

**REPORT TO CONGRESS**

**SMALL BUSINESS PAPERWORK RELIEF ACT**

**FEDERAL TRADE COMMISSION  
DECEMBER 2004**

## EXECUTIVE SUMMARY

The Federal Trade Commission (“Commission” or “FTC”) is submitting this report to Congress and the Small Business and Agriculture Regulatory Enforcement Ombudsman pursuant to Section 4 of the Small Business Paperwork Relief Act of 2002 (“SBPRA”).<sup>1</sup> That provision of SBPRA builds on requirements of the related Small Business Regulatory Enforcement Fairness Act (“SBREFA”),<sup>2</sup> which mandates that federal agencies establish small business civil penalty leniency programs. This report discusses the FTC’s Fiscal Year 2004 enforcement actions in which a civil penalty was assessed, the number of such actions against small entities, the number of those actions in which the civil penalty was reduced or waived, and the total monetary amount of reductions or waivers. As provided in SBPRA, the report also includes the agency’s definitions of “small entity,” “enforcement actions,” and “reduction or waiver.”

The Commission has a wide range of remedy options in its enforcement actions. These include civil penalties for certain types of violations. Civil penalties are not mandated for any violation, however. In some cases, the Commission determines that other remedies are more appropriate. The Commission rigorously reviews proposed civil penalty settlements to be certain that penalties achieve the desired deterrent effect and that, together with other remedies in the matter, they serve the public interest.

During the reporting period, federal district courts entered orders imposing civil penalties in 12 Commission enforcement actions. Of the 12 enforcement targets, 10 were large businesses and two were small businesses. Both of the actions involving small businesses qualified for the FTC’s civil penalty leniency program. The Commission obtained settlements in actions involving all 10 large businesses and one of the two small businesses. In all of the 11 matters where the Commission reached a settlement, it accepted the staff’s recommendations for requiring payment of civil penalties that were reduced from the initial amount sought after staff considered all the circumstances of the case and applied relevant mitigating factors.

With respect to the one case involving a small business in which a settlement was reached, the Commission reduced the civil penalty by a total of \$10,000. The second action against a small business was contested in litigation. In that case, the federal district court ordered the defendants to pay a civil penalty of \$103,900. The court did so without affording the government an opportunity to recommend a civil penalty amount or any reduction in the civil penalty. Accordingly, the Commission has not included this case in its civil penalty reduction figures.

Thus, in enforcement actions against small entities, the Commission accepted a reduced civil penalty in one action, a total reduction of \$10,000. In enforcement actions against large entities, the Commission accepted a reduced civil penalty in 10 actions. The combined total of this reduction for the 10 actions was \$7,918,765. The Commission did not totally waive civil

penalties in any of the 12 enforcement actions.

The total amount of civil penalties obtained by the Commission in the 12 cases was \$5,875,135. The total amount of reduction (for 10 cases involving large businesses and one case involving a small business) was \$7,928,765. Accordingly, the grand total of reduced and waived civil penalties was \$7,928,765.

These penalties were reduced for a variety of reasons. In some instances, during negotiations, companies produced additional information, such as evidence that there were fewer violations than originally estimated, or that the violations were less egregious than previously thought. In other instances, the reductions reflect the normal give and take of negotiations, and each party's desire to avoid unnecessary costs of litigation. In all instances, the Commission rigorously reviews each penalty and supporting rationale to ensure that the penalty is appropriate and will promote deterrence without creating an undue burden. When necessary, the Commission will request that staff increase a civil penalty amount if the reduced amount does not appear to be sufficient to deter unlawful conduct.

## INTRODUCTION

The Commission has prepared this report pursuant to Section 4 of the SBPRA. This provision of SBPRA builds on the requirements of the related SBREFA. That statute required agencies to establish a small business compliance assistance program and a small business civil penalty leniency program and to report on those programs. Section 4 of SBPRA requires that each agency file a report for fiscal years 2003 and 2004, providing specific information on the number of enforcement actions in which a civil penalty is assessed, the number of enforcement actions in which a civil penalty is assessed against a small entity, the number of enforcement actions in which the civil penalty is reduced or waived, and the total monetary amount of the reductions or waivers. The reports are to include the agency's definitions, for purposes of the report, of the terms "enforcement actions," "reduction or waiver," and "small entity."

