir. 1988). The three-part unfairness test – the injury must be (1) substantial, (2) without offsetting benefits that outweigh the harm, and (3) one that consumers cannot reasonably avoid – is designed to provide a rational, empirical means to determine whether the challenged acts or practices interfere with consumers' ability to make choices.

[34] Memorandum to FTC Chairman James C. Miller III from Timothy J. Muris, Director of Consumer Protection Bureau, on Definition of Deceptive Advertising, 42 ANTITRUST & TRADE REG. REP. (BNA) No. 1058, at 699-708 (Apr. 1, 1982).

[35] *See* discussion of Do Not Call Rule, *infra*.

[36] *See* R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 15-16 (1960) ("Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production

E. Examining the FTC's Consumer Protection Capabilities

In antitrust enforcement and litigation, the FTC routinely analyzes specific industry details and institutional arrangements. The agency's methodology is analogous to case studies and, in its finest form, pays proper attention to the institutions that influence competition.[37] Beyond the context of individual enforcement matters, careful case studies have enriched the understanding of such issues as market power and efficiencies, contributing to improvements in antitrust policy.[38] The Commission has certain institutional attributes – such as having a Bureau of Economics with over 70 professional economists – that make it well suited to apply this approach, not only for competition but for consumer protection as well.

Both consumer protection and competition serve the common aim of improving consumer welfare, and they naturally complement each other. A focus on competition theory that excludes consumer protection is not only shortsighted but, given the growing importance of consumer issues, can ultimately be self-defeating. Consumer protection policy that ignores the impact on competition can result in a cure worse than the disease. The true measure of our contribution to the economy is our progress in increasing consumer welfare overall. Thus, well-

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consequent upon the rearrangement is greater than the costs which would be involved in bringing it about.")

[37] *See* Timothy J. Muris, Chairman, FTC, *Improving the Economic Foundations of Competition Policy,* George Mason University Law Review's Winter Antitrust Symposium, Wash., D.C. (Jan.15, 2003), *available at* <http://www.ftc.gov/speeches/muris/improveconfoundatio.htm>. (Discussing how to improve the economic foundations of antitrust and concluding that antitrust analysis, if performed correctly, uses a careful, fact-based economic approach grounded in a thorough understanding of the relevant institutions.)

[38] Noteworthy examples of this type work can be found in FEDERAL TRADE COMMISSION, IMPACT EVALUATIONS OF FEDERAL TRADE COMMISSION VERTICAL RESTRAINTS CASES (Ronald N. Lafferty, *et al.*, eds., 1984).

conceived competition and consumer protection policies should take complementary paths to the goal of promoting consumer welfare.

There may be multiple ways to ensure that competition and consumer protection policy work together. Experience has shown it beneficial not only to use this approach but also to combine both the competition and the consumer protection functions in a single public institution.[39] The Federal Trade Commission's experience suggests several synergies from this arrangement.[40] First, the consumer protection function can provide useful insights about how to execute competition policy. In several important instances, enforcement of laws concerning advertising and marketing practices has improved the Commission's understanding of how markets operate. For example, the development of the agency's health care antitrust agenda benefited from what we learned about the manner in which truthful advertising informs consumer choice.

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[39] *See* Thomas B. Leary, Commissioner, FTC, *The Federal Trade Commission and the Defense of Free Markets*, at the David T. Chase Free Enterprise Institute, Eastern Connecticut State University, Willimantic, Conn. (Oct. 7, 2002) ("Competitive restraints (the antitrust violations), tend to raise the supply curve because they increase offering prices or restrain sellers in the market. False advertising tends to raise the demand curve because it creates the impression that products are worth more than they otherwise would be if they were advertised honestly. So supply and demand will intersect at a higher price, to the detriment of consumers, and society's resources will be misallocated. That is the nexus between our two missions and that is the fundamental justification for having both of these responsibilities in the same agency . . .")

[40] *See* American Bar Association, *Report of the American Bar Association Section of Antitrust Law Special Committee to Study the Role of the Federal Trade Commission* 109-110 (Apr. 7, 1989) [hereinafter "*Kirkpatrick II Report*"] (noting, *inter alia*, that combination of functions allows consideration of whether antitrust or consumer protection remedies are most appropriate and permits considerations of economic efficiency to inform consumer protection decisions).

Thus, when the Commission studied the effect of advertising and commercial practice restrictions on the business of optometry in its consumer protection mission, it proposed Consumer Protection Trade Regulation Rules to challenge those restrictions and also pursued several antitrust challenges to attempts by professions to restrict new ways of delivering their services. The Commission continues to share what it has learned as part of its competition advocacy program. Recently, the FTC staff argued in comments to a state board that sellers of replacement contact lenses should not be subject to state professional licensing requirements because the possible benefit to consumers from increased protection did not outweigh the costs from the diminution of competition. The board ultimately held that out of state lens sellers did not need a state license.[41]

The FTC's consumer protection program also has raised the possibility of new remedial strategies in competition cases. One of the principal priorities of the Bureau of Consumer Protection in the early 1980s was to obtain redress for the victims of fraud.[42] Today, the disgorgement of revenues obtained by fraud is a centerpiece of the agency's aggressive anti-fraud program. The experience with restitution and disgorgement in consumer protection laid the foundation for the Commission to use those remedies in antitrust.[43]

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[41] Connecticut Board of Examiners for Opticians, *In re: Petition for Declaratory Ruling Concerning Sales of Contact Lenses*, Declaratory Ruling Memorandum of Decision (June 24, 2003). For another example of competition advocacy in the area of eye care, see Letter from the FTC to Ward Crutchfield, Tennessee Senate Majority Leader regarding Senate Bill 855 involving regulation of the practice of Optometry (Apr. 29, 2003), *available at* <http://www.ftc.gov/be/v030009.htm>.

[42] *E.g.*, *FTC v. H.N. Singer*, 668 F.2d 1982 (9th Cir. 1982); *FTC v. Southwest Sunsites*, 665 F.2d 711 (5th Cir. 1982); *FTC v. Kitco of Nevada, Inc.*, 612 F.Supp. 1280 (D. Minn. 1985).

[43] Federal Trade Commission, *Policy Statement on Monetary Equitable Remedies in Competition Cases* (July 25, 2003), *available at* <http://www.ftc.gov/os/2003/07/disgorgementfrn.htm>.

The more important form of osmosis runs from competition to consumer protection policy. Because of its antitrust responsibilities, the agency is well aware that robust competition is the best, single means to protect consumers. Rivalry among incumbent producers, and the threat and fact of entry from new suppliers, fuels the contest to satisfy consumer needs. In competitive markets, firms prosper by surpassing their rivals. In turn, this competitive market has important implications for the design of consumer protection policies to regulate advertising and marketing practices. Without a continual reminder of the benefits of competition, consumer protection programs can impose controls that ultimately may diminish the very competition that increases consumer choice.

Competition principles can help ensure that consumer protection is consistent with consumer sovereignty. They remind us that some consumer protection measures – even those motivated by the best of intentions – can create barriers to entry that limit the freedom of sellers to provide what consumers demand. The Commission recently participated, for example, in a court challenge to a state law that banned anyone other than licensed funeral directors from selling caskets to members of the public over the Internet. While recognizing the state's intent to protect its consumers, the Commission questioned whether the law did more harm than good. In an amicus brief, the FTC noted that "[r]ather than protect[ing] consumers by exposing funeral directors to meaningful competition, the [law] protects funeral directors from facing any competition from third-party casket sellers."[44] The synergy between protecting consumers from

[44] Memorandum of Law of *Amicus Curiae* Federal Trade Commission, *Powers v. Harris*, Case No. CIV-01-445-F (W.D. Okla. Sept. 5, 2002), *available at* <http://www.ftc.gov/os/2002/09/okamicus.pdf>. The district court upheld the state law, and the matter is currently on appeal. *Powers v. Harris*, No. CIV-01-445-F (W.D. Okla. Dec. 12, 2002). *But see Pennsylvania Funeral Directors Ass'n v. FTC*, 41 F.3d 81 (3d Cir. 1994) (noting that forcing consumers to pay the funeral home mark-up on a casket constitutes substantial consumer injury); *Craigmiles v. Giles*, 110 F. Supp.2d 658, 663 (E.D. Tenn. 2000) (overturning state law

fraud or deception without unduly restricting their choices in the market or their ability to obtain truthful information undergirds all of the Commission's consumer protection initiatives today.

F. The Commission's positive agenda

In pursuit of its goal of improved consumer welfare, the Commission has developed a combination of expertise and staff that complements its strengths as an institution. These elements are necessary to the Commission's success, but they are not sufficient. To animate its principles and make the best use of its institutional abilities, a coherent vision of its overall mission must guide the Commission. To draw a simple analogy, consider a manufacturer who has developed a great product prototype through studying what consumers need and has assembled a technologically advanced factory with a highly skilled workforce. That manufacturer still needs a concrete plan to instruct its workers how to take raw materials and, using the factory's tools, fashion them into a product that can be manufactured each day and provided to consumers at the optional price and quality level. For the FTC, its positive agenda is the concrete plan for how its staff, using the Commission's statutory and institutional tools, can effectively transform principles into reality for consumers through its daily actions.

The agency's success, in large part, reflects the shared vision of the agency's role that has evolved for over 20 years through several administrations and Chairmen. Experience with public agencies confirms a vital, often-stated conclusion of academic researchers: no public institution achieves policy success without a coherent strategy for exercising its authority and spending its resources. A key manifestation of an agency's strategy is its positive agenda – a statement of the measures the agency intends to pursue to accomplish its substantive aims. Without a general

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limiting casket sales to funeral directors); *Casket Royale, Inc. v. Mississippi*, 124 F. Supp. 2d 434, 440 (S.D. Miss. 2000) (same).

strategy and a positive agenda, an agency becomes a passive observer, swept along by external developments and temporary exigencies.

A positive agenda also provides essential guidance. For the agency's staff, a positive agenda focuses effort on measures most likely to fulfill the institution's mission. For the business community and other interested parties, a clear statement of intentions reduces uncertainty and facilitates compliance with the law.

The FTC's positive agenda is founded on the principle that the first line of consumer protection is vibrant competition in a strong, working market. In pursuing this agenda, the Commission, through aggressive enforcement and focused advocacy, strives to promote competition and encourage the unfettered exchange of accurate, non-deceptive information. The Commission focuses on stopping conduct that poses the greatest threat to consumer welfare, such as fraud, deceptive advertising, and unilateral breaches of contract, employing a systematic approach for identifying and addressing serious misconduct, with special attention to harmful behavior in key industries. When the Commission did not follow these principles, such as its attempt to prohibit advertising to children, it was perceived as being seriously off course.[45]

The FTC also uses the agency's distinct institutional capabilities through the application of its full range of tools – prosecuting cases, conducting studies, holding hearings and workshops, engaging in advocacy before other government bodies, and educating businesses and consumers – to address competition and consumer protection issues. Beyond the immediate goal of stopping a particular bad practice or promoting a beneficial one, the Commission's activities improve the institutions and processes by which competition and consumer protection policies are formulated and applied.

[45] See Section III B. *infra.*

Of course, prevention of consumer harm is far preferable to enforcement against bad actors, which is expensive and rarely makes injured consumers completely whole. One of the best ways to protect consumers is to arm them with knowledge to protect themselves. Thus, the FTC undertakes extensive consumer education on numerous topics, often working in tandem with other public and private institutions.[46] Prevention is not solely up to consumers and government, however, and business can play an important role.[47]

Two interrelated developments – the accelerated development of communications technology, like the Internet, and the increasing internationalization of commerce – are rapidly expanding opportunities for both consumer benefits and consumer harm. Although the FTC strives to develop new tools to combat emerging harms, the pace of technological change and globalization is outstripping the Commission's ability to cope on its own.[48] Because the agency cannot be everywhere, it is actively encouraging other consumer protection institutions to join in its mission. Thus, the Commission's International Division of Consumer Protection works to

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[46] The gateway site to the FTC's inventory of business and consumer education publications is www.ftc.gov/ftc/consumer.htm. In addition, we have dedicated Web pages for hot topics, including the National Do Not Call Registry (www.donotcall.gov). Examples of publications produced with other entities, both public and private, are: *Looking for the Best Mortgage?, available at* <http://www.ftc.gov/bcp/conline/pubs/homes/bestmorg.pdf>; *Miracle Health Claims, available at* < http://www.ftc.gov/bcp/conline/pubs/health/frdheal.pdf;> *Businessperson's Guide to the Mail and Telephone Order Merchandise Rule, available at* <http://www.ftc.gov/bcp/conline/pubs/buspubs/mailorder.pdf;> and *Telemarketing Travel Fraud, available at*< http://www.ftc.gov/bcp/conline/pubs/tmarkg/trvlfrd.pdf>.

[47] *See, e.g.*, Timothy J. Muris, Chairman, FTC, *Do The Right Thing (Apologies to Spike Lee*), Cable Television Advertising Bureau, N.Y., N.Y. (Feb. 11, 2003) (encouraging publishers and broadcasters to engage in more rigorous screening for obviously deceptive weight loss claims, which harm not only individual consumers but also the perception of the market system overall), *available at* <http://www.ftc.gov/speeches/muris/030211rightthing.htm>.

[48] *See, e.g,* discussion on International Cooperation, *infra.*

ensure that the consumer protection rules around the globe focus on practices that distort consumer choice and raise a serious threat to the proper functioning of markets.

Part of the Commission's positive agenda is thus to increase its effectiveness through cooperation with other institutions at all levels. The FTC has worked with a number of other public and private institutions in the United States to ensure that when taking action, they consider the full range of consumer interests, including the benefits of competition. For example, the FTC staff filed comments with the Food and Drug Administration discussing the value to consumers of truthful advertising,[49] and it has filed numerous comments with the Federal Energy Regulatory Commission on competition and electricity deregulation.[50] The Commission routinely works with state agencies[51] and private associations[52] to advocate on

[49] Comment of the Staff of the Federal Trade Commission to the FDA on First Amendment Issues (Sept. 13, 2002), *available at* <http://www.ftc.gov/os/2002/09/fdatextversion.pdf>.

[50] *See, e.g.*,Comment of the Staff of the Federal Trade Commission, *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design: Wholesale Power Market Platform White Paper*, FERC Dkt. No. RM01-12-000 (June 27, 2003), *available at* <http://www.ftc.gov/os/2003/07/030627ferc.htm>.

