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FEDERAL TRADE COMMISSION REAUTHORIZATION

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

SEPTEMBER 12, 2007

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FEDERAL TRADE COMMISSION REAUTHORIZATION

WEDNESDAY, SEPTEMBER 12, 2007

U.S. SENATE,
SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:35 a.m. in room SR–253, Russell Senate Office Building, Hon. Byron L. Dorgan, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. The Committee will come to order. This is the Senate Committee on Commerce, Science, and Transportation, Interstate Commerce, Trade, and Tourism Subcommittee, hearing on the Federal Trade Commission reauthorization.

I regret to tell you that last evening, about 8:30 in the evening, they scheduled three votes, starting at 9:30 this morning. Because of that, the first vote is now underway; it'll be followed by two ten-minute votes. My expectation is, the votes will be completed by 10:15. And I deeply apologize for the inconvenience to all of you, but, because of that, we will have to recess until 10:15, at which time the hearing will begin.

The Committee is in recess.

[Recess.]

Senator DORGAN. The Committee will come to order.

First, again—I should say, again, let me apologize for the inconvenience. I know it is not convenient for any of you to wait for nearly an hour, but the schedule of the Senate sometimes isn't established for our convenience, or yours, it's an unusual body, and so, we are delayed today, but thank you very much for waiting, and thank you for being here.

Chairman Majoras, thank you very much for being with us today. We will have testimony from you, and then we will have testimony from a second panel.

The second panel will include Dr. Mark Cooper, from the Consumer Federation of America; Mr. Chris Murray, from the Consumers Union; Mr. Michael Calhoun, the President of the Center for Responsible Lending; Mr. Ari Schwartz, from the Center for Democracy and Technology; and Mr. Marty Abrams, from the Center for Information Policy Leadership.

The hearing today is a reauthorization hearing for the Federal Trade Commission, which is an independent Federal agency established in 1914. This is an agency that has a gray beard, it's been around a long, long time, and serves a very useful purpose. Under the Federal Trade Commission Act of 1914, the Commission was established to protect consumers. The mandate has two different and distinct components—first, to protect consumers from unfair or deceptive acts or practices in or affecting commerce; and, second, to protect consumers from unfair methods of competition. As part of this authority, the agency enforces some 46 statutes and is the only Federal agency with both consumer protection and competition jurisdiction in very broad sectors of the economy.

The Commission's consumer protection authority is provided under the FTC Act; and, under that Act, the Commission is charged with preventing a broad range of consumer abuses, including deceptive or misleading advertising, telemarketing fraud, credit report errors, and false labeling. The Act also grants the FTC jurisdiction over unfair methods of competition, deceptive acts or practices that unreasonably impede a consumer's ability to make an informed choice.

I don't need to remind everyone how important these particular functions are, given what we have read in the newspapers in the last several months. The issue of consumer safety is paramount in this galloping global economy and rules for that global economy are not nearly keeping pace. We have stories, these days in the newspapers, about danger and risk to American consumers. I want to talk a little about that today. It's a very important function, the function of ensuring competition, as is the function of consumer protection. We need to reauthorize the Federal Trade Commission, and we will hope to do so with legislation that we move to the floor of the Senate very soon.

The Commission itself is a five-member Commission appointed by the President, confirmed by the Senate, for 7-year terms. We have invited the Chairman of the Commission to be with us today.

Let me, again, say thank you for your patience and ask you to proceed. Your entire statement will be made a part of the record today, and we will ask you to summarize.

Madam Chair, go ahead.

STATEMENT OF HON. DEBORAH PLATT MAJORAS, CHAIRMAN, FEDERAL TRADE COMMISSION

Ms. MAJORAS. Thank you very much, Chairman Dorgan. It's a great pleasure to appear before you today to describe the FTC's broad program to protect consumers in today's dynamic marketplace through vigorous law enforcement, consumer and business education, competition advocacy, and market research.

During the past 3 fiscal years, our consumer protection work has produced more than 250 court orders requiring defendants to pay more than $1.2 billion in consumer redress, 47 court judgments for civil penalties, totaling over $38 million, and approximately 180 new Federal court complaints aimed at stopping unfair and deceptive conduct. At the same time, we've developed 250 consumer and business education campaigns and publications, completed 54 statutorily mandated rulemakings and reports, hosted 48 public

conferences and workshops, and issued 40 reports on issues of great significance to consumers. This active agenda continues.

Protecting the privacy and identity of American consumers has become, and remains, a top priority in this information age. The FTC has brought 14 enforcement actions against companies for their failure to provide reasonable security for consumers' data, actions that have helped set standards for industry, and more are in the pipeline.

Last year, we launched a nationwide identity theft consumer education campaign, "Deter, Detect, Defend," and developed a new business education guide on data security. Over the past 2 years, we've brought nearly a dozen enforcement actions against purveyors of spyware, and a steady stream of cases against spammers. We continue protecting Americans' privacy through implementation and enforcement of the highly successful Do Not Call Registry, which now contains more than 147 million telephone numbers, and enforcement actions against telephone pretexters and those who violate the Children's Online Privacy Protection Act.

To protect consumers in the financial services marketplace, we're focusing on enforcement efforts in the marketing of mortgage products, particularly in the subprime market, deception in the credit area, and illegal methods used in debt collection. We've attacked false or inadequate disclosures relating to gift cards and rebate programs. Other areas of attack in our fraud program include business-opportunity and work-at-home scams, various forms of telemarketing fraud, and bogus health and weight-loss claims, and the latter rank very high on the agenda, because they have such potential to harm consumers who forego legitimate treatment options.

We've been a driving force in the recent renewal of self-regulation in the advertising of food to children, and we continue our work in monitoring self-regulation among marketers of video games, music, and movies with violent content, as well as alcohol. Indeed, as to the latter, this week we've been sponsoring "We Don't Serve Teens Week," blanketing the Nation through PSAs and a lot of help from states and others, with the admonition not to provide alcohol to minors. Thanks to Congress, which worked with us to pass the U.S. SAFE WEB Act of 2006, we now have better tools with which we are fighting cross-border fraud.

We're equally active in protecting competition, focusing on areas that have the most significant impact on consumers; namely, healthcare, energy, real estate, and high-technology industries. So far, in this fiscal year, we've issued 31 second requests in mergers, we've had 20 merger cases that have resulted in enforcement action or withdrawal of the merger, and we've brought 11 nonmerger cases. In healthcare, for example, we've achieved substantial relief over the last year before allowing mergers in the areas of generic drugs, over-the-counter medications, injectable analgesics, and other medical devices and diagnostic services. We've challenged price-fixing agreements among competing physicians, and agreements between drug companies that delay generic entry. We are continuing to stand up against reverse-payment settlements, including by working with Congress on bipartisan efforts to advance a workable legislative remedy. And the Commission recently issued

an opinion ruling that Evanston Northwestern Healthcare Corporation's acquisition of Highland Park Hospital was anticompetitive.

So far in 2007, the Commission has challenged three mergers in the energy industry: Western Refining's acquisition of Giant Industries—unfortunately, we were unsuccessful in District Court; Equitable Resources' proposed acquisition of the People's Natural Gas Company—that is still in litigation; and the proposed $22 billion deal whereby energy firm Kinder Morgan would be taken private by its management, and a group of investment firms, including Carlyle Group and Riverstone Holdings.

We also charged the American Petroleum Company with illegally conspiring with competitors to restrict the importation and sale of motor oil lubricants in Puerto Rico. And other industries in which we've brought significant actions include real estate, grocery stores, and funeral homes, and related products and services.

Complementing these antitrust enforcement efforts are our competition advocacy efforts, our market research, which has produced reports on IP issues, municipal provision of wireless Internet, broadband policy, and competition in real estate, and our new consumer education campaign.

Mr. Chairman, the more than 1,000 employees of the FTC remain focused on our critical mission to protect consumers and competition. We always appreciate your support, and look forward to continuing to work together to further the interests of American consumers.

Thank you for holding this hearing. I'd like to thank my fellow commissioners who are with me today, and some of our staff, and I also would like to thank those on the second panel, who obviously play a very important role in the work that we do.

Thank you.

[The prepared statement of Ms. Majoras follows:]

PREPARED STATEMENT OF HON. DEBORAH PLATT MAJORAS, CHAIRMAN, FEDERAL TRADE COMMISSION

I. Introduction

Chairman Dorgan, Ranking Member DeMint, and Members of the Subcommittee, I am Deborah Platt Majoras, Chairman of the Federal Trade Commission ("Commission" or "FTC"). I am pleased to come before you today at this reauthorization hearing.[1]

The FTC is the only Federal agency with both consumer protection and competition jurisdiction in broad sectors of the economy.[2] The agency enforces laws that prohibit business practices that are harmful to consumers because they are anticompetitive, deceptive, or unfair, and promotes informed consumer choice and understanding of the competitive process.

The FTC has pursued a vigorous and effective law enforcement program in a dynamic marketplace that is increasingly global and characterized by changing technologies. Through the efforts of a dedicated, professional staff, the FTC continues to handle a growing workload.

The agency's consumer protection work has focused on data security and identity theft, technology risks to consumers such as spam and spyware, fraud in the marketing of health care products, deceptive financial practices in the subprime mortgage and credit repair industries, telemarketing fraud, and Do Not Call enforcement. During the past three fiscal years, the FTC has obtained more then 250 court orders requiring defendants to pay more than $1.2 billion in consumer redress, obtained 47 court judgments for civil penalties in an amount over $38 million, and filed approximately 180 new complaints in Federal district court to stop unfair and deceptive practices. It also completed 54 statutorily-mandated rulemakings and re-

ports, hosted 48 conferences and workshops, issued 40 reports on topics significant to consumers, and developed 250 consumer and business education campaigns.

The Commission's competition mission has worked to strengthen free and open markets by removing the obstacles that impede competition and prevent its benefits from flowing to consumers. To accomplish this, the FTC has focused its enforcement efforts on sectors of the economy that have a significant impact on consumers, such as health care and pharmaceuticals, energy, technology, and real estate. So far in Fiscal Year 2007, there have been 20 merger cases that have resulted in enforcement action or withdrawal—including three litigated preliminary injunction actions—and 11 nonmerger enforcement actions.[3]

Our testimony today summarizes some of the major activities of the recent past and describes some of our planned future initiatives. It also identifies certain legislative recommendations that the Commission believes will allow us to better protect U.S. consumers. These are:

1. to stop brand name drug companies from paying generic companies not to compete at the expense of consumers;

2. to repeal the telecommunications common carrier exemption; and

3.to ensure that the Commission has authority to impose civil penalties in cases in which the Commission's traditional equitable remedies are inadequate, such as spyware and data security cases.[4]

II. Consumer Protection

As the Nation's consumer protection agency, the FTC has a broad mandate. This year, it devoted significant resources to the issues of data security and identity theft, technology risks to consumers, fraud in the marketing of the health care products, financial practices, telemarketing fraud, and Do Not Call enforcement.[5] The Commission plans to continue our important work in these areas in 2008. This testimony highlights key issues and initiatives for the agency's consumer protection mission, as well as the methods the FTC will use to address them.

A. Data Security and Identity Theft

In 1998, Congress passed the Identity Theft Assumption and Deterrence Act ("Identity Theft Act"), which assigned the FTC a unique role in combating identity theft and coordinating government efforts.[6] This role includes collecting consumer complaints; implementing the Identity Theft Data Clearinghouse, a centralized database of victim complaints used by 1,600 law enforcement agencies; assisting victims and consumers by providing information and education; and educating businesses on sound security practices. The FTC continues to focus on combating identity theft primarily through law enforcement, implementation of the recommendations of the President's Identity Theft Task Force, and education both to help consumers avoid identity theft and to assist the millions of Americans who are victimized each year.

1. Law Enforcement

Although the FTC, a civil enforcement agency, cannot enforce criminal identity theft laws, it can take law enforcement action against businesses that fail to implement reasonable safeguards to protect sensitive consumer information from identity thieves. Over the past few years, the FTC has brought 14 enforcement actions against businesses, including BJ's Wholesale Club, ChoicePoint, CardSystems Solutions, and DSW Shoe Warehouse, for their alleged failures to provide reasonable data security. In these and other cases, the FTC has alleged, for example, that companies discarded files containing consumer home loan applications in an unsecured dumpster; stored sensitive information in multiple files when there was no longer a business need to keep the information, or in unencrypted files that could be easily accessed using commonly-known used IDs and passwords; failed to implement simple, low-cost, and readily available defenses to well-known web-based hacker attacks; failed to use readily available security measures to prevent unauthorized wireless connections to their networks; and sold sensitive consumer information to identity thieves posing as the company's clients. The Commission continues to monitor the marketplace to encourage companies to implement and maintain reasonable safeguards to protect sensitive consumer information. In appropriate cases, the Commission will bring enforcement actions.

2. Identity Theft Task Force

On May 10, 2006, the President established an Identity Theft Task Force, which I co-chair, and which comprises 17 Federal agencies with the mission of developing

a comprehensive national strategy to combat identity theft.[7] In April 2007, the Task Force published its strategic plan for combating identity theft.[8]

In the Strategic Plan, the Task Force recommends dozens of initiatives directed at reducing the incidence and impact of identity theft. To prevent identity theft, the Plan recommends that governments, businesses, and consumers improve data security. It recommends that Federal agencies and departments improve their internal data security processes; develop breach notification systems; and reduce unnecessary uses of Social Security numbers, which are often the key item of information that identity thieves need. For the private sector, the Task Force proposes that Congress establish national standards for data security and breach notification that would preempt the numerous state laws on these issues. The Plan also recommends the dissemination of additional guidance to the private sector for safeguarding sensitive consumer data; continued law enforcement against entities that fail to implement appropriate security; a multi-year consumer awareness campaign to encourage consumers to take steps to safeguard their personal information and minimize their risk of identity theft; a comprehensive assessment of the private sector's uses of Social Security numbers; and workshops on developing more reliable methods of authenticating the identities of individuals to prevent thieves who obtain consumer information from using it to open accounts in the consumer's name.

To assist victims in the recovery process, the Plan recommends development of easy-touse reference materials for law enforcement, often the first responders to identity theft; implementation of a standard police report, often a key document for victim recovery; nationwide training for victim assistance counselors; and development of an Identity Theft Victim Statement of Rights. And finally, the Plan includes a host of recommendations for strengthening law enforcement's ability to detect and punish identity thieves.

Many of the Task Force recommendations have already been implemented or are in the process of being implemented. For example, the Office of Management and Budget has issued data security and breach management guidance for government agencies.[9] The FTC has developed and distributed detailed data security guidance for businesses,[10] is planning regional data security conferences, has conducted a public workshop on consumer authentication,[11] has published an identity theft victim statement of rights on its website and at *www.idtheft.gov,* and is leading the interagency study of the private sector usage of Social Security numbers.[12] The Department of Justice has forwarded to Congress a set of legislative recommendations that seek to close existing loopholes for the prosecution of some types of identity theft,[13] and is developing and presenting expanded training for their prosecutors and, in partnership with the FTC, for state and local law enforcement.

3. Education

The FTC continues to educate consumers on how to avoid becoming victims of identity theft, and last year launched a nationwide identity theft education program.[14] This program—Deter, Detect, Defend—has been very popular. The FTC has distributed over 2.6 million brochures, has recorded more than 3.2 million visits to the program's website, and has disseminated 55,000 kits, which can be used by employers, community groups, Members of Congress, and others to educate their constituencies.

The FTC also sponsors an innovative multimedia website, OnGuard Online, designed to educate consumers about basic computer security.[15] The website provides information on such as phishing, spyware, and spam. Since its launch in late 2005, OnGuard Online has attracted more than 3.5 million visits.

The Commission directs its outreach to businesses as well. This April, the Commission released a new business education guide on data security.[16] The Commission anticipates that the brochure will prove to be a useful tool in alerting businesses to the importance of data security issues and give them a solid foundation on how to address them.

B. Technology

Although technology can play a key role in combating identity theft and improving consumers' lives, it also can create new consumer protection challenges. The Commission has worked aggressively to protect consumers from technological threats such as spam and spyware. In addition, the agency has focused on identifying new issues related to technology in order to better protect consumers in the future.

To enhance consumer protections in cases involving spyware, as well as those involving data security, the Commission continues to support provisions in pending bills that give the FTC civil penalty authority. Civil penalties are important in areas where the Commission's traditional equitable remedies, including consumer restitu-

tion and disgorgement, may be impracticable or not optimally effective in deterring unlawful acts. Restitution is often impracticable in these cases because consumers suffer injury that is either non-economic in nature or difficult to quantify. Likewise, disgorgement may be unavailable because the defendant has not profited from its unlawful acts. As such, the Commission reiterates its support for civil penalty authority in these areas and looks forward to continuing to work with this Committee to improve the Commission's ability to protect consumers.

1. Spam

Since 1997, when the FTC brought its first case involving spam, the Commission has aggressively pursued deceptive and unfair practices involving these e-mail messages through 90 law enforcement actions against 143 individuals and 100 companies, 26 of which were filed after Congress enacted the CAN–SPAM Act. These cases have focused on the core protections that the CAN–SPAM Act provides to consumers: opt-out mechanisms that function; message headers that are non-deceptive; and warnings, as appropriate, that sexually-explicit content is included. Through these 26 actions, the Commission has succeeded in obtaining strong injunctions and significant monetary relief. To date in the FTC's CAN–SPAM cases, Federal courts have awarded the Commission more than $10 million in disgorgement or redress and in excess of $2.6 million in civil penalties.

The FTC continues to devote significant resources to fight spam. In June 2007, the Commission hosted a "Spam Summit" to explore the next generation of threats and solutions in the spam arena. The Summit panelists, nearly 50 in number, all confirmed that spam is being used increasingly as a vehicle for more pernicious conduct, such as sending phishing e-mails, viruses, and spyware. This malicious spam goes beyond mere annoyance to consumers—it can be criminal, resulting in significant harm by shutting down consumers' computers, enabling keystroke loggers to steal identities, and undermining the stability of the Internet. Due to strong spam-filtering, however, much of this spam is not reaching consumers' inboxes. The panelists also confirmed that malicious spam is a technological problem, driven largely by "botnets" (networks of hijacked personal computers that spammers use to conceal their identities) and the exploitation of computer security vulnerabilities that allow spammers to operate anonymously. Industry is taking a leading role in developing technological tools, such as domain-level e-mail authentication, to "uncloak" these anonymous spammers, and the Commission is encouraged by reported increases in the adoption rates for e-mail authentication. Panelists also agreed that there is no single solution to the spam problem and encouraged key stakeholders to collaborate in the fight against spam. To that end, the Commission looks forward to continued collaboration with consumer groups, industry members, international bodies, Members of Congress, and criminal law enforcement authorities.

2. Spyware

The Commission has brought eleven spyware enforcement actions in the past 2 years. These actions have reaffirmed three key principles: First, a consumer's computer belongs to him or her, not the software distributor. Second, buried disclosures do not work, just as they have never worked in more traditional areas of commerce. And third, if a distributor puts a program on a consumer's computer that the consumer does not want, the consumer must be able to uninstall or disable it.

The Commission's most recent settlement with Direct Revenue, a distributor of adware, illustrates these principles.[17] According to the FTC's complaint, Direct Revenue, directly and through its affiliates, offered consumers free content and software, such as screen savers, games, and utilities, without disclosing adequately that downloading these items would result in the installation of adware. The installed adware monitored the online behavior of consumers and then used the results of this monitoring to display a substantial number of pop-up ads on their computers. Moreover, it was almost impossible for consumers to identify, locate, and remove this unwanted adware. Among other things, the FTC's complaint alleged that Direct Revenue used deception to induce the installation of the adware and that it was unfair for the company to make it unreasonably difficult to uninstall the adware. To resolve these allegations, Direct Revenue agreed to provide clear and prominent disclosures of what it is installing, obtain express consent prior to installation, clearly label its ads, provide a reasonable means of uninstalling software, and monitor its affiliates to assure that they (and any subaffiliates) comply with the FTC's order. In addition, Direct Revenue agreed to disgorge $1.5 million to the U.S. Treasury. The Commission will continue to monitor this area and bring law enforcement actions when warranted.

3. The Tech-Ade Workshop

The FTC is committed to understanding the implications of the development of technology on privacy and consumer protection—as, or even before, these developments happen. Last November, the FTC convened public hearings on the subject of *Protecting Consumers in the Next Tech-Ade.*[18] The FTC heard from more than 100 of the best and brightest people in the tech world about new technologies on the horizon and their potential effects on consumers. The staff has incorporated what it has learned at the hearings into its enforcement and policy planning, will issue a report shortly, and will follow-up the hearings with a series of "town hall" meetings. The first such "town hall" meeting will take place on November 1–2 in Washington, D.C. and will address the issue of online behavioral marketing. Behavioral marketing involves the collection of information about a consumer's activities online—including the searches the consumer has conducted, the web pages visited, and the content the consumer has viewed. The information is then used to target advertising to the consumer that is intended to reflect the consumer's interests, and thus increase the effectiveness of the advertising. The FTC will examine how behavioral marketing works, what types of data are collected, how such data are used, whether such data are sold or shared, and what information is conveyed to consumers about its use.

4. Repeal of the Common Carrier Exemption

To address the consumer protection challenges posed by technology convergence, the Commission continues to support the repeal of the telecommunications common carrier exemption.

Currently, the FTC Act exempts common carriers subject to the Communications Act from its prohibitions on unfair and deceptive acts or practices and unfair methods of competition.[19] This exemption dates from a period when telecommunications were provided by government-authorized, highly regulated monopolies. The exemption is now outdated. Congress and the Federal Communications Commission ("FCC") have dismantled much of the economic regulatory apparatus formerly applicable to the industry, and in the current world, firms are expected to compete in providing telecommunications services.

Technological advances have blurred the traditional boundaries between telecommunications, entertainment, and information. As the telecommunications and Internet industries continue to converge, the common carrier exemption is likely to frustrate the FTC's ability to stop deceptive and unfair acts and practices and unfair methods of competition with respect to interconnected communications, information, entertainment, and payment services.

The FTC has extensive expertise with advertising, marketing, and billing and collection, areas in which issues have emerged in the telecommunications industry. In addition, the FTC has powerful procedural and remedial tools that could be used effectively to address developing problems in the telecommunications industry if the FTC were authorized to reach them.

C. Health

Of course not all fraud is technology-related. Fraud in the marketing of health care products, for example, can still be found in the offline world as in the online world. Too often, consumers fall prey to fraudulent health marketing because they are desperate for help. Fifty million Americans suffer from a chronic pain condition[20] and have found no effective cure or treatment. Seventy million Americans are trying to lose weight.[21] The FTC continues to take action against companies that take advantage of these consumers.

From April 2006 through August 2007, the FTC initiated or resolved 19 law enforcement actions involving 31 products making allegedly deceptive health claims.[22] For example, in September 2006, a Federal district court found that defendants' claims for their purported pain relief ionized bracelets were false and unsubstantiated, and required the individual and corporate defendants to pay up to $87 million in refunds to consumers.

In January 2007, the Commission announced separate cases against the marketers of four extensively advertised products—Xenadrine EFX, CortiSlim, TrimSpa, and One-A-Day WeightSmart. Marketers for these products settled charges that they had made false or unsubstantiated weight-loss or weight-control claims. In settling, the marketers surrendered cash and other assets collectively worth at least $25 million and agreed to limit their future advertising claims.[23]

Another important issue on the Commission's health agenda is childhood obesity. In the Summer of 2005, the Commission and the Department of Health and Human Services held a joint workshop on the issue of childhood obesity.[24] The Commission's

April 2006 report on the workshop urged industry to consider a wide range of options as to how self-regulation could assist in combating childhood obesity.[25]

A number of companies took the FTC's recommendations seriously. On October 16, 2006, for example, the Walt Disney Company announced new food guidelines aimed at giving parents and children healthier eating options.[26] And in November 2006, the Children's Advertising Review Unit, or "CARU," which is administered by the Council of Better Business Bureaus, announced a new self-regulatory advertising initiative designed to use advertising to help promote healthy dietary choices and healthy lifestyles among American children.[27] Eleven leading food manufacturers—including McDonalds, The Hershey Company, Kraft Foods, and General Mills—are participants in this initiative. On July 18, 2007, at a forum on childhood obesity hosted by the FTC and the Department of Health and Human Services ("HHS"), these companies released the details of their pledges to voluntarily restrict their advertising to children under 12 on television, radio, print, and Internet. Each of the companies committed either to limiting 100 percent of their advertising directed to children to food products that meet certain nutrition criteria or to refrain from advertising to children.[28] Nutritional standards vary by company, but all are required to be consistent with established scientific and/or government standards. As part of the initiative, the companies also committed to restricting their use of third-party licensed characters to products that meet these nutritional criteria and to websites promoting healthy lifestyles.

At the July 18 FTC–HHS forum, select food and media companies reported on the progress they have made to date in adopting nutritional standards for advertising to children and reformulating products to offer children products that comport with these nutritional standards. The FTC also reported on its own research. The FTC's Bureau of Economics discussed the results of a study of children's exposure to food advertising on TV, released in June 2007. The study compared children's exposure to advertising on television in 1977 and 2004. The study concluded that today's children see more promotional advertisements for other programming, but fewer paid ads and fewer minutes of advertising on television. The study also found that children are not exposed to more food ads on television than they were in the past, although their ad exposure is more concentrated on children's programming.

The FTC also updated the audience on its efforts to conduct a more comprehensive study of food industry marketing expenditures and activities targeted toward children and adolescents. Through this effort, the FTC is exploring not only traditional TV, print, and radio advertising, but all of the many other ways that the industry reaches children—through in-store promotions, events, packaging, the Internet, and product placement in video games, movies, and television programs. The Commission hopes to get a more complete picture of marketing techniques for which publicly available data have so far been lacking. The Commission will submit the aggregated data about children's food marketing in a report to Congress, as directed in the conference report on its 2006 appropriations legislation. This endeavor will be an important tool for tracking the marketplace's response to childhood obesity and identifying where more action is needed.

D. Financial Practices

As with health issues, financial issues impact all consumers—whether they are purchasing a home, trying to establish credit or improve their credit rating, or managing rising debt. Thus, protecting consumers in the financial services marketplace is a critical part of the FTC's consumer protection mission. The FTC has focused recent efforts in this area on subprime mortgage lending, payment cards, debt collection practices, and credit and debt counseling services.[29]

1. Mortgage Lending and Servicing

In the last decade, the agency has brought twenty-one actions against companies and principals in the mortgage lending industry, focusing in particular on the subprime market.[30] Several of these cases have resulted in large monetary judgments, with courts ordering that more than $320 million be returned to consumers.

Most recently, in 2006, the Commission filed suit against a mortgage broker for deceiving Hispanic consumers who sought to refinance their homes. The FTC's complaint alleged that the broker misrepresented numerous key loan terms.[31] The alleged conduct was egregious because the FTC claimed that the lender conducted business with its clients almost entirely in Spanish, and then provided loan documents in English at closing containing the less favorable terms. To settle the suit, the broker paid consumer redress and agreed to a permanent injunction prohibiting it from misrepresenting loan terms.[32]

The Commission also has challenged deceptive and unfair practices in the servicing of mortgage loans.[33] For example, in November 2003, the Commission, along

with the Department of Housing and Urban Development ("HUD"), announced a settlement with Fairbanks Capital Corp. and its parent company. Fairbanks (now called Select Portfolio Servicing, Inc.) had been one of the country's largest third-party subprime loan servicers—it did not originate any loans, but collected and processed payments on behalf of the holders of the mortgage notes. The Commission alleged that Fairbanks failed to post consumers' payments upon receipt, charged for unnecessary insurance, and imposed other unauthorized fees. The complaint also charged Fairbanks with violating Federal laws by using dishonest or abusive tactics to collect debts, and by reporting to credit bureaus consumer payment information that it knew to be inaccurate. To resolve these charges, Fairbanks and its former chief executive officer paid over $40 million in consumer redress, agreed to halt the alleged illegal practices, and implemented significant changes to company business practices to prevent future violations.[34] Just last month, the FTC announced a modified settlement with the company, which provided substantial benefits to consumers beyond those in the original settlement, including account adjustments and reimbursements or refunds of fees paid in certain circumstances.[35]

To leverage resources in the Commission's work on subprime mortgage lending, this summer it announced that it will cooperate in an innovative pilot project with Federal banking agencies and state regulators to conduct targeted consumer-protection compliance reviews of selected non-depository lenders with significant subprime mortgage operations. The agencies will share information about the reviews and investigations, take action as appropriate, collaborate on the lessons learned, and seek ways to better cooperate in ensuring effective and consistent reviews of these institutions.

Finally, the Commission's Bureau of Economics recently announced results of a study that confirms the need to improve mortgage disclosures.[36] The research found: (1) the current federally required disclosures fail to convey key mortgage costs to many consumers; (2) better disclosures can significantly improve consumer recognition of mortgage costs; (3) both prime and subprime borrowers failed to understand key loan terms when viewing the current disclosures, and both benefited from improved disclosures; and (4) improved disclosures provided the greatest benefit for more complex loans, for which both prime and subprime borrowers had the most difficulty understanding loan terms. The Commission is working with Federal regulators on next steps.

2. Payment Cards

The Commission continues to bring law enforcement actions against marketers and distributors of payment cards within its jurisdiction. On July 30, the Commission obtained a temporary restraining order prohibiting EDebitPay and related companies from marketing reloadable prepaid debit cards[37] without adequately disclosing a processing and application fee of over $150. Moreover, the FTC alleges that some consumers who did not apply for defendants' prepaid card nevertheless suffered unauthorized debits from their bank accounts. When consumers complained about the unauthorized withdrawals, defendants allegedly erected formidable barriers to obtaining refunds, including misrepresenting that consumers could not contest the debits as unauthorized.