## BACKGROUND

The Federal Trade Commission is a small agency<sup>3</sup> with a big mission: to maintain a free and fair marketplace for both business and consumers. The Commission enforces the FTC Act, 15 U.S.C. § 41 *et seq.*, and has enforcement or other responsibilities under more than 50 additional statutes. The Commission enforces nearly 30 rules promulgated pursuant to specific statutory directive and 13 trade regulation rules promulgated under the rulemaking authority of the FTC Act. The Commission has always been aware of and attentive to the special needs and interests of small businesses subject to its jurisdiction.

The Commission has a wide range of remedies available to obtain compliance with the laws and regulations it enforces. Remedies for certain statutory and regulatory requirements may include asking a court to order civil penalties. With one exception,<sup>4</sup> the Commission is not authorized to assess civil penalties itself, but can seek a civil penalty award only in a court action brought on its behalf by the Department of Justice. None of the statutes or rules provides for mandatory imposition of civil penalties and none provides for non-discretionary penalty amounts. The Commission sometimes determines that in certain cases it would be more appropriate to pursue other remedies, such as injunctive relief, consumer redress or disgorgement, without negotiating civil penalties. Whenever the Commission does seek civil penalties, however, it rigorously reviews the proposed civil penalty amount to be certain that penalties achieve the desired deterrent effect and that, together with other remedies in the matter, they are designed to serve the public interest.

The Commission ordinarily seeks civil penalties that are a small percentage of the maximum under the FTC Act. The Commission is considering the question of whether the overall range of penalties has been too low. In any event, however, the Commission has recognized that – whatever the baseline – it is necessary to consider various mitigating factors when determining the final civil penalty. The specific application of these factors to small businesses is described below.

## The Commission's Civil Penalty Leniency Program

Pursuant to SBREFA, in 1997 the Commission issued policy statements describing how it considers small business needs in two areas: (1) providing compliance assistance, and (2) determining appropriate civil penalty amounts when bringing enforcement actions.<sup>5</sup> The Commission's Small Business Compliance Assistance Policy Statement describes various forms of assistance available to small businesses to help them understand and comply with obligations imposed by the statutes and rules enforced by the Commission. The Commission's Civil Penalty Leniency Policy Statement discusses mitigating factors the Commission considers when small businesses are subject to civil penalties for violation of a rule or statute enforced by the Commission.<sup>6</sup>

SBREFA set forth criteria for agencies to consider in establishing a policy or program for "the reduction, and under appropriate circumstances for the waiver, of civil penalties for violations of a statutory or regulatory requirement by a small entity." That statute suggested that "[u]nder appropriate circumstances, an agency may consider ability to pay in determining penalty assessments." The statute further provided that the policy or program shall contain conditions or exclusions, which may include, but need not be limited to:

1. requiring the small entity to correct the violation within a reasonable correction period;
2. limiting the applicability to violations discovered through participation by the small entity in a compliance assistance or audit program operated or supported by the agency or a State;
3. excluding from the program small entities that have been subject to multiple enforcement actions by the agency;
4. excluding violations involving willful or criminal conduct;
5. excluding violations that pose serious health, safety, or environmental threats;
6. requiring a good-faith effort to comply with the law.

Section 223 provides that the policy or program is "[s]ubject to the requirements of other statutes," and thus does not supersede existing law on penalties.

In its civil penalty leniency policy statement applicable to small businesses, the Commission explained that it has long exercised its discretion in a variety of contexts to consider mitigating factors when selecting penalty amounts to seek in court actions.

First, Section 5(m)(1)(A) of the FTC Act, 15 U.S.C. § 45(m)(1)(A), authorizes the Commission to seek, in federal district courts, up to \$11,000 per violation of certain Commission

rules,<sup>7</sup> if the defendant had actual knowledge (or knowledge fairly implied on the basis of objective circumstances) that its acts were unfair or deceptive and prohibited by the rule. In determining the appropriate amount of a penalty, the courts are directed by Section 5(m)(1)(C), 15 U.S.C. § 45(m)(1)(C), to take into account the degree of culpability; any history of prior such conduct; ability to pay; effect on ability to continue to do business; and such other matters as justice may require. The Commission also evaluates these factors to determine appropriate penalties in cases that are not litigated.

