



Federal Trade Commission

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TELEMARKETING RULE

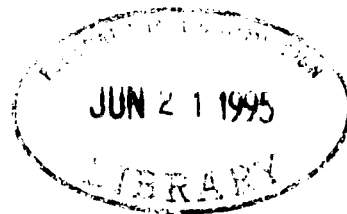
Prepared remarks of
Federal Trade Commissioner Christine A. Varney*

Before the

American Telemarketing Association Legislative Conference

Washington, D.C.
April 3, 1995

* The views expressed are those of the Commissioner and do not necessarily reflect the views of the Federal Trade Commission or staff.



Thank you very much for inviting me to speak to you this afternoon about the Federal Trade Commission's efforts to combat telemarketing fraud and, in particular, the proposed Telemarketing Rule. As many of you are aware, Congress last year enacted specific legislation to combat this serious and growing problem that imposes substantial costs on both consumers and legitimate businesses. The Telemarketing and Consumer Fraud and Abuse Prevention Act ("the Act") was passed with broad bipartisan support and the President signed it into law on August 16, 1994.¹ During the legislative process, the American Telemarketing Association was very supportive of those efforts to stamp out fraudulent telemarketing activity, and provided congressional staff with the needed perspective of the legitimate telemarketing industry. Likewise, as we continue with the rulemaking process, we welcome the extremely valuable input of the ATA and others in the telemarketing industry. The agency is sincere in its desire to draft a final rule that is appropriately balanced and not overly regulatory or burdensome.

As you know, the legislation requires the FTC to issue a rule, within one year from the date of enactment of the Act, prohibiting deceptive and abusive telemarketing acts and practices. The Act specifies that the rule contain a definition of deceptive telemarketing acts or practices. According to the statute, this definition may include acts or practices of

Pub. L. No. 103-297, 108 Stat. 1545 (1994).

entities or individuals that assist or facilitate deceptive telemarketing, including credit card laundering. The Act further specifies that, in order to prohibit other abusive acts or practices, the rule must include:

- (1) a requirement prohibiting a pattern of unsolicited telephone calls which the reasonable consumer would consider coercive or abusive of the consumer's right to privacy;
- (2) restrictions on the hours when unsolicited telephone calls can be made to consumers; and,
- (3) a requirement that telemarketers promptly and clearly disclose to the person receiving the call that the purpose of the call is to sell goods and services, and make any other disclosures the Commission deems appropriate, including the nature and price of the goods or services being sold.

The Act also directs the Commission to consider recordkeeping requirements.

The Commission will bring enforcement actions for violations of the final rule in the same manner as for other rules with respect to unfair or deceptive acts or practices under Section 5 of the FTC Act. In addition, Section 4 of the Act authorizes state attorneys general to enforce compliance with the final rule. After serving prior written notice to the Commission, states are authorized to institute Federal court enforcement

actions. Section 5 of the Act also provides for a private right of action, in Federal district court, for individuals who suffer damages of \$50,000. As with state actions, such private parties must give prior written notice to the Commission when feasible.

On February 9, 1995, the Commission published for public notice and comment a proposed Telemarketing Rule. While the comment period just closed on Friday, I do have a sense of what some of the concerns are with the proposal. Before I turn to the Rule, however, I would first like to provide an overview of the Commission's ongoing enforcement activities with respect to telemarketing fraud.

As Congress recognized, telemarketing fraud is a serious and pervasive problem, which has been and continues to be of great concern to the Commission. Estimates of yearly consumer loss due to fraudulent telemarketing range from \$3 to \$40 billion.² Financial institutions lose an estimated \$300 million a year from merchant fraud associated with fraudulent telemarketing.³ The FTC has placed a high priority on efforts to combat deceptive telemarketing and has brought more than 120 telemarketing cases in Federal court in the past few years. The Commission has

HOUSE COMM. ON GOVERNMENT OPERATIONS, THE SCOURGE OF TELEMARKETING FRAUD: WHAT CAN BE DONE AGAINST IT?, H.R. REP. NO. 421, 102d Cong., 1st Sess. 5 (1991).