The Commission has also been examining hidden expiration dates and dormancy fees on gift cards. This year, the Commission has announced two settlements in this area, one with Kmart Corporation and another with the national restaurant company, Darden Restaurants.[38] According to the FTC's complaints, both Kmart and Darden promoted their gift cards as equivalent to cash but failed to disclose that fees are assessed after 2 years (initially 15 months, in Darden's case) of non-use. In addition, the FTC alleged that Kmart affirmatively misrepresented that its card would never expire. Kmart and Darden have agreed to disclose the existence of any fees prominently in future advertising and on the front of the gift card. Both companies have also agreed to provide refunds of dormancy fees assessed on their cards. Kmart will reimburse the dormancy fees for consumers who provide an affected gift card's number, a mailing address, and a telephone number. Darden will automatically restore to each card any dormancy fees that were assessed. In 2006, both companies voluntarily stopped charging dormancy fees on their gift cards.

3. Debt Collection

The FTC is tackling the problem of unlawful debt collection practices in two ways. First, the Commission engages in aggressive law enforcement. In nineteen lawsuits filed since 1998, the FTC has alleged that the defendants—including collection agencies, collection law firms, companies that purchase and collect delinquent credit accounts, and credit issuers—used illegal debt collection practices.[39] In one such case, announced in February of this year, the Commission charged a collection agency,

Rawlins & Rivera, Inc., and its principals with violating Federal law by falsely threatening consumers with lawsuits, seizure of property, and arrest.[40] The court has granted the FTC's request for a preliminary injunction,[41] and the litigation is continuing. In another case, in June 2007, the FTC obtained an injunction against defendants who victimized Spanish-speaking consumers by posing as debt collectors seeking payments consumers did not owe.

Second, given the rise in consumer debt levels, as well as consumer complaints, it is time to take another look at the debt collection industry. This fall the FTC will hold a workshop to examine debt collection practices thirty years after enactment of the Fair Debt Collection Practices Act. The Commission will examine changes in the industry and the related consumer protection issues, including whether the law has kept pace with developments.

E. Telemarketing and Do Not Call

Since the mid-1980s, the Commission has had a strong commitment to rooting out telemarketing fraud. From 1991 to the present, the FTC has brought more than 350 telemarketing cases; 240 of these cases were brought after 1995, when the FTC promulgated the Telemarketing Sales Rule ("TSR").[42] As one illustration of the Commission's robust enforcement program, in July, the FTC halted the allegedly unlawful telemarketing operations of Suntasia Marketing[43] which, according to the FTC's complaint, took millions of dollars directly out of consumers' bank accounts without their knowledge or authorization. Suntasia allegedly tricked consumers into divulging their bank account numbers by pretending to be affiliated with the consumer's bank and offering a purportedly "free gift" to consumers who accepted a "free trial" of Suntasia's products. The complaint alleges that, once consumers divulged their bank account number, Suntasia debited many of their accounts. At the FTC's request, a court halted the scheme and froze the defendants' assets to preserve the Commission's ability to distribute redress to injured consumers, should the Commission prevail in this litigation.

The FTC also works closely with its Canadian counterparts to combat cross-border telemarketing fraud. One recent case resulted in a judgment of more than $8 million against Canadian telemarketers of advance fee credit cards.[44] In this case, the FTC closely coordinated its action with other members of the Toronto Strategic Partnerships, a group of Canadian, U.S., and U.K. law enforcers whose mission is to cooperate in bringing telemarketing fraud cases.

As a complement to its anti-fraud work in the telemarketing arena, the Commission has an active program to enforce the Do Not Call provisions of the TSR. Consumers have registered more than 147 million telephone numbers since the Do Not Call Registry became operational in June 2003. The Do Not Call provisions have been tremendously successful in protecting consumer's privacy from unwanted telemarketing calls. Because currently consumers' registrations expire after 5 years, the Commission plans a significant effort to educate consumers on the need to reregister their phone numbers.

Most entities covered by the Do Not Call provisions comply, but for those who do not, tough enforcement is a high priority for the FTC. Twenty-seven of the Commission's telemarketing cases have alleged Do Not Call violations, resulting in $8.8 million in civil penalties and $8.6 million in redress or disgorgement ordered.[45]

The Commission understands that this Committee has passed S. 781, the Do Not Call Implementation Act ("DNCIA"). The Commission supports this legislation and appreciates the Committee's work on it. The Commission believes that the legislation, if enacted, will help ensure the continued success of the National Registry by providing the Commission with a stable funding source for its TSR enforcement activities. We also believe that the proposed legislation would benefit telemarketers, sellers, and service providers who access the Registry by providing them with a level fee structure.

F. Media Violence

The Commission has continued its efforts to monitor the marketing of violent entertainment to children and to encourage industry self-regulation. Since it began examining the issue in 1999, the Commission has issued six reports on the marketing of violent entertainment products to children. In April 2007, the Commission issued its latest report, which concluded that the movie, music, and video game industries generally comply with their own voluntary standards regarding the display of ratings and labels. Entertainment industries, however, continue to market some R-rated movies, M-rated video games, and explicit-content recordings on television shows and websites with substantial teen audiences. In addition, the FTC found that while video game retailers have made significant progress in limiting sales of M-rated games to children, movie and music retailers have made only modest

progress in limiting sales of R-rated and unrated DVDs and explicit content music recordings to children. The report also provides the results of a Commission survey of parents and children on their awareness and use of the video game rating system.

G. "Green" Marketing

The Commission continues to monitor marketplace developments to identify new consumer protection issues. In monitoring developments in the energy and environmental areas, the Commission has observed that new "green" claims, such as claims for carbon reduction, landfill reduction, and sustainable packaging are entering the market daily. These claims can be extremely useful for consumers; however, the complexity of the issues involved creates the potential for confusing, misleading, and fraudulent claims. Given this potential, in the coming months, FTC staff plans to conduct research, develop consumer and business outreach, and bring appropriate enforcement actions in this area. As part of the research process, the Commission plans to host a series of public workshops to seek input from consumers, industry representatives, environmental groups, academics, and other government agencies on how to prevent fraud and deception in this marketplace, while at the same time encouraging innovation and competition on the basis of truthful claims.

H. Aiding Criminal Enforcement

This testimony has highlighted various deceptive and unfair practices pursued by the Commission, from spam to spyware to health fraud to telemarketing fraud. These frauds that the FTC pursues civilly are also often criminal violations. The FTC's Criminal Liaison Unit, or "CLU," has stepped up cooperation with criminal authorities—an illustration of the FTC's efforts to bring the collective powers of different government agencies to bear upon serious misconduct in many consumer protection areas. Since October 2006, based on CLU referrals to criminal agencies, 115 FTC defendants or their associates have been charged, pled guilty, or were sentenced in criminal cases. The FTC's criminal referral program continues to be a high priority.

III. Maintaining Competition

In addition to addressing unfair and deceptive conduct, the Commission is charged with protecting consumers by protecting competition. The goal of the FTC's competition mission is to strengthen free and open markets by removing the obstacles that impede competition and prevent its benefits from flowing to consumers. To accomplish this, the FTC has focused its enforcement efforts on sectors of the economy that have a significant impact on consumers, such as health care, energy, technology, and real estate.

A. Health Care

The health care industry plays a crucial role in the U.S. economy in terms of consumer spending and welfare, and thus, the FTC has dedicated substantial resources to protecting consumers by vigorously reviewing proposed merger transactions, investigating potentially anticompetitive conduct that threatens consumer interests.

1. Agreements that Delay Generic Entry

The FTC continues to be vigilant in the detection and investigation of agreements between drug companies that delay generic entry, including investigating some patent settlement agreements between pharmaceutical companies that are required to be filed with the Commission under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. In these "exclusion payment settlements" (or, to some, "reverse payment settlements"), the brand-name drug firm pays its potential generic competitor to abandon the patent challenge and delay entering the market. Such settlements restrict competition at the expense of consumers, whose access to lower-priced generic drugs is delayed, sometimes for many years.

Recent court decisions, however, have made it more difficult to bring antitrust cases to stop exclusion payment settlements, and the impact of those court rulings is becoming evident in the marketplace. These developments threaten substantial harm to consumers and others who pay for prescription drugs. For that reason, the Commission supports a legislative solution to prohibit these anticompetitive settlements, while allowing exceptions for those agreements that do not harm competition.

In addition, in November 2005, in the case of *FTC* v. *Warner Chilcott Holdings Company III, Ltd.,* the Commission filed a complaint in Federal district court seeking to terminate an agreement between drug manufacturers Warner Chilcott and Barr Laboratories that prevented Barr from selling a lower-priced generic version of Warner Chilcott's Ovcon 35, a branded oral contraceptive.[46] Under threat of a

preliminary injunction, in September 2006, Warner Chilcott waived the exclusionary provision in its agreement with Barr that prevented Barr from entering with its generic version of Ovcon. The next day, Barr announced its intention to start selling a generic version of the product, and it now has done so, giving consumers the benefits of price competition.[47]

2. Pharmaceuticals, Medical Devices, and Diagnostic Systems

The Commission is active in enforcing the antitrust laws in the pharmaceutical, medical devices, and diagnostic systems industries. For example, the Commission challenged the terms of Actavis Group hf.'s proposed acquisition of Abrika Pharmaceuticals, Inc., alleging that the transaction would create a monopoly in the U.S. market for generic isradipine capsules, a drug typically prescribed to patients to lower their blood pressure and to treat hypertension, ischemia, and depression. Under a consent order that allowed the deal to proceed, the companies divested all rights and assets needed to make and market generic isradipine capsules to Cobalt Laboratories, Inc., an independent competitor.[48] The FTC also challenged Barr Pharmaceuticals' proposed acquisition of Pliva.[49] In settling the Commission's charges that the transaction would have increased concentration and led to higher prices, Barr was required to sell its generic antidepressant, trazodone; its generic blood pressure medication, triamterene/HCTZ; either Pliva's or Barr's generic drug for use in treating ruptured blood vessels in the brain; and Pliva's branded organ preservation solution. Last year, the FTC challenged several other pharmaceutical mergers, including: Watson Pharmaceuticals/Andrx Corporation;[50] Teva Pharmaceutical Industries/IVAX Corporation;[51] Johnson & Johnson's acquisition of Pfizer's consumer health division;[52] and Hospira, Inc./Mayne Pharma Limited.[53] Recent FTC medical devices and diagnostic systems cases include: the FTC's challenge of the proposed $27 billion acquisition of Guidant Corporation by Boston Scientific Corporation, in which the FTC required the divestiture of Guidant's vascular business to an FTC-approved buyer;[54] and the FTC's challenges of mergers affecting markets for biopsy systems and for centrifugal vacuum evaporators used in the health care industry.[55]

FTC staff also has initiated a study on authorized generic drugs.[56] The study is intended to help the agency understand the circumstances under which innovator companies launch authorized generics; to provide data and analysis of how competition between generics and authorized generics during the Hatch-Waxman Act's 180-day exclusivity period has affected short-run price competition and long-run prospects for generic entry; and to build on the economic literature about the effect of generic drug entry on prescription drug prices.

3. Hospitals and Physicians

The Commission has worked vigorously to preserve competition in local hospital markets. Last month, the Commission ruled that Evanston Northwestern Healthcare Corporation's acquisition of Highland Park Hospital was anticompetitive,[57] upholding an October 2005 Initial Decision by an FTC Administrative Law Judge that the consummated acquisition of its important competitor, Highland Park Hospital, resulted in substantially higher prices and a substantial lessening of competition for acute care inpatient hospital services in parts of Chicago's northern suburbs.[58] Several other hospital mergers have been announced within the past several months, and the FTC has active investigations pending.[59]

The FTC continues to investigate and challenge unlawful price fixing by physicians and other health care providers that may lead to higher costs for consumers. In the past year, the FTC challenged the practices of four physician groups alleging that the competing providers jointly set their prices and collectively agreed to refuse to deal with health care payers that did not meet their fee demands. The FTC charges against these groups were resolved by consent orders.[60] Further, in June, the Commission accepted a consent order in *South Carolina State Board of Dentistry,*[61] resolving charges that the South Carolina State Board of Dentistry restrained competition in the provision of preventive care by dental hygienists, limiting access to care by children living in poverty.

B. Energy

Few issues are more important to American consumers and businesses than high energy prices. The FTC plays a key role in maintaining competition and protecting consumers in energy markets by challenging antitrust violations, conducting studies and analyses, and providing comments to other government agencies.

So far in 2007, the Commission has challenged three mergers in the energy industry. This past spring, the Commission challenged Equitable Resources proposed acquisition of The Peoples Natural Gas Company, a subsidiary of Dominion Resources.[62] Equitable and Dominion Peoples are each other's sole competitors in the

distribution of natural gas to nonresidential customers in certain areas of Allegheny County, Pennsylvania, which includes Pittsburgh. In March, the FTC filed an administrative complaint against the acquisition, and in April the staff sought an injunction in Federal court. Both actions alleged that the proposed transaction would result in a monopoly for many customers who now benefit from competition between the two firms. The district court denied the FTC's request for an injunction, asserting that because the Pennsylvania Utility Commission has the power to approve the merger, the FTC is banned from taking action under the state action doctrine. The Third Circuit has issued an injunction pending appeal, and the appeal will be argued in early October.

In January 2007, the Commission challenged the terms of a proposed $22 billion deal whereby energy firm Kinder Morgan would be taken private by its management and a group of investment firms, including The Carlyle Group and Riverstone Holdings.[63] The Commission alleged in its complaint that Carlyle and Riverstone held significant positions in Magellan Midstream, a major competitor of Kinder Morgan in the terminaling of gasoline and other light petroleum products in the southeastern United States, and that the proposed transaction would threaten competition in those markets. In settling the Commission's charges, Carlyle and Riverstone agreed to turn their investment in Magellan passive and to restrict the flow of sensitive information between Kinder Morgan and Magellan.

In the most recent petroleum merger challenge, the Commission challenged Western Refining's acquisition of Giant Industries to preserve competition in the bulk supply of light petroleum products to northern New Mexico, an area of the country where the Commission alleged that the two companies are direct and significant competitors.[64] The Commission's complaint for a preliminary injunction filed in Federal court and its subsequently issued administrative complaint alleged that, if it were not acquired by Western, Giant would soon increase the supply of gasoline to northern New Mexico, and that the transaction as proposed would prevent this. The U.S. district judge in New Mexico denied the Commission's request for a preliminary injunction.[65]

The Commission also actively monitors energy markets, and markets for related consumer products, for anticompetitive conduct. In June 2007, the Commission charged the American Petroleum Company, Inc. with illegally conspiring with its competitors to restrict the importation and sale of motor oil lubricants in Puerto Rico, in an attempt to force the legislature to repeal a law that charged importers and others within the distribution chain an environmental deposit of 50 cents for each quart of lubricants purchased.[66] The Commission's consent order bars American Petroleum from engaging in such conduct in the future.

On April 25, 2006, President Bush directed the DOJ to join the FTC and the Department of Energy to inquire into "illegal manipulation or cheating related to the current gasoline prices."[67] Accordingly, staff of the Commission and the DOJ Antitrust Division, with assistance from the Department of Energy's Energy Information Administration, conducted an economic analysis and investigation of the likely factors that led to higher national average gasoline prices during the spring and summer of 2006, and to determine whether anticompetitive conduct may have occurred.[68] This study identified six major factors that contributed to price rises during the spring and summer of 2006: (1) the market effects of the summer driving season; (2) an increase in the price of crude oil; (3) an increase in the price of ethanol; (4) capacity issues related to the transition to ethanol from MTBE; (5) refinery outages; and (6) increased demand. A report detailing the findings was sent to the President in August.[69]

In May 2006, the FTC released a report titled *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases.*[70] This report contained the findings of a Congressionally-mandated Commission investigation into whether gasoline prices were "artificially manipulated by reducing refinery capacity or by any other form of market manipulation or price gouging practices." The report also discusses gasoline pricing by refiners, large wholesalers, and retailers in the aftermath of Hurricane Katrina. In its investigation, the FTC examined evidence relating to a broad range of possible forms of manipulation. It found no instances of illegal market manipulation that led to higher prices during the relevant time periods, but found fifteen examples of pricing at the refining, wholesale, or retail level that fit the legislation's definition of evidence of "price gouging."[71] Other factors such as regional or local market trends, however, appeared to explain these firms' prices in nearly all cases.[72]

C. Real Estate

Purchasing or selling a home is one of the most significant financial transactions most consumers will ever make, and anticompetitive industry practices can raise the

prices of real estate services. In the past year, the agency has brought eight enforcement actions against associations of competing realtors or brokers. The associations, which control multiple listing services, adopted rules that allegedly discouraged consumers from entering into non-traditional listing contracts with real estate brokers. In seven of these matters, the Commission accepted settlements prohibiting multiple listing services from discriminating against non-traditional listing arrangements. The eighth matter, RealComp, is currently in administrative litigation; a trial was held in June and closing arguments are scheduled for September.[73] The result of these actions will allow consumers more choice and ensure that consumers who choose to use discount real estate brokers will not be handicapped by rules preventing other consumers from seeing their home listings on the Internet.

D. Technology

Technology is another area in which the Commission has acted to protect consumers by safeguarding competition. In February 2007, the Commission issued an opinion and final order on remedies in the legal proceeding against computer technology developer Rambus, Inc.[74] Previously, in July 2006, the Commission had determined that Rambus unlawfully monopolized the markets for four computer memory technologies that have been incorporated into industry standards for dynamic random access memory (DRAM) chips. DRAM chips are widely used in personal computers, servers, printers, and cameras.[75] In addition to barring Rambus from making misrepresentations or omissions to standard-setting organizations again in the future, the February 2007 order, among other things, requires Rambus to license its SDRAM and DDR SDRAM technology; with respect to uses of patented technologies after the effective date of the order, bars Rambus from collecting more than the specified maximum allowable royalty rates; and requires Rambus to employ a Commission-approved compliance officer to ensure that Rambus's patents and patent applications are disclosed to industry standard-setting bodies in which it participates.[76] Rambus has appealed the Commission's rulings to the U.S. Court of Appeals for the District of Columbia Circuit.

E. Retail and Other Industries

The FTC also guards against anticompetitive conduct in the retail sector. In June 2007, the Commission sought a preliminary injunction in Federal district court blocking Whole Foods' acquisition of its chief rival, Wild Oats Markets, Inc.[77] The FTC charged that the proposed transaction would violate Federal antitrust laws by eliminating the substantial competition between these two uniquely close competitors in numerous geographic markets across the country in the operation of premium natural and organic supermarkets. On August 16, 2007, a judge for the U.S. District Court of the District of Columbia denied the FTC's motion for preliminary injunction, and on August 23, the Court of Appeals denied the FTC's emergency motion for an injunction pending appeal.[78] The matter remains in administrative litigation. Also, this year in June, the FTC challenged Rite Aid Corporation's proposed $3.5 billion acquisition of the Brooks and Eckerd pharmacies from Canada's Jean Coutu Group (PJC), Inc.[79] To remedy the alleged anticompetitive impact of the proposed transaction, the Commission ordered Rite Aid and Jean Coutu to sell 23 pharmacies to Commission-approved buyers to preserve the competition that would otherwise be lost in the merger.

In March 2007, the Commission announced a proposed order settling charges that the Missouri State Board of Embalmers and Funeral Directors illegally restrained competition by defining the practice of funeral directing to include selling funeral merchandise to consumers on an at-need basis.[80] The Board's regulation permitted only licensed funeral directors to sell caskets to consumers on an at-need basis, thereby restricting competition from other retailers. The Board ended the restriction last year and agreed that it will not prohibit or discourage the sale of caskets, services, or other funeral merchandise by unlicensed persons, thereby settling the Commission's charges.

The Commission also has sought to protect customers by imposing conditions on mergers involving diverse industries such as launch services;[81] the manufacture of ammunition for mortars and artillery;[82] the Nation's two largest funeral home and cemetery chains;[83] and liquid oxygen and helium.[84]

F. Guidance, Transparency, and Merger Review Process Improvements

The FTC works to facilitate cooperation and voluntary compliance with the law by promoting transparency in enforcement standards, policies, and decision-making processes. Last year, the FTC implemented two important reforms that streamlined the merger review process. In February 2006, the Commission announced the implementation of significant merger process reforms aimed at reducing the costs borne by both the FTC and merging parties.[85] In June 2006, the FTC and the DOJ Anti-

trust Division implemented an electronic filing system that allows merging parties to submit, via the Internet, premerger notification filings required by the Hart-Scott-Rodino Act.[86]

G. Competition Advocacy

The Commission frequently provides comments to Federal and state legislatures and government agencies, sharing its expertise on the competitive impact of proposed laws and regulations when they explicitly or implicitly impact the antitrust laws, and when they alter the competitive environment through restrictions on price, innovation, or entry conditions. Recent FTC advocacy efforts have contributed to several positive outcomes for consumers. In the past year, the FTC has sought to persuade regulators to adopt policies that do not unnecessarily restrict competition in the areas of gasoline sales,[87] real estate brokerage,[88] real estate legal services,[89] attorney advertising,[90] and pharmacy benefit managers.[91]

H. Hearings, Reports, Conferences, and Workshops

The FTC's hearings, conferences, and workshops represent a unique opportunity for the agency to develop policy and research tools and help foster a deeper understanding of the complex issues involved in the economic and legal analysis of antitrust law.

Beginning in June 2006 and continuing through May 2007, the FTC and the DOJ Antitrust Division held hearings to discuss the boundaries of permissible and impermissible conduct under Section 2 of the Sherman Act.[92] The primary goal of the hearings was to examine whether and when specific types of single-firm conduct are procompetitive or benign and when they may harm competition. The Commission expects to issue a report with DOJ on the hearings.

In August 2006, the FTC convened the Internet Access Task Force to examine issues raised by converging technologies and regulatory developments, and to inform the enforcement, advocacy, and education initiatives of the Commission. Under the leadership of the Internet Access Task Force, the FTC recently addressed two issues of interest to policymakers.

First, in October 2006, the FTC released a staff report, *Municipal Provision of Wireless Internet.* The report identifies the potential benefits and risks to competition and consumers associated with municipal provision of wireless Internet service.[93] Second, in June 2007, the FTC released a staff report, *Broadband Connectivity Competition Policy,* which summarizes the Task Force's findings in the area of broadband Internet access, including so-called "network neutrality."[94] The report proposes guiding principles for assessing this complex issue, and makes clear that the FTC will continue to vigorously enforce the antitrust and consumer protection laws and expend considerable efforts on consumer education, industry guidance, and competition advocacy in the important area of broadband Internet access.

In April 2007, the Commission held a three-day conference on *Energy Markets in the 21st Century: Competition Policy in Perspective.*[95] The conference brought together leading experts from government, the energy industry, consumer groups, and the academic community to participate on panels to examine such topics as: (1) the relationship between market forces and government policy in energy markets; (2) the dependence of the U.S. transportation sector on petroleum; (3) the effects of electric power industry restructuring on competition and consumers; (4) what energy producers and consumers may expect in the way of technological developments in the industry; (5) the security of U.S. energy supplies; and (6) the government's role in maintaining competition and protecting energy consumers. The Commission expects to issue a report detailing the findings of this conference.

Also in April of this year, the FTC and the DOJ issued a joint report, titled *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition,* to inform consumers, businesses, and intellectual property rights holders about the agencies' competition views with respect to a wide range of activities involving intellectual property.[96] The report discusses issues including: refusals to license patents, collaborative standard setting, patent pooling, intellectual property licensing, the tying and bundling of intellectual property rights, and methods of extending market power conferred by a patent beyond the patent's expiration. This second report on antitrust and intellectual property joins a report issued in 2003 following extensive hearings on this important topic.

In May 2007, the Commission and the DOJ Antitrust Division released a joint report, *Competition in the Real Estate Brokerage Industry.* The purpose of the report is to inform consumers and other industry participants about important competition issues involving residential real estate, including the impact of the Internet, the competitive structure of the real estate brokerage industry, and obstacles to a more competitive environment.[97]

I. Competition Education Initiatives

The FTC is committed to enhancing consumer confidence in the marketplace through enforcement and education. This year, Commission staff launched a multi-dimensional outreach campaign, targeting new and bigger audiences, with the message that antitrust enforcement helps consumers reap the benefits of competitive markets by keeping prices low and services and innovation high, as well as by encouraging more choices in the marketplace.[98] As a part of this effort, the Commission's website, *www.ftc.gov,* continues to grow in size and scope with resources on competition policy in a variety of vital industries. This year, the FTC launched new industry-specific websites for Oil and Gas,[99] Health Care,[100] Real Estate,[101] and Technology.[102] These minisites serve as a one-stop shop for consumers and businesses who want to know what the FTC is doing to promote competition in these important business sectors. In the past year, the FTC also issued practical tips for consumers on buying and selling real estate, funeral services, and generic drugs, as well as "plain language" columns on oil and gas availability and pricing.

III. International

The FTC's Office of International Affairs (OIA), created in January 2007, brings together the international functions formerly handled in the Bureaus of Competition and Consumer Protection and the Office of General Counsel. OIA brings increased prominence to the FTC's international work, and enhances the FTC's ability to coordinate its enforcement efforts effectively to promote sound enforcement and convergence toward best practices with the agency's counterpart agencies around the world.

The FTC has built a strong network of cooperative relationships with its counterparts abroad, and plays a leading role in key multilateral fora. The growth of communication media and electronic commerce presents new challenges to law enforcement—fraud and deception know no borders. The Commission works with other nations to protect American consumers who can be harmed by anticompetitive conduct and frauds perpetrated outside the United States. The FTC also actively assists new democracies moving toward market-based economies with developing and implementing competition and consumer protection laws and policies.

A. Consumer Protection

Globalization and rapid changes in technology have accelerated the pace of new consumer protection challenges, such as spam, spyware, telemarketing fraud, data security, and privacy, that cross national borders and raise both enforcement and policy issues. The Internet and modern communications devices, such as Voice-over-Internet Protocol, have provided tremendous benefits to consumers but also have aided mass marketing fraud and raised fresh privacy concerns. The FTC has a comprehensive international consumer protection program of enforcement, networking, and policy initiatives to address these new challenges.

In the coming year, the FTC will continue to implement the U.S. SAFE WEB Act of 2006, which was signed into law last December. Thanks to the actions of this Committee, the U.S. SAFE WEB Act provides the FTC with updated tools for the 21st century. It allows the FTC to cooperate more fully with foreign law enforcement agencies in the area of cross-border fraud and other practices that are global and harm consumers, such as fraudulent spam, spyware, misleading health and safety advertising, privacy and security breaches, and telemarketing fraud. The FTC already has used the powers conferred by the Act to share information with foreign agencies in several investigations. The increasing use of these new tools will remove some of the key roadblocks to effective international enforcement cooperation.

The FTC works directly with consumer protection and other law enforcement officials in foreign countries to achieve its goals. In particular, in response to the amount of fraud across the U.S.-Canadian border, the FTC continues to build its relationship with its Canadian counterparts. The Commission has worked hard to expand partnerships with Canadian law enforcement entities to fight cross-border mass marketing fraud targeting U.S. and Canadian consumers.

Increased globalization also requires the FTC to participate actively in international policy efforts to develop flexible, market-oriented standards, backed by aggressive enforcement, to address emerging consumer protection issues. In 2006, for example, the FTC, working with its foreign partners through the Organization for Economic Cooperation and Development ("OECD") and through the London Action Plan, the international spam enforcement network, called for increased cross-border law enforcement cooperation and increased public/private sector cooperation to combat spam. Already in 2007, the FTC, working with its foreign partners through the OECD, has developed a framework for privacy regulators and law enforcement au-

thorities to facilitate cross-border privacy law enforcement cooperation and provide greater protection for consumers' personal information. Most recently, in July 2007, the FTC, again working through the OECD, agreed with its partners on a set of principles to address the practical and legal obstacles that many consumers face when trying to resolve disputes with businesses, in their own country or abroad, particularly in cross-border e-commerce transactions.

The FTC will continue to focus the international community on the importance of enforcement as a key component of privacy protection in the OECD, the Asia Pacific Economic Cooperation ("APEC"), and other multilateral organizations. The FTC also continues to participate actively in APEC's Electronic Commerce Steering Group and several OECD committees, including the Committee on Consumer Policy, and in the International Consumer Protection Enforcement Network ("ICPEN"). The FTC supported ICPEN's operations this year by hosting its Secretariat.

B. Competition

The FTC's cooperation with competition agencies around the world is a vital component of our enforcement and policy programs, facilitating our ability to collaborate on cross-border cases, and promoting convergence toward sound, consumer welfare-based competition policies.

FTC staff routinely coordinate with colleagues in foreign agencies on mergers and anticompetitive conduct cases of mutual concern. The FTC promotes policy convergence through formal and informal working arrangements with other agencies, many of which seek the FTC's views when developing new policy initiatives. For example, during the past year, the FTC consulted with the European Commission regarding its review of policies on abuse of dominance, non-horizontal mergers, and merger remedies, with the Canadian Competition Bureau on merger remedies and health care issues, and with the Japan Fair Trade Commission on revisions to its Guidelines on Patent and Know-how Licensing Agreements under the Antimonopoly Act. We are closely following competition developments in China and have held high-level meetings with the drafters of the antimonopoly law and with officials in China's Ministry of Commerce responsible for their pre-merger notification guidelines, and conducted a multi-day, hands-on seminar on merger process and analysis for Chinese officials. The FTC continues to play a lead role with respect to market-based competition and innovation issues in the U.S.-China Strategic Economic Dialogue, including participation in the May 22–23 summit meeting in Washington. We have just held our annual bilateral meetings with the Japanese Fair Trade Commission, we participated in consultations in Washington and in foreign capitals with top officials of, among others, the Korean Fair Trade Commission and Mexican Federal Competition Commissions, and we will soon hold our annual consultations with the European Commission's Directorate General for Competition.

The FTC plays a lead role in key multilateral fora that provide important opportunities for competition agencies to promote cooperation and convergence. In the International Competition Network, the FTC serves on the Steering Group, and FTC officials hold leadership positions in working groups on unilateral conduct, mergers, and competition policy implementation. We are also active in the competition work of the OECD, UNCTAD, and APEC. The FTC participates in U.S. delegations that negotiate competition chapters of proposed free trade agreements, such as with Korea, Thailand, and Malaysia.