[51] *See, e.g.*, Letter from Staff of the Federal Trade Commission to the Louisiana Attorney General (Apr. 1, 2003), *available at* <http://www.ftc.gov/be/v030008.htm>; Letter from Staff of the Federal Trade Commission to the Ohio House of Representatives on House Bill 325: Physician Collective Bargaining (Oct. 16, 2002), *available at* <http://www.ftc.gov/os/2002/10/ohb325.htm>; Letter from Staff of the Federal Trade Commission to the Alaska House of Representatives on Senate Bill 37: Physician Antitrust Immunity (Jan. 18, 2002), *available at* <http://www.ftc.gov/be/v020003.htm>.

[52] *See, e.g.*, Letter from the FTC and the Department of Justice, Comments on the American Bar Association's Proposed Model Definition of the Practice of Law (Dec. 20, 2002), *available at* <http://www.ftc.gov/opa/2002/12/letterstoaba.htm >.

behalf of consumers. It is also trying to make its actions more effective by increased cooperation with criminal authorities.[53]

III. How the FTC Puts these Principles into Action

After this discussion of principles, institutional structure, and a positive agenda, this paper now examines how these attributes take shape through the Commission's consumer protection initiatives. As the agency's top priority is stopping conduct that poses the greatest threat to consumers, it is appropriate to discuss first Commission actions to combat fraud and then consider its advertising enforcement activities, with a special emphasis on actions involving health claims. To illustrate how to use the agency's distinctive institutional capabilities to develop new rules in response to changed situations, the article next discusses FTC initiatives involving privacy and spam. Finally, as examples of how the Commission tries to expand its influence to meet the new challenges of increasing globalization and advances in communications technology, the paper describes the Commission's international outreach and our e-commerce initiative.

A. Fraud

Preventing fraud is a crucial part of the Commission's support of the market system and the common law. Fraud is essentially theft. Fraud, like price fixing, distorts market forces and

[53] The FTC staff frequently assists the Department of Justice and local United States Attorneys' offices in criminal prosecutions. Commission staff attorneys have been cross-designated as a Special Assistant United States Attorneys, pursuant to 28 U.S.C. § 543, to assist several contempt prosecutions as well as other criminal investigations and prosecutions. In addition, the Commission often provides significant investigative assistance. *See* Report to the Commission On Project Scofflaw's First Five Years from the Bureau of Consumer Protection (Jan. 2002), *available at*< http://www.ftc.gov/os/2002/01/projectscofflawreport.pdf>; Comments of the Staff of the FTC to the United States Sentencing Commission on Emergency Amendments to Sentencing Guidelines, Policy Statements and Commentary Implementing the Sarbanes-Oxley Act of 2002 (Dec. 2002), *available at* <http://www.ftc.gov/opa/2002/12/sarganesoxley.htm> .

limits the ability of consumers to make informed choices. Fraud leads to inefficiency, causing consumers to allocate their resources unproductively. Fraud also reduces consumer confidence and reduces the efficacy of legitimate advertising, thereby further diluting the amount of useful information to guide consumers' choices. This effect also raises costs for legitimate competitors, who must offer more assurances of performance to overcome consumers' wariness.

Because fraud is often national in scope, and scarce federal criminal law enforcement resources are primarily used against such matters as drug trafficking and terrorism, fraud will go largely unchecked without the active leadership of the nation's consumer protection agency. Yet, through the 1970s, the Commission essentially ignored fraud cases. Instead, the Commission was engaged in a rulemaking frenzy based on earlier court opinions that appeared to provide almost boundless authority to revamp whole industries based on authority to stop "unfair" practices.

The result was a series of proposed rules relying upon vague theories of unfairness that often had no empirical basis, could be based entirely upon the Commissioners' personal values, and did not have to consider the ultimate *costs* to consumers of foregoing their ability to choose freely in the marketplace.[54] The most prominent example of overreaching under this unfocused authority was a proposal to ban all advertising directed to children on the grounds that it was "immoral, unscrupulous, and unethical" and based on generalized public policies to protect children.[55]

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[54] For a detailed contemporaneous critique, see Timothy J. Muris, *Rules Without Reason: The Case of the FTC*, AEI J. ON GOV. & SOC'Y REG. 20-26 (Sept./Oct. 1982).

[55] *See* FTC STAFF REPORT ON TELEVISION ADVERTISING TO CHILDREN (Feb. 1978); Notice of Proposed Rulemaking on Television Advertising to Children, 43 Fed. Reg. 17,967 (1978). A possible ban was one of three alternative remedies the staff recommended the Commission consider. The other two were a ban limited to advertising of sugared food products thought to pose the most serious dental health risks and requirements that ads for sugared food products be balanced by nutritional or health disclosures funded by the industry. At the same time, Chairman

The breadth, overreaching, and lack of focus in the FTC's ambitious rulemaking agenda outraged many in business, Congress, and the media. Even the Washington Post editorialized that the FTC had become the "National Nanny."[56] Most significantly, these concerns reverberated in Congress. At one point, Congress refused to provide the necessary funding and simply shut down the agency for several days. Entire industries sought exemption from FTC jurisdiction, fortunately without success. So great were the concerns that, after 1980, Congress did not reauthorize the FTC for fourteen years. Thus chastened, the Commission abandoned most of its rulemaking initiatives and re-examined unfairness to develop a focused, injury-based test to evaluate allegedly unfair practices.[57] In short, this rulemaking effort failed because it lost sight of the appropriate role of the Commission.

In stark contrast to the failure of the agency's unfocused 1970s rulemaking agenda, the development of a vibrant anti-fraud program at the FTC in the 1980s is a great success story. Fortunately, the legal tools for such a program already existed. In 1973, Congress had amended

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Pertschuk opined that the Commission could use unfairness, *inter alia*, to regulate the employment of illegal aliens and to punish tax cheats and polluters. Michael Pertschuk, Chairman, FTC, Remarks before the Annual Meeting of the Section on Antitrust and Economic Regulation of the Association of American Law Schools, Atlanta, Ga. (Dec. 27, 1977).

[56] *The FTC as National Nanny*, WASH. POST, Mar. 1, 1978, at A22.

[57] *See* Letter from the FTC to Hon. Wendell Ford and Hon. John Danforth, Committee on Commerce, Science and Transportation, United States Senate, Commission Statement of Policy on the Scope of Consumer Unfairness Jurisdiction (Dec. 17, 1980), *reprinted in International Harvester Co.*, 104 F.T.C. 949, 1070, 1073 (1984) ("Unfairness Policy Statement"); Letter from the FTC to Hon. Bob Packwood and Hon. Bob Kasten, Committee on Commerce, Science and Transportation, United States Senate, *reprinted in* FTC ANTITRUST & TRADE REG. REP. (BNA) 1055, at 568-570 ("Packwood-Kasten letter"); and 15 U.S.C. § 45(n), which codified the FTC's modern approach.

the FTC Act to allow the Commission to sue in federal district court and obtain strong preliminary and permanent injunctive relief – including redress.[58]

The Commission's Bureau of Consumer Protection determined to use this authority to fight fraud. It began by targeting the fraudulent sale of various types of unconventional investments.[59] The double-digit inflation of the period that made traditional investments relatively unattractive propelled these "alternative investment" scams. The first case involved defendants that fraudulently sold $300 million worth of diamonds for investment.[60] Similar actions against boiler rooms selling advisory services for the federal oil and gas lease lottery followed as did actions against the sellers of worthless oil and gas leases themselves. In this early period the Commission brought three cases against sellers of gemstones and five cases involving oil and gas.[61]

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[58] Under the "second proviso" of the new § 13(b), "in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." Trans-Alaska Pipeline Authorization Act, Pub. L. No. 93-153, § 408(f), 87 Stat. 576 (1973) (codified as amended at 15 U.S.C.§ 53(b) (1997)). The statute provides that this authority may be used "whenever the Commission has reason to believe that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the FTC."

[59] Nevertheless, from the beginning of the § 13(b) program, the Commission has used this tool against a wide variety of scams, including real estate equity schemes, *FTC v. Rita A. Walker & Assoc.*, No. 83-2462 (D.D.C. filed Oct. 5, 1983); business opportunity scams, *FTC v. H. N. Singer Inc.*, 668 F.2d 1108 (9th Cir. 1982), *FTC v. Kitco, Inc.*, No. 83-467 (D. Minn. filed Apr. 9, 1983); and travel scams, *FTC v. Paradise Palms Vacation Club*, No. 81-116 (W.D. Wash. filed Sept. 25, 1981).

[60] *FTC v. International Diamond Corp.*, 1983-2 TRADE CAS. (CCH) ¶ 65,725 (N.D. Cal.1983). The Commission previously had pursued administrative cases against unconventional investments. *American Diamond Corp.*, 100 F.T.C. 461 (Sept. 28, 1982) (complaint and consent order).

[61] In these initial consumer protection § 13(b) cases, Commission staff began the practice, still followed today, of working closely with other government agencies, such as the Department of the Interior's Bureau of Land Management, and federal criminal enforcement authorities such as the United States Postal Inspection Service and the Secret Service in developing investigations

Before the shift to federal court, most of the Commission's consumer protection work used its administrative process.[62] Most investigations relied upon voluntary production of requested documents and information from the investigated targets, who had every incentive to delay. This process had obvious drawbacks for addressing fraud. Federal district court cases proved much more effective, enabling the Commission to bring fraudulent schemes to an immediate halt, to take the targets by surprise so that money might be available for redress, and to prevent destruction of records showing the extent of the fraud and identifying injured parties.

Almost from the inception of the § 13(b) program, the Commission has used this tool not only to obtain court orders halting fraudulent schemes, but also to obtain consumer redress and other potent equitable remedies. Very early in the § 13(b) consumer protection cases, the Commission began to seek, as ancillary to issuance of permanent injunctions, provisional remedies such as a freeze of assets, expedited discovery, an accounting, and the appointment of a receiver on the ground that these remedies would insure the effectiveness of any final injunction ordered.[63]

To make the best use of this approach, however, required new investigative techniques geared for speed and stealth. The primary new tool was taping of defendants' sales presentations. It has been a critical technique in many of the Commission's fraud cases. At the same time, the

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and litigating cases. Parallel investigation and prosecution by both the FTC and criminal authorities have remained an important aspect of the Commission's § 13(b) program.

[62] Prior to the amendment that created § 13(b), the Commission occasionally used the pre-existing § 13(a) authority, 15 U.S.C. § 53(a), to seek and the district courts to issue injunctions to stop the dissemination of false advertising pending the issuance of an administrative complaint. *See FTC v. Thomsen-King & Co.*, 109 F.2d 516 (7th Cir. 1940).

[63] *FTC v. H.N. Singer, Inc.* 668 F.2d 1108 (9th Cir. 1982) is a seminal case establishing the Commission's authority to seek, and the district courts' power to grant, all the traditional equitable remedies inherent in the authority granted by § 13(b) to obtain permanent injunctions. *Singer* was the first § 13(b) case to attack a franchise or business opportunity scam.

agency developed a group of professional investigators, trained to uncover fraudulent schemes, determine ownership and control of such schemes, trace assets, develop evidence, preserve evidence for trial, and testify in court. Recently, Commission investigators have become experts in Internet investigative techniques and have provided training for hundreds of local, state, federal, and international criminal and civil law enforcement offices.

Once launched, the fraud program grew in importance and success. Each succeeding FTC Chairman has expanded its scope and improved its operation. During the 1990s in particular, the agency formed strong, working relationships with state and local law enforcement agencies, leading sweeps against targeted types of fraud, thereby greatly increasing the program's effectiveness. During the late 1990s, the program matured under the strong leadership of Chairman Robert Pitofsky and Bureau Director Jodie Bernstein into the flagship of the Commission's consumer protection program. From fiscal year 1983 until fiscal year 1995 - the first full 13 years that the Commission filed § 13(b) actions – the average number brought was 23 per fiscal year. During the Pitofsky-Bernstein years, that average skyrocketed to 71 filings per fiscal year. Not surprisingly, as the number of filings increased, so has the amount of consumer redress awarded. In fiscal year 2001, for example, the redress ordered was more than $250 million. In fiscal year 2003, nearly $873 million in consumer redress was ordered in 98 judgments.

The Commission's ability to protect consumers from these scams was aided immeasurably by the creation of the Consumer Response Center (CRC) – a central facility with trained call center staff and an automated call distribution system to record and respond to consumer complaints and inquiries. The existing telemarketing fraud complaint database, in operation since

the early 1990s, was dramatically upgraded and revamped into Consumer Sentinel, a system linking law enforcers through a secure Internet web site. The Consumer Sentinel system enabled the CRC staff to enter data from consumer complaint calls in real time. Initially scores, and ultimately hundreds, of law enforcement agencies at the state, federal, and local levels joined the system, gaining access to the complaint database, as well as the opportunity to "cross-walk" their own complaint data into the Consumer Sentinel database. Other entities, such as local Better Business Bureaus, also were invited to contribute complaint data to the Sentinel database. Consumer Sentinel strengthened the fraud program by improving the staff's ability to spot emerging trends, to identify emerging bad actors more quickly, and to locate potential witnesses to support the Commission's cases.

Of course, any program, no matter how good, can be improved. To ensure that the Commission is using its database to its maximum potential, it has for the first time undertaken national surveys of fraud victims. This information is vitalto assess the significance of complaints the FTC receives, and more importantly, of complaints it does not receive. In addition, it is likely that only an increased threat of criminal prosecution will deter some hardcore scam artists. The Commission continues to work hard to develop relationships with criminal law enforcement authorities to encourage the prosecution of the worst actors. This includes working with the Office of Criminal Litigation at the Department of Justice to determine the best cases for criminal prosecution, as well as developing staff-level relationships with Assistant United States Attorneys across the country to help them prosecute fraud that occurs in their back yards.[64] Many

[64] For example, the Commission works closely with the Department of Justice, and directly with United States Attorneys, to develop criminal cases against fraudulent telemarketers after we obtain preliminary relief, including access to the premises and asset freezes. *See, e.g., FTC v. First Credit Alliance*, Civ. Dkt. No. 3:00CV1049 (D.Conn. Dec. 5, 2001) (final settlement) (principal indicted by the Connecticut U.S. Attorney's office); *FTC v. North American*

of the fraud cases the Commission brings are criminal theft and involve wire fraud, mail fraud, money laundering, or all three. The Commission has had tremendous success, but is constantly working to improve relationships and processes to increase the number of criminal prosecutions.[65] The challenge is to use limited prosecutorial resources efficiently; improving this aspect of the fraud program is a high priority.