Patrick Michela, *"You May Have Already Won . . .": Telemarketing Fraud and the Need for a Federal Legislative Solution*, 21 PEPP. L. REV. 553, 577 (1994).

obtained the full range of remedies for unfair or deceptive acts or practices that violate Section 5 of the FTC Act: ex parte temporary restraining orders accompanied by orders freezing corporate and personal assets; preliminary and permanent injunctive relief; monetary and other redress for injured consumers; and permanent bans and bonds to ensure against defendants' future participation in particular activities or industries where the severity of consumer injury or the recidivism of the defendants warrants such measures.

In addition, the Commission continues to work closely with representatives of local and state law enforcement agencies. We work reciprocally with individual state attorneys general to bring cases, and we cooperate closely with the National Association of Attorneys General ("NAAG") both to develop overall strategies and to implement systems for joint attacks on telemarketing fraud. The NAAG/FTC Telemarketing Fraud Database is one example of this cooperation. NAAG and the Commission created the Database in 1987 as a cooperative endeavor and is an electronic system for compiling and sharing complaints about telemarketing fraud. The Database is a useful tool for identifying the fraudulent telemarketers generating the largest number of complaints or the complaints with the highest dollar volume. It provides the information needed to spot trends in illegal activity. It also enables participating law enforcement agencies to learn about investigations being conducted by other participating members. Finally, it is an invaluable aid in

identifying prospective witnesses that can provide evidence against fraudulent schemes targeted for law enforcement action. Because telemarketing scams are highly mobile -- all that is needed is a bank of phones and a deceptive script -- complaints in the database often enable the participating law enforcement agencies to identify telemarketers that have closed down a scam in one location or jurisdiction only to reestablish operations elsewhere.

The Commission has recently taken steps to make the database an even more useful resource. We have improved and streamlined the procedures for entering data. We have designed new software that makes the system more "user-friendly" and upgrades its search capacity. We have expanded the number of participating organizations -- there are now 78 federal and state law enforcement organizations participating, including 41 state attorneys general. Other organizations, such as the Council of Better Business Bureaus, Call for Action, the National Futures Association, and the National Office Machine Dealers Association, contribute data to the system. These groups cannot gain access to information in the system because they are not law enforcement agencies.⁴ Finally, we have arranged with the National Consumers League to input complaint data from its 800-number telemarketing fraud hotline into the Database within hours after

This limitation is needed to ensure compliance with applicable confidentiality requirements.

it is received. This major contribution by the National Consumers League has significantly improved the quantity and timeliness of the data in the system. With these developments, the Database has become a very useful tool for federal, state and local law enforcement.

Over the past several years, the Commission has brought telemarketing fraud cases involving a multitude of schemes, ranging from sales of overpriced and phony water purifiers, luggage, rare coins, gemstones, luxury vacations, health and diet aids, and investment and business opportunities. New scams emerge regularly. The most numerous single category of complaints in the Database concern promotional sweepstakes.⁵ This is a type of deceptive telemarketing particularly targets elderly individuals. In terms of the aggregate amount paid by complainants, promotional sweepstakes are second only to gemstone scams.

We have recently observed a sudden increase in "recovery room" scams. These so-called recovery rooms contact consumers that have been victims of prior telemarketing scams, most often sweepstake schemes. The pitch typically used by recovery room telemarketers makes reference to the consumer's prior victimization, sympathetically warns the consumer not to fall for

The Commission has brought a number of cases against allegedly deceptive telemarketing sweepstakes promotions. See, e.g., *FTC v. Denny Mason*, CV-S-93-135-PMP (D. Nev. filed Feb. 22, 1993); *FTC v. Sierra Pacific*, CV-S-93-134-PMP (D. Nev. filed Feb. 22, 1993); *FTC v. Pioneer Enterprises*, Civ. No. CV-S-92-615-LDGRJJ (D. Nev. filed July 20, 1992).

unscrupulous telemarketing schemes again, and then falsely represents that, for an up-front fee, the scammer will assist the consumer in obtaining a refund of the amount the consumer initially lost.⁶ In fact, the recovery room is simply bilking consumers one more time and will not engage in any such "recovery" on their behalf.