As competition enforcement has proliferated worldwide, the FTC's international competition program has promoted sound, coherent, and fair application of competition laws, to the benefit of American businesses and consumers.

C. International Technical Assistance

The FTC assists developing nations that are moving toward market-based economies to develop and implement sound competition and consumer protection laws and policies. Our program is funded mainly by the United States Agency for International Development ("USAID") and conducted in cooperation with the DOJ Antitrust Division. In 2007, the FTC sent 20 staff experts on 20 technical assistance missions to 14 countries, including the ten-nation ASEAN Community, India, Russia, Azerbaijan, South Africa, Central America, Tanzania, and Egypt.

Because USAID resources for these activities have been declining, the Commission may need to consider alternative funding sources. The Antitrust Modernization Commission recently recommended that Congress appropriate funds for use by the agencies directly for this important work.

V. Conclusion

The Commission wants to ensure that the quality of our work is maintained despite the breadth of our mission and the challenges that have been described involv-

ing technological change and an evolving global economy. In the last several years, Congress has passed a variety of significant new laws that the FTC is charged, at least in part, with implementing and enforcing, such as the CAN–SPAM Act, the Fair and Accurate Credit Transactions Act, the Children's Online Privacy Protection Act, the Gramm-Leach-Bliley Act, and the U.S. SAFE WEB Act. In light of these new laws and challenges, the FTC appreciates the Committee's continued support for providing the Commission with the authority, personnel, and resources needed to ensure that the FTC vigorously protects American consumers and promotes a vibrant marketplace.

I would be happy to answer any questions that you and other Members may have about the FTC's reauthorization.

Endnotes

[1] The written statement represents the views of the Federal Trade Commission. My oral presentation and responses to questions are my own and do not necessarily reflect the views of the Commission or any other Commissioner.

[2] The FTC has broad law enforcement responsibilities under the Federal Trade Commission Act, 15 U.S.C. § 41 *et seq.* With certain exceptions, the statute provides the agency with jurisdiction over nearly every economic sector. Certain entities, such as depository institutions and common carriers, as well as the business of insurance, are wholly or partly exempt from FTC jurisdiction. In addition to the FTC Act, the agency has enforcement responsibilities under more than 50 other statutes and more than 30 rules governing specific industries and practices.

[3] The Commission wants to ensure that the quality of our work is maintained despite the quantity of demands placed upon us, the breadth of our mission, and the increasing challenges of a dynamic domestic and global marketplace. Today, the FTC has 1,074 full-time equivalent employees ("FTEs"). In the last few years, Congress has passed a variety of significant new laws that the FTC is charged, at least in part, with implementing and enforcing, such as the CAN–SPAM Act, the Fair and Accurate Credit Transactions Act, the Children's Online Privacy Protection Act, the Gramm-Leach-Bliley Act, and the U.S. SAFE WEB Act. We would like to work with the Committee to help ensure that our reauthorization includes appropriate increases in resources to meet these growing challenges.

[4] The Commission's ability to seek civil penalties is limited, and we look forward to working with you to ensure that the FTC has the authority it needs to deter wrongful conduct and protect American consumers. For example, where civil penalties are authorized (such as for violations of specific statutes like CAN–SPAM, or regulations including the Telemarketing Sales Rule), the Commission cannot, unlike other agencies such as the Securities and Exchange Commission or the Commodity Futures Trading Commission, go directly to court, but must first refer the case to the Department of Justice, which has 45 days in which to decide whether to bring the action. Only if the DOJ declines may the FTC bring the civil penalties claim. The Commission has a good, long-standing working relationship with DOJ, which has greatly assisted us in our consumer protection efforts. But, for example, there are cases in which we must forgo seeking civil penalties in the interest of seeking expeditious injunctive relief. We look forward to working with the Committee to examine this issue.

[5] So far during FY 2007, the FTC's Bureau of Consumer Protection has achieved many successes. It obtained 57 court orders requiring defendants to pay more than $236 million in consumer redress, obtained 8 court judgments for civil penalties in an amount over $4.9 million, and filed 35 new complaints in Federal district court to stop unfair and deceptive practices. It also completed 14 statutorily-mandated requirements such as rulemakings and reports, led 2 law enforcement sweeps, hosted 11 conferences and workshops, issued 5 reports on topics significant to consumers, and developed 16 consumer and business education campaigns.

[6] Pub. L. 105–318, 112 Stat. 3007 (1998) (codified at 18 U.S.C. § 1028).

[7] Exec. Order No. 13,402, 71 FR 27945 (May 10, 2006).

[8] The President's Identity Theft Task Force, *Combating Identity Theft: A Strategic Plan* ("Strategic Plan"), available at *http://www.idtheft.gov.*

[9] OMB Memorandum 07–16, "Safeguarding Against and Responding to the Breach of Personally Identifiable Information" (May 22, 2007), available at *http://www.whitehouse.gov/omb/memoranda/fy2007/m07-16.pdf;* OMB Memorandum, "Recommendations for Identity Theft Related Data Breach Notification" (Sept. 20, 2006), available at *http://www.whitehouse.gov/omb/memoranda/fy2006/task_force_theft_memo.pdf.*

[10] *See http://www.ftc.gov/infosecurity/.*

[11] *See http://www.ftc.gov/bcp/workshops/proofpositive/index.shtml.*

[12] On July 30, 2007, the FTC issued a request for public comment on the uses of Social Security numbers in the private sector, and announced that it was planning to host one or more public forums on the issue in the coming months. *See http://www.ftc.gov/opa/2007/07/ssn/shtm.*

[13] *See http://www.usdoj.gov/opa/pr/2007/July/07_crt_522%20%20%20.html.*

[14] FTC News Release, *FTC Launches Nationwide Id Theft Education Campaign* (May 10, 2006), available at *http://www.ftc.gov/opa/2006/05/ddd.htm.*

[15] Available at *http://onguardonline.gov/index.html.*

[16] Available at *http://www.ftc.gov/bcp/edu/microsites/idtheft/business/data-breach.html.*

[17] *In the Matter of Direct Revenue, LLC,* FTC Dkt. No. C–4194 (June 29, 2007), available at *http://www.ftc.gov/os/caselist/0523131/index.shtm.*

[18] *See* FTC News Release, *Hearings Will Explore Emerging Technologies and Consumer Issues in the Next Decade* (July 26, 2006), available at *http://www.ftc.gov/opa/2006/07/techade.htm.*

[19] 15 U.S.C. § 45(a)(2) exempts from the FTC Act "common carriers subject to the Acts to Regulate Commerce." 15 U.S.C. § 44 defines the "Acts to regulate commerce" as "Subtitle IV of Title

49 (interstate transportation) and the Communications Act of 1934" and all amendments thereto.

[20] Partners for Understanding Pain, *Pain Advocacy Tool Kit* (Sept. 2006) (including members from American Cancer Society, American Pharmacists Association, and Arthritis Foundation, among others), available at *http://www.nmmra.org/resources/Home__Health/Nurses__Tool__Kit__2006.pdf*.

[21] *E.g.,* Approximately two-thirds of U.S. adults are overweight or obese. National Center for Health Statistics, Prevalence of Overweight and Obesity Among Adults: United States, 2003–2004. available at *http://www.cdc.gov/nccdphp/dnpa/obesity/faq.htm#adults;* and approximately 127 million adults in the U.S. are overweight, 60 million obese, and 9 million severely obese, American Obesity Association, AOA Fact Sheet, available at *http://obesity1.tempdomainname.com/subs/fastfacts/obesity__US.shtml*.

[22] *E.g., FTC* v. *Window Rock Enters., Inc.,* No. CV04–8190 (JTLx) (C.D. Cal. filed Jan. 4, 2007) (stipulated final orders) (Cortislim), available at *http://www.ftc.gov/os/caselist/windowrock/windowrock.htm; In the Matter of Goen Techs. Corp.,* FTC File No. 042 3127 (Jan. 4, 2007) (consent order) (TrimSpa), available at *http://www.ftc.gov/os/caselist/goen/0423127agreement.pdf; United States* v. *Bayer Corp.,* No. 07–01 (HAA) (D.N.J. filed Jan. 3, 2007) (consent decree) (One-A-Day), available at *http://www.ftc.gov/os/caselist/bayercorp/070104consentdecree.pdf; FTC* v. *Chinery,* No. 05–3460 (GEB) (D.N.J. filed Dec. 26 , 2006) (stipulated final order) (Xenadrine), available at *http://www.ftc.gov/os/caselist/chinery/070104stipulatedfinalorder.pdf; FTC* v. *QT, Inc.,* No. 03 C 3578 (N.D. Ill. Sept. 8, 2006) (final judgment order), available at *http://www.ftc.gov/os/caselist/0323011/061113qrayfinaljdgmntorder.pdf*.

[23] *See* FTC News Release, *Federal Trade Commission Reaches "New Year's" Resolutions with Four Major Weight-Control Pill Marketers* (Jan. 4, 2007), available at *http://www.ftc.gov/opa/2007/01/weightloss.htm*.

[24] *See* FTC News Release, *Workshop Explores Marketing, Self-Regulation, and Childhood Obesity* (July 15, 2005), available at *http://www.ftc.gov/opa/2005/07/obesityworkshopma.htm*.

[25] *Perspectives on Marketing, Self-Regulation, & Childhood Obesity: A Report on a Joint Workshop of the Federal Trade Commission and the Department of Health and Human Services* (Apr. 2006), available at *http://www.ftc.gov/os/2006/05/PerspectivesOnMarketingSelf-Regulation&ChildhoodObesityFTCandHHSReportonJointWorkshop.pdf*.

[26] *See* Bruce Horovitz and Laura Petrecca, *Disney to Make Food Healthier for Kids,* USA Today (Oct. 17, 2006), available at *http://www.usatoday.com/money/media/2006-10-16-disney__x.htm*.

[27] *See* Annys Shin, *Ads Aimed at Children Get Tighter Scrutiny; Firms to Promote More Healthful Diet Choices,* Wash. Post, Nov. 15, 2006, at D1.

[28] The one exception is Cadbury Adams, LLC, which committed either to refrain from advertising to children under 12 or to devote at least 50 percent of such advertising to a product that offers a healthier dietary option. Bubblicious gum is currently the only product Cadbury Adams advertises to children under 12.

[29] The Commission also brings other law enforcement actions related to financial services, such as credit reporting, financial privacy, data security, and identity theft. For a description of some of these recent cases, *see* "The FTC in 2007: A Champion for Consumers and Competition," Federal Trade Commission, April 2007, at 24–25, *http://www.ftc.gov/os/2007/04/ChairmansReport2007.pdf* at 29–30, 37.

[30] *FTC* v. *Mortgages Para Hispanos.Com Corp.,* No. 06–00019 (E.D. Tex. 2006); *FTC* v. *Ranney,* No. 04–1065 (D. Colo. 2004); *FTC* v. *Chase Fin. Funding,* No. 04–549 (C.D. Cal. 2004); *United States* v. *Fairbanks Capital Corp.,* No. 03–12219 (D. Mass. 2003); *FTC* v. *Diamond,* No. 02–5078 (N.D. Ill. 2003); *United States* v. *Mercantile Mortgage Co.,* No. 02–5079 (N.D. Ill. 2002); *FTC* v. *Associates First Capital Corp.,* No. 01–00606 (N.D. Ga. 2002); *FTC* v. *First Alliance Mortgage Co.,* No. 00–964 (C.D. Cal. 2002); *United States* v. *Action Loan Co.,* No. 00–511 (W.D. Ky. 2000); *FTC* v. *Nu West, Inc.,* 00–1197 (W.D. Wash. 2000); *United States* v. *Delta Funding Corp.,* No. 00–1872 (E.D.N.Y. 2000); *FTC* v. *Barry Cooper Prop.,* No. 99–07782 (C.D. Cal. 1999); *FTC* v. *Capitol Mortgage Corp.,* No. 99–580 (D. Utah 1999); *FTC* v. *CLS Fin. Serv., Inc.,* No. 99–1215 (W.D. Wash. 1999); *FTC* v. *Granite Mortgage, LLC,* No. 99–289 (E.D. Ky. 1999); *FTC* v. *Interstate Res. Corp.,* No. 99–5988 (S.D.N.Y. 1999); *FTC* v. *LAP Fin. Serv., Inc.,* No. 99–496 (W.D. Ky. 1999); *FTC* v. *Wasatch Credit Corp.,* No. 99–579 (D. Utah 1999); *In re First Plus Fin. Group, Inc.,* FTC Docket No. C–3984 (2000); *In re Fleet Fin., Inc.,* 128 F.T.C. 479 (1999); *FTC* v. *Capital City Mortgage Corp.,* No. 98–00237 (D.D.C. 1998).

[31] *FTC* v. *Mortgages Para Hispanos. Com Corp, supra* note 28.

[32] Stipulated Final Judgment and Order of Permanent Injunction, *FTC* v. *Mortgages Para Hispanos. Com Corp., supra* note 28, Sept. 25, 2006.

[33] *United States* v. *Fairbanks Capital Corp, supra* note 28; *FTC* v. *Capital City Mortgage Corp., supra* note 28.

[34] Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital Corp. and Fairbanks Capital Holding Corp., *United States* v. *Fairbanks Capital Corp., supra* n. 28, Nov. 21, 2003; Stipulated Final Judgment and Order as to Thomas D. Basmajian, *United States* v. *Fairbanks Capital Corp., supra* n. 28, Nov. 21, 2003.

[35] FTC News Release, *FTC, Subprime Mortgage Servicer Agree to Modified Settlement* (Aug. 2, 2007), available at *http://www.ftc.gov/opa/2007/08/sps.shtm*.

[36] FTC, Bureau of Economics Staff Report, James M. Lacko and Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms,* June 2007. An earlier BE study addressed mortgage broker compensation disclosures. FTC, Bureau of Economics Staff Report, James M. Lacko and Janis K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment,* Feb. 2004, *http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf*.

[37] A prepaid debit card, also called a prepaid card, is typically a plastic stored valued card that uses magnetic stripe technology to store information about funds that consumers "prepay"

or "load" onto the card. Consumers can use prepaid cards to make purchases or withdraw money from merchants and ATMs that accept the network brand on the card.

[38] *See* FTC News Release, *National Restaurant Company Settles FTC Charges for Deceptive Gift Card Sales* (Apr. 3, 2007), available at *http://www.ftc.gov/opa/2007/04/darden.htm.*

[39] *FTC* v. *Rawlins & Rivera, Inc.,* No. 07–146 (M.D. Fla. 2007); *United States* v. *Whitewing Financial Group,* No. 06–2102 (S.D. Tex. 2006); *FTC* v. *Check Investors, Inc.,* No. 03–2115 (D.N.J. 2003), *appeal docketed,* Nos. 05–3558, 05–3957 (3rd Cir. Aug. 2, 2005); *United States* v. *Capital Acquisitions and Management Corp.,* No. 04–50147 (N.D. Ill. 2004); *FTC* v. *Capital Acquisitions and Management Corp.,* No. 04–7781 (N.D. Ill. 2004); *In re Applied Card Systems, Inc.,* FTC Docket No. C–4125 (Oct. 8, 2004); *United States* v. *Fairbanks Capital Corp., supra* n. 14; *FTC* v. *Associates, supra* n.14; *United States* v. *DC Credit Services, Inc.,* No. 02–5115 (C.D. Cal. 2002); *United States* v. *United Recovery Systems, Inc.,* No. 02–1410 (S.D. Tex. 2002); *United States* v. *North American Capital Corp.,* No. 00–0600 (W.D.N.Y. 2000); *United States* v. *National Financial Systems, Inc.,* No. 99–7874 (E.D.N.Y. 1999); *Perimeter Credit, L.L.C.,* No. 99–0454 (N.D. Ga. 1999); *In re Federated Department Stores, Inc.,* FTC Docket No. C–3893 (Aug. 27, 1999); *FTC* v. *Capital City Mortgage Co., supra* n. 14; *United States* v. *Nationwide Credit, Inc.,* No. 98–2920 (N.D. Ga. 1998); *United States* v. *Lundgren & Associates, P.C.,* No. 98–1274 (E.D. Cal. 1998); *In re May Dep't Stores Co.,* FTC Docket No. C–3848 (Nov. 2, 1998); *In re General Electric Capital Corp.,* FTC Docket No. C–3839 (Dec. 23, 1998).

[40] *FTC* v. *Rawlins & Rivera, supra* n. 34.

[41] Order Granting Motion for Preliminary Injunction, *FTC* v. *Rawlins & Rivera, supra* n. 34, Apr. 6, 2007.

[42] 16 C.F.R. § 310. The Commission promulgated the TSR following Congressional enactment of the Telemarketing and Consumer Fraud and Abuse Prevention Act in 1994. 15 U.S.C. §§ 6101–6108.

[43] *FTC* v. *FTN Promotions, Inc.,* No. 8:07–cv–1279–T–30TGW (M.D. Fla. July 23, 2007).

[44] *FTC* v. *120199 Canada, Ltd.,* No. 1:04–CV–07204 (N.D. Ill.) (permanent injunction order entered Mar. 8, 2007).

[45] These Do Not Call cases are included in the 240 TSR cases noted above.

[46] *FTC* v. *Warner Chilcott Holdings Co. III,* No. 1:05–cv–02179–CKK (D.D.C. filed Nov. 7, 2005), available at *http://www.ftc.gov/os/caselist/0410034/051107comp0410034%20.pdf.*

[47] FTC News Release, *Consumers Win as FTC Action Results in Generic Ovcon Launch* (Oct. 23, 2006), available at *http://www.ftc.gov/opa/2006/10/chilcott.htm.* In October 2006, the district court entered a final order that settled the FTC's charges against Warner Chilcott. As a result of the settlement, Warner Chilcott: (1) must refrain from entering into agreements with generic pharmaceutical companies in which the generic agrees not to compete with Warner Chilcott and there is either a supply agreement between the parties or Warner Chilcott provides the generic with anything of value and the agreement adversely affects competition; (2) must notify the FTC whenever it enters into supply or other agreements with generic pharmaceutical companies; and (3) for 3 months, had to take interim steps to preserve the market for the tablet form of Ovcon in order to provide Barr the opportunity to compete with its generic version. *FTC* v. *Warner Chilcott Holdings Co. III,* No. 1:05–cv–02179–CKK (D.D.C. filed Oct. 23, 2006) (stipulated permanent injunction and final order), available at *http://www.ftc.gov/os/caselist/0410034/finalorder.pdf.* The FTC's case against Barr is ongoing.

[48] *In the Matter of Actavis Group,* FTC Docket No. C–4190 (May 18, 2007) (decision and order), available at *http://www.ftc.gov/os/caselist/0710063/index.shtm.*

[49] *In the Matter of Barr Pharms., Inc.,* FTC Docket No. C–4171 (Dec. 8, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610217/0610217barrdo__final.pdf.*

[50] *In the Matter of Watson Pharms., Inc., and Andrx Corp.,* FTC Docket No. C–4172 (Dec. 12, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610139/061212do__public__ver0610139.pdf.*

[51] *In the Matter of Teva Pharm. Indus. Ltd. and IVAX Corp.,* FTC Docket No. C–4155 (Mar. 2, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510214/0510214.htm.*

[52] *In the Matter of Johnson & Johnson and Pfizer Inc.,* FTC Docket No. C–4180 (Jan. 19, 2007) (decision and order), available at *http://www.ftc.gov/os/caselist/0610220/0610220c4180decisionorder__publicversion.pdf; see also In the Matter of Allergan, Inc. and Inamed Corp.,* FTC Docket No. C–4156 (Apr. 17, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610031/0610031.htm.*

[53] FTC News Release, *FTC Challenges Hospira/Mayne Pharma Deal* (Jan. 18, 2007), available at *http://www.ftc.gov/opa/2007/01/hospiramayne.htm; In the Matter of Hospira, Inc. and Mayne Pharma Ltd.,* FTC Docket No. C–4182 (Jan. 18, 2007) (decision and order), available at *http://www.ftc.gov/os/caselist/0710002/070118do0710002.pdf.*

[54] *In the Matter of Boston Scientific Corp. and Guidant Corp.,* FTC Docket No. C–4164 (July 25, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610046/060725do0610046.pdf.*

[55] *In the Matter of Hologic, Inc.,* FTC Docket No. C–4165 (Aug. 9, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510263/0510263decisionandorderpubrecver.pdf; In the Matter of Thermo Electron Corp.,* FTC Docket No. C–4170 (Dec. 5, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610187/061205do0610187.pdf.*

[56] FTC News Release, *FTC Proposes Study of Competitive Impacts of Authorized Generic Drugs* (Mar. 29, 2006), available at *http://www.ftc.gov/opa/2006/03/authgenerics.htm.*

[57] *In the Matter of Evanston Northwestern Healthcare Corp.,* FTC Docket No. 9315 (Aug. 6, 2007) (Opinion of the Commission), available at *http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf.*

[58] *In the Matter of Evanston Northwestern Healthcare Corp.,* FTC Docket No. 9315 (Oct. 20, 2005) (initial decision), available at *http://www.ftc.gov/os/adjpro/d9315/051021idtext version.pdf.*

[59] The Commission also challenged the merger of two of the top three operators of outpatient kidney dialysis clinics and required divestitures in 66 markets throughout the United States. *In the Matter of Fresenius AG,* FTC Docket No. C–4159 (June 30, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510154/0510154.htm.*

[60] *In the Matter of Puerto Rico Ass'n of Endodontists, Corp.,* FTC Docket No. C–4166 (Aug. 24, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510170/0510170c4166praedecisionorder.pdf; In the Matter of New Century Health Quality Alliance, Inc.,* FTC Docket No. C–4169 (Sept. 29, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510137/0510137nchqaprimedecisionorder.pdf; In the Matter of Advocate Health Partners, et al.,* FTC Docket No. C–4184 (Feb. 7, 2007) (decision and order), available at *http://www.ftc.gov/os/caselist/0310021/0310021.htm;* and *In the Matter of Health Care Alliance of Laredo, L.C.,* FTC Docket No. C–4158 (Mar. 23, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0410097/0410097.htm.*

[61] *In the Matter of South Carolina State Board of Dentistry,* FTC Docket No. 9311 (June 20, 2007) (decision and order), available at *http://www.ftc.gov/os/adjpro/d9311/070620decision.pdf.*

[62] *FTC* v. *Equitable Resources, Inc., Dominion Resources, Inc., et al.,* No. 07–cv–490 (W.D. Pa. filed April 13, 2007) (complaint filed), available at *http://www.ftc.gov/os/adjpro/d9322/070413cmpltforpi-tro.pdf.*

[63] FTC News Release, *FTC Challenges Acquisition of Interests in Kinder Morgan, Inc. by The Carlyle Group and Riverstone Holdings* (Jan. 25, 2007), available at *http://www.ftc.gov/opa/2007/01/kindermorgan.shtm.*

[64] FTC News Release, *FTC Files Complaint in Federal District Court Seeking to Block Western Refining's Acquisition of Rival Energy Company Giant Industries, Inc.* (April 12, 2007), available at *http://www.ftc.gov/opa/2007/04/westerngiant_tro.shtm.*

[65] Other recent energy matters include: *Chevron/USA Petroleum,* an abandoned transaction in which Chevron would have acquired most of the retail gasoline stations owned by USA Petroleum, the largest remaining chain of service stations in California not controlled by a refiner (USA Petroleum's president stated that the parties abandoned the transaction because of resistance from the FTC), see Elizabeth Douglass, *Chevron Ends Bid to Buy Stations,* LA Times, Nov. 18, 2006, Part C at 2; *EPCO/TEPPCO,* in which EPCO's $1.1 billion acquisition of TEPPCO's natural gas liquid storage business was only allowed to proceed if TEPPCO first agreed to divest its interests in the world's largest natural gas storage facility in Bellvieu, Texas, to an FTC-approved buyer, see *In the Matter of EPCO, Inc., and TEPPCO Partners, L.P.,* FTC Docket No. C–4173 (Oct. 31, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510108/0510108c4173do061103.pdf; Chevron/Unocal,* which resolved the Commission's administrative monopolization complaint against Unocal and antitrust concerns arising from Chevron's proposed $18 billion acquisition of Unocal, see *In the Matter of Chevron Corp.,* FTC Docket No. C–4144 (July 27, 2005) (consent order), available at *http://www.ftc.gov/os/caselist/0510125/050802do0510125.pdf* and *Union Oil Co. of Calif.,* FTC Docket No. 9305 (July 27, 2005) (consent order), available at *http://www.ftc.gov/os/adjpro/d9305/050802do.pdf;* and *Aloha Petroleum/Trustreet Properties,* in which the Commission alleged that Aloha's proposed acquisition of Trustreet Properties' half interest in import-capable terminal and retail gasoline assets in Hawaii would have reduced from five to four the overall number of island gasoline marketers that had guaranteed access to supply, and from three to two the number of suppliers selling to unintegrated retailers, see *FTC* v. *Aloha Petroleum Ltd.,* No. CV05 00471 HG/KSC (Dist. Hi. complaint filed July 27, 2005), available at *http://www.ftc.gov/os/caselist/1510131/050728comp1510131.pdf.* Ultimately, *Aloha Petroleum* was dismissed at the agency's request after Aloha announced a long-term agreement with a third party, Mid Pac Petroleum, that would give Mid Pac substantial rights to use the terminal to import gasoline into Hawaii.

[66] *In the Matter of American Petroleum Company, Inc.,* FTC File No. 061–0229 (June 14, 2007) (decision and order), available at *http://www.ftc.gov/os/caselist/0610229/0610229decisionorder.pdf.*

[67] President George W. Bush, Remarks to the Renewable Fuels Summit 2006 (Apr. 25, 2006), available at *http://www.whitehouse.gov/news/releases/2006/04/20060425.html.*

[68] The Commission and DOJ also extended an open offer to assist state Attorneys General with gasoline pricing investigations upon request. As part of its continuing law enforcement interaction with the states, through the National Association of Attorneys General, the Commission sponsored a Federal/state enforcement conference in September 2006 to explore competition issues in petroleum markets.

[69] *"Federal Trade Commission Report on Spring Summer 2006 Nationwide Gasoline Price Increases"* (August 30, 2006), available at *http://www.ftc.gov/reports/gasprices06/P040101Gas06increase.pdf.* Commissioner Leibowitz dissented from the Report. *See http://www.ftc.gov/speeches/leibowitz/P010401gas06dissent.pdf.*

[70] FTC News Release, *FTC Releases Report on its "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases"* (May 22, 2006), available at *http://www.ftc.gov/opa/2006/05/katrinagasprices.htm.*

[71] Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2007, Pub. L. No. 109–108 § 632, 119 Stat. 2290 (2005) ("Section 632").

[72] Federal Trade Commission, *Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases* (Spring 2006), available at *http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf; but see* concurring statement of Commissioner Jon Leibowitz (concluding that the behavior of many market participants leaves much to be desired and that price gouging statutes, which almost invariably require a declared state of emergency or other triggering event, may serve a salutary purpose of discouraging profiteering in

the aftermath of a disaster), available at *http://www.ftc.gov/speeches/leibowitz/060518 LeibowitzStatementReGasolineInvestigation.pdf*.

[73] *See, e.g.,* FTC News Release, *FTC Charges Austin Board of Realtors With Illegally Restraining Competition* (July 13, 2006), available at *http://www.ftc.gov/opa/2006/07/austinboard.htm; see also* FTC News Release, *FTC Charges Real Estate Groups with Anticompetitive Conduct in Limiting Consumers' Choice in Real Estate Services* (Oct. 12, 2006), available at *http://www.ftc.gov/opa/2006/10/realestatesweep.htm;* FTC News Release, *Commission Receives Application for Proposed Divestiture from Linde AG and The BOC Group plc; FTC Approves Final Consent Orders in Real Estate Competition Matters* (Dec. 1, 2006), available at *http://www.ftc.gov/opa/2006/12/fyi0677.htm.*

[74] FTC News Release, *FTC Issues Final Opinion and Order in Rambus Matter* (Feb. 5, 2007), available at *http://www.ftc.gov/opa/2007/02/070502rambus.htm.*

[75] *In the Matter of Rambus, Inc.,* Docket No. 9302 (July 31, 2006) (opinion of the Commission), available at *http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf.*

[76] *In the Matter of Rambus Inc.,* Docket No. 9302 (Feb. 5, 2007) (opinion of the Commission on remedy) (Harbor, P., and Rosch, T., concurring in part, dissenting in part), available at *http://www.ftc.gov/os/adjpro/d9302/070205opinion.pdf; In the Matter of Rambus Inc.,* Docket No. 9302 (Feb. 2, 2007) (final order), available at *http://www.ftc.gov/os/adjpro/d9302/070205finalorder.pdf.*

[77] *FTC* v. *Whole Foods Markets and Wild Oats Markets,* No. 1:07–cv–01021 (D.D.C. filed June 5, 2007), (complaint filed), available at *http://www.ftc.gov/os/caselist/0710114/070605 complaint.pdf.*

[78] *FTC* v. *Whole Foods Markets and Wild Oats Markets,* No. 07–1021 (D.D.C. Aug. 16, 2007); *FTC* v. *Whole Foods Markets and Wild Oats Markets,* No. 07–5276 (D.C. Cir. Aug. 23, 2007).