B. Advertising[66]

As discussed above, the prevention of deceptive advertising helps consumers both by deterring individual deceptive sellers and by making it easier for honest sellers to make credible product claims. While the Commission has had a substantial national advertising program since the agency's creation in 1914, it became a central focus of the agency's consumer protection mission in the 1970's. The Commission continues to maintain an active program, adjusted to reflect the plethora of new advertising methods, such as infomercials, telemarketing, and the Internet.[67]

Charitable Services, Civ. Dkt. No. SACV 98-968-DOC (C.D.Calif. May 15, 2003) (final settlement) (principals Mitch Gold and J.P. Cohen were prosecuted by the U.S. Attorney's office for the Central District of California, plead guilty, and were sentenced to eight and three years, respectively).

[65] For example, our Internet training program has helped create relationships with local, state, and federal prosecutors around the country, and has led directly to criminal prosecution of Internet fraud. In April, our joint crackdown on Internet auction fraud with the National Association of Attorneys General included fifteen criminal actions. *See* <http://www.ftc.gov/opa/2003/04/bidderbeware.htm>.

[66] The previous section discussed FTC enforcement actions against sellers engaged in fraud. In contrast, this section discusses the Commission's enforcement actions against sellers who normally do not make deceptive claims and whose products normally are reputable. For short hand, the FTC refers to its law enforcement activities related to such sellers as its "national advertising program."

[67] *See, e.g., Kent & Spiegel Direct, Inc.*, 124 F.T.C. 300 (1997) (infomercial);

Advertising illustrates the intertwined nature of competition and consumer protection issues. Advertising can be a visible manifestation of competition among sellers. Claims in advertising also constitute legally enforceable promises made by sellers to buyers regarding certain product attributes. Comparative advertising provides a clear example of how advertising can implicate both competition and consumer protection issues. A company engages in comparative advertising when it claims that its own product is superior in price or other attributes to the products of its competitors,*e.g.* , "A is 10% cheaper than B," or "Brand X has fewer calories than Brand Y." Up until the late 1970s, many trade associations prohibited or discouraged the use of comparative advertising. In 1979, after conducting an extensive study, the Commission concluded that:

> Comparative advertising, when truthful and non-deceptive, is a source of important information to consumers and assists them in making rational purchasing decisions. Comparative advertising encourages product improvement and innovation, and can lead to lower prices in the marketplace.[68]

Because truthful comparative advertising has such a positive effect on competition and consumers, the Commission announced that the agency "will continue to scrutinize carefully restrictions upon [comparative advertising's] use."[69] Most trade associations no longer impose limits on comparative advertising.

Unduly expansive principles of deception can impede the vigorous competition that comparative advertising usually provides. For example, several decades ago, the Commission in

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FTC v. Lane-Labs-USA, Inc., No. 00 Civ. 3174 (D.N.J. June 28, 2000) (stipulated final order) (Internet); Telemarketing and Consumer Fraud and Abuse Prevention Act of 1994, 15 U.S.C. § 6101 *et seq*.

[68] FTC Policy Statement in Regard to Comparative Advertising, 16 C.F.R. § 14.15(b) (2003); *see also* R. Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising,* 90 HARV. L. REV. 661, 671 (1977) (discussing the advantages to consumers and competition that flow from comparative advertising).

69FTC Policy Statement in Regard to Comparative Advertising, 16 C.F.R. § 14.15(b) (2003)

Kroger[70] challenged a grocery store that in newspaper advertisements truthfully compared its prices for specific grocery store items to those of a competing grocery chain. Applying the standard that claims are deceptive if they have the "tendency and capacity to deceive," the Commission concluded that these claims were deceptive, because they were not based on "methodologically sound" and "statistically projectible" surveys showing that the advertised price difference applied to all products sold in the two grocery chains. The Commission did not rely on any survey evidence to support its conclusion, but instead relied simply on intuition. Fortunately, this case and other cases like it[71] led the FTC in 1983 to issue its Deception Policy Statement, replacing its outmoded "tendency or capacity to deceive" standard with the "reasonable consumer" standard. This change helped circumscribe the Commission's concept of deception, thereby diminishing the agency's ability to chill comparative advertising.

Because truthful and non-misleading advertising is critical for competition, the Commission also has been vigilant to prevent overly broad private and government restrictions on such advertising. During the 1970s, for example, the Commission mounted a precedent-setting challenge to the American Medical Association's prohibition on physician advertising.[72]

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[70] *The Kroger Co.*, 98 F.T.C. 639 (1981), *order modified*, 100 F.T.C. 573 (1982).

[71] Some courts likewise were wary of blessing overly broad deception principles in Commission cases. For example, in *Standard Oil Co. v. FTC*, the Commission had concluded that consumers took away from an ad depicting clear automobile exhaust in a bag the claim that the gasoline used had removed "all harmful emissions from automobile exhaust." 577 F. 2d 653, 657 (9th Cir. 1978). On appeal, the Ninth Circuit, in an opinion by Judge, now-Justice, Kennedy, rejected the FTC's claim interpretation, explaining that "neither the courts nor the Commission should freely speculate that the viewing public will place a patently absurd interpretation on an advertisement. . . . We do not think that any television viewer would have a level of credulity so primitive that he could expect to breathe fresh air if he stuck his head into a bag inflated by exhaust, no matter how clean it looked." *Id*. at 657.

[72] *American Medical Association*, 94 F.T.C. 701, 993-96 (1979), *enforced as modified*, 638 F. 2d 443 (2d Cir. 1980), *aff'd per curiam by an equally divided court*, 455 U.S. 676 (1982).

Similarly, the agency frequently has criticized limitations that states have imposed or considered imposing on attorney advertising.[73]

The Commission similarly has been careful about the support it requires for claims under its advertising substantiation doctrine. The doctrine, created in the 1970s, requires that all objective claims have a "reasonable basis" before the claim is distributed, and it has its genesis in fundamental deception principles. If an advertisement makes an express or implied representation about the particular level of support for a claim, (*e.g.*, "clinical tests prove our supplement reduces the risk of colds"), then consumers expect the advertiser to have that amount of support and are deceived if it does not. On the other hand, if an advertisement does not make any representation about the support for an objective claim, consumers expect that the advertiser has a "reasonable basis" for the claim and are deceived if it does not.[74]

As applied in recent years, the doctrine provides sellers with substantial discretion in developing and making advertising claims.[75] It does not set substantive standards (*i.e.*, claims about "x" product must be supported by "y" tests), but instead takes a flexible approach, looking to the actual claim made by the advertisement (I have "x" support for my product) or to a series of

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[73] *See, e.g.*, Letter from Staff of the Federal Trade Commission to the Clerk of the Alabama Supreme Court (Sept. 30, 2002), *available at* <http://www.ftc.gov/be/v020023.pdf>. The Alabama Supreme Court ultimately rejected proposed restrictions on truthful attorney advertising in 2003. *See also* Submission of the Staff of the Federal Trade Commission to the American Bar Association Commission on Attorney Advertising, Wash., D.C. (June 24, 1994).

[74] *Thompson Medical Co.*, 104 F.T.C. 648, 813 n. 37 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1086 (1987).

[75] *See, e.g.*, *Novartis Corp. v. FTC*, 223 F.3d 783 (D.C. Cir. 2000) (unsubstantiated claims for over-the-counter-drug), *Unither, Inc.*, Dkt. No. C-4089 (July 29, 2003) (unsubstantiated claims for dietary supplement) (consent order); *Interstate Bakeries Corp.*, Dkt. No. C-4043 (Apr. 19, 2002) (unsubstantiated claims for food) (consent order).

seven flexible factors to determine whether the claim had a "reasonable" basis".[76] These factors include consideration of the benefits of a truthful claim and the costs of a false or misleading claim, thus expressly balancing the goal of preventing deception with the need to ensure access to truthful information and vigorous competition.[77]

C. Health Claims

An important part of the Commission's program to regulate advertising involves health claims. Products making such claims are prime examples of credence goods because of the difficulty in measuring the efficacy of a particular food in preventing any specific disease. Allowing such claims if truthful and non-misleading, however, has important informational benefits for consumers and helps consumers make better-informed food choices.[78] It also benefits competition by spurring food marketers to develop and market foods based on their health attributes. The evolution of the Commission's treatment of such claims is an especially good example of the importance of pursuing an unified approach that respects the value of truthful advertising to both consumers and competition.

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[76] FTC Policy Statement Regarding Advertising Substantiation, 49 Fed. Reg. 31000, 31000 (Aug. 2, 1984) ("The Commission's determination of what constitutes a reasonable basis depends, as it does in an unfairness analysis, on a number of factors relevant to the benefits and costs of substantiating a particular claim."); *see Pfizer*, 81 F.T.C. 23, 64 (1972).

[77] FTC Policy Statement Regarding Advertising Substantiation, 49 Fed. Reg. at 31000; *see also* JOHN E. CALFEE & JANIS K. PAPPALARDO, FTC BUREAU OF ECONOMICS, HOW SHOULD HEALTH CLAIMS FOR FOODS BE REGULATED? AN ECONOMIC PERSPECTIVE, ECONOMICS ISSUES PAPER 35 (1989).

[78] *See* Comment of the Staff of the FTC before the Department of Health and Human Services Food and Drug Administration, In the Matter of Food Labeling: Health Claims; Dietary Guidance, *Docket No. 2003-0496* (Jan. 2004), *available at* <http://www.ftc.gov/os/2004/040126fdacomments.pdf>.

"Health claims" for food contend that eating more or less of particular foods can lower the risk of chronic diseases like cancer, heart disease, and diabetes. There is strong, developing, and continuously-changing scientific evidence concerning the relationship between specific foods and the risk of disease. Most of these studies examine the role of overall diet on health. Diets, of course, are comprised of individual foods, and healthy diets reflect individual food choices. Because the effects of a particular food on disease risk are difficult to study, however, claims for individual foods have long been a flash point for advertising and labeling policies. Food regulatory agencies both in the United States and elsewhere have followed a variety of approaches, including prohibiting these claims in the name of protecting consumers from deception. Even the Federal Trade Commission in the 1970s flirted with the idea of a ban before shelving staff proposals to do so.[79]

FTC staff economists have conducted empirical studies on the effects of these different approaches. One particularly important study looked at sales of high fiber cereal before and after the landmark National Cancer Institute/Kellogg's "All Bran" fiber advertising in the 1980s.[80] Because that campaign occurred when such claims were technically impermissible under FDA

[79] In 1974, the Commission commenced an industry-wide rulemaking that would have banned all diet-disease claims as inherently deceptive. The Presiding Officer in 1978 recommended that the agency at least allow a fatty acid and heart disease claim. In 1980, the FTC voted to terminate most of this rulemaking to focus on case-by-case law enforcement, except that it decided to continue that part of its rulemaking concerning the fatty acid and heart disease claim. In 1982, the Commission discontinued its rulemaking entirely in favor of a case-by-case approach to health claims.

[80] PAULINE M. IPPOLITO & ALAN D. MATHIOS, FTC STAFF REPORT, HEALTH CLAIMS IN ADVERTISING AND LABELING: A STUDY OF THE CEREAL MARKET (1989); *see also Information, Advertising and Health Choices: A Study of the Cereal Market*, 21 RAND J. OF ECONS. 459-80 (Autumn 1990).

regulations, it offered a unique opportunity to compare the effects of advertising against other efforts – such as government information programs to alert consumers to the same information.

The study looked at Kellogg's 1984 campaign claiming that All Bran cereal was high in fiber and that diets high in fiber could reduce the risk of cancer. By 1987, three years after these claims began appearing in the marketplace, the study found that consumers had substantially increased consumption of high-fiber cereals. The greatest increase occurred among consumers who had previously consumed the least amount of high-fiber cereal. Most significant is that consumption of high-fiber cereals increased the most among the least advantaged consumers. Thus, the study demonstrated that truthful advertising can efficiently spread information widely.

Fiber-cancer health claims changed the cereal market, too. Competing cereal manufacturers responded to Kellogg's health claim by making similar health claims for their own high-fiber cereals. The market share for high-fiber cereals increased by almost four percentage points, sales of high-fiber cereals increased by $280 million, and more high-fiber cereal products were introduced.

These and other analyses from the Commission's Bureau of Economics make a powerful case for the role of advertising in helping consumers improve their health. They underscore the wisdom of the Commission's balanced approach that seeks vigorously to protect consumers from deception, while allowing them to benefit from the dissemination of truthful and non-misleading health information.

Other studies demonstrate that government regulatory policies directly impact the amount of helpful nutrition information available to consumers in advertising. For example, in 1990, Congress passed the Nutrition Labeling and Education Act ("NLEA"), which requires food

companies to petition the FDA for approval prior to making health claims on labels. The NLEA also states that the FDA cannot approve such a petition unless "significant scientific agreement" among experts supports the claim.

A recent study by the FTC's Bureau of Economics examined a sample of 11,647 food advertisements that appeared in eight leading magazines between 1977 and 1997.[81] The sample revealed that heart disease and serum cholesterol health claims peaked in 1989, and then dropped substantially in the early 1990's following the NLEA's passage. Likewise, following the NLEA, advertisements for fats and oils no longer make claims about the health reasons to choose one fat over another. The FTC study concluded that experience under the NLEA supports the hypothesis that the law and its implementing regulations decreased health claims in food advertising.

Of course, the NLEA has led to important benefits. The NLEA's nutrition labeling information box is widely and appropriately recognized as one of the most helpful nutrition regulatory actions ever. But the FTC's enforcement experience and empirical studies clearly show that following a more market-oriented approach will best serve the goal of providing consumer access to truthful and non-misleading health information. Fortunately, the FDA's Commissioner, Dr. Mark McClellan, has seized the opportunity to adopt this approach. His Consumer Health Information for Better Nutrition Initiative will continue to protect consumers, but also allow them to receive more, truthful health information about foods and dietary supplements.[82]

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[81] PAULINE M. IPPOLITO & JANIS K. PAPPALARDO, FTC BUREAU OF ECONOMICS STAFF REPORT, ADVERTISING NUTRITION & HEALTH, EVIDENCE FROM FOOD ADVERTISING 1977-1997 (Sept. 2002).