Another recently popular fraudulent scheme that strikes businesses and individuals alike is deceptive "telefunding." Legitimate telefundraisers raise funds for *bona fide* charities through telephone solicitation campaigns. Fraudulent or deceptive telefundraisers, however, raise funds for themselves or for nonexistent or phony charities, although sometimes they may use the names of *bona fide* charities in their solicitations. The Commission has brought several cases in federal district court challenging allegedly deceptive telefunding.⁷ The only difference between a telefunding scam and a run-of-the-mill telemarketing operation is that in cases involving fundraising

A story by reporter Hattie Kaufman broadcast on *CBS This Morning* on September 15, 1994, provided excellent insight into the workings of the recovery room scam. This report highlighted a sting operation, conducted by the Idaho Attorney General's office, targeting Las Vegas recovery rooms. The broadcast included the audio portion of the recovery pitch delivered to a state investigator posing as a prior victim.

FTC v. Publishing Clearing House, No. CV-S-94-00623 (D. Nev. filed July 13, 1994); *FTC v. Genesis Enterprises*, No. CV-S-94-00624 (D. Nev. filed July 13, 1994); *FTC v. Int'l. Charity Consultants, Inc.*, No. CV-S-94-00195-DWH (LRL) (D. Nev. filed March 1, 1994); *FTC v. NCH, Inc.*, No. CV-S 94-138 LDG (LRL) (D. Nev. filed Feb. 14, 1994). The Commission recently brought another case against an allegedly deceptive fundraiser preying upon small businesses, but the scheme did not involve telefunding. *FTC v. Baylis*, No. 94-0017-S-LMB (D. Idaho filed Jan. 10, 1994).

for a purported charity, the telemarketers entice consumers with the promise of extravagant prizes in return for a donation to the "charity," instead of hawking overpriced cosmetics and fun-filled "luxury" vacations that turn out to have substantial hidden costs and restrictions.

In addition, there have been two recent developments in deceptive telemarketing. These developments are not merely new variations on what we have regrettably come to think of as "conventional" deceptive telemarketing, but involve new uses of technology. Fraud operators are very adaptive, and are often among the first to recognize the potential of new technology. For example, when pay-per-call, or 900 number, technology emerged a few years ago, unscrupulous operators were among the first to appreciate its possibilities for deceptive schemes.⁸ Congress and the Commission took steps to address abuses in the pay-per-call industry through regulation;⁹ the ingenuity of fraud operators, however, is seemingly inexhaustible, and they continually move on to exploit other new technologies. The latest manifestation of this opportunism is use of the

In response, the Commission initiated a number of lawsuits. *See, e.g., Phone Programs, Inc.*, Docket No. 9247 (consent agreement issued Dec. 10, 1993); *FTC v. U.S. Sales Corp.*, C.A. No. 91 C 3893 (N.D. Ill. filed June 24, 1991); *FTC v. Transworld Courier Services, Inc.*, C.A. No. 1:90-CV-1635-JOF (N.D. Ga. filed July 26, 1990).

The Telephone Disclosure and Dispute Resolution Act of 1992, 15 U.S.C. § 5701 *et seq.*, required both the FTC and the Federal Communications Commission to prescribe rules governing pay-per-call services or 900 numbers. The FTC's 900 Number Rule, 16 C.F.R. Part 308, was adopted on July 26, 1993, and became effective on November 1, 1993.

"information superhighway" to perpetrate fraud. This could potentially affect businesses and individual consumers alike.