Second, one Commission rule has a special penalty assessment and mitigation mechanism. As noted in the policy statement, under the Energy Policy and Conservation Act, 42 U.S.C. § 6303(a), the Commission has authority to assess civil penalties, up to \$110 per violation, for violations of its Appliance Labeling Rule, 16 C.F.R. Part 305. The Commission's Rules of Practice provide that factors to be considered in determining the amount of penalty include the respondent's size and ability to pay; the respondent's good faith; any history of previous violations; the deterrent effect of the penalty action; the length of time involved before the Commission was made aware of the violation; the gravity of the violation, including the amount of harm to consumers and the public caused by the violation; and such other matters as justice may require.<sup>8</sup>

Third, civil penalties also may be imposed for violations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a ("HSR Act"). Under the HSR Act, acquisitions above a certain amount,<sup>9</sup> involving businesses above certain sizes,<sup>10</sup> cannot be consummated unless certain information is filed with the Commission and with the Department of Justice and certain waiting periods are observed. By statute, civil penalties of up to \$11,000 for each day a person is in violation of the HSR Act may be imposed in a federal court action brought by DOJ. The Commission is charged with administering the premerger notification program established by the HSR Act, and recommends actions and penalty amounts to DOJ. The Commission considers the firm's ability to pay when recommending appropriate penalties. The Commission generally will not seek an enforcement action for a violation of the HSR Act that appears to be truly inadvertent and where the filing is made promptly after discovery of the oversight. If the violation is the firm's first, and is not the result of gross negligence or a reckless disregard for the filing obligation, the Commission staff generally sends a letter calling attention to the filing obligation but indicating that no further action will be taken if the filing requirement is promptly met.

Fourth, judicial opinions interpreting Section 5(l) of the FTC Act, which provides for civil penalties of up to \$11,000 per violation of FTC administrative orders, are instructive. The statute does not set forth criteria for determining specific penalties for Section 5(l) violations, but the Third Circuit Court of Appeals in *United States v. Reader's Digest Ass'n*, 662 F.2d 955, 967 (3d Cir. 1981), *cert. denied*, 455 U.S. 908 (1982), set out five factors bearing on the selection of an appropriate civil penalty or remedy: the good or bad faith of the respondent; the injury to the public; the respondent's ability to pay; the desire to eliminate the benefits derived from the violations; and the necessity of vindicating the Commission's authority. In each penalty case, the Commission selects an appropriate penalty amount after weighing the above factors, along

with the litigation risks and penalties imposed in similar cases.

### **Scope of the Commission's Civil Penalty Leniency Policy**

In light of the Commission's past experience, as well as the factors suggested in SBREFA itself, the Commission adopted the following policy for reducing, or in appropriate circumstances waiving, civil penalties for violations of a statutory or regulatory requirement by a small entity:

When the Commission identifies a small entity as failing to comply with a statutory or regulatory requirement within the Commission's jurisdiction, the Commission will consider the propriety of penalty waiver or reduction. The following factors will weigh in favor of leniency:

1. The small entity reported the violation to the Commission promptly after discovering it.
2. The small entity corrected the violation within a reasonable time, if feasible.
3. The small entity had a low degree of culpability. The degree of culpability reflects the efforts taken by the entity to determine and meet its legal obligations. These efforts are judged in light of such factors as the size of the business; the sophistication and experience of its owners, officers, and managers; the length of time it has been in operation; the availability of relevant compliance information; the clarity of its legal obligations; and any active attempts to clarify any uncertainties regarding its obligations.
4. The small entity is financially unable to pay the usual penalty, or the usual penalty would impair the small entity's ability to do business or to compete effectively.
5. The small entity has not been subject to any previous enforcement action by the Commission or other federal, state, or local law enforcement jurisdiction for the same or similar conduct for which the small entity is being considered for leniency. Where there have been prior enforcement actions, however, the Commission may take into consideration, as possible mitigating factors, when the previous enforcement action occurred, and whether the small entity's management has changed since the previous enforcement action.
6. The small entity's violations did not involve willful or criminal conduct.
7. The violations did not pose a serious health, safety, environmental, or economic threat to consumers or the public.