[82] *See* Announcement of FDA Task Force Report on Consumer Health Information Initiative (July 10, 2003), *available at* <http://www.ftc.gov/os/2003/07/diethealthstmnt.html>.

Under the Initiative, the FDA will determine the level of science supporting all proposed health claims. The agency will place each proposed health claim into a category based on the level of supporting science. Companies can make the proposed health claim if they include the qualifying language that the FDA has developed for claims within the category. Companies thus will have greater freedom to make health claims if they are properly qualified to describe the amount of supporting science.[83]

This change may sound simply technical, but it can have a large impact. For example, there is accumulating evidence on the relationship between foods high in Omega 3 fatty acids – like certain types of fish – and the reduced risk of heart disease. Based on this evidence, the American Heart Association has recommended that consumers eat more foods rich in these acids. Under the FDA's old approach to health claims, food manufacturers had to wait until all the evidence on this relationship was proven beyond a reasonable doubt. They were prohibited from sharing emerging evidence about the benefits of Omega 3 fatty acids in reducing the risk of heart disease. The old approach ensured certainty, but at the cost of delay in getting important health information to consumers. The new approach will be a bit less definitive, yet it will get relevant health information to consumers far more quickly, allowing Americans to make better-informed choices sooner about what to eat.

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[83] The FDA has solicited public comment on whether to make permanent the approach it adopted in the Initiative. In the Matter of Food Labeling: Health Claims; Dietary Guidance, 68 Fed. Reg. 66040 (Nov. 25, 2003). FTC Staff filed a comment stating that it finds this approach acceptable because it appears to recognize the importance of protecting consumers from deception, promoting truthful, non-misleading commercial speech, and ensuring flexibility in accommodating changes in science. Comment of the Staff of the FTC before the Department of Health and Human Services Food and Drug Administration, In the Matter of Food Labeling: Health Claims; Dietary Guidance, *Docket No. 2003-0496* (Jan. 2004), *available at* <http://www.ftc.gov/os/2004/040126fdacomments.pdf>.

Of course, greater access to health information only benefits consumers if it is true and non-misleading. Deception is unlikely to increase under the Initiative, however. First, the FDA must still *pre-approve* all health claims for foods and dietary supplements. Second, the FDA and the FTC have been increasingly coordinating their law enforcement efforts. In December 2002, the two agencies committed to cracking down on fraudulent health claims for dietary supplements and other products. Since December of 2002, the FTC has filed or resolved 17 enforcement actions involving false or misleading advertising claims for dietary supplements and other devices and therapies. These were not small sellers; the estimated sales for these products exceeded $1 billion. With these actions, the Commission is proclaiming that it will not allow deception to increase with the greater freedom to make health claims under the FDA Initiative.

D. Privacy

Fueled by the development of the Internet, privacy emerged as a major consumer issue in the mid 1990s. Most observers wanted to do *something* to protect privacy. *What* to do was less clear.

The debate over privacy showed clearly the importance of relying on strong principles to guide an institution like the FTC through new territory. Grappling with the issues surrounding privacy required careful consideration of the basic questions of common law – why should the government protect privacy and what role should the government play in defining and enforcing privacy rules for private exchange? Strong principles were needed to ensure that if the Commission went beyond enforcing a particular contract provision to provide new "rules of the game" that it develop those rules based on a deep understanding of the issues and an appreciation

of the possible harm if the new rules restricted the many consumer benefits that an information-based economy offers.

By June 2001, the agency had spent several years developing a sophisticated understanding of the issuesthrough conferences and workshops. Industry, spurred by consumer interests and the Commission's activity, had begun addressing consumers' concerns, especially by posting privacy policies on commercial web sites. At that time many policy makers equated support for privacy protection as support for "notice, access, and choice" legislation on the Internet.[84] Treating the same information collected from the same consumer differently depending on whether it was collected online or off was not grounded in coherent consumer protection policies, and it would certainly place online businesses at a competitive disadvantage for no apparent reason.

1. The Inadequacy of "Fair Information Practices"

Fair Information Practices or "FIPs" appears to be an appealing model because it is seemingly based on consumer consent, on contracts between consumers and businesses. In practice, however, consent is illusory. For most consumers, the costs of exercising choice – although not high – are not worth the perceived benefits. Consider the billions of privacy notices

[84] In its 1998 Report, PRIVACY ONLINE: A REPORT TO CONGRESS, the FTC summarized widely-accepted principles regarding the collection, use, and dissemination of personal information, known as Fair Information Practices (FIPs): (1) **notice**: data collectors must disclose their information practices before collecting personal information from consumers; (2) **choice**: consumers must be given options about how personal information collected from them may be used for purposes beyond those for which the information was provided; (3) **access**: consumers should be able to view and contest the accuracy and completeness of data collected about them; and (4) **security**: data collectors must take reasonable steps to assure that information collected from consumers is accurate and secure from unauthorized use. The report also identified **enforcement** – the use of a reliable mechanism to impose sanctions for noncompliance with these fair information practices – as a critical ingredient in any governmental or self-regulatory program to ensure privacy online. *See* PRIVACY ONLINE: A REPORT TO CONGRESS (June 1998), *available at* <http://www.ftc.gov/reports/privacy3/priv-23.htm>.

sent to consumers under Gramm Leach Bliley.[85] Very few have exercised their right to opt-out of information sharing. Part of the problem, no doubt, is the difficulty of understanding some of the notices, which can undoubtedly be improved. A more fundamental problem exists, however. Exercising just one opportunity to opt-out may take a consumer only a few minutes, but opting out for each of the companies with which a consumers does business with would take much longer. Given that time is scarce and even reading the notice takes effort that could be spent elsewhere, it is not surprising that few consumers opt-out, even when it is seemingly easy.

Nor is opt-in the solution. Because most consumers will not expend the time and effort to consider the choice, opt-in is only the correct default if most fully-informed consumers would refuse to share information. Explaining the benefits and costs of information sharing is beyond the competence of even the best drafted short notices. One cannot *make* people focus on this, or any other, issue. Moreover, many of the benefits of information sharing are beneficial externalities, in that they are absorbed into larger models of risk analysis, insurance actuarial information, and the like. Thus, each individual, if given the choice, might prefer to free ride, gaining the benefit of these more accurate risk models while refusing to participate.

Thus, the FIPs model has fundamental problems. Because considering the choice imposes costs apparently in excess of the benefits for many consumers, applying the model would not reveal consumer preferences. Moreover, legislation codifying the principles runs the risk of unnecessarily hobbling development of the many benefits that an information-based economy

[85] Gramm Leach Bliley Act, 15 U.S.C. § 682 et seq. (2001).

could offer consumers.[86] It is hard to describe in advance technology or beneficial information uses that have not been invented or even considered.

2. New Framework

a. The Information Economy

An efficient model of information sharing balances the benefits of information sharing with the costs. Surveys indicate that consumers are troubled by the seemingly excessive amount of information collection by on-line businesses[87] At the same time, consumers willingly part with personal information every day to facilitate transactions. For example, few consumers seem worried about the many companies that have to share their information to clear checks or, for that matter, to process ATM transactions. They generally understand that the information must be collected and shared to complete the transaction. Indeed, surveys reveal that most Americans are

[86] Implementing Fair Information Practices can itself require difficult distinctions. In the FTC's Info Flows workshop, discussed more fully in Section IV below, a Senior Vice President of an international hotel company stated that a caller in Germany who wishes to make a reservation for a hotel in Washington, D.C., would probably call a reservation center in Amsterdam, which would use a computer data center in Georgia to make the reservation. The company might be pulling data from other countries as well. He noted that under the European opt-in privacy model, his company must go to great lengths to disclose to consumers that their reservation information will be transferred overseas to be processed by a computer in Atlanta. He stated that this is very costly in the aggregate, even if it only adds 5 to 10 seconds to each call and that consumers do not find this information helpful and may even find it confusing or annoying. Of course, a sensitive application of FIPs leads to the conclusion that notice and choice are unnecessary in this context. But if one makes an exception here, why not elsewhere? This example, and many others like it, illustrate the difficulty of making reasonable distinctions when applying FIPs in practice.

[87] That concern has been expressed in many public opinion polls. *See e.g.*, Alan F. Westin/Harris Interactive, *Privacy On and Off the Internet: What Consumers Want* (Nov. 2001); IBM/Harris Interactive, *Multi-National Consumer Privacy Survey* (Oct. 1999); Lorrie Faith Cranor et al., *Beyond Concern: Understanding Net Users' Attitudes About Online Privacy*, AT&T Labs-Research Technical Report TR 99.4.1 (Mar. 1999).

"privacy pragmatists," who care about privacy but are willing to share information when they see tangible benefits and they believe care is taken to protect that information.[88]

The American economy generates an enormous amount of data, mostly used by honest businesses for purposes that benefit consumers. One example that was influential in forming the FTC's alternative approach to privacy is the nation's credit reporting system. The agency has longstanding familiarity with this system through its enforcement of the nation's oldest commercial privacy law, the 1970 Fair Credit Reporting Act (FCRA).

One often takes for granted the fact that the average American today enjoys access to credit and financial services, shopping choices, and educational resources that earlier Americans could never have imagined. Today, consumers can check credit card and bank balances over the phone 24 hours a day; order books, clothes, or gifts online anytime; or review finances in a convenient, consolidated statement whenever it is convenient. All over America, every day consumers who have good credit can borrow $10,000 or more from a complete stranger and actually drive away in a new car in an hour or less. This "miracle of instant credit" has revolutionized the consumer economy.

This "miracle" is only possible because of our credit reporting system. The system works because, without consumer consent, very sensitive information about consumers' credit history is given to the credit reporting agencies. If FIPs were used, requiring notice and choice, consumers could then decide – on a creditor-by creditor basis – whether they wanted their information

[88] According to the March 2003 Westin/Harris Interactive poll, 64% of adults polled are "privacy pragmatists" who are often willing to permit the use of their personal information if they are given a rationale and tangible benefits for such use and if they sense that safeguards are in place to prevent the misuse of their information. *See* <http://www.harrisinteractive.com/harris_poll/index.asp?PID=365>. In a notice and choice system, however, most of these consumers are unlikely to take the time and effort in individual transactions to understand the benefits and costs of a specific sharing of information.

reported. Many consumers would not bother to exercise choice. Consumers with poor credit would have an incentive to withhold the sharing of negative information. The current system would collapse, and with it, enormous benefits to consumers. The lack of choice does not mean consumers' privacy is unprotected. Because credit histories are one of our most sensitive pieces of information, their use is, and should be, carefully protected under the FCRA.[89]

b. Focus on the Misuse of Consumer Information

Consumers benefit from legitimate uses of information; such uses do not cause their privacy concerns. Consumers are concerned, however, that information, once collected, may be misused to harm them or disrupt their daily lives. It is these adverse consequences that drive consumer concerns about privacy.

Thus, the most important objective of a privacy agenda should be *stopping* practices that can harm consumers. These include *physical harm*: certainly, parents do not want information on the whereabouts of their kids to be freely available. The misuse of information also can cause *economic harm.* Such harm includes denial of credit – or even a job – based on inaccurate or incomplete information. In extreme cases, the misuse of information also can lead to identity theft, our top consumer complaint category for three years in a row. Finally, the misuse of information can cause *annoying, irritating, and unwanted intrusions* in daily lives. These include the unwanted phone calls that disrupt the dinner or the "spam" that clogs our computers.

Focusing on the harms that occur when information is misused or inaccurate, rather than on notice and choice about whether the information can be collected or used at all, is a more workable approach. Concentrating on harm reflects what troubles consumers the most, while not

[89] 15 U.S.C. § 1681 *et seq.* The FCRA privacy protections are discussed in Section 3.e., *infra.*

unduly restricting the free flow of information that benefits our economy. It also imposes costs on harmful practices and the companies who use them, rather than raising the expenses of everyone engaged in commerce.

c. Explicit Recognition of Trade-Offs

Targeting practices that involve misuse of consumer information also recognizes the trade-offs inherent in any regulation designed to protect consumer privacy. Privacy is not, nor can it ever can be, an absolute right. Everyday consumers make practical compromises between privacy and other desirable goals – like having our briefcase or backpack inspected at the airport or before entering a building or a sports arena. These trade-offs exist in the commercial sphere as well – where information-sharing poses risks, but also offers benefits. Like the FTC's approach to protecting consumers from deceptive advertising, our privacy agenda seeks both strong protection of privacy *and* preservation of the important benefits of our information economy. Ignoring the reality of trade-offs does not make them go away, it just makes it more difficult to craft coherent public policy.

Focusing on a principled consumer protection policy also brings into question the FTC's previous primary emphasis on addressing consumers' concerns about *online* data collection. If the concern is reducing the adverse consequences that can occur when information is misused, then it does not matter whether information is originally collected online or offline. It simply matters if it is misused. The risk of identity theft, for example, is no less real and the consequences no different if a thief steals a consumer's credit card number from a website or from the mailbox in front of the consumer's house. Equal treatment of information collected online or off provides better protection for consumers. Moreover, an equal playing field for online and offline businesses is also less likely to impede continuing growth and development of Internet commerce.

3. Implementation of an FTC Privacy Program Based on Principles

For two years, the FTC has implemented these principles through a variety of privacy initiatives. To achieve its goals, in each of the past two fiscal years, the Commission has increased significantly the agency resources devoted to privacy. In Fiscal Year 2002, it increased staff hours devoted to privacy issues by 60 percent. Compared to 2001, the agency now spends several times more of its resources on protecting consumer privacy.

a. National Do Not Call Registry

Perhaps the clearest illustration of the benefits of this approach is the Commission's "Do Not Call" rulemaking. It is no secret that intrusive phone calls that disrupt dinner and other increasingly scarce family time are a major annoyance to many. Not surprisingly, the response to the FTC's National Do Not Call Registry has been overwhelming: consumers have registered more than 57 million telephone numbers.