Last September, the Commission filed its first case involving use of the Internet to perpetrate an allegedly deceptive scheme, *F.T.C. v. Brian Corzine*.¹⁰ In its complaint, the Commission alleged that Mr. Corzine (also known as "Brian Chase"), doing business on an online computer service as Chase Consulting, promoted a credit repair program advising consumers to take illegal steps to repair their credit records while falsely representing that the recommended course of action is "100 percent legal." The Commission obtained a temporary restraining order, and on November 21, 1994, the court entered a consent agreement settling the charges. The order permanently enjoined the defendant from engaging in the practices alleged in the complaint and called for full consumer redress. It is my understanding that distribution of the redress funds is currently underway (redress in this case is relatively modest because the Commission was able to halt the practices before substantial consumer injury occurred). If history serves as a guide, however, we know that Corzine may be only the harbinger of many future cases alleging deception and fraud through exploitation of the Internet.

With that overview, let me return to the proposed Telemarketing Rule. As the recent Corzine case illustrates, con

No. CIV-S-94-1446 (DFL) (E.D. Cal. filed Sept. 12, 1994).

artists are able to skillfully manipulate new technology to defraud consumers for their own financial benefit. Accordingly, it is imperative that any rule the Commission issues to address deceptive telemarketing is forward-looking to ensure that it will not be obsolete upon final publication. As currently drafted, the proposed Rule would cover certain activities on the Internet. Yet, it is unclear how much activity should be covered. We anticipate that the written comments will provide some suggestions in this area, and help us craft an appropriate limitation.

As proposed, the Rule defines "telemarketing" as a plan, program, or campaign which is conducted to induce payment for goods or services by use of one or more telephones (including a facsimile machine, computer modem, or other telephonic medium) and involves more than one interstate call. Catalog sales are excluded. We took this definition directly from the statute. In an effort to narrow the potentially unlimited scope of the Rule, staff has proposed excluding three additional areas from the Rule's coverage: (1) the solicitation of sales by any person who engages in fewer than 10 telemarketing sales a year; (2) most telephonic contacts between businesses; and (3) telephonic contacts initiated solely by the consumer where there has been no initial sales contact by the seller. There has been considerable discussion on whether such exemptions are appropriate. In addition, it is not settled whether the FTC has the discretion to

carve out additional exemptions beyond those contained in the statute. In my opinion, these additional exemptions comport with the original legislative intent to address fraudulent telemarketing directed to consumers. Further, such exemptions appropriately limit the scope of the Rule; otherwise, virtually any consumer or business transaction could be covered in today's telephonic society. Again, we look forward to reviewing the comments on this issue.

As the implementing legislation makes clear, the core of the Rule is to prohibit certain enumerated "deceptive telemarketing acts and practices." Accordingly, in an attempt to draw a bright line between lawful and unlawful conduct, the Rule sets forth several dozen examples of practices that would fall within the prohibition. This was intended to provide guidance not only for consumers, but also for you, the legitimate telemarketing industry. No doubt the comments will let us know if we succeeded here!

Examples of prohibited conduct include misrepresenting that any person has been selected to receive a prize, which, as you know, is a key component of fraudulent prize promotion schemes, and misrepresenting any affiliation with law enforcement or a government entity, which often occurs in scams involving recovery rooms where the defendant purports to be calling on behalf of an official sounding organization -- i.e., the Consumer Recovery

Agency. Also prohibited are misrepresentations concerning the market value or risk of any investment opportunity. Such misrepresentations form the basis for most fraudulent investment schemes. Again, as noted above, these examples and others contained in the proposed Rule are open for discussion and modification where necessary.