It is not necessary for each factor to be present for a small entity to qualify for leniency,

and, depending upon the particular circumstances, some factors may be weighed more heavily than others. Also, any other factors relevant in particular circumstances will be considered, as appropriate.

The above criteria include most of the factors suggested in SBREFA. The one suggested factor that the Commission did not include is one that would limit the penalty reduction policy or program to violations discovered by the small entity through participation in an agency-run or state-run compliance assistance or audit program. The Commission does not have formal compliance assistance or audit programs. Given the variety and scope of the rules and statutes that the Commission enforces, imposing a parallel requirement, such as a self-auditing program, would unnecessarily restrict the availability of penalty waivers or reductions.

In addition, the Commission expanded somewhat the scope of two of the factors suggested in SBREFA. First, SBREFA suggests excluding entities that have been subject to multiple enforcement actions by the agency. The Commission broadened this category to include entities that have been subject to actions for the same or similar conduct by other federal agencies or state or local agencies. The law violations prosecuted by the Commission are frequently very similar to violations prosecuted by other federal, state, and local law enforcement agencies. It is therefore appropriate, in considering whether to exclude entities from lenient treatment, to consider whether similar conduct has been subject to enforcement efforts by other authorities.

Second, SBREFA also suggests excluding violations that pose serious health, safety, or environmental threats. In addition to such risks, the Commission also considers serious economic injury, as that form of injury is the type most often encountered in Commission cases, and in many instances may cause as much serious injury as that arising from health, safety, or environmental threats.

#### **CIVIL PENALTIES IN FTC ENFORCEMENT ACTIONS AND THE FTC'S SMALL BUSINESS CIVIL PENALTY LENIENCY PROGRAM FY 2004**

In accordance with Section 4 of SBPRA, this report covers the twelve-month period from October 1, 2003, through September 30, 2004, and describes the number of enforcement actions against entities, both small and large, in which the Commission recommended a civil penalty to the court, or, as in one case, the court ordered the defendants to pay a civil penalty without seeking a government recommendation; the number of enforcement actions in which the Commission reduced or waived civil penalties; and the total monetary amount of such civil penalty reductions or waivers.

SBPRA provides that each agency's report shall include definitions, selected at the discretion of the agency, of the terms "enforcement actions," "reduction or waiver," and "small entity." For purposes of the Commission's report, consistent with SBREFA, the term

“enforcement action” or “civil penalty enforcement action” will refer to actions in which the agency sought, or anticipated seeking, a civil penalty for violation of a statute or rule enforced by the Commission.<sup>11</sup>

The term “reduction or waiver” will apply when a preliminary civil penalty amount that reflects the staff’s initial assessment of the case has been reduced or waived. The “preliminary civil penalty amount” is not necessarily the maximum civil penalty for which the company might have been liable under the statute. The Commission may accept or seek a reduced amount, or waive penalties, after discussions with the respondent company and production of relevant material, considering all of the circumstances of the case and applying any relevant mitigating or leniency factors. The figures for civil penalties actually sought in court actions reflect any reductions or waivers based on these discussions and factors.

The term “waiver” will apply to cases in which the agency anticipated seeking a civil penalty but waived all penalties in light of relevant mitigating or leniency factors; it does not include cases in which the Commission had the authority to seek civil penalties but preferred other remedies.<sup>12</sup>

The term “reduction or waiver” will also include partial or total suspension of civil penalties. Settlement agreements in some Commission enforcement actions suspend civil penalties due to a defendant’s financial situation, premised upon the truthfulness, accuracy, and completeness of the defendant’s financial condition as represented in sworn financial statements submitted to the Commission. Suspensions may be revoked and the full amount become due if the defendant’s financial submissions are found to be false.