One possible approach to this problem would be a complicated system of notice and choice about the collection and use of consumers' telephone numbers. This approach has severe limitations. As the FTC's experience under the Gramm-Leach-Bliley Act demonstrates, it is expensive to implement. If the consumer even once gives permission to share his phone number, all prior efforts may be undone. In any event, given the widespread availability of telephone numbers, the approach is also likely to be ineffective.

In contrast, the approach encapsulated in the Commission's rule is simple and straightforward. It creates a default rule that consumers can continue to receive telemarketing calls unless they register. But it also gives consumer a way to reallocate this default rule with low transaction costs. It allows consumers themselves to decide whether they want to receive these calls at home.[90] As noted above, the Commission strives to protect consumer choice by ensuring that such choice is not restricted or distorted before it is made or disregarded once it is expressed. The rule's real effect is not to supplant consumer choice but to provide each consumer an effective vehicle for expressing his or her choice. Thus, this rule provides a clear example of the Commission using its basic principles to guide its actions.

The Do Not Call rule's "business relationship" exception ensures that the rule does not sweep too broadly.[91] The retention of the rule provisions allowing consumers to

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[90] This approach also reduces the transaction costs for consumers by making it easier to express their preferences about receiving telemarketing calls. *See* R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. at 15-16.

[91] One example of the exception's benefits is for consumers who subscribe to a magazine and also register for the National Do Not Call Registry. When the subscription is about to end, the telemarketer for the magazine can call the consumer and ask if she wants to renew without violating the Do Not Call provision of the Telemarketing Sales

"opt out" of future calls from any individual company ensures consumers control over even those calls. Most significantly, in contrast to the Gramm-Leach-Bliley notice approach that has been estimated to have *direct costs* of as much as $1.25 billion[92], the Commission's Do Not Call rule has direct costs of only a small fraction of that amount.

The Do Not Call rule also illustrates the positive role that a centralized administrative agency can play. In theory, one could arrive at a similar point through private contracts and market exchanges. But this would require significant transaction costs because telemarketing calls come from all 50 states and from thousands of marketers and each state or each telemarketer may have a different system for allowing consumers to opt-out of such calls. Even with centralized lists, there was no requirement that any marketer adhere to the list. Clearly, it would be very difficult for a consumer to express his or her preference to each marketer.

b. Identity Theft

The FTC has established other privacy priorities using the same approach. Identity theft is a most serious form of misuse. The agency addresses this problem with three main components: an Identity Theft Data Clearinghouse (the "Clearinghouse"); consumer education and assistance resources, including a toll-free hotline, web site, and

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Rule. For consumers who desire to renew but ignore mail requests, this phone call is beneficial.

[92] *See* <http://www.cei.org/gencon/004,01724.cfm>. This article estimates that, on average, each of the 103 million U.S. households will receive 30 to 50 privacy notices, resulting in the generation of 3 to 5 billion notices annually. At a cost of 25 cents to prepare, print, and mail the notice as an insert with a customer statement, the annual price will range between $750 million and $1.25 billion. The article notes that these estimates do not include customer service and other administrative expenses – for example, the cost of adding paper inventory, rewriting software, printing, processing, postage and handling, adjusting operating machinery, and customer service.

educational brochures; and collaborative and outreach efforts with law enforcement and private industry.

The FTC's primary role in combating identity theft derives from the 1998 Identity Theft Assumption and Deterrence Act ("the Identity Theft Act" or "the Act").[93] The Act directed the Commission to establish the federal government's central repository for identity theft complaints and to provide victim assistance and consumer education. The Commission also works extensively with industry to help victims, including providing direct advice and assistance when information has been compromised. The agency has committed significant resources to assisting law enforcement. Investigation and prosecution not only stop the offender from destroying another person's financial well being, but also can deter would-be identity thieves from committing the crime. Moreover, as discussed below, the Commission can take enforcement action when companies fail to take adequate security precautions to protect consumers' personal information.

c. Enforcing Privacy Promises

Another serious form of misuse is collecting information under false pretenses or misrepresenting the purposes for which the information was collected, practices that clearly thwart consumer choice. The Commission has undertaken aggressive enforcement against companies who violate promises they make about privacy, with a particular focus on promises made about the security provided for consumer information. Here, again, the FTC focuses on misuses of information that causes adverse consequences – in this case, the use of information for purposes different from those

[93] Pub. L. No. 105-318, 112 Stat. 3007 (1998) (codified at 18 U.S.C. § 1028).

consumers bargained for or in a manner that creates unreasonable risks that information will be misused. This focus on adverse consequences also makes the agency particularly concerned about misuses of sensitive information – for example, credit card and social security numbers, medical data, and information about children.

Ensuring information security is a particular priority at the agency; poor security practices put consumer information at risk and can ultimately lead to identity theft or other serious misuses of information. The Commission has thus far brought three cases challenging promises companies made about the security provided for consumer information – against *Eli Lilly*,[94] *Microsoft*,[95] and *Guess*.[96] Each case involved the failure to implement reasonable security procedures to protect sensitive information, despite promises to the contrary. *Lilly* involved information about consumers' health. *Microsoft* and *Guess* involved credit card numbers, and *Microsoft* also involved personal information about children.

The Commission is not simply condemning all security breaches. While a breach may indicate a problem with a company's security, breaches can happen even when a company has taken every reasonable precaution. In such instances, the breach will not violate the laws that the FTC enforces. Instead, the Commission recognizes that security is a process of using reasonable and appropriate measures given the circumstances.

In the FTC's first two offline privacy cases, it also challenged claims about how information collected from children – through surveys administered at schools – would

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[94] *Eli Lilly & Co.*, Dkt. No. C-4047 (May 10, 2002).

[95] *Microsoft Corp.*, Dkt. No. C-4069 (Dec. 24, 2002).

[96] *Guess? Inc. and Guess.com., Inc.*, File No. 022 3260 (June 18, 2003).

be used.[97] These cases, once again, involved sensitive information for which misuse could have serious consequences – including, for example, children's name, address, gender, grade point average, date of birth, academic and other interests, and racial and religious background. The Commission alleged that, in collecting the information, the companies represented that it would be shared only with colleges, universities, and others providing education-related services. In fact, they shared the information with brokers who sold it to buyers for commercial marketing. In other words, students thought their information would be used only to help them get into college but ended up with solicitations for beauty pageants, shaving cream, and credit cards.

d. Consumer Information Security

Information security is a core part of any program of preventing misuse of information. Good security is important to prevent theft and other misuses of sensitive information. If there was any doubt, consider the TriWest[98] and Ford/Experian[99] incidents, in which major breaches of company databases put the sensitive personal information of tens of thousands of consumers at risk. To prevent these harms, the FTC is emphasizing security on a number of fronts.

First, as just discussed, the Commission has challenged false statements companies make about their security practices. These cases appear to be having an

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[97] *Educational Research Center of America, Inc.*, Dkt. No. C- 4079 (May 6, 2003); *The National Research Center for College & University Admissions*, Dkt. Nos. C-4071 & C-4072 (Jan. 28, 2003).

[98] Adam Clymer, *Officials Say Troops Risk Identity Theft After Burglary*, N.Y. TIMES, Jan. 12, 2003, § 1 (Late Edition), at 12.

[99] Kathy M. Kristof & John J. Goldman, *3 Charged in Identity Theft Case*, LA TIMES, Nov. 6, 2002, Main News, Part 1 (Home Edition), at 1.

effect: word is spreading, companies are changing their incentives, and the cases are helping employees convince their CEOs to take appropriate care in this area.

The Commission also has an important new tool – the Gramm-Leach-Bliley Safeguards Rule – to help it promote and enforce good security practices. Under the Rule, financial institutions must undertake certain basic steps to ensure that they have security appropriate for their businesses and for the information they collect. These steps include designating someone to coordinate security efforts and assessing risk in all areas of the business that might affect the security of customer information.

The FTC plans to enforce this Rule vigorously, and it is investigating companies that may not be complying. But the chief value of the Rule is educational. By requiring companies to take these basic steps, the Rule forces companies that may not have thought about security previously to study their practices and assess the risks to the information they collect and store. The Rule could substantially reduce potential misuses of information caused by simple inattention to basic safeguards – such as when a company puts sensitive financial documents outside in a dumpster instead of having them shredded or burned.

Moreover, the FTC is attempting to educate the public about information security. It has developed a web site, disseminated materials, and held several workshops to promote better security practices by consumers and businesses alike.[100] As head of the

[100] *See* <http://www.ftc.gov/infosecurity>. On September 26, 2002, FTC Commissioner Orson Swindle announced a multimedia and multifaceted consumer education effort to increase public awareness of the importance of good information security practices. The FTC's information security home page has registered more than 200,000 accesses. In addition, the Commission produced a video news release, which was seen on local news stations by an estimated 1.5 million consumers and distributed 160,000 postcards featuring Dewie the Turtle, the campaign mascot, and his information security message to about 400 college campuses nationwide.

U.S. delegation to the OECD Experts Group for Review of the 1992 OECD Guidelines for the Security of Information Systems, Commissioner Orson Swindle, led efforts to revise the Guidelines, which were finalized in August 2002.[101]

e. Increased FCRA Activity

The Commission also is increasing enforcement of the Fair Credit Reporting Act. As discussed above, the FCRA strikes the same balance between privacy and the beneficial use of information that the Commission tries to achieve with the rest of its privacy program. The FCRA allows credit data to be used to grant credit and other benefits but limits use of the data to certain "permissible purposes." It also requires steps to enhance the accuracy of the data, so that consumers are not denied important benefits due to errors in their reports. One of the most significant steps is that consumers be notified whenever information in their credit report is used to deny them credit, insurance, employment, or other benefits or grant less favorable terms. Consumers can then check their credit reports and correct any errors when they have the greatest incentive to do so. When Congress was considering amendments to the FCRA, the Commission proposed that Congress strengthen this important safeguard.[102]

In December 2003, the President signed into law the Fair and Accurate Credit Transactions Act ("FACT Act"), significantly amending the FCRA.[103] The FACT Act has three fundamental goals: to improve consumers' ability to prevent and remedy

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[101] *See* <http://www.ftc.gov/opa/2002/08/oecdsecurity.htm>.

[102] *See* Commission Testimony before the Committee on Banking, Housing, and Urban Affairs, United States Senate (July 10, 2003), *available at* <http://www.ftc.gov/os/2003/07/fcrasenatetest.htm>.

[103] Fair and Accurate Credit Transactions Act, H.R. 2622 (signed into law Dec. 4, 2003).

identity theft; strengthen privacy and other consumer protections in the FCRA; and make permanent the national credit reporting standards that would have otherwise expired at the end of 2003. To implement the new law, Congress placed extensive obligations on the FTC and other federal regulators to promulgate rules and conduct studies.

All three of the FACT Act goals reflect the balancing of interests necessary for sound consumer protection policy. To reduce identity theft, the FACT Act creates a number of new approaches, many of which are based on providing businesses and consumers the proper incentives and tools to fight it. For example, the Act requires financial regulators to develop identity theft "red flags" for the regulated institutions to adhere to when granting credit. The Act also provides for greater information exchange between victims, creditors, and consumer reporting agencies once the theft has occurred.

The FACT Act also includes new ways to help consumers express their privacy preferences. For example, a consumer's ability to opt out of prescreened credit and insurance offers will be enhanced by an FTC rulemaking designed to make the opt out notice included in these offers clearer and more effective.

The FACT Act has also strengthened the accuracy requirements of the FCRA, and one of its new provisions is worth highlighting because it illustrates the careful balance the FCRA strikes between privacy and the beneficial use of information. The FCRA already requires credit grantors to issue an "adverse action" notice to notify consumers whenever information in their credit report is used to deny them credit, insurance, employment, or other benefits. The FACT Act includes a new requirement that credit grantors notify consumers when, based in whole or in part on the consumer's credit report, the grantor offers terms materially less favorable than those available to a

substantial proportion of its other customers. This so-called "risk-based pricing notice" addresses the increasingly common situation in which creditors do not outright deny credit to less credit-worthy consumers but rather raise rates or impose other restrictions on those consumers to compensate for their higher risk. The new notice is designed to fill gaps in the existing adverse action requirement of the FCRA, which exempts, for example, situations when the consumer accepts a counter-offer of less favorable terms.[104]

The FACT Act also gives consumers the right to one free credit report each year from each of the nationwide consumer reporting agencies, as well as the right to purchase their credit scores, so that they can spot possible errors. Finally, the FACT Act ensures that the national credit reporting standards that have, at least in part, facilitated the development of our highly successful credit system remain in place.[105]

The FTC has maintained an active enforcement program to ensure that all of the players in the credit reporting system comply with their obligations. It continues to enforce the adverse action notification requirements of creditors and recently reached a settlement with an internet lender that failed to provide such notices to prospective

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[104] The Commission had urged Congress to broaden the notification requirements and worked with Congressional staffers in formulating the new risk-based pricing provision. *See* Commission Testimony before the Committee on Banking, Housing, and Urban Affairs, United States Senate (July 10, 2003), *available at* <http://www.ftc.gov/os/2003/07/fcrasenatetest.htm>.

[105] The FCRA provides uniform standards and preempts state laws with respect to (1) the prescreening of consumer reports, (2) the time within which CRAs must investigate consumer disputes, (3) the adverse action duties of users of consumer reports, (4) the duties of furnishers, (5) the age of information allowed in consumer reports, (6) the exchange of information among affiliated companies, and (7) certain consumer disclosures. These standards were scheduled to sunset on January 1, 2004, but were made permanent by FACTA. *See* FACTA § 711(3).

borrowers to whom they had denied preapproval.[106] In addition, the Commission has acted recently to prevent firms from using credit reports impermissibly, such as to solicit new business.[107] It also requires that credit bureaus comply with their accuracy duties under the statute; for example, recently settling allegations against Equifax that it violated an FTC order requiring it to make personnel accessible to answer consumers' questions about possible errors in their credit reports.[108] The Commission also has brought recent cases against information furnishers who have provided inaccurate information to the credit bureaus.[109]

The Commission also is working closely with the credit bureaus on a voluntary initiative to address the consumer complaints it receives about information in credit reports, when consumers have used the credit bureaus' dispute resolution process and are not satisfied with the result. The agency will send the credit bureaus the complaints so

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[106] *Quicken Loans Inc.*, Docket No. 9304, Decision and Order (Apr. 8, 2003), *available at* <http://www.ftc.gov/os/2003/04/quickendo.htm>.