Experience acquired by the Commission in its law enforcement actions has demonstrated that unscrupulous telemarketers frequently depend for their success upon an extensive support network of service providers, such as credit card launderers. The participants in these networks distance themselves from the consumer transactions that consummate the fraud or deception, but their behind-the-scenes participation is essential to the success of the larger deceptive scheme.¹¹ Congress unambiguously directed the Commission's Rule to treat those who "assist or facilitate" deceptive telemarketing as within the ambit of the law. Thus, under the proposed Rule, it is a "deceptive telemarketing act or practice" for a person to provide substantial assistance or support to a seller engaged in a

In recent years Commission law enforcement actions have targeted participants in the telemarketing fraud support network. *See, e.g., Citicorp Credit Services, Inc.*, FTC Docket No. C-3413 (consent order, Feb. 4, 1993) (settling allegations that Citicorp Credit Services, Inc. provided processing of credit card charges for a travel telemarketer, BankCard Travel Club, when it knew or should have known about the Club's deceptive sales practices, as evidenced by, among other things, a high level of consumer complaints it received concerning BankCard, and a chargeback rate for BankCard that was more than 20 times the average chargeback rate in the industry).

telemarketing scam. Similarly, credit card laundering is a prohibited practice. These provisions will significantly strengthen the Commission's enforcement posture in combating deceptive telemarketing.

The proposed Rule also provides examples of conduct that would be "abusive" and thus a prohibited practice under the Telemarketing Act -- for example, directing a courier to pick up payments directly from a consumer. Staff was originally told that legitimate telemarketers usually do not send couriers; instead, fraudulent telemarketers often employ this practice to avoid the mail. Again, I trust the comments will bear out whether staff's initial understanding was correct. A number of the proposed abusive practices, such as prohibiting re-soliciting the same consumer until the terms of the first sale have been fulfilled (to prevent "re-loading"), and requiring paid professional fundraisers to disclose their professional status,¹² have generated substantial comment.

I would note also that the hours of calling restrictions (no calls before 8 a.m. or after 9 p.m.) contained in this section conform exactly to the requirements of the Telephone Consumer Protection Act (TCPA). There had been some initial concern that the FTC would adopt hours of calling restriction that differed from those adopted by the FCC under the TCPA. Of course, all of

¹² The Commission's recent experience with "telefunding" cases suggested such a disclosure requirement was appropriate.

the proposed Rule's requirements will be closely reexamined in light of the comments received. I want to emphasize that it is not the Commission's intent to propose Rules that unduly burden the legitimate industry or are otherwise unworkable. Instead, the Commission wants to ensure a fair and open marketplace for consumers and business alike.

Finally, the Rule as presently drafted requires telemarketers to keep certain records. For a period of two years, the following records are required: (1) all advertising, brochures, telemarketing scripts, and promotional materials; (2) the name and address of each prize recipient and the prize awarded; (3) the name and address of each customer, the goods or services purchased, the date such goods or services were shipped or provided, and the amount paid; (4) the name, home address and telephone number, and job title(s) for all current and former employees directly involved in telephone sales; and (5) any written notices, disclosures, and acknowledgments required to be provided under the Rule. In drafting these recordkeeping requirements, staff attempted to be mindful of the potential burdens they might impose. They were provided information that these five categories of records were the types of records already retained by legitimate telemarketers in the regular course of business, and, therefore, they should not impose significant additional burdens. The comments, I am sure, will shed light on whether staff correctly assessed the anticipated

burden of the recordkeeping requirements.

In closing, I would like to emphasize that, despite the current anti-regulatory climate, the Commission's proposed telemarketing rule is an extremely important weapon in the battle against telemarketing fraud, a costly war for both consumers and legitimate businesses. Moreover, once final, the States will be able to enforce the Commission's Telemarketing Rule, which is consistent with current efforts to return power to the States. While the exact parameters of the final Rule are still to be determined, I firmly believe that the Commission will be able to craft a Rule that is appropriately balanced -- one that achieves maximum consumer protection with the minimum of regulatory burden.

Thank you for your attention today, and I look forward to the ATA's participation in our Telemarketing Workshop in Chicago later this month. I would be pleased to take any questions you may have.