[79] *In the Matter of Rite Aid Corporation and The Jean Coutu Group,* FTC Docket No. C–4191 (June 4, 2007) (complaint filed), available at *http://www.ftc.gov/os/caselist/0610257/070604complaint.pdf.*

[80] *In the Matter of Missouri Board of Embalmers and Funeral Directors,* FTC File No. 061 0026 (Mar. 9, 2007) (proposed decision and order), available at *http://www.ftc.gov/os/caselist/0610026/0610026decisonorder.pdf.*

[81] *In the Matter of Lockheed Martin Corp. and The Boeing Co.,* FTC File No. 051 0165 (Oct. 3, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0510165/0510165decisionorderpublicv.pdf; In the Matter of Lockheed Martin Corp. and The Boeing Co.,* FTC File No. 051 0165 (Oct. 3, 2006) (agreement containing consent order), available at *http://www.ftc.gov/os/caselist/0510165/0510165agreement.pdf.*

[82] *In the Matter of Gen. Dynamics Corp.,* FTC Docket No. C–4181 (Dec. 28, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610150/0610150decisionorder.pdf; In the Matter of Gen. Dynamics Corp.,* FTC Docket No. C–4181 (Dec. 28, 2006) (agreement containing consent orders), available at *http://www.ftc.gov/os/caselist/0610150/0610150agreement.pdf.*

[83] *In the Matter of Serv. Corp. Int'l and Alderwoods Group Inc.,* FTC Docket No. C–4174 (Dec. 29, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610156/070105do0610156.pdf.*

[84] *In the Matter of Linde AG and The BOC Group PLC,* FTC Docket No. C–4163 (Sept. 5, 2006) (decision and order), available at *http://www.ftc.gov/os/caselist/0610114/0610114c4163LindeBOCDOPubRecV.pdf.*

[85] FTC News Release, *FTC Chairman Announces Merger Process Reforms* (Feb. 16, 2006), available at *http://www.ftc.gov/opa/2006/02/merger__process.htm.*

[86] FTC News Release, *Federal Trade Commission and Department of Justice Allow Electronic Submission of Premerger Notification Filings* (June 20, 2006), available at *http://www.ftc.gov/opa/2006/06/premerger.htm.*

[87] FTC Staff Comments to Councilmember Mary M. Cheh, Chairperson, Committee on Public Services and Consumer Affairs, Council of the District of Columbia (June 8, 2007), available at *http://www.ftc.gov/os/2007/06/V070011divorcement.pdf;* FTC Staff Comments to Christopher R. Stone, State of Connecticut House of Representatives (May 2, 2007), available at *http://www.ftc.gov/be/V070008.pdf.*

[88] Federal Trade Commission and United States Department of Justice Comments to Governor Jennifer M. Granholm of Michigan (May 30, 2007), available at *http://www.ftc.gov/be/v050021.pdf.*

[89] Federal Trade Commission and United States Department of Justice Comments to Assemblywoman Helene E. Weinstein, Chair, Committee on Judiciary, New York State Assembly (Apr. 27, 2007), available at *http://www.ftc.gov/be/V070004.pdf.*

[90] FTC Staff Comments to Ms. Lilia G. Judson, Executive Director, Indiana Supreme Court (May 11, 2007), available at *http://www.ftc.gov/be/V070010.pdf;* Brief of the Federal Trade Commission As *Amicus Curiae* Supporting Arguments to Vacate Opinion 39 of the New Jersey Supreme Court Committee on Attorney Advertising (May 8, 2007), available at *http://www.ftc.gov/be/V070003opinion39.pdf;* FTC Staff Comments to the Florida Bar (Mar. 23, 2007), available at *http://www.ftc.gov/be/V070002.pdf;* FTC Staff Comments to the Rules of Professional Conduct Committee, Louisiana State Bar Association (Mar. 14, 2007), available at *http://www.ftc.gov/be/V070001.pdf;* FTC Staff Comments to the Office of Court Administration of the New York Unified Court System (Sept. 14, 2006), available at *http://www.ftc.gov/os/2006/09/V060020-image.pdf.*

[91] FTC Staff Comments to Assemblywoman Nellie Pou, Chair, Appropriations Committee, New Jersey General Assembly (Apr. 17, 2007), available at *http://www.ftc.gov/be/V060019.pdf;* FTC Staff Comments to Terry G. Kilgore, Member, Commonwealth of Virginia House of Delegates (Oct. 2, 2006), available at *http://www.ftc.gov/be/V060018.pdf.*

[92] FTC News Release, *FTC and DOJ to Host Joint Public Hearings on Single-Firm Conduct as Related to Competition* (Nov. 28, 2005), available at *http://www.ftc.gov/opa/2005/11/unilateral.htm.*

[93] FTC Staff Report, *Municipal Provision of Wireless Internet* (Sept. 2005), available at *http://www.ftc.gov/os/2006/10/V060021municipalprovwirelessinternet.pdf.*

[94] FTC Staff Report, *Broadband Connectivity Competition Policy* (June 2007), available at *http://www.ftc.gov/reports/broadband/v070000report.pdf.*

[95] FTC Conference, *Energy Markets in the 21st Century: Competition Policy in Perspective* (Apr. 10–12, 2007), available at *http://www.ftc.gov/bcp/workshops/energymarkets/index.html.*

[96] Federal Trade Commission and Department of Justice, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (April 17, 2007), available at *http://www.ftc.gov/opa/2007/04/ipreport.shtm.*

[97] Federal Trade Commission and United States Department of Justice, *Competition in the Real Estate Brokerage Industry* (Apr. 2007), available at *http://www.ftc.gov/reports/realestate/V050015.pdf.* To complement the report, the Commission simultaneously released a consumer education publication, *Buying a Home: It's a Big Deal,* which has tips for considering the services of a real estate professional and using the Internet as a source of real estate information. FTC Consumer Education, *Buying a Home: It's a Big Deal* (May 2007), available at *http://www.ftc.gov/bc/edu/pubs/consumer/alerts/zalt001.shtm.*

[98] Available at *http://www.ftc.gov/ftc/antitrust.htm.*

[99] Available at *http://www.ftc.gov/ftc/oilgas/index.html.*

[100] Available at *http://www.ftc.gov/bc/healthcare/index.htm.*

[101] Available at *http://www.ftc.gov/bc/realestate/index.htm.*

[102] Available at *http://www.ftc.gov/bc/tech/index.htm.*

Senator DORGAN. Madam Chair, thank you very much. We appreciate your testimony.

Let me ask a number of questions of you.

First, in your testimony, you indicate that you would like to work with the Committee to help ensure that the reauthorization includes appropriate resources—increases in resources to meet growing challenges. I note that, in 1979, the Federal Trade Commission had 1,750 full-time employees, it now has 1,074. So, from 1,700-plus to 1,000, that's a very substantial reduction in the number of employees of the Federal Trade Commission. What do you think represents a level of employment and an increase in the investment in the FTC that would be appropriate, given the challenges?

Ms. MAJORAS. I think part of it depends, Chairman Dorgan, on whether new—whether there are new enforcement priorities that are assigned to the FTC. I think where we are today is, if we can grow by 10 to 15, perhaps 20, FTEs a year over the next number of years, we probably will still be in a strong position to continue to protect consumers at the level at which we have been.

It's—there are—I think there are several reasons why the agency, particularly back in the 1980s, began to diminish in size. Over the last few years, it actually has been growing, and certainly in my tenure we've been growing steadily over the last few years as Congress—well, as markets have changed and required us to step in more—in new and different areas, and as Congress has given us new responsibilities.

Senator DORGAN. Let me ask about the common carrier exemption. You have referred to that, and we've talked about that previously. The common carrier exemption is a gap that, in my understanding, prevents the Federal Trade Commission from moving in certain areas dealing with communications. Can you describe that gap? And how important is it that we deal with it?

Ms. MAJORAS. I'm happy to do that. Thank you.

Increasingly, as we are seeing the communications industry and players in that industry converging, technologies are converging, functions are changing, and, obviously, less of our communications function in this country falls under the rubric of common carrier. What we are bumping up against in trying to bring cases, say, in

area of calling cards or the area of advertising of bundles of services—so, a bundle that might include your cable, your Internet access, and telephone—we are being asked to look at whether there may be some deception in those areas, whether the advertising is not fully accurate. And the difficulty is that, if a company falls under the rubric of common carrier, what they argue to us is that we have no authority. Now, we've taken a view that common carrier status, from our perspective—we look at the activity and whether it's common carriage, not the label that a company puts on itself, but, nonetheless, what we are finding in our enforcement work is that the telecom companies want to prohibit us from going in those areas, and we simply—this is what we, I think, are very good at. We have a lot of experience at rooting out deception in advertising and in other disclosures that are made to consumers in services that are extremely important to them. And so, we're—what we're worried about is that this problem is going to grow as the markets continue to evolve, and not be reduced.

Senator DORGAN. Well, we agree. And my hope would be, in the reauthorization bill, that we will eliminate that exemption and give the FTC the authority that is necessary.

Now, let me ask a question on a subject that you and I have disagreed on over the years, and that is the issue of oil pricing. There have been substantial mergers in the oil industry, mergers that have meant that virtually every oil company has two names—Exxon Mobil, ConocoPhillips—they marry up and have two names; they're bigger, they're stronger, they have more economic muscle in the marketplace. And many people feel that that has played a role in disadvantaging consumers and giving more market power to the companies. The reports I have seen recently suggest that refiners—I'm talking about the refinery capability in this country—are taking a larger share of the profits of oil. *The Wall Street Journal* noted, and I'll quote, "Lately, American refiners have made a pretax profit of roughly $30 on each barrel of oil they use to produce gasoline, more than three times the margin in Singapore, a major Asian refining center." If refiners are making twice as much on a gallon today, versus a few years ago, does that not suggest to someone in your position in the Federal Trade Commission, that there is market power being exercised in a way that disadvantages consumers, coming from, and stemming from, substantial mergers?

Ms. MAJORAS. That's not what we've concluded in the various investigations and studies that we've done into this industry, Senator. I mean, the fact of the matter is that, in refining in particular, if you actually look at it from concentration standpoint, it's still a very unconcentrated marketplace. The problem we have is that demand continues to grow year after year, and refining capacity, while it has grown—some people say, "Well, all these refineries have closed, how could it have grown?" Well it's grown through expansion, and we now have some bigger refineries, and a lot of the smaller and less efficient refineries have gone away. We also have better technologies and can refine more gasoline out of one barrel of oil. So, there has actually been an expansion in capacity, but, nonetheless, demand has continued to grow, and so, we're now importing, actually, refined gasoline into this country, because we

have not—because the refiners and their capacity hasn't kept up with the demand.

Senator DORGAN. But if, in fact, it is the case that refiners are making twice as much now on a gallon of gasoline as they made previously, wouldn't that suggest that the market power exists there because of mergers to impose that upon consumers? And wouldn't that encourage the Federal Trade Commission to take a skeptical look at it?

Ms. MAJORAS. Well, the—a couple of things—it doesn't suggest that they have market power that comes from mergers. I mean, it could suggest that, but we've looked at it, and that's not what we believe it suggests. The second thing is that, you know, we've brought three cases this year in the energy area; indeed, we brought one to challenge the merger between two refiners, because we felt that, in that part of the country, that would—that could, potentially, give the remaining refiner market power. And the District Court disagreed with us and said, "No, we're not concerned about that, there's plenty of competition here," and denied our request for an injunction. So, surely we are being very vigilant and looking at mergers very, very closely, and identifying those that we think will inhibit competition, going forward.

Senator DORGAN. But, in many ways, the mergers are already completed. I mean, we've had dramatic consolidation, and that consolidation, it seems to me, just intuitively, provides much greater muscle in the marketplace, and the consumers, at this point, are the victims at the end of the process. Is that not the case?

Ms. MAJORAS. We actually don't—we actually don't believe it is, because—I mean, obviously, you're referring to the mergers that occurred in the 1990s, the very large mergers. Interestingly, if—I mean, we look at the market in different pieces. If you look at upstream, for example, exploration and production of actual oil—there, consolidation has almost no effect; OPEC sets the price at that level. Exxon Mobil, indeed, has about a—just over, I think—last stats I saw were, maybe, a 3 percent market share—in the exploration and production of oil. So, you know, hard to see how a merger hurts consumers, when you have numbers that low. OPEC is clearly setting the price of oil, and the price of oil—is the greatest determinant of what we're going to pay—of what we're going to pay at the pump. Moving down the chain of distribution, obviously you get to the refining and wholesale levels. It's true that, after years of very low profits, which probably contribute to having less investment in more refineries, over the last couple of years we have seen the profits for the refiners go up, as I said, as we've—as we've—it isn't that the mergers have given us fewer—less refinery capacity, it's—again, it's—we have—we have more capacity now than we had 10 years ago. The problem is that we also have greater demand. And even as we hear consumers really feeling the pain at the pump; nonetheless, we look at the figures and the demand continues to go up.

Senator DORGAN. But it seems to me, with all due respect, that that rationalizes a set of facts, to the best extent one can, with a conclusion one has already developed. It seems to me that here's the case. As the large oil companies merge and our country waves a green light or a green flag or something, and says, "Go right

ahead"—as they merge and become stronger and have more muscle in the marketplace, they, in many cases, have eliminated refineries. I would guess you would agree with that. We have more refining capacity, yes, but many of those mergers have resulted in refineries closing. And, in fact, it seems to me they have opportunities, through market power, to decide refining capacity in a way that maximizes their profits. And the refinery industry is not, as you suggest, widely dispersed in ownership; there is a substantial amount of ownership of the refining capacity by the major integrated companies.

And I think you said that OPEC has a prominent influence in setting the price of oil. You're right about that. There are three things that tell me there is no free market at all. The three things are: first, the OPEC ministers sitting in a closed room, making judgments; second, bigger, stronger, merged oil companies with more economic muscle in the marketplace; and third, a futures market that has become an orgy of speculation. Those three things tell me there's not a free market. I mean, we talk about all this "free market" stuff. There's no free market here. And if, in fact, that's the case, there is no free market, then it means it is much, much more important to have your agency be the watchdog to make certain that consumers are not gouged.

Ms. MAJORAS. Well, thank you, Senator. I mean, I disagree with you that there's not a free market in gasoline. We see the workings of the market, constantly. And—but where I absolutely agree with you is, regardless—I mean, you and I could agree to disagree on that point, but, nonetheless, where I absolutely agree with you is, we still have to be the watchdog in this area. And we are the watchdog. And, as I said, we've brought three energy cases this year; early last year, we were pushing on a merger that Chevron was trying to do. They abandoned the merger. They said it was because of concerns of the FTC. So, performing that watchdog function, we absolutely are doing.

As far as closing refineries as a result of mergers, you know, I wasn't—I have to say, of course, I wasn't here in the 1990s, but, while there may have been some of that, there were a number of other things that happened. One is, the FTC did not allow these mergers to go through without significant divestitures. And some of those divestitures, as I understand it, occurred in the refining area. So, what we have today is, a lot of the largest refiners are not the Exxon Mobils in this country, they're companies like Valero and others, who have—who bought refineries from the bigger companies and now are significant players in that. So, you actually have some relatively new players in the refining business, as well.

We did do a study—we did do an investigation, in 2006 and the early part of 2007, to see whether, in fact, we could find evidence that refiners were using capacity in making decisions, particularly jointly, to keep the price—to keep the price high; and we just didn't find any evidence of that.

Senator DORGAN. North Dakota has the second highest price of gasoline in the country, next to Hawaii, today. We are the sixth largest energy-producing state in the country, with oil, natural gas, and coal. I mean, I would say that there are a whole lot of folks out there that have real questions about how these prices are set.

I don't suggest this is the case with what is happening with oil or gas, but I would tell you that I chaired the hearing in this room—Ken Lay sat where you were sitting—the former CEO of Enron. And I also, on the Energy Committee, on another committee, sat at a dais when the Federal Energy Regulatory Commission sat at the table; and they weren't watchdogs, they were lapdogs. The fact is, we were told—those of us that said, "What's happening on the West Coast?"—we were told, "You're wrong." The Vice President said we were wrong, "It's a free market. The free market system is working." Turns out, it wasn't, there was grand theft going on. I'm not suggesting that that is the case here, but what I am suggesting is, the role of a watchdog and the role of a referee is a very important role in this country, especially if we have decided to allow substantial numbers of mergers, where you have increased concentration. That has been the case in this industry. And I want the industry to succeed. It's certainly succeeding beyond most people's dreams these days. But I also want the consumers to have a watchdog that gives them a voice, to determine whether there is market manipulation.

Let me go to a couple of other things that I want to talk to you about.

One is, as you might imagine, subprime loans. There's an enormous consequence to this country's economy with respect to what is happening with the consequences of subprime loans now. Tell me your impression of what kind of deceptive advertising, if any—or deceptive lending—existed that has caused this problem. Some will say, "Well, look, this is the fault of those that lent the money to people that shouldn't have gotten it, and it's the fault of the people that borrowed the money, who should have known better." So, everybody's at fault. But is there not a case to be made here that there has been substantial deceptive advertising?

Ms. MAJORAS. Just yesterday, we announced that—earlier this summer, we did a—an Internet and other advertising sweep, and, just yesterday, sent letters to 200 advertisers of mortgage loans, to tell them that we believe that they may be violating Federal law by deceptively advertising loans on their—particularly on the first page; you go to the second page and get fine print—but teasing consumers into believing that they could get loans at 1 percent and the like. So, definitely, as, you know—the FTC has been active in this space, in terms of deception in mortgage loan advertising, for years, before this even became a big problem, and we've brought a number of cases, and we've gotten back $320 million for consumers. So, this is something that's not a fad for us at all; we've been on—we've been on this. And I do think that deception played a role.

I also, though, think that, even and, obviously, we wouldn't be doing this work if we didn't think it was extremely important, but there's another thing, Senator, that we're worried about, that I'd like to bring to your attention, and that is, even for those who weren't deceived, and even for those who are getting loans—you know, both in the subprime arena, but also not—consumers just are not understanding what they're getting in their mortgage. And we published a study earlier this summer that our economists did, which showed that, across the board, the mortgage disclosures,

even when the law is being followed, are just not explaining to people what their mortgage means. And so, I think we should look at both parts of this, the deception part, which we're working on, but we're also concerned about, even if honest disclosures are given, are our consumers understanding what their mortgage means and what they're getting?

Senator. DORGAN. So, first of all, I appreciate the work that you have done for some while in this area, but—Warren Buffet said, "Every bubble will burst." We forget that as the bubble builds. We always forget that. And it seems to me that we were in this period for some years, where we had all these advertisements for subprime loans and credit cards: "Have no income, have no job, have bad credit, come to us." I mean, you see it and hear it on radio and——

Ms. MAJORAS. Yes.

Senator DORGAN.—television and so on. And have you—during this period, have you put together initiatives that are more aggressive, that reach out? I mean, you describe what you've just done, and I appreciate that, but have we gone through a period where you weren't very active? Or should the Commission have been more active during the period that the bubble was being created? And, if so, what can we learn from that, and how can we be more aggressive now to make sure this doesn't happen again?

Ms. MAJORAS. Well, I—no, you raise a good point. Obviously, it's part of my job and my commissioners' job and our other managers to always evaluate how we're using our resources. We've—we certainly brought—have brought a number of cases in this area over the last few years. Should—could we, and should we, have been more active? That's entirely possible. Our staff that works on this particular area was swamped, over this same period, with identity theft and data security issues. And we were sometimes, you know, the ones in the Federal Government who needed to deal with those issues.

I was so concerned that we needed to be spending more time on some lending and other traditional financial issues that I split apart our financial services division last year, and said, "You focus on data security and identity theft, and these others—you need to redouble your efforts in the area of lending, other credit issues, and debt collection issues." And we've now done that.

Senator DORGAN. Let me read to you a couple of ads that I know you're aware of. There's an ad from probably the largest mortgage lender in the country, one that has had to go borrow $11 billion to meet a shortfall. Here's the ad that they were running: "Homeowners, do you want to refinance, get cash? We have a great reason to do it now. No cost to refinance, no points, no application fee, no credit reporting, no third-party fees, no title, no escrow, no appraisal fees, no closing costs. You wind up with a lot more cash."

I've got a whole list of them here—"Easy mortgage." All of these are seductive advertisements to consumers, to say, "You know what, need money, fast bucks? Come here." I mean, it reminds me of a different kind of industry that used to be operating in the shade someplace. While all of this was going on, did we intercept any of it, did we take action, at this point, to say, "Wait a second, this doesn't sound right, doesn't seem right"?

Ms. MAJORAS. Well, we did. We certainly brought cases. We got consumer complaints in. We continue to monitor those complaints. We brought cases.

Senator DORGAN. But you said you were swamped. And that gets back to the first question I asked you. If we're going to increase by ten people a year, what's that, 100 years before we get to 1,000 people? And how long to add back what we used to have, some years ago at the FTC?

Ms. MAJORAS. Well, I think the FTC was a very different place in 1980, and did a lot of things that most people would agree it shouldn't have been doing. So, it's——

Senator DORGAN. Like what?

Ms. MAJORAS.—it's not a perfect——

Senator DORGAN. Like what?

Ms. MAJORAS.—comparison. Like industrywide rulemakings on things that were not very helpful to consumers, as opposed to some enforcement. And—no, look, I mean, the resource—the resource question is a fair one, but the thing to remember in this area is that we're sharing—I mean, we have a piece——

Senator DORGAN. I understand.

Ms. MAJORAS.—and we're sharing with the banking agencies, and with all the states, who have, actually, greater powers than we have in this area. And so, we're not the only players. Now, there's just no—all I'm trying to admit to you, Senator, is that, of course, when there's an economic crisis of some sort, or a bubble bursts, it's part of my job to look back on it and say, "Yes, of course, if we had had more resources, we would have—we would have done it even more." And, of course, that's the case in almost everything we do.

Senator DORGAN. I understand. But when you say, "We were swamped," and we see an agency that went from 1,700 to 1,000 people, and we now see not just this—in this particular area, which is going to have significant consequence to our whole economy and to a lot of the American people—but in addition to this, the toys coming in from China. I want to talk about that a little bit; I know that that relates to the Consumer Product Safety Commission, as well. But when you say, "We're swamped"—look, my interest is in having an enforcement agency that's a referee and that represents us in going after deceptive advertising and issues of concentration and competition that you have the resources you need. That's why—that's the first question I asked you. I don't want you to be too swamped to wake up in the morning and see an ad, or to have your people peruse all these ads, and say, "We're going after it. This is wrong. Consumers are being bilked. This is unfair." I mean, I want you to have the resources necessary. And as you know—there are people who believe that there ought to be a minimalist role here, "If someone gets stung by bad business practices, tough luck. They'll just understand, they'll learn, you don't do business with that kind of situation any more, you don't do business with that company." There are people with that minimalist attitude.

Ms. MAJORAS. And——

Senator DORGAN. I don't want that. I want an FTC with teeth and with aggressiveness.

Ms. MAJORAS. That is absolutely not my attitude. It's not that it's minimalist. The difficulty for a small agency, though, is that I can't absorb 50 people every year. I mean, it's—the hiring cost that it takes just to get that done, the absorption of people into the agency, the training—I think we should grow, and—look, we'll grow as fast as we can and I agree that we should grow. My only point is, having worked in this organization and others, it's very difficult to suddenly—when you're small, to begin with—grow by leaps and bounds——

Senator DORGAN. Right.

Ms. MAJORAS.—all at once.

Senator DORGAN. A fair point. I accept the point. And my only point is that whatever the level should be at the Federal Trade Commission to protect us in the manner that we want to be protected, to protect consumers, we want that level to exist with respect to resources.

And I want to come, now, to this issue of the products that we read about on the pages of our newspapers. Someone buys a set of tires, to discover that the tires are faulty, bad products; and someone's on the road, driving 70 miles an hour, and has a problem with a tire, and somebody dies. A young boy swallows a heart-shaped charm—a small heart-shaped charm that comes with a pair of tennis shoes. Turns out it's 99 percent lead, and the 4-year-old boy is dead. You know, the list is endless of trinkets and toys, Elmo and Big Bird, coming in from overseas now in this galloping global economy. And we discover—you know what?—we not only exported the jobs, we exported minimal requirements to attend to the production, and we don't have the foggiest idea of the conditions under which these products are being produced.

So, describe to me your role and the role of the Consumer Product Safety Commission, as well, with respect to product safety and what we're now seeing with respect to the global economy and products coming in that are unsafe.

Ms. MAJORAS. The Consumer Product Safety Commission, Senator Dorgan, has almost the entire responsibility for this current problem. We obviously have the ability to go after deceptive and unfair practice—and unfair practices. But as far as product safety has gone, that has been the province of the CPSC. Obviously, in food and pharma and so forth, that has been FDA. And we work with those agencies, as appropriate. But, in fact, we haven't even worked much with CPSC, because we just don't have much overlap with them.

Senator DORGAN. The CPSC was originally an outgrowth of the Federal Trade Commission, is that——

Ms. MAJORAS. That's my——

Senator DORGAN.—correct?

Ms. MAJORAS.—understanding. And that——

Senator DORGAN. You have no relationship at this point, really?

Ms. MAJORAS. Oh, no, we have—we have a relationship. Occasionally—to tell you the truth, we overlap more in the international arena, because some agencies overseas have the same—still have both functions in their agencies; and so, sometimes they want to meet with both of us, and we may be consulting. And there may be the occasional issue on which we consult with them. But I can't

think of anything official I've had to consult with them on anytime recently.

Senator DORGAN. I'm going to send you a list of questions about this area, because I think there needs to be closer consultation. And I also want to explore the issue of whether the Federal Trade Commission should retain some kind of a role here, working in cooperation with the Consumer Product Safety Commission.

It's clear to me that, with the global economy these days, and substantial outsourcing of production, we now insource products from all around the world, and, in many cases, we don't have the foggiest idea what the conditions of production were. And now we discover that Elmo and Big Bird have lead paint which exceeds the amount of lead that we would allow American children to be exposed to. This is not new. I mean, Benjamin Franklin warned us about that. So, it's not as if we've discovered some new phenomenon, except that we have just outsourced production, and we have plants operating in parts of the world where they want to reduce costs, so they use lead—fast-drying, cheap, bright. The problem is, it can kill children.

Ms. MAJORAS. Yes.

Senator DORGAN. And so——

Ms. MAJORAS. Yes.

Senator DORGAN.—I want to explore some of that with you, with some written questions.

Let me ask, if I might, about network neutrality. I'm sure you expected I would want to ask you about your statement.

Ms. MAJORAS. Yes.

Senator DORGAN. The Federal Trade Commission has made some statements—you have made some statements—about the issue of network neutrality, or net neutrality. Tell me your impression of these issues.

Ms. MAJORAS. Well, it's a broad issue, but I'll try to give you a summary.

We—when I first was trying to figure out what my impression of the issues were, probably back in the summer of 2006, my impression was that there wasn't enough—there wasn't enough out there in the marketplace that I could read, that could fully educate us on the issue. We were being asked a lot of questions about whether competition laws are sufficient to deal with these issues as they come up. And I just—I felt there wasn't enough good information out there, so I asked my staff to go out and get some. And they did. They spoke to dozens and dozens of folks with an interest in this area, and then we held a couple of days of public hearings, which went over extremely well, because I think people were very happy to get together and talk about this issue honestly.

We then issued a report, in—I believe it was June—in which what we concluded was that, in thinking about acting in this area, legislators or other policymakers should exercise caution, because there's so much that we still don't know about what's happening in this marketplace, what's going to happen in this marketplace. There's no question that people on both sides of the issue say, "These Internet service providers are going to have this incentive or that incentive." "No, they're not. They're going to have this incentive or that incentive." That could be—either side could be right.

Variations on what either side believe could be right. And because this is such a dynamic area, where we don't want to squelch the innovation that's going on, squelch the development as we move forward, we are concerned that regulating prematurely, and perhaps on such a broad basis, as opposed to trying to take care of problems that we know are occurring, really could serve to squelch this market in a way that's harmful to consumers.

Senator DORGAN. Can I ask what you mean by "regulating"? Because my understanding is that, prior to a recent decision by the FCC, we had nondiscrimination rules in place, which do not now exist. But were those nondiscrimination rules what you define as "regulation"?

Ms. MAJORAS. They're part of regulation, yes.

Senator DORGAN. And so, a regulatory framework that requires nondiscrimination, you think that's inadvisable?

Ms. MAJORAS. That's not what the report says. What the report says is that, "Here are the things that one needs to think about before you do it." And we don't think there's enough—first of all, we don't think there's evidence that discrimination is occurring, or even that it surely will occur. We don't think—if it does occur, we think there are certainly possible economic scenarios in which, if it did occur, it would not be harmful to consumers, necessarily. And so, if you have an inflexible rule that prevents it, we're concerned that that may—that may prevent business models from developing that would actually be helpful.

Senator DORGAN. Let me ask you—there was an op-ed piece a while back by a local telephone company that provides broadband service, and so on, in a region, and the manager of that company said, "You know, we need some additional revenue, and one way that I hope to get that revenue is to take a look at some of the big folks that are on the Internet and say to them, 'You've got to pay a toll charge to get to the people I'm serving.'" That seems to be classically what we exactly want to prohibit in this country. And yet, if that telephone company decided to do that on their Internet service, to say to a large or a small site out there, "You've got to pay money to us in order for us to move your site—or make your site accessible to our customers," that would, under current circumstances, that would be all right, wouldn't it? Because there's no nondiscrimination requirement, and it would be fine for that company to do that. I think that's a horrible thing to have happen. My guess is that your philosophy is, "Well, if it happens, there's going to be some other alternatives, and competition will solve the problem." Is that your position?

Ms. MAJORAS. Well, I have to—I have two positions. First of all, I don't know whether it will be completely awful for that to happen. I know that companies like Google and Microsoft don't want to have to pay for it. They like the—they like—they like the fact that they're not. So, I understand, you know, that perspective. I certainly understand the perspective of small content providers, and we do want to make sure that there are lots of—that we have lots of content on the Internet. But I do think that—a couple of things. One, I think competition takes—does—likely takes care of a lot of it, because the fact of the matter is—I can't imagine consumers tolerating not getting the content that they want. I mean,

there has just never been a medium that consumers have believed was their own like the Internet. So, I think that these telecom providers have if they haven't gotten the message, they probably will, that this won't be tolerated. But, moreover, I'm not suggesting that if you start to see something that really is harmful to consumers, that there might not be a time when some new rules are necessary. That's—you know, that's obviously part of what——

Senator DORGAN. Well——

Ms. MAJORAS.—regulators do, and what you do. But I just—to do it now, we think—we think—we just have to realize—could create more problems.