[107] *FTC v. Associates First Capital Corp.*, Civil No.1:01-CV-00606JTC (N.D. Ga. Sept. 19, 2002) Order Preliminarily Approving Stipulated Final Judgment and Order, *available at* <http://www.ftc.gov/os/2002/09/associates.pdf>.

[108] *United States v. Equifax Credit Info. Serv.*, Civil No. 1:00-CV-0087-MHS (N.D. Ga. Jan. 13, 2000) (joint motion for modification of consent decree stipulating to payment of $250,000 in disgorgement by defendant). *See* <http://www.ftc.gov/opa/2003/07/equifax.htm>.

[109] *United States v. Fairbanks Capital Corp.*, Civil No. 03 12219 DPW (D. Mass. Oct. 2003) (Stipulated Final Judgment and Order as to Defendant Thomas D. Basmajian, *available at* <http://www.ftc.gov/os/2003/11/0323014stip.pdf> and Order Preliminarily Approving Stipulated Final Judgment and Order as to Defendants Fairbanks Capital Corp., and Fairbanks Capital Holding Corp., *available at* <http://www.ftc.gov/os/2003/11/0323014order.pdf>; *United States v. Performance Capital Management*, 2:01civ1047 (C.D. Cal. 2000) Complaint, *available at* <http://www.ftc.gov/os/2000/08/performcomp.htm> and Consent Decree, *available at* <http://www.ftc.gov/os/2000/08/performconsent.htm>.

they can both resolve them and identify and correct any systematic problems. The program, which does not limit its ability to pursue law enforcement, will provide the Commission and the credit reporting industry with information on how well the system is working.

E. Spam

Although the principles the Commission applies for consumer protection have proven useful in formulating an effective privacy program, they face their most significant test in dealing with spam. There are some similarities between the spam problem and other agency actions. Just as the unwanted intrusion into homes created by telemarketing calls implicates consumers' privacy and frustrates consumer preferences, so too does the clogging of Internet mailboxes by unwanted and unsolicited commercial email, or "spam." Spam has become one of the biggest intrusions into consumers' daily lives. People enjoy reading email they want, whether messages from friends or news about a sale at a favorite store. Today, though, consumers' inboxes are filled with objectionable and fraudulent messages.

As discussed above, the National Do Not Call Registry will protect consumers from the unwanted intrusion of telemarketing calls while not unduly inhibiting the flow of useful information. It is not apparent, however, that any regulatory solution exists for spam. Spam is one of the most daunting consumer protection problems that the Commission has ever faced.

The problems from spam go well beyond the annoyance it causes. These problems include the fraudulent and deceptive content of most spam messages, the sheer volume of spam being sent across the Internet, and the security issues raised when spam

is used to disrupt service or as a vehicle for sending viruses. Although a single piece of spam to a single consumer causes *de minimis* economic harm, the cumulative economic damage from spam is enormous, and growing. There is no reliable, empirical research regarding the costs of spam, but estimates – guesses might be a better word – have ranged from $10 billion to $87 billion a year.[110]

Despite the concerted efforts of government regulators, legislators, Internet service providers, and other interested parties, the problem continues to worsen. Virtually all of the panelists at the FTC's 2003 Spam Forum[111] opined that the volume of unsolicited email is increasing exponentially and that we are at a "tipping point," requiring some action to avert deep erosion of public confidence that could hinder, or even, for many, destroy, email as a tool for communication and online commerce. In other words, spam is "killing the killer app."[112] This is a concrete example of the harm

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[110] These estimates cover everything from the cost of anti-spam technology, such as filters, to the cost of lost worker productivity. *See* Saul Hansell, *Totaling Up the Bill for Spam*, N.Y. TIMES, July 28, 2003, § C, col. 2 (Late Edition):

> Ferris Research, says the cost is $10 billion in the United States this year. The Radicati Group estimates the worldwide cost at $20.5 billion. Another firm, Nucleus Research, shoots higher. By its reckoning, the economic cost is $874 a year for every office worker with an e-mail account, which multiplied by 100 million such workers amounts to about $87 billion for the United States.

[111] The Commission convened a three-day forum to discuss the problems posed by spam from April 30 to May 2, 2003. The panelists included representatives of ISPs, marketers, law enforcement, legislators, technologists, and bulk emailers.

[112] *See* Prepared Statement of the Federal Trade Commission on Unsolicited Commercial Email before the Committee on Commerce, Science, and Transportation, United States Senate (May 21, 2003) (presented by Commissioner Mozelle Thompson and Commissioner Orson Swindle), *available at* <http://www.ftc.gov/os/2003/os/spamtestimony.pdf>.

that unchecked deception can do to the marketplace overall by degrading consumers' confidence in all advertising via a certain medium. This harm affects not just legitimate marketers, who must shift to higher-cost strategies to disseminate their message, but also consumers, who may pay higher prices because of the sellers' increased costs or who may forego purchases that would be beneficial.

Two facts make spam different from other forms of marketing. First, unlike telemarketers or direct mail users, spammers can easily hide their identity and cross international borders. Email can be sent from anywhere to anyone in the world, without the recipient knowing who sent it. Spammers are technologically adept at hiding their identities, using false header information, and routing their emails across borders and through open relays or open proxies,[113] making it extremely difficult even for experienced government investigators with subpoena power to track them. The FTC's enforcement experience, and that of the few states that have tried to punish spammers, is that it can take months of investigation, and the issuance of a dozen or more subpoenas, simply to locate a spammer. Although the Commission is dedicating significant

[113] Because an open relay is an email server configured to accept and transfer email on behalf of any user anywhere, including unrelated third parties, spammers can route their email through servers of other organizations, disguising the origin of the email. An open proxy is a mis-configured proxy server through which an unauthorized user can connect to the Internet. Spammers use open proxies to send spam from the computer network's ISP or to find an open relay. *See* FTC Facts for Business, *Securing Your Server: Shut the Door on Spam* (January 2004), *available at* <http://www.ftc.gov/bcp/conline/pubs/buspubs/secureyourserver.htm> and FTC Facts for Business, *Open Relays – Close the Door on Spam* (May 2003), *available at* <http://www.ftc.gov/bcp/conline/pubs/buspubs/openrelay.htm>.

resources to attacking deceptive spam,[114] it is difficult to prosecute enough spammers to have a serious deterrent effect, let alone stop, or even slow down, the problem.

Second, there are fundamental differences between the costs of email and other forms of marketing. Unlike phone calls or mail solicitations, sending additional spam is essentially costless. Instead, recipients and Internet Service Providers bear most of the costs. Because email technology allows spammers to shift the costs almost entirely to third parties, there is no incentive for the spammers to reduce the volume. This shifting of costs encourages inefficiency because the total cost to send tens of millions of emails, if borne by the spammer, would presumably outweigh the proceeds that most spam generates. Yet at the FTC's Spam Forum, a bulk emailer testified that he could profit even if his response rate was less than 0.0001%. Because there is virtually no marginal cost to increasing the number of messages, fraud artists and pornographers, who generally have little to gain from reputation, profit from extremely low response rates by sending untold millions of messages. If spammers had to pay the actual costs of spam, normal market forces would eliminate much of the spam problem.

Because of the anonymity the technology affords, spammers are often exceptionally bold fraud artists, flooding inboxes with outrageous claims. In April 2003,

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[114] In February, 2002, the FTC announced its first systematic crackdown on deceptive spam. Since then it has tackled spam on three fronts: law enforcement, education, and research. To date, the agency has announced 57 enforcement actions targeting deceptive spam, and the staff continues to investigate and prepare new cases. Among other unfair or deceptive practices, it has challenged:

- false subject line information;
  false "remove me" representations;
- false representations that a service could stop spam from other sources;
- false claims that buying a spamming business opportunity could make you rich; and
- "spoofing" – forging the "from" line in an email to make it appear that the email was sent from an innocent third-party.

the FTC released a report analyzing false claims made in spam.[115] To prepare the report, the agency staff reviewed a sample of approximately 1,000 pieces of spam.[116] Of the 1,000 pieces, 66 percent contained facial elements of obvious deception in the "from" line, the "subject" line, or the text of the message.[117] When these data are further analyzed to exclude sexually explicit email and email hawking products or services that are permeated with fraud – such as chain letters, credit repair, and cable de-scramblers – only 16.5% of the spam did not contain obvious deception and came from possibly legitimate marketers.[118] The Commission staff further analyzed a random sample of 114 of these pieces of spam, looking behind the header information to see who had registered the domain name for any web sites connected to the email by hyperlink. The staff found none from Fortune 500 companies, and only one from a Fortune 1000 company.[119] The study also showed that only 2% of all of the sample contained an "ADV:" label – even

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[115] FTC STAFF REPORT, FALSE CLAIMS IN SPAM (Apr. 2003), *available at* <http://www.ftc.gov/reports/spam/030429spamreport.pdf>.

[116] The sample came from three sources. First, staff took 450 emails from the FTC's "Spam Refrigerator" – a database of unsolicited commercial email forwarded by consumers to uce@ftc.gov; second, staff took 450 emails from the Commission's "Harvest" database – collected from email accounts that staff set up to accept email, but from which no emails were ever sent; finally, staff reviewed 100 unsolicited commercial emails forwarded by FTC staff.

[117] The remaining spam messages were not necessarily truthful, but they did not contain any obvious indicia of falsity.

[118] The word "possibly" is appropriate because FTC staff has not analyzed this subsample in detail to screen for truthfulness.

[119] FTC staff's statistical analysis provides 95% confidence that less than 3% of the email in the database of over 11 million emails was sent by or on behalf of Fortune 500 companies, and less than 5% was sent by or on behalf of Fortune 1000 companies.

though laws in 11 states, including California, require such a label. It thus appears that the overwhelming majority of spammers completely ignore state labeling laws.

Clearly, then, spam is a major problem that normal market forces will not overcome and is therefore a prime candidate for governmental intervention. The very technology that makes email such a powerful and revolutionary tool for business, however, makes spam a problem that the application of the Commission's law enforcement and regulatory tools cannot solve. There is no quick or simple "silver bullet." Rather, solutions must be pursued from many directions – technological, legal, and consumer action.

This is what the FTC is doing. First, the Commission continues to investigate and prosecute deceptive spam, as well as the deceptive and unfair use of email technology. To leverage its enforcement resources, the agency formed a Spam Task Force consisting of federal, state, and local law enforcement agencies. By providing technical support and coordination, the FTC hopes to encourage enforcement by state and local agencies to prosecute scams that likely originate outside of their jurisdiction.[120]

On December 16, 2003, President Bush signed into law the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 ("CAN-SPAM" or "the Act"). CAN-SPAM is the first federal law that specifically addresses unsolicited

[120] The FTC has dozens of open investigations, many with criminal authorities. Recently, the Commission announced a case developed in conjunction with the FBI and the Department of Justice's Computer Crimes and Intellectual Property Section that addressed a practice called "phishing" or "brand spoofing," whereby spammers trick consumers into giving sensitive financial information by spoofing the brands of companies with whom they have existing accounts. *See* <http://www.ftc.gov/opa/2003/07/phishing.htm>.

commercial email. The Act enumerates unlawful conduct for spammers and authorizes the Commission to conduct a series of rulemakings and write a series of reports.[121]

Although CAN-SPAM itself, or for that matter any other possible regulatory approach, can do little to resolve the overwhelming volume of spam that is already illegal, it contains provisions that can assist state and federal law enforcers and Internet Service Providers in their efforts to attack the problem. Among other things, it prohibits commercial email that contains false or misleading header information, uses deceptive subject lines, or fails to contain the Act's required disclosures.[122] Many of these practices violate other laws as well, including the FTC Act. CAN-SPAM also requires that senders include a link to let consumers opt out of receiving further commercial email and that senders honor a consumer's opt-out request within ten business days of receiving it.[123]

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[121] CAN-SPAM provides the Commission with mandatory and permissive rulemaking authority to implement and interpret certain provisions of the Act. See CAN-SPAM Act §§ 3(2)(C) (mandatory rulemaking to determine "the primary purpose" of a commercial email message), 3(17)(B) (providing the FTC permissive rulemaking authority to expand or contract the categories of a "transactional or relationship message"), 4(c) (providing permissive rulemaking to modify the 10-business day period to act on opt-out requests if a different period will be more reasonable and to specify additional aggravating factors if those factors substantially contribute to the proliferation of unlawful commercial messages), 13 (providing the FTC with general permissive rulemaking authority to issue regulations to implement the provisions of the Act), and 14(b) (requiring the FCC, in consultation with the FTC, to promulgate rules regarding wireless spam). The Commission must also provide Congress with reports on a Do Not Email Registry, CAN-SPAM Act § 9, the effectiveness of the Act, CAN-SPAM Act § 10, the use of bounty systems, CAN-SPAM Act § 11(1), and the use of ADV labels, CAN-SPAM Act § 11(2). Further, the Act requires the Commission, in consultation with the Department of Justice, to publish a mark or notice that must be carried by all commercial email containing sexually oriented material. *See* CAN-SPAM Act § 5(d)(3).

[122] CAN-SPAM requires all commercial email messages to include a clear and conspicuous identification that the message is an advertisement or solicitation, a clear and conspicuous notice of the opportunity to decline to receive further commercial email from the sender, and a valid physical postal address of the sender. CAN-SPAM § 5(a)(5).

[123] CAN-SPAM Act § 5(a)(4).

More important, and potentially more useful for government prosecutors, are newly-created criminal penalties for sending spam from a computer without authorization; using a computer to relay or to retransmit spam; sending multiple commercial email messages containing materially false header information; falsely representing oneself as the registrant or successor in interest to the registrant of five or more Internet Protocol addresses and sending spam from those addresses; or using information that materially falsifies the identity of the actual registrant for email accounts or online user accounts.[124] The Act also authorizes private actions by Internet Service Providers, which may strengthen their ability to pursue spammers.

Although CAN-SPAM provides law enforcement with additional civil and criminal powers, it does not address either of the two problems that make spam so challenging to law enforcers: the low cost of sending spam and the anonymity that technology affords spammers. Until these two issues are addressed, it is unlikely that anyone will make significant progress in controlling spam.