Finally, the term “small entity” as used in the Commission’s report will refer to small businesses, small organizations, and small governmental jurisdictions, as defined in 5 U.S.C. § 601.<sup>13</sup>

## **Results**

During the reporting period, federal district courts entered orders imposing civil penalties in 12 Commission enforcement actions. Of the 12 enforcement targets, 10 were large businesses and two were small businesses. Both of the actions involving small businesses qualified for the FTC’s civil penalty leniency program. The Commission obtained settlements in actions involving all 10 large businesses and one of the two small businesses. In all of the 11 matters in which the Commission accepted settlements, it required payment of civil penalties that were reduced from the initial amount sought based on factors previously discussed in this report.

With respect to the one case involving a small business in which a settlement was reached, the Commission reduced the civil penalty by a total of \$10,000. The second action against a small business was contested in litigation. In that case, the federal district court ordered the defendants to pay a civil penalty of \$103,900. The court did so without affording the government an opportunity to recommend a civil penalty amount or any reduction in the civil

penalty. Accordingly, the Commission has not included this case in its civil penalty reduction figures.

Thus, in enforcement actions against small entities, the Commission accepted a reduced civil penalty in one action, a total reduction of \$10,000. In enforcement actions against large entities, the Commission accepted a reduced civil penalty in 10 actions. The combined total of this reduction for the 10 actions was \$7,918,765. The Commission did not totally waive civil penalties in any of the 12 enforcement actions.

The total amount of civil penalties obtained by the Commission in the 12 cases was \$5,875,135. The total amount of reduction (for 10 cases involving large businesses and one case involving a small business) was \$7,928,765. The Commission did not waive all civil penalties in any of its small or large business enforcement actions. Accordingly, the grand total of reduced and waived civil penalties was \$7,928,765.

### ***Small Business Reductions***

In one enforcement action involving a small business, the Commission accepted the staff's recommendation to file a settlement requiring the payment of a civil penalty that was *reduced* from the initial civil penalty the staff sought by a total of \$10,000. In this instance, the small business settled FTC charges, filed in federal district court, alleging violation of a rule enforced by the Commission. The size of the company was the most significant factor considered by the FTC in determining how much to reduce the civil penalty. Applying the mitigating factors enunciated in its leniency policy and Section 5(m)(1)(C) of the FTC Act, the Commission reduced civil penalties sought in the case primarily because the small business was financially unable to pay the usual penalty, and the usual penalty would have impaired the small business's ability to do business or to compete effectively. The federal district court accepted the settlement without modifying the civil penalty amount agreed upon by the parties.

In a second, litigated enforcement action involving a small business, the federal district court ordered the defendants to pay a civil penalty of \$103,900. This amount was far less than the maximum civil penalty for which the defendants might have been liable, and the court did not afford the government an opportunity to recommend a civil penalty amount or any reduction in the civil penalty. Accordingly, the Commission has not included this case in its civil penalty reduction figures. The Commission did not waive all civil penalties in any of its small business enforcement actions.

### ***Large Business Reductions***

In 10 enforcement actions involving large businesses, the Commission accepted the staff's recommendations to file settlements requiring the payment of civil penalties that were reduced from the initial civil penalties the staff sought after staff considered all the circumstances of the case and applied relevant mitigating factors. The combined total amount of reduction in the 10 cases was \$7,918,765. In each instance, the large business settled FTC

charges, filed in federal district court, alleging violation of a statute or rule enforced by the Commission. Applying the factors enunciated in Section 5(m)(1)(C) of the FTC Act, the Commission reduced the civil penalties sought in each of these 10 cases primarily because of the degree of culpability of the business (*i.e.*, the degree of culpability did not warrant penalties at the highest end of the spectrum); because the business, although large, was financially unable to pay the penalty initially sought; or because the penalty initially sought would have impaired the firm's ability to do business or to compete effectively. The federal district courts accepted each settlement without modifying the civil penalty amounts agreed upon between the parties. The Commission did not waive all civil penalties in any of its large business enforcement actions.

## **SUMMARY AND CONCLUSION**

During the reporting period, federal district courts entered settlement agreements, as well as an order in a contested matter, that provided for civil penalties in 12 enforcement actions, of which two involved small businesses. In pursuing these actions, the agency considered relevant mitigating and leniency factors in its decisions about the amount of civil penalties to seek. The number of cases was so small that statistical inferences about the cases are unlikely to be of value. The civil penalties ultimately obtained represented an appropriate reduction from the preliminary amount sought in connection with one uncontested small business enforcement action.