Senator DORGAN. But, you see, this gets back to the questions I've asked about some previous issues. You say, "Well, don't worry. If there becomes a problem, we'll deal with it later." I'd like us to prevent a problem from existing here. And let me give you an example. When Ed Whitaker, the former CEO of AT&T, then with BellSouth, said, quote, "They don't have any fiber out there, they don't have any wires, they don't have anything. They use my lines for free. That's bull. For a Google or a Yahoo! or a Vonage or anybody to expect these pipes for free is nuts." It's quite clear what the interest is, and it's clear to me where we're headed. We're headed toward a circumstance where big providers that have a lot of muscle and will be able to make it stick, will set up different kinds of lanes and freeways here, some toll, some not. And consumers will not know what they don't have. That's just a fact.

Ms. MAJORAS. And I just don't—I just don't completely agree with that.

Senator DORGAN. Well, I know you don't agree with it, but I'm right.

[Laughter.]

Senator DORGAN. Let me tell you why. Consumers won't know what they don't have, because there will be providers out there, there will be sites out there—I'll give you an example. I don't have a big thing for Google. I don't have any contact with Google. But Larry and Sergey, just 9 years ago, were moving to a garage with a garage-door opener, and had nine employees. That's 9 years ago. And they had an idea. Nine years later, they have a company that exceeds the combined valuation of Coca Cola, Ford Motor, and General Motors. Now, would two guys in a dorm room or a garage have access to the consumers in X, Y, or Z city if the big interests said, "Oh, by the way, you get a shot to go on our toll road if you can pay the toll"? I don't know. I don't think consumers will ever know what they miss. We created this Internet system through innovation. Innovation was available to everybody under every circumstance, and it was able to be accessed by everybody under every circumstance. If we get to a point where we say, "Now there's no nondiscrimination rules, there's no rules against discrimination, you can discriminate," we won't know what we miss. We won't know what innovation we squelch. And I would hope that the philosophy at the Federal Trade Commission is not to say, "You know what, let's wait and see what develops. We'll respond to it like a catcher responds to a foul ball here." Let's—how about deciding that what we've built, we built with nondiscrimination require-

ments. That's the regulatory framework in which we built this successful venture.

Ms. MAJORAS. But what I don't—what I don't want to see happen—Senator, you and I would not have been able to predict where we are—5 years ago, we would not have been able to predict where we are today. That makes it very difficult for us to predict where the Internet is going, or probably even where we want it to be 5 years from now, and we just have to remember that if we put rules into place here, there will be some unintended consequences. That's just part of what we're pointing out. There always are. And, again, I think that this medium is so dynamic that—no way is Verizon or any of these other companies powerful enough to squelch it. The amount of consumer-generated content that's out there, if they suddenly start putting a stop to that, there will be a hue and cry in this—across this Nation like no tomorrow, and they'll lose—you know, they'll lose a lot of customers. So, I just—I don't disagree with you. I don't want the bad result that you're talking about. I think that there just may be a difference in how we get there.

Senator DORGAN. I fail, ever, to see a downside from nondiscrimination. I mean, I can't think of a detrimental impact of nondiscrimination. Maybe——

Ms. MAJORAS. May I——

Senator DORGAN.—you can.

Ms. MAJORAS. May I offer one?

Senator DORGAN. Sure.

Ms. MAJORAS. OK. Today there are certain types of content that require faster speeds. And, unfortunately, because there's—you know, I—I'm not always great at technical terms, forgive me, Senator—but you're—where we're running out of space, almost—when we look at prioritization and who should go first, in terms of transmittal, if, for example, you don't prioritize certain things, like movies or VoIP or these other things that consumers are really starting to want on the Internet, over things that, sure, you're going to transmit, but they don't need to go as quickly or with greater priority, then you're going to lose those—the functions, the capability, at least in the short run.

Senator DORGAN. Well——

Ms. MAJORAS. So, to be able to prioritize those—that's a form of discrimination.

Senator DORGAN. We see a different landscape, I guess. I think both the lack of informed public policy and the lack of effective competition means that we have 1/20 the speed at twice the price for the same Internet service that many of our foreign competitors have. If you're living in Japan or Korea, you have a whole lot better speed—a whole lot more speed and at a lot less cost.

What I see in virtually every area of telecommunications is galloping concentration, and I would encourage you, Madam Chair, to take a look at the bills you pay every month for your services. Most Americans do the same, and they understand there is not robust competition to drive prices down, which would be the effect of robust competition.

But we'll save that for another day. My hope is that you will agree with me that, rather than wait for bad things to happen, we might want to preserve the same nondiscrimination rules that we

have always had with the growth of the Internet. I see no downside to nondiscrimination. But you and I will have more back and forth, on this issue.

Because we have another panel, let me thank you for coming, and say this. I think the discussions we've had about energy prices, about the subprime loans, about staffing at the FTC, about deceptive advertising, and about foreign products coming into this country, tainted products and so on, all of these things are really very important, and the Federal Trade Commission, I think, is in a position to play a very, very important role. I don't ask you to come up here today to denigrate a lot of good people that serve in the Federal Trade Commission. I do have heartburn, from time to time, that, especially in recent years, almost anybody that wants to merge gets a shot at merging without any oversight. And I know you've told me today of some circumstances where you have been an impediment to these mergers, and I appreciate that, because I think there are times when mergers clearly are not in the public interest. I want the Federal Trade Commission to be an aggressive and an active advocate on behalf of competition and on behalf of American consumers. My own belief is that, given the world we live in, we need to add resources to the Federal Trade Commission, and give the Federal Trade Commission the capability and the resources that it needs to do the job that is required of it by law.

So, I thank you for coming today, and let me ask you to thank the other Commissioners for the Committee. We will be trying to report a bill out of the Committee, a reauthorization bill, to finally get this through the U.S. Senate and through Congress. Thank you very much.

Ms. MAJORAS. Thank you for your support, Chairman Dorgan, we appreciate it.

Senator DORGAN. Thanks for being here.

Let me call the next panel up: Dr. Mark Cooper, Mr. Chris Murray, Mr. Michael Calhoun, Mr. Ari Schwartz, and Mr. Marty Abrams.

I want to indicate that your entire statement will be made a part of the permanent record, and I would ask that you summarize. I've had a chance to review your testimony.

And we will begin, today, with Dr. Mark Cooper, who represents the Consumer Federation of America.

Dr. Cooper, welcome, to you. You've appeared before this Committee on a number of previous occasions, and we appreciate your appearance today. You may proceed.

STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Dr. COOPER. Mr. Chairman, thank you.

There are certainly some areas where the FTC has done a good job, but, for oil and high-speed broadband Internet access, it has failed consumers badly. Here, the FTC asserts that there is vigorous competition, when there is not; and has claimed that there is no harm, when there is a great deal. The FTC has allowed refining markets and wholesale gasoline markets to become highly concentrated through lax merger review. The resulting tight oligopoly imposes severe pain at the pump and in the pocketbook, hundreds

of billions of dollars of overcharges. The FTC's analysis of recent price spikes ignores fundamental structural problems of its own making in oil markets.

If the subject of the FTC's 2006 price gouging investigation, mentioned earlier, had been the first price spike in the petroleum industry in recent years, then the report might be plausible. But, as every gasoline consumer knows, the 2006 spike was the sixth in a string of seven that have occurred in the last 8 years. Given the ever-lengthening list of events—fire, flood, hurricane, lightning, rust, demand surges—that Federal agencies use to excuse these price spikes, the only way one can characterize the FTC's analysis is that the price spikes are not the result of a conspiracy, they are the result of stupidity. The industry is simply unable to cope with any event that is out of the ordinary, or even do routine spring cleaning, without driving the price through the roof.

What are some of the surprises the FTC identified in the 2006 price spike? Seasonal effects of summer driving, increased consumer demand for gasoline, refinery outages resulting from hurricane damage, other unexpected or external events, and required maintenance.

Surprise, surprise—consumers drive more in the summer, and we drive more as we grow in population and wealth. These two facts have been in evidence since Mr. Ford first mass-produced the Model T, but they still somehow seem to have snuck up on the oil industry.

Surprise, surprise—refineries need to be maintained, and they break. How could the industry not have noticed? Worse still, why is there so little spare capacity that the industry has to run at such high levels of utilization that they are much more prone to accidents? Accidents don't just happen, they happen because you overuse your facilities.

Why is there a deficit of over 3 million barrels a day in domestic refining, more than twice what it was a decade and a half ago? Why have stockpiles been cut in half so they are inadequate to deal with any small blip in supply and demand?

In fact, five of the six excuses that the FTC gave for the price spikes of 2006 are the result of strategic underinvestment in capacity and management mistakes that have created a tight market in which you don't need collusion to put prices up. True competitive markets expand capacity. Tight oligopolies increase prices and profits.

Let me turn to broadband. When Congress passed the Telecommunications Act of 1996, the U.S. was a global leader in the Internet. Virtually all Internet traffic in this country traveled on telecommunications networks that were obligated to provide nondiscriminatory interconnection and carriage under Title II of the Communications Act. But the FCC abandoned the principle of nondiscrimination, allowing a cozy duopoly of telephone and cable companies to dominate the broadband marketplace without any obligation to provide nondiscriminatory access.

Chairman Majoras was dead wrong in her example. Ed Whitaker is not being prevented from prioritizing movies. What he wants to do is discriminate in favor of his movie and against the other guy's

movies. Establishing priorities for categories of service is differentiation, not discrimination. She got that absolutely wrong.

The FTC and the DOJ have cheered this decision by the FCC to allow this cozy duopoly to come into existence, claiming, "Two's enough for consumer protection." But theory and empirical evidence contradict that plan. The cozy duopoly in America dribbles out bandwidth at 10 to 20 times the—what other people pay around the world.

We have fallen from third, 6 years ago, to at least 15th, maybe 24th, depending on how you counted. Consumers pay too much for too little in this country, and other nations with consumer-friendly and competition-friendly policies have become the focal point of innovation. We can see what we're missing, Mr. Chairman, by looking at those who have less—left us in their dust.

Efforts to explain away the declining state of the U.S. by population density, market concentration, household size, income levels, income inequality, education, and age, among other things, do not negate the fact and the finding that the U.S. has fallen behind at least a dozen other nations. The success of the Internet, as you pointed out, was built on communications networks that were operated in an open and nondiscriminatory manner so that vigorous competition between applications and service providers was free to provide innovation and consumer-friendly services that drove demand. The way to break out of the current quagmire is not to claim that a duopoly is all you need, but to return to the successful procompetitive policies of open communications that made the Internet possible and allowed the U.S. to be the world leader in the first generation of the digital age.

The nations that have passed us by have relied on that very policy that we used 30, 20, 10 years ago to achieve leadership. We need to get back to that simple policy of nondiscrimination in communications.

Thank you.

[The prepared statement of Dr. Cooper follows:]

PREPARED STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee,

Thank you for the opportunity to testify. My name is Mark Cooper and I am Director of Research at the Consumer Federation of America (CFA).[1]

In my comments today I address two areas where the antitrust authorities, the Federal Trade Commission (FTC) in particular, have dropped the ball, failing to protect consumers from the abuse of market power. While the two sectors I address—the oil industry[2] and high-speed, broadband Internet access[3]—would appear to be

[1] The Consumer Federation of America (CFA) is a non-profit association of 300 consumer groups, with a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumer's interest through advocacy, research, and education.

[2] "The Failure of Federal Authorities to Protect American Energy Consumers from Market Power and Other Abusive Practices," *Loyola Consumer Law Review,* 19:4 (2007); *The Role of Supply, Demand, Industry Behavior and Financial Markets in the Gasoline Price Spiral* (Prepared for Wisconsin Attorney General Peggy A. Lautenslager, May 2006); *Record Prices, Record Oil Company Profits: The Failure Of Antitrust Enforcement To Protect American Energy Consumers* (Consumer Federation of America, Consumers Union, September 2004).

[3] This testimony draws on Mark Cooper, "The Importance of Open Networks in Sustaining the Digital Revolution," in Thomas M. Lenard and Randolph J. May (Eds.) *Net Neutrality or Net Neutering* (New York, Springer, 2006); *Open Architecture as Communications Policy* (Stanford Law School, Center for Internet and Society: 2004); "Open Communications Platforms: Cornerstone of Innovation and Democratic Discourse In the Internet Age," *Journal on Telecommuni-*

dramatically different, the underlying problem that afflicts consumers in each of these markets is the same—inadequate competition and the failure of antitrust authorities to act to promote competition or prevent anti-consumer, anti-competitive behavior by the industry. Federal authorities have allowed a tight oligopoly in oil and a cozy duopoly in broadband to engage in strategic under-investment in facilities, creating artificial shortages that allow them to overcharge consumers.

There are other areas where we think the FTC is doing a good job, including certain aspects of consumer protection, merger review in other industries, and anti-competitive, anti-consumer practices in the drug industry. But the oil industry and the broadband industry are extremely important and they are real weak spots.

The FTC has allowed refining markets and wholesale gasoline markets to become highly concentrated through lax merger review. The result is a tight oligopoly and severe pain in the pocketbook—hundred of billions of dollars in overcharges and excess profits. The FTC's analysis of recent price spikes ignores fundamental structural problems of its own making in oil markets.

The FCC has allowed a cozy duopoly of telephone and cable companies to dominate the broadband access market, without any obligation to provide nondiscriminatory access. The FTC[4] and the DOJ[5] have cheered this decision claiming that market forces in a duopoly will protect consumers, but theory and empirical evidence contradict that claim. As a result, the cozy duopoly dribbles out bandwidth at prices that are 10 to 20 times as high as in other nations around the world. The reliance on this cozy duopoly has been disastrous for the United States. In a short half decade, we have fallen from third in the world in broadband penetration and now are behind at least a dozen nations (15th) and, by some counts almost two dozen. Consumers pay too much for too little and the economy suffers as other nations with consumer and competition-friendly policies become the focal point of innovation.

Oil Prices

If the subject of the recent FTC oil price gouging investigation had been the first price spike in the petroleum industry in recent years, then the report on the 2006 price spike might be plausible, but as every gasoline consumer knows, it was not the first price spike by any stretch of the imagination. In fact, the 2006 spike was the sixth in a string of seven that have occurred in the last 8 years.

Given the ever lengthening list of unnatural events—fire, flood, hurricane, lightening, rust, demand surges—that Federal agencies use to explain recent price spikes, the only way you can characterize the FTC conclusion is that the price spikes are not the result of a conspiracy—they are the result of stupidity. The industry is simply unable to cope with any event that is out of the ordinary and even deal with routine spring cleaning without driving prices through the roof. When there are surprises and unexpected events for which the industry is unprepared, prices go up and oil companies just happen to make a lot more money. Its all quite innocent; dumb, but innocent—stupid like a fox.

What are these surprises and unexpected events that the FTC identified in the 2006 price spike? "Seasonal effects of the summer driving season . . . and increased consumer demand for gasoline beyond the seasonal effects."

Surprise, surprise—consumers drive more in the summer and more as the population and economy grow. Those two facts have been in evidence since Mr. Ford first mass produced the Model T, but they still seem to have snuck up on the oil industry. As Exhibits 1 and 2 show, the long term growth trend and seasonal driving patterns predict the gasoline demand in 2006 almost perfectly.

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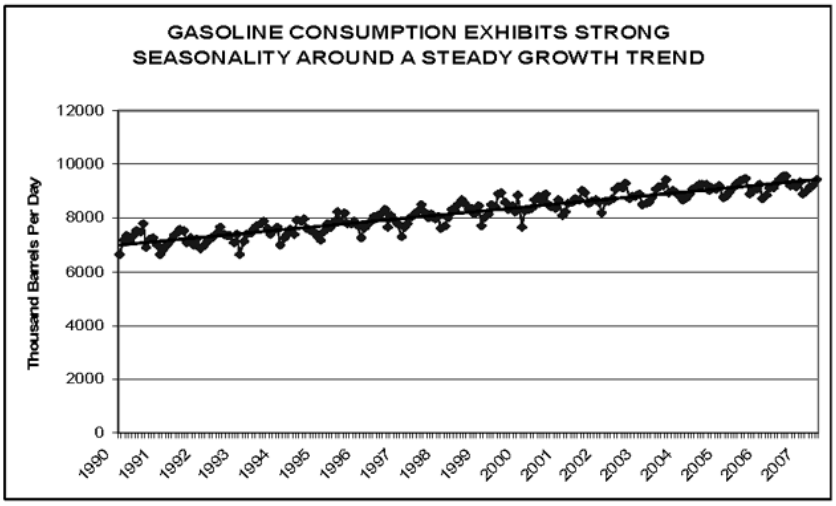
cations, Technology and Intellectual Property, 2:1, 2003, first presented at *The Regulation of Information Platforms,* University of Colorado School of Law, January 27, 2002.

[4] Federal Trade Commission, *Report on Spring/Summer 2006 Nationwide Gasoline Price Increases.*

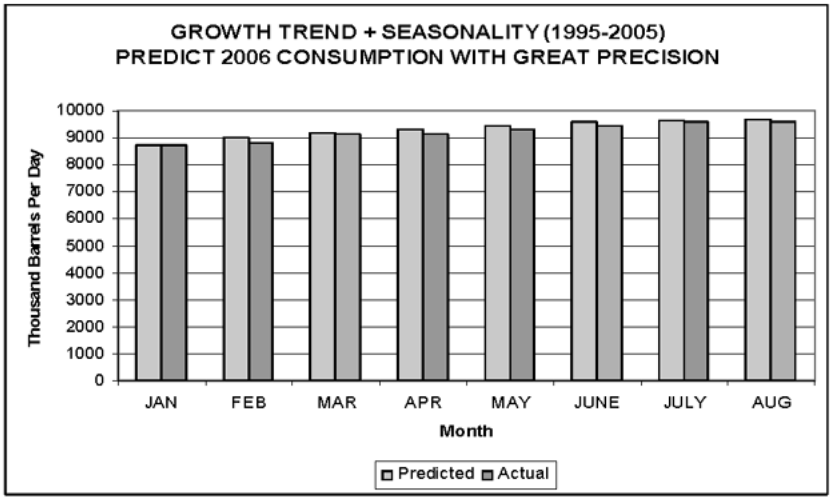
[5] "U.S. Department of Justice Ex Parte Filing," *In the Matter of Broadband Industry Practices,* WC Docket No. 07–52,

Exhibit 1



Source: Energy Information Administration, Database, Petroleum Consumption.

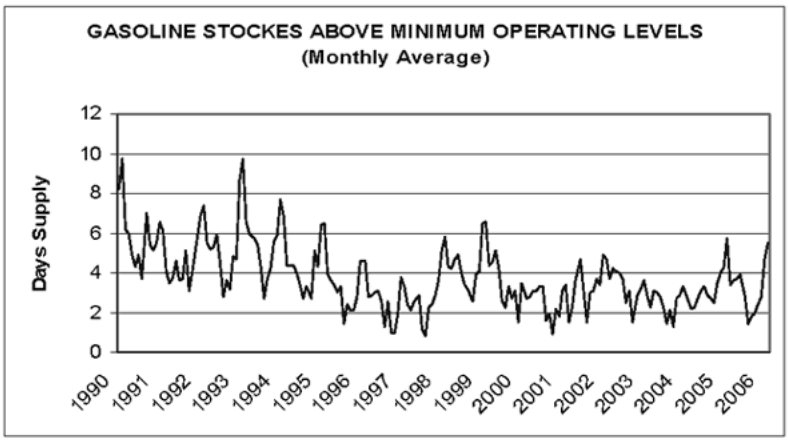
Exhibit 2



Source: Energy Information Administration, Database, Petroleum Consumption.

Even if there were a bit of a surprise, why is there no spare capacity or stockpiles to deal with it? In competitive industries, when there is a seasonal pattern, producers build systems to respond without having to raise prices dramatically, for fear that they will lose their customers. Prices fluctuate, but competition drives seasonal sectors to shave the peaks. In the oil industry they don't work that way, they just put the prices up. Over the past couple of decades the oil industry has systematically under-invested in storage (see Exhibit 3), reducing the amount of gasoline on hand, thereby creating a tight market with little capacity to respond not only to genuinely unexpected shifts in demand, but even to routine seasonal patterns.

Exhibit 3: Gasoline Stocks above Minimum Operational Levels

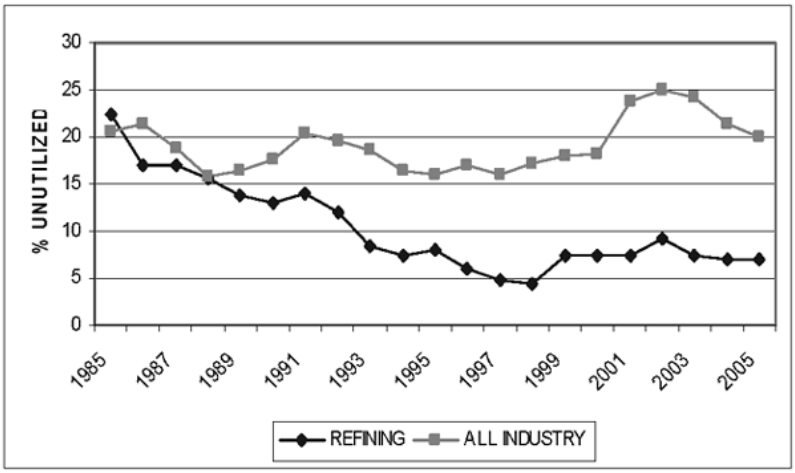


Source: Energy Information Administration, Petroleum Database.

What are these surprises and unexpected events? "Refinery outages resulting from hurricane damage, other unexpected problems or external events, and required maintenance."

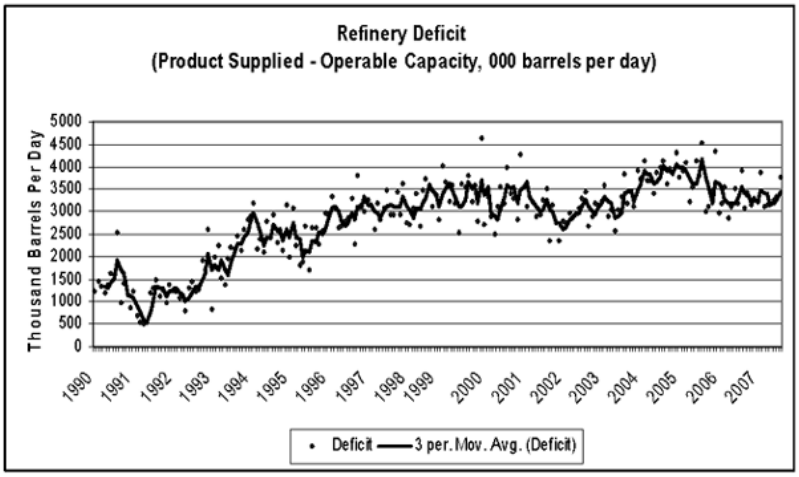
Surprise, surprise—refineries need to be maintained and they break. How could the industry have been so stupid as not to notice? Never mind that in a competitive industry each individual producer would carry more spare capacity for fear that he might get caught short if he had an outage or have to raise prices, which would cost him his customers (see Exhibit 4). In the oil industry they don't work that way, they just put the prices up. Worse still, the stupidity of the oil industry makes matters worse. When you don't build enough refineries and you run them at high levels of capacity, they break more often. Over the past couple of decades the oil industry has systematically under-invested in refining capacity—closing dozens of refineries and refusing to build new ones—thereby creating a system that not only cannot respond to accidents, but that cannot even provide routine maintenance without causing price spikes. There is now a shortfall of over 3 million barrels a day of refining capacity (see Exhibits 5 and 6).

Exhibit 4: Spare Capacity in Refining v. All Industry



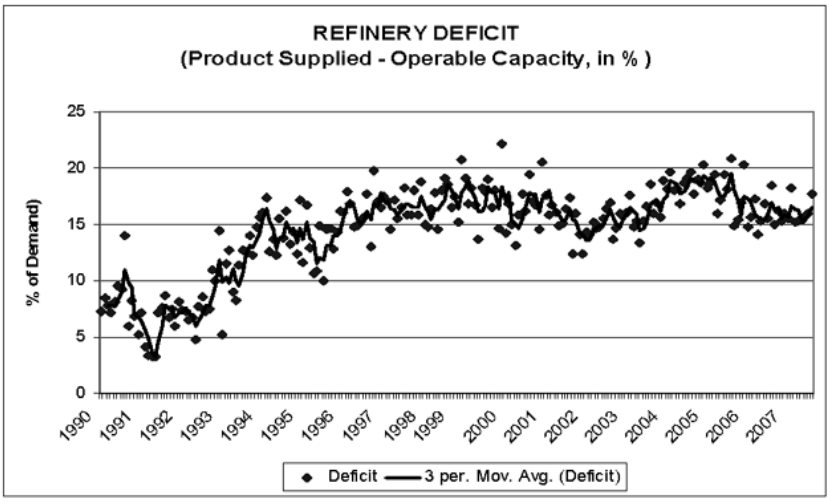
Source: Calculated from Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release, Industrial Production and Capacity Utilization;* Energy Information Administration, U.S. Department of Energy, *U.S. Percent Utilization of Refinery Operable Capacity*.

Exhibit 5



Source: Energy Information Administration, Database, Petroleum Consumption, Refining.

Exhibit 6



Source: Energy Information Administration, Database, Petroleum Consumption, Refining.

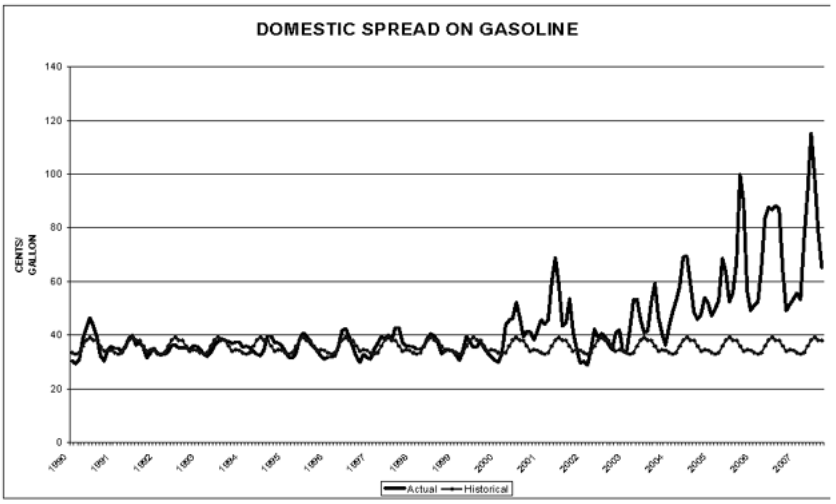
What are these surprises and unexpected events? "Increased price of ethanol . . . capacity reductions stemming from refiners' transition from methyl tertiary-butyl ether (MTBE) to ethanol."

That summer fuels require oxygenates has been known for well over a decade. That everyone in the industry switched to ethanol at the same time creating a temporary shortage was dumb. They did not have to switch, they chose to, en mass, even though they had not arranged for adequate supplies. They switched without making sure that alternatives would be available. The result is a most remarkable pattern of behavior. When ethanol is cheap they don't use it, when it is expensive they all want it.

Thus, five of the six excuses that the FTC gave for the price spikes of 2006 are the result of strategic under-investment in capacity and management mistakes that have created a tight market and exploit that tightness. If the cost of inputs, like crude and ethanol, and the need to bring expensive imports to market were the

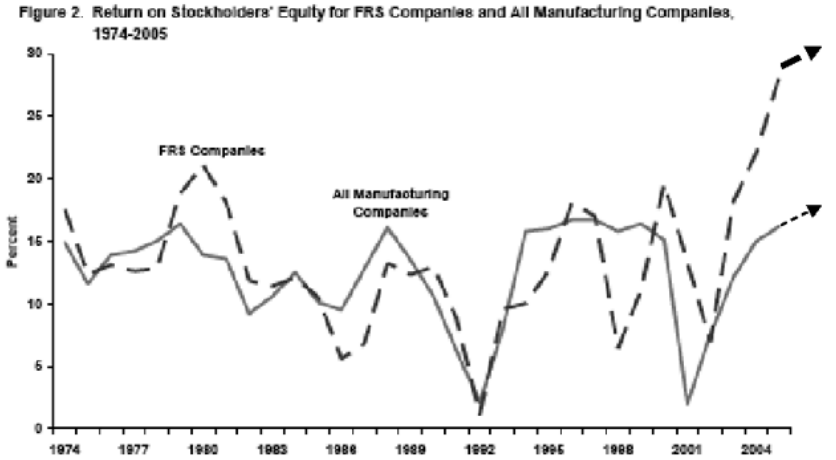
cause of increases in prices at the pump, then one would not expect the domestic spread and refinery margins and oil industry profits to be increasing, but they are (see Exhibits 7 and 8).

Exhibit 7



Source: Energy Information Administration, Database, Petroleum Consumption, Retail Gasoline (excluding taxes) minus refiner acquisition cost of crude.