There are also additional tools, which are not in CAN-SPAM, that can provide the Commission assistance in finding and taking action against spammers. In the 108th Congressional session, the Commission made several legislative recommendations to address the changing nature of the consumer marketplace and improve the agency's ability to cooperate and share information in cases and investigations relating to cross-border fraud.[125] The Commission's recommendations focus primarily on improving its

[124] CAN-SPAM Act § 4(a).

[125] On June 19, 2003, the U.S. Senate Commerce Committee reported out S. 1234, the FTC Reauthorization Act of 2003, which includes all of the Commission's legislative recommendations addressing cross-border fraud. On October 1, 2003, the

ability to combat fraud involving foreign parties, evidence, or assets. These proposals also would help the FTC fight deceptive spam. Information presented at the FTC's Spam Forum revealed that the path from a fraudulent spammer to a consumer's inbox frequently crosses at least one international border and often several. Thus, fraudulent spam exemplifies the growing problem of cross-border fraud, and the FTC's legislative recommendations would be particularly helpful in investigating deceptive spammers more effectively and working better with international law enforcement partners.[126] Without such cooperation, enforcement efforts could be rendered meaningless if the illegal spammers simply move offshore.

While enforcement has been an important first step in fighting spam, the Commission has taken additional measures. Although spam is universally regarded as a major problem, there has been relatively little research about it. Thus, as a second step,

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House Energy and Commerce Committee reported out H.R. 3143, the International Consumer Protection Act of 2003, which contains the FTC's cross-border proposals.

[126] The FTC's cross-border proposal includes four main components. First, the FTC seeks to strengthen its ability to cooperate with foreign counterparts, who are often investigating the same targets. Under current law, for example, the FTC is prohibited from sharing with foreign counterparts certain information that the FTC has obtained in its investigations. Legislation is necessary to allow the agency to share such information and provide other investigative assistance in appropriate cases. Second, the FTC seeks enhancements to its information-gathering capabilities to obtain more easily information from federal financial regulators about those who may be defrauding consumers. The FTC also seeks enhancement of its ability to obtain information from third parties without the request triggering advance notice to investigative targets and thus prompting the targets to move their assets overseas. Third, the FTC seeks improvements to its ability to obtain consumer redress in cross-border litigation, by clarifying the agency's authority to take action in cross-border cases and expanding its ability to use foreign counsel to pursue offshore assets. Finally, the FTC seeks to strengthen international cooperative relationships by obtaining authority to facilitate staff exchanges and to provide financial support for certain joint projects.

the Commission has conducted research on spam, including the Remove- Me Surf,[127] Spam Harvest,[128] False Claims in Spam Study,[129] and the April 2003 Spam Forum.[130] The Spam Forum in particular contributed valuable information to the FTC's spam agenda and helped develop the contacts in the IT industry the Commission needs to stay well informed as it helps lead the fight against spam. The Commission will continue to pursue research into spam and to work with its partners in industry, state government, and other federal agencies to provide the best possible information to consumers and businesses through consumer alerts, brochures, and other appropriate methods.

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[127] In April, 2002, the Commission announced the results of its Remove-Me surf. The FTC and ten law enforcement partners tested whether "remove me" or "unsubscribe" options in spam were honored. From email forwarded to the FTC's spam database, the agencies culled more than 200 emails that purported to allow recipients to remove their name from a spam list. The agencies set up dummy email accounts to test the pledges, but discovered that the vast majority of addresses to which they sent the requests were invalid. Most of the "remove me" requests did not get through. Based on information gathered, the FTC has sent more than 75 letters warning spammers that deceptive "removal" claims in unsolicited email are illegal. *See* <http://www.ftc.gov/bcp/conline/edcams/spam/pubs/removeme.pdf>. Since then, the Commission has brought two cases alleging that the defendants failed to honor their removal representations. *See FTC v. GM Funding*, Civ. Action No. SACV 02-1026 DOC (C.D. Cal. filed Nov. 6, 2002); *FTC v. Brian Westby*, Civ. Action No. 032-3030 (N.D. Ill. filed Apr. 15, 2003).

[128] Ten agencies participated in the FTC's *Spam Harvest*, an initiative designed to test which actions consumers take online put them most at risk for receiving spam. According to the investigators, spammers typically use computer programs that search public areas on the Internet to compile, capture, or otherwise "harvest" lists of email addresses from web pages, newsgroups, chat rooms, and other online destinations. *See* <http://www.ftc.gov/bcp/conline/pubs/alerts/spamalrt.htm>.

[129] FTC MARKETING PRACTICES REPORT, FALSE CLAIMS IN SPAM (Apr. 30, 2003), *available at* <http://www.ftc.gov/reports/spam/030429spamreport.pdf>.

[130] Information on the Spam Forum is available at <http://www.ftc.gov/bcp/workshops/spam/index.html>.

A third, key component of the FTC's efforts against spam is educating consumers and businesses about how they can decrease the amount of spam they receive. The agency's educational materials provide guidance on how to decrease the chances of having an email address harvested and used for spam, and suggest several other steps to decrease the amount of spam an address may receive.[131] The FTC's educational materials on spam are available on the Commission's website.[132]

Fourth, led by Commissioner Swindle, the Commission has brought together interested parties, including government, ISPs, marketers, and technologists. This is a crucial component in the battle against spam because, in the haste to reduce the problem, it is important to avoid over-regulation that could impede the flow of useful information to consumers. Including legitimate marketers in this discussion is essential because they have a strong interest in solving the spam problem – the sheer volume of spam and its impact on consumer confidence is eroding a valuable form of marketing.

Despite all these efforts by the FTC and state law enforcement officials, in the end, spam will only be reduced, if at all, through several technological improvements, as well as safer computing practices by users, that decrease the amount of spam evading ISPs' anti-spam filters. The seamless integration of anti-spam technologies into the email services consumers use will be crucial. Ultimately, the Internet protocols for email may

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[131] FTC's tips for consumers to avoid unwanted spam include: (1) try not to display your email address in public; (2) check the privacy policy before you give a website your email address; (3) use a unique email address, containing both letters and numbers; (4) read the entire form before transmitting your personal information through a website; (5) consider using two email addresses – one for personal use and one for newsgroups and chat rooms. *See* <http://www.ftc.gov/bcp/conline/pubs/online/inbox>.

[132] *See* <http://www.ftc.gov/spam>.

need to be changed.[133] Such a solution, however, is unlikely in the near term. Until then, Internet Service Providers need to empower consumers by providing them the means to deal with spam more easily.

F. International cooperation

As noted earlier, the development of the Internet and the related increase in international commerce provide enormous benefits to consumers but also have multiplied opportunities for consumer harm. In developing new tools to fight these harms, the Commission has sought to multiply its effectiveness by working with other consumer protection institutions around the world. Through these efforts, the FTC tries to ensure that consumer protection rules outside the U.S. focus on practices that distort consumer choice and raise a serious threat to the proper functioning of markets. To this end, it hopes to foster consistent, market-driven policies internationally.

The emergence of new technologies, especially global communication systems, has changed the marketing landscape. Today, satellite networks broadcast advertisements around the world, with operators waiting to take orders in the caller's own language. Telemarketers routinely call U.S. consumers from Canada. Most significantly,

[133] At the Spam Forum, panelists discussed many technical initiatives, including possible changes in the email protocol by the Internet Research Task Force's Anti-Spam Research Working Group. One proposed change is to insert identity, or authentication, into the email system, such as requiring correct routing information, which would prevent spoofing. Other proposals are to create systems for charging senders for bulk email. Panelists at the forum noted that while such changes might be necessary to address spam, an effective protocol change will be difficult to achieve in the near future given the consensus-driven procedures of the Internet Engineering Task Force (the group of technologists that devises Internet protocols) and the need for any protocol changes to be "backward compatible," *i.e.*, to enable email to be transmitted using technologies that predate the change.

in many markets the Internet is transcending national borders. Thus, one cannot avoid global consumer protection issues.

Given this trend, international convergence of consumer protection rules is especially important. Greater consistency among consumer protection rules will reduce compliance burdens for businesses selling internationally. In particular, the more commonality among different consumer protection regimes, the less burdened merchants are in complying with different, and potentially conflicting, rules. Indeed, the European Commission recently found that 68% of businesses it surveyed agreed that harmonization of national consumer protection regulations would make cross-border advertising within the European Union more efficient.[134] A study by the European Mail Order Trade Association found that five of the top ten barriers to selling across borders related wholly or in part to differences in national rules on commercial practices.[135]

More consistent consumer protection rules internationally also benefit consumers by ensuring that they have more choices. Inconsistent rules can drive businesses from the marketplace, or deter their entry in the first place, thus reducing consumer choice. As discussed previously, having uniform default rules facilitates exchange, enhancing

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[134] European Opinion Research Group EEIG and EOS Gallup Europe, *Public Opinion in Europe: Views on Business-to-Consumer Cross-Border Trade*, 57.2 EUROBAROMETER 52 (Nov. 14, 2002).

[135] Proposal for a Directive of the European Parliament and of the Council Concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market, Extended Impact Assessment at ¶ 1.4, *available at* <http://europa.eu.int/comm/consumers/cons_int/safe_shopping/fair_bus_pract/impact_assessement_en.pdf.>

consumer welfare.[136] Because there will be more competition with better rules, consumers should also benefit from lower prices.

For these reasons, the development of international consumer protection policies is a priority for the Commission. In 2002, the agency created an International Division of Consumer Protection, which seeks international rules that promote a consistent market-oriented approach to consumer protection. As with consumer protection in general, the first priority of an international consumer protection program should be combating fraud. Indeed, as the Commission's *domestic* efforts have become more effective, scam artists have recognized that the FTC and its foreign counterparts face significant obstacles in trying to fight *cross-border* fraud. Increasingly, scam artists take advantage of these law enforcement difficulties by using facilities in one country to target consumers in others. In 2000, 11% of consumer complaints filed with the FTC involved cross-border fraud; by 2002, the number of cross-border fraud complaints had risen to over 14%.[137] There also has been an increase in agency cases involving offshore defendants, offshore evidence, or offshore assets. In 2002, for example, the FTC brought over 20 law enforcement actions involving cross-border fraud. Cases in 2003 year involved advance fee credit cards peddled by Canadian telemarketers,[138] allegedly bogus international driving licenses

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[136] *See* Section II C & D, *supra*.

[137] For complete statistics on the growth of cross-border fraud, see <http://www.consumer.gov/sentinel>.

[138] *FTC v. STF Group Inc.*, Civ. Action No. 02 C 0977 (N.D. Ill. filed Feb. 10, 2003), *available at* <http://www.ftc.gov/opa/2003/02/medplan.htm>*; FTC v. Assail, Inc.*, Civ. Action No. W03CA007 (W.D. Tex. filed Jan. 9, 2003), *available at* <http://www.ftc.gov/opa/2003/02/assail.htm>.

advertised through spam email by defendants in Denmark,[139] Israel, the Bahamas, and Romania,[140] and products and programs sold over the Internet by defendants based in Switzerland,[141] Canada, the U.K., and Mexico[142] that allegedly falsely claim to cure cancer, AIDS, and other serious diseases.

Fraud harms any economy, even a well-established one. In emerging markets, the damage of fraud may be even greater. It is bad enough that consumers suffer out-of-pocket losses. In a transition environment, fraud can undermine consumer confidence amid the uncertainty that often accompanies the abandonment of central planning. The inability of Albania, for example, to address effectively the pyramid schemes that masqueraded as legitimate investments led to the fall of the government and a was serious setback to market reforms.[143] Unless a nation visibly and effectively suppresses seller deceit, consumers may perceive that in a market system commercial dishonesty is the norm, not the exception.

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[139] *FTC v. Carlton Press, Inc.*, Civ. Action No. 03-CV-0226-RLC (S.D.N.Y. filed Jan. 10, 2003), *available at* <http://www.ftc.gov/opa/2003/01/idpfinal.htm>.

[140] *FTC v. Mountain View Systems, Ltd..*, Civ. Action No. 1:03-CV-OOO21-RMC (D.D.C. filed Jan. 7, 2003), *available at* <http://www.ftc.gov/opa/2003/02/fyi0314.htm>.

[141] *FTC v. Dr. Clark Research Ass'n*, Civ. Action No. 1:03CV0054 (N.D. Ohio filed Jan. 8, 2003), *available at* <http://www.ftc.gov/opa/2003/01/drclark.htm>.

[142] *FTC v. CSCT, Inc.*, Civ. Action No. 03 C 00880 (N.D. Ill. filed Feb. 6, 2003), *available at* <http://www.ftc.gov/opa/2003/02/csct.htm>.

[143] *E.g.*, Radio Free Europe/Radio Liberty, Albania, *Pyramid Schemes Common Across Eastern Europe* (Jan.16, 1997), *available at* http://www.rferl.org/nca/features/1997/01/F.R.U.<http://www.rferl.org/nca/features/1997/01/F.RU.970116172653.htm>. Chris Jarvis, *The Rise and Fall of Pyramid Schemes in Albania*, 47 I.M.F. Staff Papers No. 1 (2000), *available at* <http://www.imf.org/external/pubs/ft/staffp/2000/00-01/jarvis.htm>.

Moreover, consumers in countries that fail to develop effective anti-fraud strategies may become especially attractive targets for fraudsters. Countries that house the targets of cross-border fraud are not the only victims; countries that unwittingly host them suffer as well. What country wants the dubious reputation as a haven for perpetrators of international fraud? Thus, Canada is determined to resist attempts by fraudulent telemarketers to make Canada their safe haven. A consortium of Canadian agencies that includes the Competition Bureau, the Royal Canadian Mounted Police, and provincial and local authorities have worked with us effectively to attack fraud.[144]

The Commission is building international consensus on the importance of combating cross-border fraud. FTC Commissioner Mozelle Thompson chairs the OECD Committee on Consumer Policy, which, in 2003, announced new Guidelines for international cooperation to combat the growing problem of cross-border fraud.[145] Importantly, the Guidelines will help governments work more effectively and efficiently to combat the increasing incidence of cross-border fraud. The Guidelines create a common definition of "fraudulent and deceptive commercial practices" and express a commitment among OECD member countries to cooperate on combating these practices. In the United States, the government ha begun to implement these Guidelines to ensure that the FTC has the tools it needs to combat cross-border fraud. As discussed above, the

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[144] *See, e.g.*, Cross Border case list at <http://www.ftc.gov/opa/2002/06/crossbordercaselist.htm>.