## ENDNOTES

1. Pub. L. No. 107-198, 116 Stat. 729 (June 28, 2002), codified at 5 U.S.C. § 601 note (attached as Appendix A).
2. Pub. L. No. 104-121, 110 Stat. 857 (March 29, 1996), codified at 5 U.S.C. § 601 note.
3. In fiscal year 2004, the FTC was appropriated 1,063 FTE (full time equivalents).
4. The Commission may assess civil penalties of up to \$110 per violation of the Commission's Appliance Labeling Rule, 16 C.F.R. Part 305, pursuant to a provision of the Energy Policy and Conservation Act, 42 U.S.C. § 6303(a).
5. 62 Fed. Reg. 16809 (attached as Appendix B). The policy statements also are available on the Commission's website at <http://www.ftc.gov/os/1997/04/62fr16809.pdf>. Although the statements were drafted specifically with respect to small businesses, similar compliance assistance is available to larger businesses, and some comparable factors for determining civil penalty amounts may be relevant to larger businesses too. These policy statements provide guidance and information only, and do not create any rights, duties, obligations, or defenses, implied or otherwise. The Commission retains the discretion to determine how to proceed in particular cases.
6. Consistent with Section 223 of SBREFA, the Commission's small business leniency policy encompasses civil penalty actions brought by the Commission for violations of a statute or rule enforced by the Commission. Because the leniency policy is prescribed only for civil penalties for violations of a statutory or regulatory requirement, it does not apply to civil penalty actions under Section 5(l) of the FTC Act, 15 U.S.C. § 45(l), for violations of Commission orders (which are not actions to enforce a statutory or regulatory requirement), or to Commission cease and desist orders, federal court injunctions, affirmative requirements for fencing-in, or redress contained in Commission orders. In all cases, however, the agency considers individual circumstances that may affect the remedy to be sought in each particular case.
7. In 1996, the Commission issued a rule implementing the Debt Collection Improvement Act of 1996 (Pub. L. No. 104-134) by making inflation adjustments in the dollar amounts prescribed for each type of violation established by the statutory civil penalty provisions within the FTC's jurisdiction. *See* 61 Fed. Reg. 54548 (Oct. 21, 1996).
8. The criteria for assessing penalties for violations of the Appliance Labeling Rule are set forth in Part 1.97 of the Commission's Rules of Practice, 16 C.F.R. § 1.97.
9. Generally, transactions valued at \$50 million or higher are reportable under HSR.
10. Because of the statutory thresholds, few if any small businesses are subject to the premerger notification reporting requirements of the HSR Act.

11. Thus, like the Commission's 1998 report to Congress pursuant to SBREFA, this report excludes actions involving a penalty for violation of a prior Commission order. *See* n.6 *supra*.

12. For example, in many instances a firm may be liable both for civil penalties and for substantial restitution to injured consumers, and the Commission may focus on restitution and not penalties. The Commission also has an innovative program to increase compliance with its Funeral Industry Practices Rule by focusing on compliance training rather than civil penalties. Under this program, funeral providers may be offered an opportunity to make a voluntary payment to the U.S. Treasury or state Attorney General in an amount generally lower than would have been sought in a civil penalty action, and enroll in an industry-managed compliance program. The program includes a review of the firm's practices, compliance training, and follow-up testing and certification. Matters handled under this program have not been included in the report as civil penalty waiver cases. Although the Commission had authority to seek civil penalties, these are not matters in which the agency anticipated seeking civil penalties, and thus, for example, did not investigate the extent of the violations to estimate an appropriate penalty.

13. The FTC applies the size standards developed by the Small Business Administration to carry out the purposes of the Small Business Act. Those size standards can be found at 13 C.F.R. § 121.201. Depending on the type of industry, the size standard for small businesses generally is 500 or fewer employees for manufacturing, or \$6 million or less in receipts for retailing or service industries. Different figures apply in specific industries.