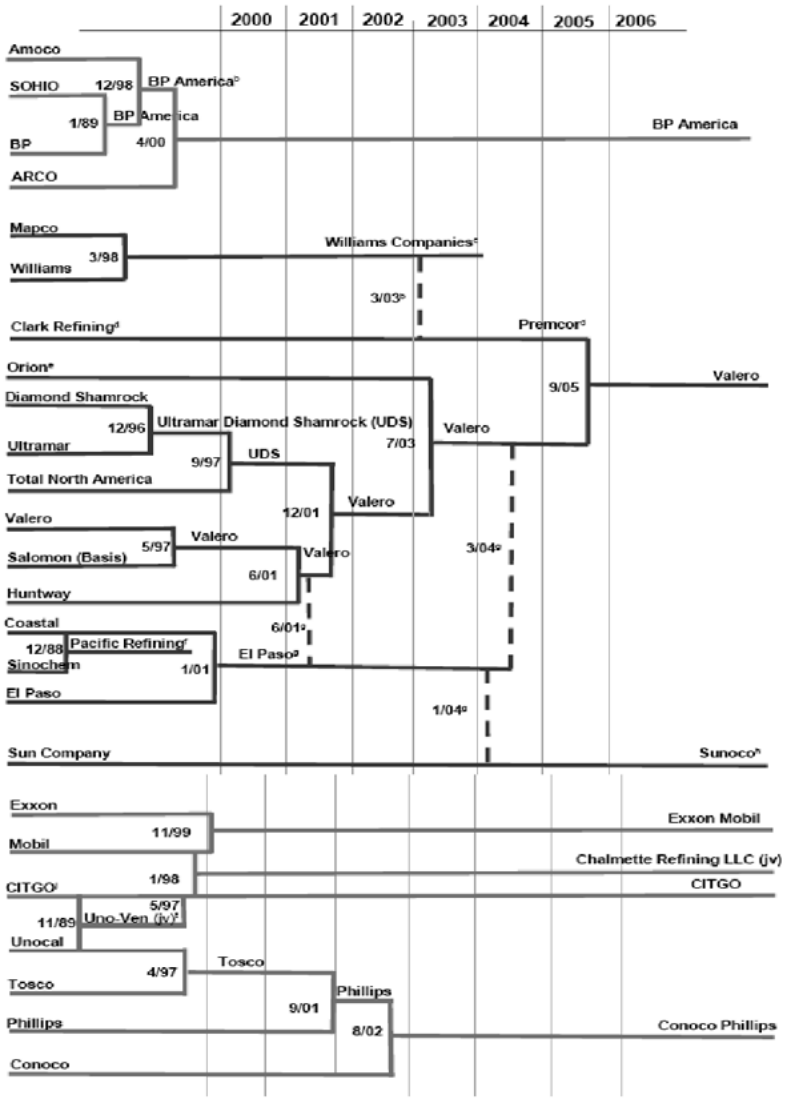
Exhibit 8: Major Oil Company Return on Equity is Far Above Historic Levels



Source: FRS Companies: Energy Information Administration, Form EIA–28 (Financial Reporting System). All Manufacturing Companies: U.S. Census Bureau Quarterly Financial Report, All Manufacturing Companies.

The simple fact of the matter is that this pattern of behavior was made possible by the merger wave of the past decade (see Exhibit 9). It has created a situation in which the industry does not have to collude to increase prices and profits. It just waits for the inevitable driving season to arrive, leavened by inadequate capacity and excuses, to put prices up.

Exhibit 9: Mergers have severely reduced the number of refiners



Source: *http://tonto.eia.doe.gov/FTPROOT/financial/mergers/dwnstream.pdf.*

The FTC adopts a very consumer unfriendly definition of price gouging. The domestic spread on gasoline was 49 cents per gallon higher in 2006 than the average for 1990–1999 (see Exhibit 9). However, the FTC assumes that the inflated prices of 2001–2005 as the base, so it concludes that the "extraordinary" increase in 2006 was only 16–21 cents. Because the market is too tight, it estimates that prices could have risen by as much as $1.35 to $2.21, so consumers should take solace in the fact that the industry left a lot on the table. When it looks at price gouging for individual companies, it assumes that if all the companies raise prices at the same time, then none is gouging, even though profits are going through the roof.

Broadband Internet

The FTC and the Department of Justice have made precisely the same mistakes in analyzing the broadband market place that have afflicted the FTC's analysis of the oil industry. They see vigorous competition,[6] where there is little; they see little harm,[7] where there is a great deal of damage.

The decision to abandon the principle of open communications networks after the Telecommunications Act of 1996 (the 1996 Act) resulted in a cozy duopoly of the telephone and cable companies that has failed to accomplish the most fundamental goals of the Telecommunications Act of 1996. In comparison to at least a dozen other nations, the closed proprietary networks of the cozy duopoly have:

- Failed "to make available to all people of the United States . . . adequate facilities at reasonable charges,"
- Failed to "encourage the deployment on a reasonable and timely basis" of a two-way communications network, with advanced telecommunications capabilities, with "high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, graphics, and video telecommunication," and
- Threatened the vibrant and competitive Internet that Congress sought to preserve in the 1996 Act.

The failure of the closed, proprietary, and cozy duopoly is evident in a multi-dimensional context. This model has

- Failed to deliver *any* broadband services to substantial numbers of American households (around 9 percent, according to the GAO);
- Failed to deliver bandwidth with data transfer rates comparable to the broadband networks which are deployed in other industrialized nations.
- Failed across the board to deliver facilities that afford two-way communications at full broadband functionality and at reasonable prices.

In addition,

- Where last-mile broadband networks are available, the prices charged for broadband are excessive when compared with the price per megabit available in other industrialized nations;
- The target recipients of advanced broadband facilities, which are capable of providing bandwidth on par with the higher speeds available in other industrialized nations, are households with high incomes, reflecting pricing practices which demand extremely high charges for access.

When Congress passed the Telecommunication Act of 1996, virtually all Internet traffic originated by or delivered to the public traveled on telecommunications networks that were obligated to provide nondiscriminatory interconnection and carriage under Title II of the Communications Act. The U.S. was the global Internet leader by far. But the FCC abandoned the principles of nondiscrimination, first for broadband provided by cable companies, then for telephone companies.

Half a decade latter we have fallen far behind many other nations (see Exhibits 10, 11 and 12). When it comes to truly broadband communications that Congress envisioned in the 1996 Act, compared to many other nations, most of which strengthened their commitment to open communications networks,

- Americans pay over ten times more for far less service than the leading broadband nations (see Exhibit 13) and
- The communications networks being deployed in America relegate the public to the role of passive listeners and restrict their opportunity as producers of content and speakers to fully utilize the immense functionality of broadband technologies in civic discourse (see Exhibit 14).

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[6] FTC Staff Report, *Broadband and Connectivity Competition Policy,* June 2007, p. 10; DOJ, Ex Parte Filing, p. 1.

[7] FTC Staff Report, p. 11; DOJ, Ex Parte Filing, p. 24.

Exhibit 10: The U.S. Is Falling Behind On Broadband: 3 OECD Nations Were Ahead Of The U.S. In 2001, 14 Nations Are Now Ahead of the U.S.

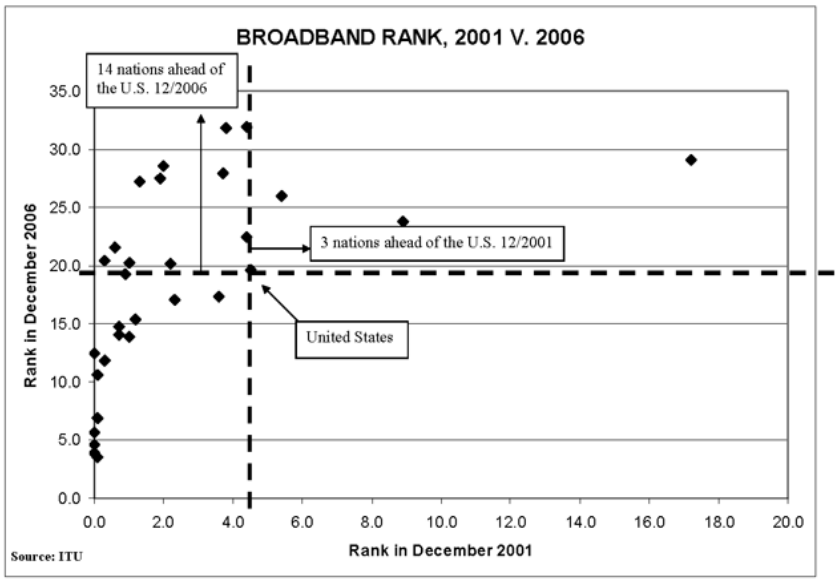


Exhibit 11: The U.S. Ranks 15th on Broadband Penetration by Households and Per Capita

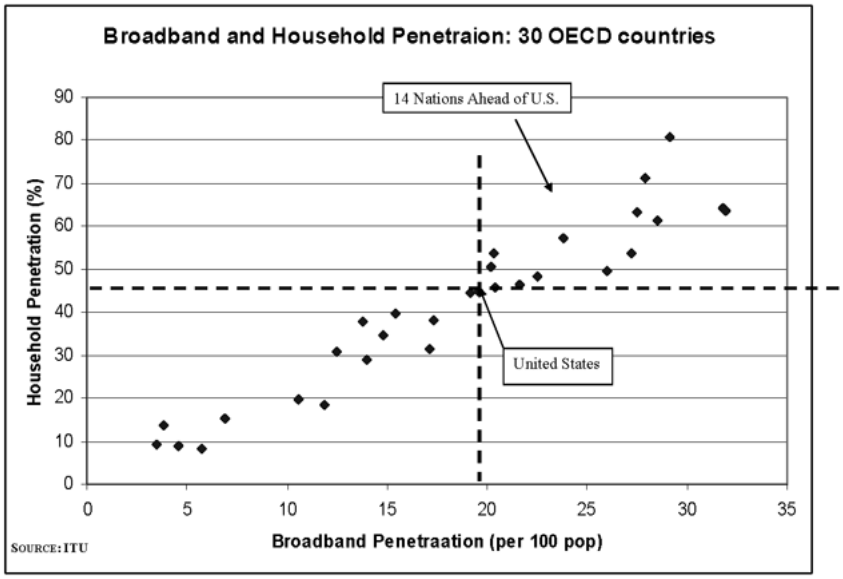
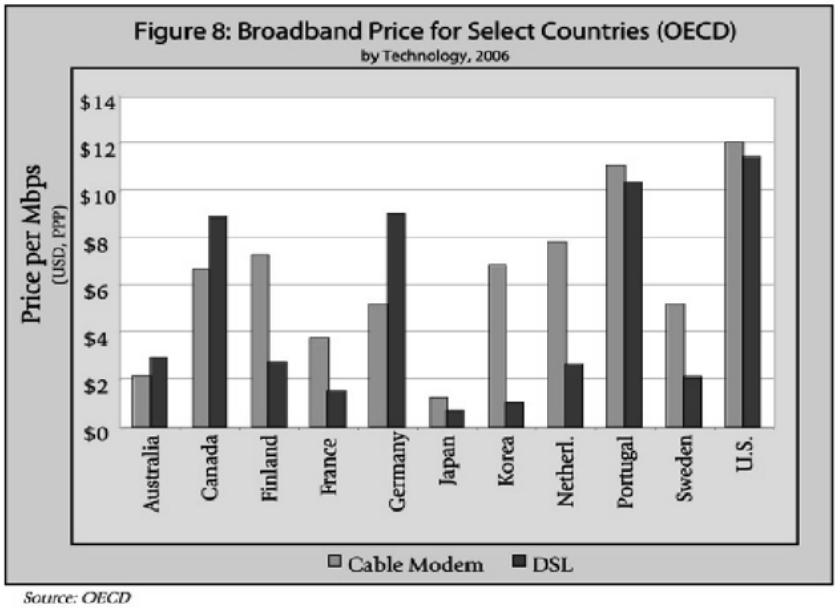


Exhibit 12: 60% of U.S. States have lower broadband penetration than Spain, 40% have lower broadband penetration than Portugal

% of Nation/State HH

80.9 *South Korea*
71.1 *Iceland*
64.2 *Netherlands*
63.6 *Denmark*
63.4 *Norway*
61.4 *Switzerland*
61.1 Hawaii
60.7 New Jersey
59.9 Connecticut
57.3 Massachusetts
57.2 *Canada*
56.8 New Hampshire
56.8 California
53.9 *Finland*
53.3 Maryland
52.6 Rhode Island
51.8 New York
51.4 Delaware
50.5 *Japan*
50.4 Nevada
49.5 *Sweden*
48.2 *Belgium*
48.2 Florida
47.9 Washington
46.9 Kansas
46.6 *France*
46.3 *United Kingdom*
46.1 Virginia
45.7 *Luxembourg*
45 Australia
45 DC
45 Arizona
44.6 *United States avg.*
44.5 *Spain*
44.4 Alaska
43.8 Texas
42.9 Nebraska
42.8 Minnesota
41.6 Maine
41.1 Utah
40.8 Pennsylvania
40.2 Ohio
40.2 Vermont
39.7 Austria
39 Wisconsin
38.9 Missouri
38.3 *Portugal*
37.9 *Italy*
37.6 Indiana
37 Oklahoma
36.8 Michigan
36.1 Louisiana
35.6 Wyoming
34.6 *Germany*
34.5 South Carolina
33.5 Tennessee
33.4 Montana
33.3 North Carolina
32.5 Iowa
31.7 Kentucky
31.6 *Ireland*
31.4 Idaho
30.9 New Zealand
30.8 West Virginia
30.1 Arkansas
29.8 New Mexico
29.4 Alabama
28.8 *Czech Republic*
21.3 South Dakota
20.4 North Dakota
20.2 Mississippi
19.6 *Czech Republic*
18.3 *Hungary*
15.3 *Poland*
13.6 *Turkey*
9.2 *Mexico*
8.8 *Greece*
8.4 *Slovak Republic*

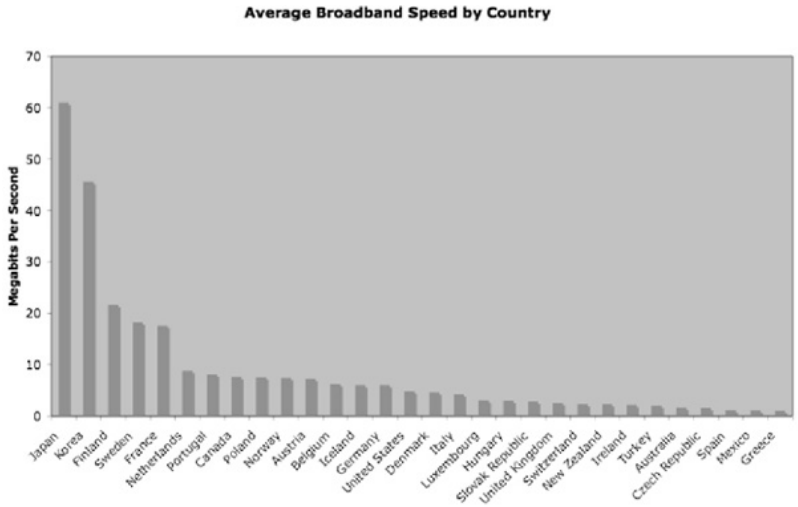
Exhibit 13:



Source: OECD

Derek Turner, *Broadband Reality Check II,* Free Press, August 2006.

Exhibit 14: The U.S. Ranks 14th in Average Speed

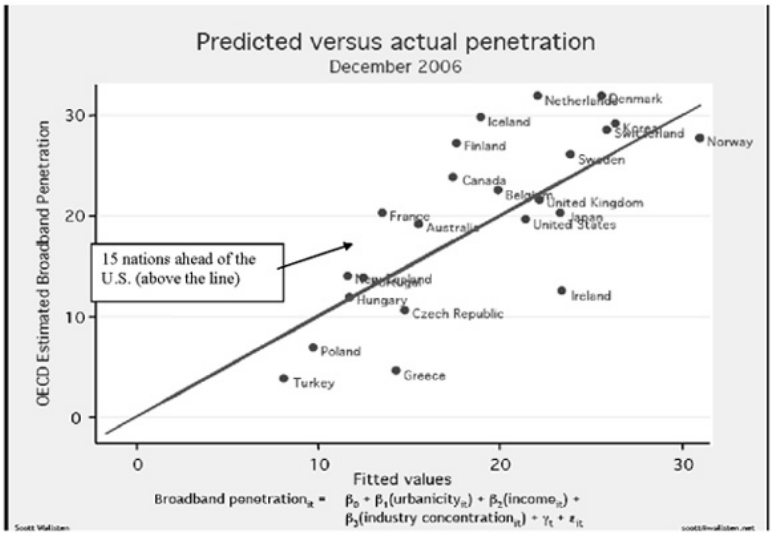


Source: Information Technology and Innovation Foundation

The root cause of this failure is the abandonment of the commitment to open communications networks and the reliance on feeble competition between, at best, two closed proprietary networks that possess and abuse market power. With inadequate competition and little public obligation, the cozy duopoly dribbles out capacity at high prices and restricts the uses of the network, chilling innovation in applications and services and causing a much lower rate of penetration of broadband in the U.S. than abroad.

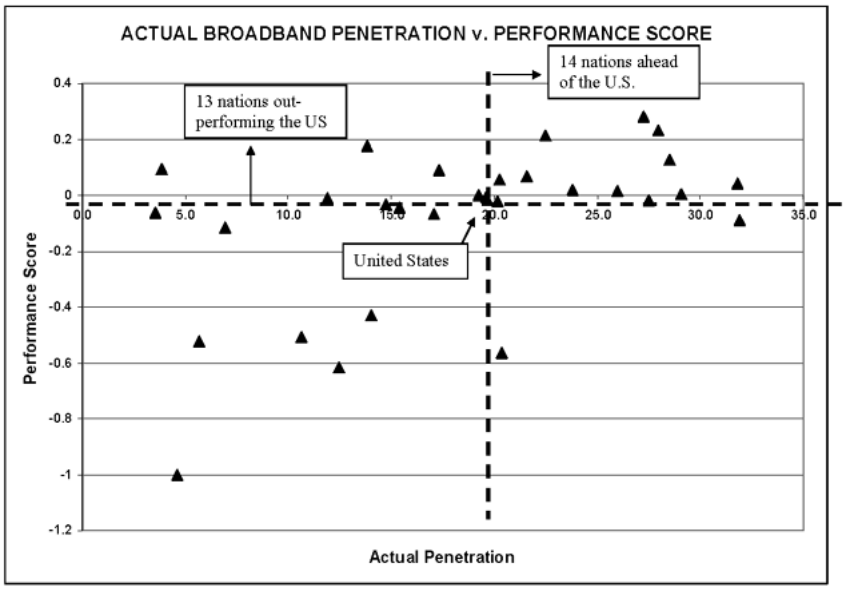
Efforts to explain away the declining status of the U.S. by population density, market concentration, household size, income levels, income inequality, education, age, among other factors do not negate the finding the U.S. is well behind a dozen or more developed nations (see Exhibits 15 and 16).

Exhibit 15: Controlling for Urbanicity, Income and Industry Concentration, the U.S. is outperformed by 15 OECD Nations



Source: Scott Wallstein, *Everything You Hear about Broadband in the U.S. is Wrong,* Progress and Freedom Foundation, June 2007

Exhibit 16: Lowering expectations does not improve the picture: The U.S. ranks 14th on performance and 11 of the 14 nations ahead on broadband are also outperforming the U.S.



Source: Phoenix Center, *The Broadband Performance Index,* July 2007; OECD rankings

The demonstrated failure of the cozy duopoly model to achieve the goals of the 1996 Act, the flawed theory of the benefits of discrimination, the clear initial signs of anti-competitive and anti-consumer practices, as well as the extremely dim prospects for vigorous competition in facilities, combine to create a very dismal future for broadband consumers in America. The Federal antitrust agencies have turned a blind eye to the problem. The only way to break out of this quagmire is to return to the successful policies of open communications that made the Internet possible and allowed the U.S. to be the world leader in the first generation of the digital age. The success of the Internet was built on communications networks that were operated in an open and nondiscriminatory manner so that the vigorous competition between applications and service providers was free to provide innovations and consumer-friendly service that drove demand.

Senator DORGAN. Dr. Cooper, thank you very much. As always, you seem to have had breakfast and have a lot of energy.

[Laughter.]

Senator DORGAN. And we appreciate your being here.

Mr. Michael Calhoun, the president of the Center for Responsible Lending.

Mr. Calhoun, welcome.

STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. Thank you, Chairman.

My testimony today will address the Federal Trade Commission's regulation of the mortgage market, with focus on the subprime market, looking at how they can be more effective in protecting the integrity of that market.

I'm the President of the Center for Responsible Lending, which is a nonprofit research organization that studies the mortgage market. Equally important, the Center is an affiliate of Self-Help,

which is a lender for first-time homebuyers, and we have provided over $5 billion of financing for first-time homebuyers across the country. This participation in the subprime market has given us a front-row seat for the mess that we now face in the current crisis.

I'll focus my testimony on two key points. First, what is the status of the crisis in the mortgage market? And, second, how could the FTC be more effective in reducing or preventing this problem?

We are now painfully aware of the subprime mortgage market, which is, I think, bad news for a lot of people, because of the large number of families losing their homes, and, equally, the ripple effects throughout the whole mortgage market and the whole economy. When you look at the features of the mortgages that families were sold, it's no surprise that we have a major problem. The typical subprime mortgage that families have today has a payment that, after 2 years, increases by 35 to 50 percent, even if market interest rates do not increase at all. Few families can absorb that kind of payment shock. To compound matters, lenders sold these loans to families based only on their ability to make the initial payments, and those payments could be more than 50 percent of their borrower's gross income, before taxes. When the payment increases take effect, we often see monthly mortgage payments that are equal to 80 percent or more of a family's take-home income. To make matters even worse, over half of these loans were provided without documentation of the family's income, and lenders and brokers typically, in over three-fourths of these loans, did not include any escrow for taxes or insurance, in order to make the monthly payments look lower, but creating, again, further financial shock.

To be clear, these were junk loans, not loans made to junk borrowers. And that's shown by the fact that, even in the subprime market, borrowers and families who received fixed-rate subprime mortgages have been able to keep up their payments on those loans. In contrast, these exploding ARM loans could continue only as long as home values increased by double digits each year so that the families could refinance the loans and pay them, in effect, out of their home equity.

This reckless lending is taking a heavy toll on American families, costing more than 2 million families their homes. And since most subprime loans are refinancings of existing homes, only about 10 percent of these loans were loans to first-time homebuyers. That's a common misconception.

This crisis is driving families out of homeownership and out of the middle class. It is particularly devastating in communities—for example, half of all African-American and Latino loans are subprime loans. And these impending foreclosures are the greatest threat to their family wealth in a generation. And all observers of the market agree, the worst is yet to come.

This market has not been able to correct itself, as the lack of substantive standards has rewarded the least responsible practices. Families, but also lenders and investors, have been hurt by this lack of market integrity. Federal and State regulators have moved, recently, to enact some modest protections, such as the common sense idea that they should check to see if families can repay the loans after the initial low payments expire. The FTC has taken action to protect consumers in some ways. Much more action is need-

ed by the FTC, and more authority and resources are needed for the FTC.

The announcements and consumer information brochures are helpful, but more is needed to protect families in their largest financial transactions. The FTC needs to establish substantive standards, as it has done with other credit practices and in other fields, previously. Mere case-by-case enforcement means that most cases are never addressed when you have an agency of very limited resources.

More tools for the agency are also needed, including joint authority for the FTC and Federal depository regulators, standard rulemaking procedures are needed so the FTC can act in a timely fashion. And a private right of action is needed so that violations of the FTC Act are enforceable by consumers. Perhaps most importantly, there have been suggestions to preempt existing authority that the states have in the mortgage area, and that would make things only far worse. We need as many cops on this beat as possible.

In conclusion, most families rely on their homes not only for the physical and emotional shelter, but it's a repository of most of a families' hard-earned wealth. Over the past few years, we've seen unscrupulous mortgage brokers and lenders seize that wealth for their own gain, at great cost to our communities, families, and the Nation as a whole. The FTC, the Fed, and Congress need to act to help provide families with the means to safeguard their homes in what now are perilous transactions when they take out a mortgage.

Thank you.

[The prepared statement of Mr. Calhoun follows:]

PREPARED STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Chairman Dorgan, Ranking Member DeMint, and Members of the Subcommittee, thank you for holding this hearing and considering this reauthorization in the context of the current turmoil in the subprime mortgage market. I serve as the President of the Center for Responsible Lending (CRL) (*www.responsiblelending.org*). CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

We also have direct experience as a subprime lender. CRL is an affiliate of the Center for Community Self Help (*www.self-help.org*), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families, those often targeted for subprime loans. Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country. Our loan losses have been less than 1 percent per year.

Through this lending experience, I understand the benefits of subprime loans that contribute to sustainable homeownership. Unfortunately, when it comes to fair, affordable mortgages and opportunities for lasting homeownership, the subprime market's record is sorely lacking. The Center for Responsible Lending estimates that 2.2 million families have lost or will lose their homes as a result of abusive subprime loans made in recent years. That is one in every five subprime loans made in 2005 and 2006, a rate unseen in the modern mortgage market. When we consider the subsequent loans subprime borrowers have been refinanced into, the probable foreclosure rate jumps to over one-third of all subprime borrowers.

My main messages to you today are these:

1. Problems caused by the subprime market are severe and widespread.

2. Abusive loans led to today's devastating foreclosures, and we need to keep reckless lenders off the streets.

3. The FTC could play a vital role in restoring integrity to the subprime market and reducing abusive home loans.

I. The Current Situation: An Epidemic of Foreclosures

Last December, the Center for Responsible Lending published a report that represents the first comprehensive, nationwide research projecting foreclosures in the subprime market. The report, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," is based on an analysis of over six million subprime mortgages, and the findings are disturbing. Our results show that despite low interest rates and high housing appreciation during the past several years, the subprime market has experienced high foreclosure rates comparable to the worst foreclosure experience ever in the modern prime market. We also show that foreclosure rates will increase significantly in many markets as housing appreciation slows or reverses. As a result, *we project that 2.2 million borrowers will lose or have lost their homes and up to $164 billion of wealth* in the process. That translates into foreclosures on one in five subprime loans (19.4 percent) originated in recent years.[1]

Since we issued that report, the condition of the subprime market has deteriorated rapidly, and subsequent events have shown our projection to be conservative. A recent study by the investment bank, Lehman Brothers, shows that the number of 2006-originated loans likely to face foreclosure is 30 percent.[2] Headlines appear daily in the news detailing the negative ripple effects of bad subprime loans that have extended to investors and financial interests in many places throughout the world.

At the same time, many in the lending industry still fail to acknowledge the scope of the problem, the damage caused by reckless lending practices, and the need for more than cursory solutions. As recently as last month, the Mortgage Bankers' Association denied that subprime foreclosure rates are of concern for the economy.[3]

Yet, the Mortgage Bankers' own figures show that the problem is severe and widespread. Last week, the MBA released the "Second Quarter National Delinquency Survey," the latest figures available on the performance of home loans. The survey shows that mortgage loans entering foreclosure have increased in 47 states since this time last year. On average, the increases were 50 percent higher. Only four states—North Dakota, South Dakota, Utah and Wyoming—did not experience increases in new foreclosures. Less than 2 percent of the American population lives in those states.

While the rate of subprime foreclosures is alarming today, the worst is still ahead. With 1.7 million foreclosures predicted to occur in the next two to 3 years, it is imperative that Congress take action to assist homeowners struggling today, not just protect future subprime borrowers.[4]

Several factors have driven massive home losses, including dangerous products, loose underwriting, broker abuses, investor demands, and Federal neglect. In the context of today's hearing, I will focus on reckless lending, dangerous loans, and the need to strengthen protections on the Federal level.

II. The Role of Reckless Lending

Under typical circumstances, foreclosures occur because a family experiences a job loss, divorce, illness or death. However, the epidemic of home losses in today's subprime market is well beyond the norm. Subprime lenders have virtually *guaranteed* rampant foreclosures by approving risky loans for families while knowing that these families will not be able to pay the loans back. Subprime lenders flooded the market with high-risk loans and made them appealing to borrowers by marketing low monthly payments based on low introductory teaser rates.

One of the key findings in our research on subprime mortgages is that subprime mortgages typically include characteristics that significantly increase the risk of foreclosure, regardless of the borrower's credit.[5] Since foreclosures typically peak several years after a family receives a loan, we focused on the performance of loans made in the early 2000s to determine what, if any, loan characteristics have a strong association with foreclosures. Our findings are consistent with other studies: increases in mortgage payments and poorly documented income substantially boost the risk of foreclosure. For example, even after controlling for differences in credit scores, these were our findings for subprime loans made in 2000:

- Adjustable-rate mortgages had 72 percent greater risk of foreclosure than fixed-rate mortgages.
- Mortgages with "balloon" payments had a 36 percent greater risk than a fixed-rate mortgage without that feature.
- Prepayment penalties are associated with a 52 percent greater risk.

- Loans with no documentation or limited documentation of the applicant's income were associated with a 29 percent greater risk.

Lenders and mortgage insurers have known for decades that these features increase the risk of foreclosure, yet these characteristics—adjustable-rate loans with prepayment penalties, made with little documentation—describe typical subprime mortgage loans made in recent years.

A significant culprit in today's foreclosure was the proliferation of hybrid adjustable-rate mortgages ("ARMs," called 2/28s or 3/27s), which begin with a fixed interest rate for a short period, then convert to a much higher interest rate and continue to adjust every 6 months, quickly jumping to an unaffordable level. Commonly, this interest rate increases by between 1.5 and 3 percentage points at the end of the second year, and such increases are scheduled to occur even if interest rates in the general economy remain constant.[6] This type of loan, as well as other similar hybrid ARMs (such as 3/27s) have rightfully earned the name "exploding" ARMs.

A. Loose Qualifying Standards and Business Practices

The negative impact of high-risk loans could have been greatly reduced if subprime lenders had been carefully screening loan applicants to assess whether the proposed mortgages are affordable. Unfortunately, many subprime lenders—as well as lenders writing "non-traditional" mortgages such as "payment option ARMs" and interest-only loans—have been routinely abdicating the responsibility of underwriting loans in any meaningful way.

Lenders today have a more precise ability than ever before to assess the risk of default on a loan. Lenders and mortgage insurers have long known that some home loans carry an inherently greater risk of foreclosure than others. However, by the industry's own admission, underwriting standards in the subprime market have become extremely loose in recent years, and analysts have cited this laxness as a key driver in foreclosures.[7] Let me describe some of the most common problems:

Not considering payment shock: Lenders who market 2/28s and other types of high-risk mortgages often do not consider whether the homeowner will be able to pay when the loan's interest rate resets, setting the borrower up for failure. Subprime lenders' public disclosures indicate that most are qualifying borrowers at or near the initial start rate, even when it is clear from the terms of the loan that the interest rate can (and in all likelihood, will) rise significantly, giving the borrower a higher monthly payment. For example, as shown in the chart below, publicly available information indicates that these national subprime lenders, who were prominent in recent years, do not adequately consider payment shock when underwriting ARMs:

Sample Underwriting Rules For Adjustable Rate Mortgages [8]

Lender	Underwriting Rule
OPTION ONE MORTGAGE CORP	Qualified at initial monthly payment.
FREMONT INVESTMENT & LOAN	Ability to repay based on initial payments due in the year of origination.
NEW CENTURY	Generally qualified at initial interest rate. Loans to borrowers with FICO scores under 580 and loan-to-value ratios of more than 80 percent are qualified at fully indexed rate minus 100 basis points.