[145] OECD Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices Across Borders, C (2003)116 (June 2003), *available at* <http://www.oecd.org/sti/crossborderfraud>.

agency in June of 2003 proposed legislation to Congress that would make it easier to share information and cooperate with its counterparts abroad.[146]

G. E-Commerce

The FTC's e-commerce initiative is another example of the Commission using its institutional strengths to support competitive markets and the common law as they adapt to technological change. Although the Internet can provide consumers with important benefits, online commerce also has pitfalls. As already noted, the Commission has undertaken many enforcement and educational efforts to protect online consumers against fraud and other problems. These consumer protection initiatives will help the Internet continue to thrive as a legitimate and reputable sphere of commerce and likely lead to greater consumer confidence in, and use of, the medium. The Internet also raises competition issues. While many states are regulating e-commerce to promote important public interest objectives, such as protecting consumers from deception and fraud, some of these actions also shield local businesses from out-of-state competition. For example, some states require that online vendors maintain a physical office in the state, others completely prohibit online sales or shipments of certain products. Many states also require that out-of-state sellers obtain an in-state license before selling particular goods, such as caskets or contact lenses, or services, such as medical or legal advice. Some observers question whether the attendant higher prices and loss of variety outweigh the consumer protection benefits.[147]

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[146] *See* S. 1234 FTC Reauthorization Act of 2003; H.R. 3143, International Consumer Protection Act of 2003. *See supra* notes 125, 126.

[147] *See* Thomas B. Leary, Commissioner, FTC, *The Significance of Variety in Antitrust Analysis* (May 18, 2000) (essay based on a speech delivered at the Steptoe &

In March 2002, Commission staff commented to the Connecticut Board of Examiners for Opticians against the Board requiring that Internet sellers of replacement contact lenses have a Connecticut optician's license.[148] Such sellers merely mail out prepackaged lenses pursuant to a valid prescription. The staff concluded that the proposed requirement would increase consumer costs without offsetting health benefits and would hinder the expansion of Internet commerce. Indeed, such licensing could harm public health by raising the cost of replacement contact lenses, inducing consumers to replace the lenses less frequently than doctors recommend or to substitute other types of contact lenses that pose greater health risks. On June 24, 2003, the Board ruled that contact lens sellers located outside of the state who sell lenses to Connecticut residents do not need a Connecticut license, but must merely sell pursuant to a lawfully issued prescription. The effect of the Board's ruling is that state licensing or other requirements will not hamper Internet commerce in replacement contact lenses, which was the goal of the Commission's advocacy.[149]

The issue of industry members imposing restrictions on consumer choice led the Commission, with the Department of Justice, to oppose a proposed bar opinion in North Carolina that required the physical presence of an attorney at residential loan closings,

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Johnson 2000 Antitrust Conference), *available at* <http://www.ftc.gov/speeches/leary/atljva4.htm>.

[148] Comments of the Staff of the Federal Trade Commission, Intervener, before the Connecticut Board of Examiners for Opticians (Mar. 27, 2002), *available at* <http://www.ftc.gov/be/v020007.htm>.

[149] Memorandum of Law of *Amicus Curiae* Federal Trade Commission, *Powers v. Harris*, Case No. CIV-01-445-F (W.D. Okla. Sept. 5, 2002), *available at* <http://www.ftc.gov/os/2002/09/okamicus.pdf>.

including simple refinancings.[150] The Commission argued that the proposal would not only raise costs for consumers, who would have to pay for additional services, but also created an uneven playing field for out-of-state Internet lenders, because in-state lenders were allowed to close loans without attorneys. In January 2003, the state bar adopted a pair of opinions that eliminate the requirement that an attorney be physically present at closings. The opinions also allow non-attorneys to obtain signatures and receive and disburse funds. This outcome preserved competition for consumers in real estate closings, ensured even greater consumer choice, and helped promote Internet lending options for North Carolina consumers.

The Commission also has addressed these issues in other states[151] and on a national scale. In late 2002, the FTC and the Department of Justice wrote to an American Bar Association (ABA) task force that was considering a proposed model definition of the practice of law.[152] The letter urged the ABA not to adopt the proposed definition, which was over broad and could restrain competition between lawyers and nonlawyers to provide similar services to consumers. The agencies cautioned that, if adopted by state

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[150] Letter from Charles A. James and Timothy J. Muris to the Ethics Committee of the North Carolina Bar Re: North Carolina State Bar Opinions Restricting Involvement of Non-Attorneys in Real Estate Closings and Refinancing Transactions (Dec. 14, 2001), *available at* <http://www.ftc.gov/be/VO20006.htm>.

[151] *See* Federal Trade Commission and Department of Justice Comments to the State Bar of Georgia on Potential Unlicensed Practice of Law Opinion Regarding Real Estate Closing Activity (Mar. 20, 2003), *available at* <http://www.ftc.gov/be/v030007.htm>; Federal Trade Commission and Department of Justice Comments to the Rhode Island House of Representatives on Proposed Bills H. 5936 and H. 5639: Proposed Restrictions on Competition From Non-Attorneys (Mar. 28, 2003), *available at*< http://www.ftc.gov/be/v020013.htm>.

[152] Letter from the FTC and the Department of Justice, Comments on the American Bar Association's Proposed Model Definition of the Practice of Law (Dec. 20, 2002), *available at*< http://www.ftc.gov/opa/2002/12/lettertoaba.htm>.

governments, the proposed definition likely would raise costs for consumers and limit their competitive choices. The letter also noted the lack of evidence that this competition hurts consumers and the substantial evidence that they benefit from it. The ABA task force ultimately withdrew the proposed model definition and instead suggested that each jurisdiction adopt its own definition and determine who may provide services based upon the potential harm and benefit to the public.[153]

It is important to stress that the policy issue in the FTC's e-commerce activities is not whether licensing and certification regimes should be scrapped. The question is instead whether legitimate consumer protection, safety, and other objectives motivate refusals to permit reasonable accommodations of such licensing regimes or instead they represent a desire to exclude competitors from the marketplace.

IV. Policy Research and Development

This discussion of the FTC's positive agenda identifies a necessary condition for the Commission's future success in consumer protection. Continuing, substantial efforts to increase the Commission's base of knowledge are indispensable to address new commercial phenomena, to analyze complex technical issues involving health and safety, and to respond to new technologies that, among other capabilities, permit the assembly and rapid transmission of vast amounts of information. All of these developments occur in a regulatory environment in which the Commission must use the force of its arguments, not fiat, to persuade public authorities at home and abroad to cooperate in law enforcement and other forms of policymaking.

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[153] American Bar Association, Task Force on the Model Definition of the Practice of Law, *Report to the House of Delegates* (2003), *available at* <http://www.abanet.org/cpr/model-def/taskforce_rpt_429.pdf>. The ABA adopted this position officially in August 2003.

The agency's knowledge base is truly an investment in policy research and development (R&D).[154] The Commission is the public equivalent of a private firm whose success requires substantial R&D. Just as a high technology company must perform research to develop new products, so too must the FTC expand its knowledge to design law enforcement and other policies to conquer current and anticipated consumer protection problems.

A far-sighted feature of the FTC's institutional design is that Congress gave the agency flexible tools to perform the necessary consumer protection R&D.[155] Several examples illustrate how the Commission uses its distinctive institutional strengths to ensure that it accurately understands and properly responds to new challenges.

Possible Barriers to E-commerce workshop

In October 2002, the Commission sponsored a three-day workshop on Possible Anticompetitive Efforts to Restrict Competition on the Internet.[156] The workshop examined state regulations and private arrangements, often adopted for purposes unrelated to competition, that may aid existing bricks-and-mortar businesses at the expense of new Internet competitors, ultimately hurting consumers. The workshop

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[154] *See* Timothy J. Muris, Chairman, FTC, *Looking Forward: The Federal Trade Commission and the Future Development of U.S. Competition Policy*, Milton Handler Annual Antitrust Review (Dec. 10, 2002), *available at* <http://www.ftc.gov/speeches/muris/handler.htm>.

[155] For a recent definitive treatment of the FTC's establishment, see Marc Winerman, *The Origins of the FTC: Concentration, Cooperation, Control, and Competition*, 71 ANTITRUST L.J. (2003) (forthcoming).

[156] Notice of Public Workshop and Opportunity to Comment, 67 Fed. Reg. 48,472 (Jul. 24, 2002). The workshop agenda, the participants' written statements, and public submissions are available at <http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm>.

sought to enhance the agency's understanding of these issues, inform policymakers about how restrictive state regulation affects competition and consumers, educate private entities about business practices that may raise concerns, and learn of additional avenues to promote competition through e-commerce.

More than 70 representatives of industry, academia, state and federal government agencies, and independent public policy organizations participated in the workshop and discussed possible barriers to e-commerce in ten different industries ranging from financial services to automobiles to wine. The workshop spawned several projects. For example, the FTC Bureau of Economics issued a working paper on the availability of wine over the Internet.[157] The paper examined the effect of Virginia's ban on direct wine shipments from out-of-state sellers on price and variety available to Virginia consumers. The study found that Virginia's direct shipment ban reduces the varieties of wine available to consumers and prevents them from purchasing certain premium wines at lower prices online. The FTC staff then issued a report assessing the impact on wine consumers of barriers to e-commerce.[158] The report found that states could significantly enhance consumer welfare by allowing the direct shipment of wine to consumers. The wine report will be followed by reports on other industries discussed at the workshop.[159] Each report will analyze the competitive and consumer protection aspects of the possible

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[157] Alan E. Wiseman & Jerry Ellig, *How Many Bottles Make a Case Against Prohibition? Online Wine and Virginia's Direct Shipment Ban* (Mar. 2003), *available at* <http://www.ftc.gov/be/workpapers/wp258.pdf>.

[158] FTC STAFF REPORT, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE (July 2003), *available at* <http://www.ftc.gov/os/2003/07/winereport2.pdf>.

[159] *See* FTC STAFF REPORT, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: CONTACT LENSES (Mar. 2004), *available at* <http://www.ftc.gov/os/2004/03/contactlensreport.pdf>.

anticompetitive barriers, including regulations and business practices. What the Commission learned from the barriers to e-commerce workshop will continue to inform the agency's advocacy and enforcement agenda.

Information flows workshop

In June 2003, the Commission held a workshop on Information Flows to examine the benefits and costs to consumers and businesses of the collection and use of consumer information. As discussed above, the Commission's privacy agenda focuses on stopping practices that cause real harm to consumers, while not restricting unduly the free flow of information that benefits our economy. To help ensure that its approach both protects privacy and preserves important benefits, the Commission convened the workshop to learn from knowledgeable observers with a range of perspectives, including executives from a variety of businesses that use consumer information extensively, academic researchers, consumer privacy advocates, and government officials. Panelists presented their original research and debated the appropriate methodology for evaluating information practices from consumer and business perspectives, including the appropriate use of benefit/cost analysis.

More research is needed so that policy makers can understand more fully the role of information practices in our information economy. The knowledge gathered at this workshop, and the future research that it is likely to spur, will help inform the Commission and other policymakers as they debate the difficult issues involving privacy and the free flow of consumer information.

FCRA Recommendation

The FTC's efforts to increase knowledge through workshops, such as the Information Flows event, are not merely aspirational. Research presented at the Information Flows workshop helped guide the Commission's recommendations on FCRA reauthorization. As mentioned above, the Fair Credit Reporting Act tries to balance the beneficial use of information with the costs. Participants at the Information Flows workshop provided research on likely effects of changes to the FCRA's current uniform standards and preemption of state laws with respect to certain matters.[160] This research indicated that allowing the national standards to expire likely would harm consumers. One study measured the impact of different scenarios of possible state regulation on credit score modeling and, ultimately, on the cost and availability of credit. The results suggested that the hypothesized changes in FCRA standards would alter most consumers' credit scores and lower the predictive power of scoring models, leading to increased delinquency rates or (to maintain current delinquency rates) restricted availability of credit.[161] Based in part on this research, the Commission recommended in testimony before Congress that all of the standards be made permanent,[162] and the FACT Act ultimately made such standards permanent.

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160 *See, e.g.*, Information Policy Institute, *The Fair Credit Reporting Act: Access, Efficiency & Opportunity - The Economic Importance of Fair Credit Reauthorization* (June 2003) [hereinafter *IPI Report*] which was submitted to the workshop and discussed by the workshop participants. *See also* Fred H. Cate, Robert E. Litan, Michael Staten, Peter Wallison, *Financial Privacy, Consumer Prosperity, and the Public Good: Maintaining the Balance* (2003) (workshop submission), *available at* <http://www.ftc.gov/bcp/workshops/infoflows/statements/cate01.pdf>.

161 *IPI Report* at 9.

162 Prepared Statement of the Federal Trade Commission on The Fair Credit Reporting Act before the Senate Committee on Banking, Housing, and Urban Affairs (July 10, 2003), *available at* <http://www.ftc.gov/os/2003/07/fcrasenatetest.htm>.

V. Conclusion

The FTC's consumer protection program has been transformed during the past 25 years. This transformation clarified the agency's mission and enhanced its effectiveness by better deploying its inherent strengths, to the benefit of both the agency and, more important, consumers. What can one learn from this discussion of the underlying principles for formulating an effective consumer protection policy and the recitation of agency activities that illustrate these principles? One key lesson is that, of course, principles matter. An institution that merely reacts to circumstances and does not work from a coherent philosophy will ultimately fail to achieve lasting success. Even if it wins a few battles, it is not orchestrating an overall strategy to succeed on a larger scale by reinforcing its strengths, filling gaps in the lines of defense, and carefully venturing into new terrain with a compass firmly in hand.

Beyond principles, an agency needs a plan for implementation. The heart of the FTC's strategy for consumer protection is the search for practices that harm consumers by hampering the competitive process and violating the basic rules of exchange. While the Commission will do much of this work through case selection and prosecution, it should also make full use of its distinctive institutional attributes, including the ability to perform advocacy and conduct studies.

A necessary condition for the FTC's future success in consumer protection is to increase the Commission's base of knowledge to address new commercial phenomena, to analyze complex technical issues involving health and safety, and to respond to new technologies. This base of knowledge will enable the Commission to retain the

intellectual leadership necessary to persuade others to join it in its mission to foster consistent, market-driven consumer protection.