These underwriting rules indicate that lenders routinely qualified borrowers for loans based on a low interest rate when the cost of the loan is bound to rise significantly—even if interest rates remain constant. In fact, until very recently, it was not uncommon for 2/28 mortgages to be originated with an interest rate 4 percentage points under the fully-indexed rate. For a loan with an 8 percent start rate, a 4 percentage point increase is tantamount to a 40 percent increase in the monthly principal and interest payment amount.

Failure to escrow: The failure to consider payment shock when underwriting is compounded by the failure to escrow property taxes and hazard insurance.[9] In stark contrast to the prime mortgage market, most subprime lenders make loans based on low monthly payments that do not escrow for taxes or insurance.[10] This deceptive practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs. Given that the typical practice in the subprime industry is to accept a loan if the borrower's debt is at or below 50 to 55 percent of their pre-tax income, using an artificially low monthly payment based on a teaser rate and no escrow for taxes and insurance virtually guarantees that a bor-

rower will not have the residual income to absorb a significant increase whenever taxes or insurance come due during the first year or two, or certainly not when payments jump up after year two.

A study by the Home Ownership Preservation Initiative in Chicago found that for as many as one in seven low-income borrowers facing difficulty in managing their mortgage payments, the lack of escrow of tax and insurance payments were a contributing factor.[11] When homeowners are faced with large tax and insurance bills they cannot pay, the original lender or a subprime competitor can benefit by enticing the borrowers to refinance the loan and pay additional fees for their new loan. In contrast, it is common practice in the prime market to escrow taxes and insurance and to consider those costs when looking at debt-to-income and the borrower's ability to repay.[12]

Low/no documentation: Inadequate documentation also compromises a lender's ability to assess the true affordability of a loan. Fitch recently noted that "loans underwritten using less than full documentation standards comprise more than 50 percent of the subprime sector. . . ."[13] "Low doc" and "no doc" loans originally were intended for use with the limited category of borrowers who are self-employed or whose incomes are otherwise legitimately not reported on a W–2 tax form, but lenders have increasingly used these loans to obscure violations of sound underwriting practices. For example, a review of a sample of these "stated-income" loans disclosed that 90 percent had inflated incomes compared to IRS documents, and "more disturbingly, almost 60 percent of the stated amounts were exaggerated by more than 50 percent."[14] It seems unlikely that all of these borrowers could not document their income, since most certainly receive W–2 tax forms, or that they would voluntarily choose to pay up to 1.5 percent higher interest rate to get the "benefit" of a stated-income loan.[15]

Multiple risks in one loan: In addition, regulators have expressed concern about combining multiple risk elements in one loan, stating that "risk-layering features in loans to subprime borrowers may significantly increase risks for both the . . . [lender] and the borrower."[16] Previously I described a brief overview of the increased risk associated with several subprime loan characteristics, including adjustable-rate mortgages, prepayment penalties, and limited documentation of income. Each of these items individually is associated with a significant increase in foreclosure risk, and each has been characteristic of subprime loans in recent years; combining them makes the risk of foreclosure even worse.

B. Broker Abuses and Perverse Incentives

Mortgage brokers are individuals or firms who find customers for lenders and assist with the loan process. Brokers provide a way for mortgage lenders to increase their business without incurring the expense involved with employing sales staff directly. Brokers also play a key role in today's mortgage market: According to the Mortgage Bankers Association, mortgage brokers now originate 45 percent of all mortgages, and 71 percent of subprime loans.[17]

Brokers often determine whether subprime borrowers receive a fair and helpful loan, or whether they end up with a product that is unsuitable and unaffordable. Unfortunately, given the way the current market operates, widespread abuses by mortgage brokers are inevitable.

First, unlike other similar professions, mortgage brokers have no fiduciary responsibility to the borrower who employs them. Professionals with fiduciary responsibility are obligated to act in the interests of their customers. Many other professionals already have affirmative obligations to their clients, including real estate agents, securities brokers and attorneys. Buying or refinancing a home is the biggest investment that most families ever make, and particularly in the subprime market, this transaction is often decisive in determining a family's future financial security. The broker has specialized market knowledge that the borrower lacks and relies on. Yet most mortgage brokers deny that they have any legal responsibility to refrain from selling inappropriate, unaffordable loans, or to put their own financial interest ahead of their clients'.[18]

Second, the market, as it is structured today, gives brokers strong financial incentives to ignore the best interests of homeowners. Brokers and lenders are focused on feeding investor demand, regardless of how particular products affect individual homeowners. Moreover, because of the way they are compensated, brokers have strong incentives to sell excessively expensive loans. They earn money through upfront fees, not ongoing loan payments. To make matters worse for homeowners, brokers typically have a direct incentive to hike interest rates higher than warranted by the risk of loans. In the majority of subprime and similar transactions, brokers demand a kickback from lenders (known as "yield spread premiums") if they deliver mortgages with rates higher than the lender would otherwise accept. Not all loans

with yield-spread premiums are abusive, but because they have become so common, and because they are easy to hide or downplay in loan transactions, unscrupulous brokers can make excessive profits without adding any real value.

Experts on mortgage financing have long raised concerns about problems inherent in a market dominated by broker originations. For example, the chairman of the Federal Reserve Board, Ben S. Bernanke, recently noted that placing significant pricing discretion in the hands of financially motivated mortgage brokers in the sales of mortgage products can be a prescription for trouble, as it can lead to behavior not in compliance with fair lending laws.[19] Similarly, a report issued by Harvard University's Joint Center for Housing Studies, stated, "Having no long term interest in the performance of the loan, a broker's incentive is to close the loan while charging the highest combination of fees and mortgage interest rates the market will bear."[20]

In summary: Mortgage brokers, who are responsible for originating over 70 percent of loans in the subprime market, have strong incentives to make abusive loans that harm consumers, and no one is stopping them. In recent years, brokers have flooded the subprime market with unaffordable mortgages, and they have priced these mortgages at their own discretion. Given the way brokers operate today, the odds of successful homeownership are stacked against families who get loans in the subprime market.

C. Abusive Loan Terms: Prepayment Penalties and Yield-Spread Premiums

Prepayment penalties—an "exit tax" for refinancing or otherwise paying off a loan—are a destructive feature of the subprime market that lock borrowers in to high-cost loans, and make it difficult for responsible lenders to refinance them into lower-cost loans. Today prepayment penalties are imposed on about 70 percent of all subprime loans,[21] compared to about 2 percent of prime loans.[22] This disparity belies any notion that subprime borrowers freely "choose" prepayment penalties. All things being equal, a borrower in a higher-cost loan, or in an unpredictable, adjustable rate loan with a very high margin, would not choose to be inextricably tied to that product by a high exit tax.[23] With common formulations of 6 months' interest, or amounts of approximately 3 percent of the principal, the amount of equity lost is significant. For a $200,000 loan, a 3 percent prepayment penalty costs borrowers $6,000, eating almost entirely the median net worth for African American households.[24]

It has long been recognized that prepayment penalties trap borrowers in disadvantageous, higher cost loans. Indeed, this is the penalty's purpose—in industry parlance, to "build a fence around the borrower" or "close the back door." Less well known is the fact that these penalties also increase the cost of the loan at origination because they are linked to higher rates on loans that pay higher so-called "yield-spread premiums" to brokers.[25] Thus, contrary to the claims of some lenders, prepayment penalties do not decrease, but, rather, frequently increase the cost of subprime loans.

Yield-spread premiums are a bonus paid by the lender to the mortgage broker as a reward for placing the borrower into a higher cost loan than the borrower qualifies for. Lenders are willing to pay the premium only where they are sure that the borrower will remain in the higher-cost loan long enough to enable the lender to recoup the cost of the premium from the borrower.

It is important to note that the lender does not allow the broker to get any yield-spread premium if the loan has no prepayment penalty, a result that is common in the subprime sector. Yield-spread premiums and prepayment penalties are intertwined in a way that is harmful to consumers and detrimental to competition. For a fuller discussion of these issues, please refer to our recent comment letter to the Federal Reserve Board, submitted on August 15.[26]

D. Racial Steering

Eliminating the practice of steering borrowers to pricier and riskier loans is also critical to assuring a fair marketplace that does not impose a discrimination tax on borrowers of color. We know that for borrowers of color, the odds of receiving a higher-cost loan are greater, even after controlling for legitimate risk factors, such as credit scores.[27] We are long past the time when we can—or should—close our eyes to this. Tax cuts are popular in Washington. Ending the discrimination tax on mortgage lending is a tax cut that is long overdue, and prohibiting steering is the way to do it.

It serves the interest not only of homeowners, but of the world economy, to assure that all families seeking loans who qualify for lower-cost prime mortgages should receive a prime mortgage, not a subprime loan. We know that far more people have been placed in high-cost loans than should have been.[28] Since it is now abundantly

clear that "risky loans," as much or more than "risky borrowers," are a threat, market professionals—loan originators, whether brokers or retail lenders—should be required to assure that borrowers are put into the rate they qualify for. Market incentives that encourage originators to put as many people as possible into the priciest (and most dangerous) loans possible helped make this problem; prohibiting those incentives is a necessary part of the solution.

The subprime market has long cited "riskier borrowers" or "credit-impaired borrowers" as its justification for the higher prices on these loans. The argument is that investors need the higher prices to justify their risk, yet that extra price burden for the subprime loan puts credit-strapped borrowers that much closer to the edge.

III. Federal Neglect and the Potential Role of the FTC

Policymakers have long recognized that Federal law—the Home Ownership and Equity Protection Act of 1994 (HOEPA)—governing predatory lending is inadequate and outdated. Although the Federal Reserve Board (hereinafter, the "Board") has the authority to step in and strengthen relevant rules, they have thus far refused to act in spite of years of large-scale abuses in the market, though they will reportedly propose some regulations this year. Other Federal regulators with relevant authority, such as the Office of the Comptroller of Currency, have done very little enforcement, and they have been slow to enact rules. The result: For the majority of subprime mortgage providers, there are no consequences for making abusive or reckless home loans.

On July 25 this year, we joined the Consumer Federation of America and other concerned groups in presenting testimony before the U.S. House Committee on Financial Services.[29] In part of that testimony, we discuss the important role the Federal Trade Commission could play in eliminating abusive lending practices in the home loan market. The FTC brings two particular strengths:

First, the FTC is the agency with long experience in interpreting and enforcing the law against unfair and deceptive acts and practices (UDAP) in commerce, having been in that business for well over half a century. This experience contrasts sharply with that of the banking regulatory agencies, who only recently even gave thought to utilizing such authority.[30] In addition to longer experience with UDAP concepts, the FTC is also the agency whose chief job is to protect consumers from unfair and deceptive acts in commerce, and to protect the integrity of the marketplace for honest and ethical competition. Though the agency, like several others, could have done more to prevent the current subprime debacle, it makes little sense to prevent the agency with the most experience.[31]

Second, the FTC is also the agency with the fewest conflicts of interest since, unlike the bank regulatory agencies, there is no structural conflict of interest—it is not dependent upon assessments for its funding, does not need to compete with other regulators for entities to regulate, and its primary role is to protect consumers, not bank profitability.

With these strengths in mind, we offer two recommendations:

1. Enhance the power of section 5 of the FTC Act by expanding the rule-making and enforcement authority of the agency.

Section 5 of the Federal Trade Commission Act prohibits unfair and deceptive acts and practices in trade and commerce. Expanding the regulatory and enforcement authority of the Federal Trade Commission related to mortgage lending—and many other aspects of consumer financial services—would enhance the capacity for appropriate Federal regulatory response, as the Consumer Federation of America, we at CRL, and others recommended in earlier Congressional testimony.[32] The FTC is the agency charged with primary interpretive and enforcement authority under Section 5, but the Act places that authority as to federally chartered depositories institutions with the Federal financial regulators.[33] Though the FRB, NCUA and OTS have rule-making authority under the FTC Act, and others have enforcement authority as well, removing limits on the FTC's capacity to act makes sense.

While more could have been done with their rule-making authority, the FTC has promulgated two rules that have been effective in curbing abuses in the consumer finance area. The first, the "anti-holder rule," abrogates the holder in due course rule for credit sales where the seller refers the borrower to the lender or arranges or assigns the sales financing.[34] (A "holder in due course" is any subsequent owner of a check, note or other financial instrument of value.) That rule is based on the principle that, after the interest in a debt obligation is transferred, it is fundamentally unfair to separate the borrower's obligation to pay for a good or service if the provider of that good or service failed in its legal and contractual obligations to the borrower.

The anti-holder rule provides an important object lesson for the current foreclosure crisis. It recognized that when the ultimate owner of the obligation sought payment from the consumer, the consumer's "right" to seek redress against the originator while still obligated to pay the current holder was largely theoretical. It further recognized that those who were in the business of buying up credit obligations were in a far better position to police the marketplace of originators than consumers. That model demonstrates that accountability up the chain is workable, and the FTC should be commended for recognizing that.

Another FTC rule that brought significant reform to the market is the Credit Practices Rule, which eliminated abusive contractual remedies that were standard practices in the finance company industry.[35] This rule was aimed at contracts that provided powerful remedies to finance companies in non-negotiated contracts that denied due process and other legal rights to borrowers. Though vociferously opposed by the industry, the FTC recognized that industry wide practices can be—and sometimes are—inherently unfair or deceptive, and should be simply banned. Their authority to do so has been upheld by the courts,[36] and the practical sense of doing so without doing harm to the marketplace has been upheld by history.

Finally, states should be permitted parallel enforcement authority under Section 5 or their state analogues. It adds considerably to the available resources—more "cops on the beat"—and, like the FTC, they have experience, and are less subject to conflicts.

2. Create a private right of action under Section 5 of the FTC Act.

Currently, harmed consumers have no right to enforce the Federal FTC Act: only public enforcement is possible. Even absent the intrinsic conflicts of interest, enforcement agencies such as the FTC have limited resources. When problems become the rule in an industry, rather than the exception, as is the case recently, public resources will simply never be adequate. Regulatory investigations are also very time consuming, and hold no remedy for homeowners who face foreclosure today. It is imperative that consumers be able to wield their own tools when they need them.

Though consumers in many states can invoke their state unfair and deceptive acts and practices law, there are significant gaps, such as exclusions for "regulated entities." Further, with the overly expansive assertion of preemption of state law by Federal banking regulators, it is unclear whether we are about to see a constriction in the ability of consumers to use their state UDAP laws.[37]

IV. Conclusion

The mortgage industry has argued for years that regulation of subprime lending would have the unintended consequence of restricting credit, but it is now apparent that the current tightening of credit has been caused by the *lack* of adequate regulation and the reckless lending that followed. If subprime lenders had been subject to reasonable rules—the kind of rules that responsible mortgage lenders have always followed—we wouldn't have the problems we're seeing today.

Common-sense protections would prevent this catastrophe from happening again. We need a combination of sensible state laws backed by a strong Federal floor. In recent years, many states have taken action to curb specific predatory lending practices, but Federal regulators have remained largely passive until recently, and still have a ways to go. These recommended changes to the FTC Act will help protect families from abusive financial practices and help restrain the market from the excesses of recent years in the future.

Endnotes

[1] A full copy of the "Losing Ground" foreclosure study and an executive summary appear on CRL's website at *http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=31217189.*

[2] Mortgage Finance Industry Overview, Lehman Brothers Equity Research, p. 4 (December 22, 2006).

[3] Comment letter from the Mortgage Bankers Association to the Board of Governors of the Federal Reserve Board, p. 4, dated August 15, 2007.

[4] Moody's *Economy.com,* "Into the Woods: Mortgage Credit Quality, Its Prospects, and Implications," a study incorporating unique data from Equifax and Moody's Investors Service (2007).

[5] See note 1.

[6] Here we are describing the 2/28 because it is by far the most common product in the subprime market, but the concerns are the same with the 3/27, which differs only in that the teaser rate remains in effect for 3 years.

[7] *See e.g.,* Office of the Comptroller of the Currency, National Credit Committee, *Survey of Credit Underwriting Practices 2005.* The Office of The Comptroller of Currency (OCC) survey of credit underwriting practices found a "clear trend toward easing of underwriting standards as banks stretch for volume and yield," and the agency commented that "ambitious growth goals

in a highly competitive market can create an environment that fosters imprudent credit decisions." In fact, 28 percent of the banks eased standards, leading the 2005 OCC survey to be its first survey where examiners "reported net easing of retail underwriting standards." *See also* Fitch Ratings, 2007 Global Structured Finance Outlook: Economic and Sector-by-Sector Analysis (December 11, 2006).

[8] *See* Option One Prospectus, Option One Mortgage Loan Trust 2006–3 424B5 (October 19, 2006) available at: *http://www.sec.gov/Archives/edgar/data/1378102/000088237706003670/d581063__424b5.htm;* Fremont Investment and Loan Prospectus, Fremont Home Loan Trust 2006–1 424B5 (April 4, 2006) available at: *http://www.sec.gov/Archives/edgar/data/1357374/000088237706001254/d486451__all.htm;* Morgan Stanley Prospectus, Morgan Stanley ABS Capital I Inc. Trust 2007–NC1 Free Writing Prospectus (January 19, 2007) available at: *http://www.sec.gov/Archives/edgar/data/1385136/000088237707000094/d609032__fwp.htm; Best Practices Won't Kill Production at New Century,* p. 3 Inside B&C Lending (November 24, 2006).

[9] *See, e.g.,* "B&C Escrow Rate Called Low," *Mortgage Servicing News Bulletin* (February 23, 2005) "Servicers of subprime mortgage loans face a perplexing conundrum: only about a quarter of the loans include escrow accounts to ensure payment of insurance premiums and property taxes, yet subprime borrowers are the least likely to save money to make such payments . . . Nigel Brazier, senior vice president for business development and strategic initiatives at Select Portfolio Servicing, said only about 25 percent of the loans in his company's subprime portfolio have escrow accounts. He said that is typical for the subprime industry."

[10] *See, e.g.,* "Attractive Underwriting Niches," Chase Home Finance Subprime Lending marketing flier, at *http://www.chaseb2b.com/content/portal/pdf/subprimeflyers/Subprime_AUN.pdf* (available 9/18/2006) stating "Taxes and Insurance Escrows are NOT required at any LTV, and there's NO rate add!" (suggesting that failing to escrow taxes is an "underwriting highlight" that is beneficial to the borrower). 'Low balling' payments by omitting tax and insurance costs were also alleged in states' actions against Ameriquest. *See, e.g., State of Iowa, ex rel Miller* v. *Ameriquest Mortgage Co. et al,* Eq. No. EQCE–53090 Petition, at ¶16(B) (March 21, 2006).

[11] *Partnership Lessons and Results: Three Year Final Report,* p. 31 Home Ownership Preservation Initiative, (July 17, 2006) at *www.nhschicago.org/downloads/82HOPI3YearReport__Jul17-06.pdf.*

[12] In fact, Fannie Mae and Freddie Mac, the major mortgage investors, require lenders to escrow taxes and insurance.

[13] *See Structured Finance: U.S. Subprime RMBS in Structured Finance CDOs,* p. 4 *Fitch Ratings Credit Policy* (August 21, 2006).

[14] Mortgage Asset Research Institute, Inc., *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association,* p. 12, available at *http://www.mari-inc.com/pdfs/mba/MBA8thCaseRpt.pdf* (April 2006); *see also* 2007 Global Structured Finance Outlook: Economic and Sector-by Sector-analysis, Fitch Ratings Credit Policy (New York, N.Y), December 11, 2006, at 21, commenting that the use of subprime hybrid ARMS "poses a significant challenge to subprime collateral performance in 2007."

[15] Traditional Rate Sheet effective 12/04/06 issued by New Century Mortgage Corporation, a major subprime lender, shows that a borrower with a 600 FICO score and 80 percent LTV loan would pay 7.5 percent for a fully-documented loan, and 9.0 percent for a "stated wage earner" loan.

[16] *See* Interagency Guidance on Nontraditional Mortgage Product Risks, note 42.

[17] MBA Research Data Notes, "Residential Mortgage Origination Channels," September 2006.

[18] About one-third of the states have established, through regulation or case law, a broker's fiduciary duty to represent borrowers' best interests. However, many of these provisions are riddled with loopholes and provide scant protection for borrowers involved in transactions with mortgage brokers. In other states, the question has not been specifically addressed.

[19] Remarks by Federal Reserve Board Chairman Ben S. Bernanke at the Opportunity Finance Network's Annual Conference, Washington, D.C. (November 1, 2006).

[20] Joint Center for Housing Studies, "Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations," Harvard University at 4–5. Moreover, broker-originated loans "are also more likely to default than loans originated through a retail channel, even after controlling for credit and ability-to-pay factors." *Id.* at 42 (citing Alexander 2003).

[21] *See, e.g.,* David W. Berson, *Challenges and Emerging Risks in the Home Mortgage Business: Characteristics of Loans Backing Private Label Subprime ABS,* Presentation at the National Housing Forum, Office of Thrift Supervision (December 11, 2006). According to MBA data, there was a 69.2 percent penetration rate for prepayment penalties on subprime ARMs originated in 2006. Doug Duncan, *Sources and Implications of the Subprime Meltdown,* Manufactured Housing Institute, (July 13, 2007). A recent CRL review of 2007 securitizations showed a penetration rate for prepayment penalties averaging over 70 percent.

[22] *See* Berson, *id.* A recent MBA analysis shows that 97.6 percent of prime ARMs originated in 2006 had no prepayment penalty, and 99 percent of 2006 prime FRM had no penalty. Doug Duncan, *id.*

[23] Marketing jargon in the industry is more honest about the role of prepayment penalties, along with high- LTV loans: "Build a fence around the customer:" or bring them in and "close the back door" are phrases that surfaced during regulatory investigations of subprime lenders in which one of the authors of this Comment was involved.

[24] Indeed, according to one study, it would exceed the median net worth in 2002 for African American households ($5,988). And it drains almost 7 percent of the median net worth for white households that year ($88,651). Rakesh Kochhar, *The Wealth of Hispanic Household: 1996–2002* p. 5, (Pew Center for Hispanic Studies), *http://pewHispanic.org/files/reports/34.pdf.*

[25] Christopher A. Richardson and Keith S. Ernst, *Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages,* Center for Responsible Lending (January 2005).

[26] Comment letter from the Center for Responsible Lending to the Board of Governors of the Federal Reserve Board (August 15, 2007).

[27] Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages,* Center for Responsible Lending (May 31, 2006). Study finds that African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors. For example, African-American borrowers with prepayment penalties on their subprime home loans were 6 to 34 percent more likely to receive a higher-rate loan than if they had been white borrowers with similar qualifications.

[28] Mike Hudson and E. Scott Reckard, *More Homeowners with Good Credit Getting Stuck in Higher-Rate Loans,* L.A. Times, p. A–1 (October 24, 2005). For most types of subprime loans, African-Americans and Latino borrowers are more likely to be given a higher-cost loan even after controlling for legitimate risk factors. Debbie Gruenstein Bocian, Keith S. Ernst and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages,* Center for Responsible Lending, (May 31, 2006) at *http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010; See also* Darryl E. Getter, *Consumer Credit Risk and Pricing, Journal of Consumer Affairs* (June 22, 2006); Howard Lax, Michael Manti, Paul Raca, Peter Zorn, *Subprime Lending: An Investigation of Economic Efficiency,* 533, 562, 569, Housing Policy Debate 15(3) (2004).

[29] Testimony of Travis Plunkett, *Improving Federal Consumer Protections in Financial Services,* Hearing Before the House Financial Services Committee, (July 25, 2007).

[30] The FTC has had UDAP authority to protect consumers for nearly 70 years. Though the bank regulatory agencies were granted parallel enforcement authority in 1975, it is only since 2000 that they have recognized that. Even so, they have been parsimonious in utilizing it in the context of mortgage lending, for example, the OCC's action against a small bank, Laredo National Bank, # 2005–142. In contrast, the FTC took enforcement action against a non-depository subprime lender that was at the time among the top originators of subprime loans, the Associates, *FTC* v. *Associates First Capital,* (*http://www.ftc.gov/opa/2002/09/associates.shtm#*) and other major predatory lenders, such as First Alliance Mortgage Company (FAMCO) and Delta Funding, in cooperation with other agencies. Abusive practices in servicing is another major problem in the mortgage context, and the FTC brought an action against Fairbanks, a major subprime servicer, (The FTC has a list of predatory lending cases on its website, *http://www.ftc.gov/opa/2002/07/subprimelendingcases.shtm*.

[31] It has been suggested that Congress may need to make clear to the FTC that it will gain this authority only if it commits to using it in an appropriate fashion. *See* Test. of Travis Plunkett, note 30.

[32] See note 30.

[33] 15 U.S.C. Sec. 45, 12 U.S.C. Sec. 57a(a), 57a(f). *See also* Julie L. Williams & Michael S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks,* 58 Bus. Law. 1243 (2003).

[34] 16 C.F.R.433.

[35] 16 C.F.R. 444.

[36] *American Financial Serv. Ass'n* v. *Federal Trade Commission,* 767 F.2d 957 (D.C. Cir. 1985).

[37] For example, given the OTS' position that its rules "occupy the field," what will be the impact if it promulgates UDAP rules, as it has recently proposed? (OTS Adv. Notice of Proposed Rule Making , Unfair or Deceptive Acts or Practices, Dkt. ID OTS–20007–0015 (*http://www.ots.treas.gov/docs/7/73373.pdf*).

Senator DORGAN. Mr. Calhoun, thank you very much for your testimony.

Next we'll hear from Chris Murray, the Senior Counsel of Consumers Union.

Mr. Murray?

STATEMENT OF CHRIS MURRAY, SENIOR COUNSEL, CONSUMERS UNION

Mr. MURRAY. Thank you, Subcommittee Chairman Dorgan, for the opportunity to represent Consumers Union this morning, the nonprofit publisher of *Consumer Reports* magazine.

I want to touch on a few different areas focused in the media and telecom sectors, and note that the FTC does serve as a critical first line of defense for anticompetitive practices, as well as unfair and deceptive behavior.

The first thing we would strongly urge Congress to do is eliminate the constraints of the common carrier exemption. This exemption from FTC jurisdiction was created for a bygone era, that—we no longer have a single monopoly provider that's tightly regulated by the Federal Communications Commission. Unfortunately, the

Commission has been steadily walking away from regulating the full bundle of communications, and Congress needs to provide the authority for the FTC to fill this critical void.

We see carriers using aggressive bundling tactics. They're advertising unlimited services that are sharply limited, and promoting plans that are not reflective of actual costs. But what happens when a telephone company advertises a misleading promotion that bundles a service that's, today, exempt, such as landline telephone service, with a service that is not, such as broadband Internet? We would argue that the agency has the authority to deal with the problem, but that's not clearly settled. Conversely, we see areas where the FTC already has clear authority and needs to do more to prosecute unfair and deceptive practices. I would note recent examples of cable companies who are terminating consumers because they're using too much bandwidth. If a consumer buys a particular Internet plan, companies can cap them at that bandwidth, no more and no less than what they purchased. We're not arguing that consumers should get unlimited bandwidth, just that they should get whatever bandwidth they've been sold. A spokesman for the cable company that was terminating these subscribers wouldn't even tell people what the real limit of their plans were. If that's not unfair and deceptive practices, I'm not sure what is. I don't understand how a company can advertise a particular high-speed capacity, and then refuse to tell subscribers what they bought.

So, I would, again, argue that it's critical, not just in the area of common carrier services, but, now that we see these full bundles, we need to eliminate the common carrier exemption, and we need to have an expectation that the FTC is going to deal with truth in broadband advertising across the full bundle.

Turning to the digital TV transition, we need the FTC to help defend against the digital up-sell. As the Committee is aware, in 2009 consumers' analog television sets will no longer work for over-the-air broadcast without a digital converter box. Consumer awareness of the transition is low, and it's confusing even for those consumers who are aware of it. What equipment will they need? Will cable and satellite subscribers need a converter box? Will they need a high-definition television set? Will they need a digital cable-ready television set? Or will an analog set with this converter box that we're going to see a coupon for, will that be sufficient?

Alongside this confusion are the inevitable incentives to up-sell. You've got cable companies who want to get people to buy their service. You've got consumer electronics manufacturers who want to get people to buy new televisions. The incentives are various, and the combination of low consumer awareness, technological complexity, and financial incentives to up-sell creates a situation ripe for deceptive practices. We would ask that the FTC pay special attention to advertising during this transition period, to make sure that consumers are given the whole truth.

On identity theft and privacy, I'll note briefly that the FTC has conducted numerous workshops to explore privacy issues. One important workshop is planned this fall regarding online collection of consumer behavioral data for marketing uses. Consumers are paying an increasing price for the convenience of shopping online, as marketers, data-mining companies, are creating near-complete pro-

files of consumer behaviors, matched with public data on zip codes and incomes. We commend the FTC also for evaluating the important privacy issues raised by the Google-Doubleclick merger, and the growing concern over behavioral tracking.

Finally, I'll remind the Committee that the National Do Not Call Registry is required to purge its numbers every 5 years, meaning that everybody who signed up for this list is going to have to sign up for it again, unless Congress takes action. Consumers who joined this enormously popular program will again encounter the annoyance of advertising at the dinner table, beginning in June 2008. With this annoyance will also come another round of expenditures for the Federal Government to publicize the availability of the list and the necessity of signing up again. Congressman Doyle announced, this week, that he will introduce a vehicle in the House to make the Do Not Call Registry permanent, and it's my hope that Members of this Committee might introduce a parallel bill and pass it expeditiously.

I can't help actually just to note, in passing, one of our deep disappointments with the Federal Trade Commission has, indeed, been this net neutrality report. The notion that markets are going to discipline the right player here is curious. I was on the inside of Madison River, one of the few incidents where we've seen documented blocking, and what we saw there—it was sheer dumb luck that we discovered the blocking in the first place, because we had a network engineer as one of the customers who was blocked. He ran a trace route, and he called the company up, and the company told him they were blocking our packets because they wanted to make more from their own service. That is not going to repeat itself. We believe we've seen blocking in other instances. It's just incredibly difficult to document. And the problem is, the market disciplines the wrong player. If somebody has trouble with their Internet phone service, who do they call? Do they call their Internet service provider and say, "Hey, you should sign a better deal with AT&T"? No, they call their Internet phone provider and say, "Why is your service junk?"

And the notion that competition is going to prevent this behavior, I think, is also a little bit laughable. I live 2 miles north of the White House, in Washington, D.C., and I have a choice of precisely one provider. I'm not able to get cable modem service in my neighborhood. And so, I'm not quite sure how I, as a consumer, would do anything. And, while I hear, "Ninety percent of consumers have a choice between two," I just find that really difficult to believe those numbers, when, you know, here I am, in downtown Washington, D.C., in a relatively affluent neighborhood, and I don't have a choice of two providers.

I thank you for the opportunity to testify today.

[The prepared statement of Mr. Murray follows:]

PREPARED STATEMENT OF CHRIS MURRAY, SENIOR COUNSEL, CONSUMERS UNION

Subcommittee Chairman Dorgan, Ranking Member DeMint, and Members of the Subcommittee, I am grateful for the opportunity to testify before you today rep-

resenting Consumers Union, the nonprofit publisher of *Consumer Reports* magazine.[1]

The Federal Trade Commission (FTC) serves as a key line of defense against unfair and deceptive practices and anti-competitive behavior. Today I will highlight some of the barriers in the Commission's authority and enforcement powers that hinder its ability to protect consumers as well as note a few priority areas in which the FTC could do more.

Given the FTC's broad authority to protect consumers, Consumers Union intersects with the FTC in many ways. One notable area in which the FTC has led is in the area of "Exclusion Payments," or "pay for delay" settlements, where generic drug manufacturers are paid by brand name drug makers to keep generic drugs out of a market. The agency prevailed on cases to end the practice of paying off drug competitors not to compete, until it was reversed by the 11th circuit in the *Schering* case.[2] We support legislation to end these anti-consumer practices and applaud the FTC for conducting more investigations with an eye toward bringing more cases. These "pay for delay" deals cost consumers billions every year. I hope Congress will also act expeditiously to end this practice.

Today I'll turn my attention primarily to the telecommunications and media sectors, and what can be done to improve the FTC's ability to protect consumers in these areas.

Eliminating the Common Carrier Exemption, Policing Truth in Broadband Advertising

First, Congress should eliminate the constraints of the common carrier exemption, as it was crafted for a time when a single monopoly telephone provider was tightly regulated by the Federal Communications Commission (FCC). As the marketplace evolves with a broader array of services, and the FCC steadily backs away from regulating the full bundle of communications that consumers are buying, there is a void that is critical for the FTC to fill—and Congress should provide the FTC authority to fill it.

What happens when a telephone company advertises a misleading promotion that bundles a service that is today exempt, such as landline telephone, with a service that is not, such as broadband Internet? We would argue that the agency has authority to deal with the problem, but this would likely be litigated before it is settled, consuming already scarce agency resources.

For example, in the *Verity* case, the agency brought an action against an overseas firm billing illegally for "adult videotext" services that consumers didn't even know had been accessed through their phone lines. The company attempted to evade FTC jurisdiction by claiming the common carrier exemption. While the FTC eventually prevailed, it required litigation at the district and appellate court levels, and Verity even attempted an appeal to the Supreme Court, but the case was not accepted.

When we see carriers using aggressive bundling tactics, advertising "unlimited" services that are sharply limited, and promoting plans that are not reflective of actual costs, the case for FTC jurisdiction could not be more clear.

And the FTC should prosecute "unfair and deceptive" practices wherever they may lurk, especially where the agency already has clear authority. We saw recent examples of cable companies offering high-speed Internet to their customers, and terminating those who use "too much" bandwidth. We're not arguing that consumers should have unlimited bandwidth by any means, just that they should get whatever bandwidth they've been sold. If a consumer buys a certain amount of connectivity, then cap them at amount—no more, no less than what was advertised. In a *Washington Post* article,[3] a spokesman for this particular company wouldn't even disclose to its subscribers how much is "too much"! They argue that if limits were disclosed, then subscribers would use right up to that maximum capacity.

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance. Consumers Union's income is solely derived from the sale of *Consumer Reports,* its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* (with approximately 4.5 million paid circulation) regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[2] *Schering-Plough Corp.* v. *Federal Trade Commission,* 2005 U.S. App. LEXIS 3811, (11th. Cir. 2005).

[3] Hart, Kim. "*Shutting Down Big Downloaders,*" *Washington Post* (September 7, 2007).

I simply don't understand how a company can advertise a particular high-speed capacity, and then refuse to tell subscribers what they really bought. If that's not an unfair and deceptive practice, I can't imagine what would be.

The agency needs to act to ensure that consumers get truth in broadband and communications advertising, and Congress needs to give the FTC clear, concurrent jurisdiction with the FCC to deal with the full range of communications services, whether common carrier or otherwise.

Digital Television Transition—Defending against the "Digital Upsell"

The digital television transition creates unique vulnerabilities for consumers and therefore unique opportunities for businesses to mislead them. Not only is consumer awareness of the transition low, the transition is confusing for even those consumers who are aware of it—consumers lack clarity on what equipment they'll need under what circumstances. Will cable subscribers need a converter box? For those who need a new television now, do they need a digital television? A digital cable-ready television? An analog set with a converter box?

Along with these complexities are strong incentives by a variety of market players to upsell to consumers. Cable companies have an incentive to encourage non-subscribers to purchase their service, and to upsell current subscribers to digital cable. Retailers and manufacturers have an incentive to sell high-end HDTVs rather than more affordable lower definition, smaller-screen digital sets. And they have no incentive to inform consumers that their analog sets will continue to receive digital broadcasts as long as they have a converter box.

The combination of low consumer awareness, technological complexity, and financial incentives to upsell creates a situation ripe for deceptive practices. For vulnerable populations—such as the elderly or low-income households—the potential for being misled, intentionally or unintentionally, is significant.

Last week the cable industry launched a $200 million ad campaign to educate consumers about the DTV transition. The ads, which urge cable customers to relax because "cable will take care of them" in the digital transition, fail to indicate whether cable will convert all digital broadcast signals, or whether consumers will need to pay more for a set top box or other services that make it possible for consumers to continue using their analog cable services.

The cable industry has made a voluntary commitment to offer both digital and analog signals to their customers for 3 years—but they have not committed to do this nationwide. Their public statements indicate that they would not provide these signals to customers in a significant part of the country, including rural areas. After this 3 year dual carriage period ends, it is not clear that consumers will not have to purchase new equipment or pay more for digital cable service.

Congress and the FTC should take an aggressive stance to ensure that consumers are not taken advantage of. In the last Congress, this Committee reported (in the Communications Opportunity Promotion and Enhancement Act) an amendment offered by Sen. Nelson of Florida that imposed on retailers the duty to adequately inform consumers, and made it a violation of law to fail to adequately inform consumers about the availability of digital-to-analog converter boxes or to provide misleading information about the availability and cost of such converter boxes. Consumers Union supported that provision and encourages Congress to make such failure a violation of Section 5 of the FTCA subject to civil penalties.

Rulemaking and Enforcement Authority

Despite its broad jurisdiction to take action against unfair and deceptive practices by most types of businesses and its broad rulemaking authority to issue specific trade rules, the Commission faces significant procedural and judicial hurdles in proposing and adopting new rules and in taking enforcement action against unlawful practices.

Preventative Rules: The Commission faces significant statutory restrictions in proposing and adopting rules to prevent unfair and deceptive practices before they occur. First, rulemaking is encumbered by significant procedural requirements, including judicial review according to a higher review standard than most agencies face. Second, in order to propose such rules, the Commission must make a showing that the practice it seeks to correct is prevalent or widespread. The apparent internal Commission policy not to issue such rules, coupled with its theoretically broad but practically cramped authority, means that consumers cannot rely on FTC rules to prevent unfair and deceptive practices before they occur. Thus, Congress must be more aggressive in ensuring that consumers are protected by mandating that the Commission develop rules that protect consumers from unfair and deceptive practices in the emerging priority areas, some of which are outlined below.

Enforcement Authority: The Commission's enforcement authority is likewise constrained. Section 5 of the FTCA empowers the FTC to take action against those who engage in unfair and deceptive practices. For example, the Commission has authority to seek civil penalties against those businesses and individuals that violate Section 5, but only after it has issued a cease and desist order, a court has enjoined a practice and the order or injunction has been violated.[4] This slap on the wrist approach sends a clear message: "It's OK to break the law until you get caught, and when you do, just don't do it again."

The combination of few preventative rules and enforcement limitations encourage those who engage in unfair or deceptive practices to roll the dice in hopes that FTC resources and enforcement limitations will limit their financial exposure, assuming they are ever caught. Congress must step in to ensure that at least for high priority issues, the Commission is fully empowered to prevent consumer harm by mandating that FTC issue tough regulations or making explicit that certain practices violate Section 5 explicitly and by strengthening FTC's enforcement powers by authorizing it to seek strong civil penalties for initial violations.

Identity Theft and Privacy

The FTC plays an important role in preventing identity theft, encouraging improved data security measures, and enforcing elements of some key privacy laws.

FTC has conducted numerous workshops to explore privacy issues; one important workshop is planned this fall regarding online collection of consumer behavioral data for marketing uses. Consumers will pay an increasingly heavy price for the convenience of shopping for goods and services online as marketers, researchers and data-mining companies grow ever closer to creating near-complete profiles of consumer behaviors, easily matched with public data on zip codes and incomes. We also commend FTC for evaluating the important privacy issues raised by the Google-Doubleclick merger, and the growing concern over behavioral tracking.

The Commission also manages the Identity Theft Data Clearing House and conducts important consumer education on prevention of ID theft and mitigation of its harms. We are pleased that the FTC has updated its website to provide information about state "security freeze" laws—state laws giving consumers the right to freeze access to their credit files—that 39 states have now enacted. The security freeze is a key tool in preventing new account fraud. Given the essential nature of this protection, more prominent placement of freeze rights information would strengthen FTC educational efforts. And finally, the Commission has taken enforcement action under Section 5 against databrokers, retailers and other businesses who fail to live up to their privacy promises to protect and secure consumers' personal information, or who fail to employ reasonable and appropriate security practices.[5]

While the Commission's action to date to improve data security and deter deceptive privacy disclosures is laudable, more must be done to protect consumer privacy both by the Commission and by Congress. Continued reliance of FTC's Section 5 authority, with its significant enforcement limitations (discussed above), leave consumers vulnerable to deceptive and unfair practices that put them at significant risk of ID theft.

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[4] Although the Commission's Section 13(b) authority allows it to avoid the lengthy administrative enforcement process by filing a case directly in Federal district court, except where explicitly authorized by statute, rule or court decree, the Commission cannot seek civil penalties for initial violations.

Examples of these enforcement difficulties abound. When the Commission filed its complaint against ChoicePoint for its security breach, it was able to seek civil penalties against the company only because they were authorized under the Fair Credit Reporting Act.[4] Had the complaint been premised solely on the company's Section 5 violations, the Commission could have sought only equitable and monetary relief—damages suffered in cases where the breach caused ID theft. Without the threat of FCRA-based civil penalties, it is unlikely that the Commission would have successfully achieved its record-setting $15 million settlement agreement. And in some cases, the actual monetary damages to consumers may be limited, difficult to assess and prove or otherwise inadequate to provide for a strong deterrent to unlawful actions. One such example is telephone pretexting, an issue which this Committee attempted to address in the 109th Congress. The Commission has sought explicit civil penalty authority from Congress to enforce violations of this type of deceptive practice.[4] Such authority is important because when consumers phone records are obtained through pretexting, although there may be a severe privacy invasion (as in the case of the Hewlett-Packard board members whose phone records were obtained), monetary damages may be scant. In such cases, Section 13(b) provides little deterrence effect and thus is as limited as FTC's administrative enforcement options. Borrowing the words of Commissioner Liebowitz in his dissent in FTC's DirectRevenue case, in such cases, FTC enforcement action becomes merely "a cost of doing business."[4]

[5] For an accounting of FTC's actions against companies that fail to comply with their own privacy policies, see *http://www.ftc.gov/privacy/privacyinitiatives/promises_enf.html.*

Unfortunately, currently the Commission has explicit authority to issue data security rules only for those entities regulated under the Gramm-Leach-Bliley Act. Except under its general rulemaking authority—which, as noted above, the Commission is reluctant to use—the FTC does not have an explicit Congressional mandate to issue rules governing the privacy and data security practices of non-GLBA entities.

We urge Congress to provide the FTC with new enforcement authority for new Federal data security mandates for any business operating in interstate commerce that collects, stores, or otherwise uses consumers' sensitive personal information. S. 1178, reported by the Senate Commerce, Science, and Transportation Committee earlier this year, takes an important first step in applying FTC's GLBA data security rules adopted by FTC to all such businesses. If the rule is violated, the Commission will have authority to seek civil penalties for the initial violation, creating greater incentives to secure data. Unfortunately, despite the generality of the data security requirements under S. 1178 and FTC's GLBA data security rules, the legislation also displaces state data security safeguard rules that require stronger or more explicit security measures. We urge the Committee not to displace stronger state protections in this area, or to significantly strengthen data security safeguard mandates.

But data security requirements are not enough. Consumers also deserve notice when the security of their sensitive personal information held by others has been breached so they can take steps to protect themselves. Consumers Union strongly supports the security freeze provisions of S. 1178 and urges their adoption. We urge, however, that Congress strengthen the notice of breach requirement in the bill. Under the legislation, notice obligations are not triggered unless the breached entity determines that there is a reasonable risk of identity theft. Such "trigger" notice will leave consumers in the dark when there is inadequate data for the breached entity to evaluate the level of risk. Moreover, the legislation weakens existing protections because it displaces far stronger state notice laws that now protect more than half of all American consumers. The more consumer protective approach to notice of breach provided in S. 495 better ensures that businesses cannot evade notice when the security of sensitive consumer data has been breached.

Finally, it is essential that both Congress and the FTC step up protection of consumers Social Security Numbers (SSNs). SSNs provide the key to a consumer's financial identity. As a result, the widespread availability and use of SSNs by the private and public sector increases consumers' vulnerability to ID theft by making it easier for thieves to obtain the information.

In comments filed last week by CU before the Commission as part of its inquiry regarding private sector use of SSNs, CU reported that in its recent national consumer survey, nearly four in five adults reported that they had been asked for their SSN by a business or government entity in the last year. Most consumers clearly understood the dangers of providing the number but feared the consequences of refusing to provide it. And nearly all survey respondents supported new laws that would restrict the use, sale, purchase, and solicitation of their SSNs.

Consumers Union encourages adoption of laws creating new Federal protections for SSNs to reduce consumers' vulnerability to identity thieves. The SSN protection provisions of S. 1178 provide a starting point, but we have strong concerns that the numerous exceptions provided to prohibitions on solicitation, sale, purchase and display swallow the rule and leave consumers unprotected. We also urge the FTC take more aggressive action under its existing Section 5 authority to prevent collection, use, sale and purchase of SSNs except for credit, investment, tax and employment purposes.

Spam/Spyware

Consumers Union, in its 2007 "State of the Net" survey found that more than 34 percent of survey respondents reported a spyware infection in the prior 6 months. The chances of being infected with spyware is one in three. One of every eleven consumers infected suffers serious damage. In addition to hardware and software damage, spyware poses grave risks to consumer privacy.

Consumers will pay an increasing personal price for the convenience of shopping for goods and services online as marketers, researchers and data-mining companies grow ever closer to creating near-complete profiles of consumer behaviors, easily matched with public data on zip codes and incomes. Badware at best assaults consumers computers with unwanted pop-up advertising and, at worst, may unknowingly render their computers a tool for cybercriminals who use thousands of infected machines to steal identities, rob banks, and even cripple the Internet with malicious denial-of-service attacks.

We commend FTC for its aggressive stance on spyware, bringing at least eleven actions in the past 2 years, although some settlements have produced disappointingly low fines. But more must be done to protect consumer privacy.

In addition to new authorities for FTC, the agency, despite its good work, can take yet a more aggressive stance beyond enforcement of Section 5 violations. It should investigate the online marketplace in light of new developments in the field, expose marketing practices that compromise user privacy, issue the necessary injunctions to halt current practices that abuse consumers, and craft policies and recommend Federal legislation that prevents such abuses in the future.

National Do Not Call Registry

Finally, I'll note that the National Do Not Call Registry is required to purge its numbers every 5 years, meaning all consumers who signed up for it will have to sign up for it again, unless Congress takes action. Consumers who signed up for this enormously popular program will again encounter the annoyance of advertising at the dinner table, beginning in June 2008. And with this will come another round of marketing expenditures for the Federal Government to publicize the availability of the List and necessity of signing up yet again.

132 million citizens put their home and mobile telephone numbers on the list, and I'm confident those voters will be distressed to find out that they are again facing telemarketing calls unless Congress acts.

Congressman Doyle announced this week that he will introduce a vehicle in the House to make the Do Not Call Registry permanent; it is my hope that members of this Committee will introduce a parallel bill, and seek its expeditious passage.

The Federal Trade Commission is a critical line of defense against unfair and deceptive practices and anti-competitive behavior. The Committee should act to improve the agency's ability to accomplish its mission, especially by eliminating the common carrier exemption. We look forward to supporting the agency's efforts on consumer privacy, spam and spyware, the Do Not Call List, and would urge the agency to take a closer look at advertisements concerning the Digital Television Transition to ensure that consumers are not misled.

Thank you Chairman Dorgan.

Senator DORGAN. Mr. Murray, thank you very much.

Finally, next we will hear from Mr. Schwartz. Mr. Schwartz is representing the Center for Democracy and Technology.

Mr. Schwartz, you may proceed.

STATEMENT OF ARI SCHWARTZ, DEPUTY DIRECTOR, CENTER FOR DEMOCRACY AND TECHNOLOGY

Mr. SCHWARTZ. Thank you very much, Chairman Dorgan. Thank you for holding this public hearing today and inviting CDT to participate.

As more consumers' services move online, consumer protection agencies are facing new challenges. The Federal Trade Commission has played a leadership role to meet these challenges, including overcoming such difficulties as locating the perpetrators of online schemes, keeping up with the rapid pace of technological evolution, and following the increasing financial motivation of Internet fraudsters.

In particular, the FTC has been the lead law enforcement agency in the world in the fight against spyware. Spyware has become one of the most serious threats to the Internet's future. *Consumer Reports* magazine estimates that consumers will lose $1.7 billion this year to spyware attacks alone. The magazine estimates that almost 1 million consumers simply gave up fixing their spyware-riddled computers and had to throw them away.

The good news is that consumer losses are down dramatically from 2006, when they peaked at $2.6 billion. The main reasons for this decrease in the spyware threat are, first, the improvement in anti-spyware technology; second, the public pressure on companies

advertising with nuisance or harmful adware; and, finally, the enforcement of consumer protection law, led by the work of the FTC and some State attorneys general.

The FTC recognized the profound threat posed by the rising tide of spyware early, and actively moved to limit its spread. The Commission has been the leading enforcer against spyware, pursuing 11 cases to fruition in the past two and a half years, including three based, at least in part, on the petitions brought my organization, the Center for Democracy and Technology. CDT has learned, through our own research, that, as consumer fraud increases, the FTC's ability to work internationally becomes more important. Congress passed the SAFE WEB Act late last year to provide the FTC powers to promote international cooperation. The FTC's ability to use this new law, and staff resources that it will need, will be very important to monitor.

In fact, in general, the Commission staff has not grown in equal proportion to its new responsibilities, such as SAFE WEB, the FACT Act, Gramm-Leach-Bliley, CAN–SPAM, and more.

Mr. Chairman, you mentioned, earlier, that, according to its own statistics, in 2008 the FTC will only be about three-fifths of the size that it was almost 30 years ago, in 1979, well before the Internet explosion, and decades before the growth of online fraud. For online consumer protection to be truly effective in the future, Congress will need to appropriate resources commensurate with the FTC's new responsibilities.

Finally, CDT would like to impress upon the Committee the important role that the FTC has played in promoting good privacy practices online. While progress has been made by many of the good actors in the industry in this regard, CDT continues to actively urge Congress to take a more comprehensive approach to privacy to ensure that consumers are protected in the new networked economy.

Last year, we were joined in this effort not only by privacy advocates, but also by 14 major companies, including eBay, Microsoft and HP. The FTC's experience on privacy will be essential as this effort moves forward. In particular, the Commission will need adequate resources to participate in the discussion to implement whatever legislation emerges from this process. We hope that this committee will be the leader on the general privacy issue, and will continue to promote the urgency of privacy matters with the Commission and on the rest of the Congress, moving forward.

Thank you for your attention, and I look forward to your questions.

[The prepared statement of Mr. Schwartz follows:]

PREPARED STATEMENT OF ARI SCHWARTZ, DEPUTY DIRECTOR, CENTER FOR DEMOCRACY AND TECHNOLOGY

Chairman Dorgan, Ranking Member DeMint and Members of the Committee, thank you for holding this public hearing on the Reauthorization of the Federal Trade Commission (FTC). The Center for Democracy and Technology (CDT) is pleased to have the opportunity to participate. CDT is a nonprofit public interest organization dedicated to preserving and promoting privacy, civil liberties and other democratic values on the Internet. CDT has been a widely recognized leader in the

policy debate about spyware, phishing and related privacy threats to the Internet.[1] As we have worked to build trust on the Internet, we have worked closely with the Consumer Protection Bureau at the Federal Trade Commission. The Bureau's work is essential to the protection of consumer privacy online.

Summary

The FTC's consumer protection mission with respect to the Internet is expanding and becoming increasingly complex. The Commission's jurisdiction over Internet-related laws has expanded including new laws to fight spam, identity theft and more. At the same time, the rapid pace of technological change, the increasing financial pay-off for malicious actors and complicated nature of international cooperation has increased the complexity of enforcement and the need for adequate resources. Five years ago, CDT foresaw these emerging issues when we urged this subcommittee to reauthorize the FTC and, in doing so, to "use its new resources to stop unfair information practices as well as deceptive ones."[2] While the Commission has not been reauthorized since 1996, it has, under Chairman Majoras, begun to bring more cases using its unfairness powers and has assumed a lead law enforcement agency role in online consumer protection.

In particular, the FTC has taken the lead law enforcement role in fighting spyware, one of the most serious threats to the Internet's continued usefulness, stability and evolution. The Commission should be commended for recognizing early on the profound threat posed by the rising tide of spyware and for actively moving to limit its spread.

As consumer Internet fraud increases, the FTC's ability to work with its international counterparts becomes ever more important. At the request of the Commission and with support from groups like CDT, Congress passed the SAFE WEB Act late last year to provide the FTC with powers to promote international cooperation. Yet, while the Commission clearly recognizes the importance of the new law, we will need to closely monitor the Congressional reporting on the law to see if those powers are being used effectively to improve international cooperation.

CDT would also like to impress upon the Committee the important role that the FTC has played in promoting good privacy practices online. In particular, the Commission has promoted industry best practices and also shown that it will take action when laws are broken.

For the last decade, CDT has actively urged Congress to take a more comprehensive approach to privacy. Last year, we were joined in the call for comprehensive privacy legislation, not only by privacy advocates, but also by 14 major companies. CDT urges this Committee to take up general consumer privacy legislation and make it clear that the FTC's unfairness jurisdiction includes violations of the privacy rights of American consumers. As the discussion about privacy legislation moves forward, the FTC's expertise and experience on privacy will be essential.

Finally, it is important to note that while the Internet revolution and the growth of digital technologies have heightened the FTC's importance to consumer protection, the resources available to the Commission have declined. When adjusted for inflation, the Commission's staff in 2008 will only be 62 percent of the size that it was almost 30 years earlier in 1979, well before the Internet explosion.[3] For online

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[1] *See, e.g.,* CDT leads the Anti-Spyware Coalition (ASC), a group of anti-spyware software companies, academics, and public interest groups dedicated to defeating spyware; In 2006, CDT Deputy Director Ari Schwartz won the RSA Award for Excellence in Public Policy for his work in building the ASC and other efforts against spyware; "Eye Spyware," *The Christian Science Monitor,* Apr. 21, 2004 ["Some computer-focused organizations, like the Center for Democracy and Technology, are working to increase public awareness of spyware and its risks."]; "The Spies in Your Computer," *The New York Times,* Feb. 18, 2004 ["Congress will miss the point (in spyware legislation) if it regulates specific varieties of spyware, only to watch the programs mutate into forms that evade narrowly tailored law. A better solution, as proposed recently by the Center for Democracy and Technology, is to develop privacy standards that protect computer users from all programs that covertly collect information that rightfully belongs to the user."]; John Borland, "Spyware and its discontents," *CNET News.com,* Feb. 12, 2004 ["In the past few months, Ari Schwartz and the Washington, D.C.-based Center for Democracy and Technology have leapt into the front ranks of the Net's spyware-fighters."].

[2] Testimony of Ari Schwartz, Associate Director, Center for Democracy and Technology on "Reauthorization of the Federal Trade Commission" before the Senate Committee on Commerce, Science, and Transportation Subcommittee on Consumer Affairs, Foreign Commerce and Tourism," July 17, 2002.

[3] According to the FTC, the Commission had 1,746 FTEs in 1979 (see *http://www.ftc.gov/ftc/oed/fmo/fte2.htm*) and requested 1,019 FTEs in 2008 (see *http://www.ftc.gov/ftc/oed/fmo/budgetsummary08.pdf*).

consumer protection to continue to be effective, Congress will need to appropriate resources commensurate with the FTC's new responsibilities.

I. Growth of Internet Commerce Has Led to New Roles for FTC

The exponential growth of Internet commerce has delivered enormous benefits to consumers. With low barriers to entry and a profusion of tools for comparing various sellers, e-commerce has lowered prices and expanded consumer choice. Users also benefit from the enormous convenience e-commerce provides, conducting transactions from their home offices, laptop computers and increasingly even mobile devices like PDAs and phones.

These benefits, however, are being undermined by the rise in privacy intrusions, fraud and abuse. An entire shadow industry has arisen with the sole purpose of gathering personal information on Internet users—often surreptitiously through invasive means such as spyware. Most of this information ends up being used to bombard users with unwanted marketing, but in the wrong hands it also may be used for more malicious purposes, such as identity theft, the fastest growing crime in the United States.

Consumers also are subjected to a constant barrage of annoying and frequently offensive spam e-mail. Some of this spam is sent by fraudsters posing as legitimate e-commerce sites and financial institutions, These "phishing" e-mails typically try to dupe consumers into visiting fake websites where they are prompted to submit passwords and personal information, such as a Social Security numbers, which can, in turn, be used for identity theft. Making matters worse, many of these scams originate overseas, out of reach of U.S. law enforcement.

Consumers are increasingly alarmed about these kinds of scams, Internet privacy intrusions, fraud and abuse. In an April 2006 poll conducted by the Center for American Progress, 69 percent of respondents indicated they were very or somewhat worried about having their identities stolen, making it the most widely cited risk category from a list that included getting cancer, being victimized by violent crime, and being hurt or killed in a terrorist attack.[4]

The FTC is the lead Federal agency responsible for protecting consumers against spam, spyware, identity theft and other Internet fraud and is responsible for enforcing the:

- Children's Online Privacy Protection Act
- CAN–SPAM Act
- Fair and Accurate Credit Transactions Act
- Do Not Call List
- Gramm-Leach-Bliley Act

The Commission also plays a lead role in addressing the growing threats related to:

- Identity theft
- Spyware
- Phishing
- General Internet fraud

The FTC is also engaged in evaluating and developing responses to changes in the online marketplace that may affect consumer protection. One example is behavioral advertising, which involves the compilation of detailed profiles of consumers' online activities for the purposes of serving targeted advertising. Although this practice is not new, the FTC has recognized that the evolution of technology and the online marketplace require that the Commission take a fresh look at behavioral advertising's privacy and consumer protection implications. The FTC has scheduled a town hall meeting in November to address the issue. In this and many other areas, the FTC is constantly looking to educate itself and the public about developing threats online.

When we take into account the scope of the FTC's responsibilities it becomes obvious that maintaining aggressive enforcement and comprehensive consumer education requires additional resources for the FTC. The online marketplace will become both more complex and more essential over time. The FTC has been and will

[4] Poll conducted April 13–20, 2006, by Greenberg Quinlan Rosner Research for the Center for American Progress; Center for Responsible Lending; National Military Family Association; and AARP.

continue to be a critical force in maintaining consumer trust in the Internet. Increased resources are a vital part of making that happen.

II. New Challenges in Investigating Malicious Internet Actors

In the early days of Internet crime, a vast number of offenses amounted to little more than virtual vandalism. Hackers would often circumvent Internet security as a way of showing off to their friends and proving their skills. That trend has long been on the decline, as malicious actors on the Internet are increasingly going after financial gain first and foremost.[5] This means that more consumers are losing more money than ever before either as a direct or indirect result of malicious activity online, and that malicious hackers have more financial resources than ever before. As a result, the FTC's consumer protection mission is at its most vital moment. Compensating consumers who have been harmed and putting a stop to fraudulent schemes becomes ever more important as fraud and monetary loss become more widespread.

As the FTC's role in fighting new fraud increases, its job becomes more complicated. One of the great paradoxes of the Internet is that while most Internet users are having their movements tracked and traced in ways never before imagined, those that are willing to take the time and energy can hide the tracks of their online activities in ways that make them very difficult to find. While this is a huge boon for free expression around the world, it also can help criminals and malicious Internet operations to evade the grasp of law enforcement. Using just a few simple tools, criminals and scammers can quickly and easily cloak their identities and locations. Tracking them down may require the assistance of multiple network operators, applications providers and technical experts to unravel a complex web of online identities and cloaking services.

Tracking individuals online is made more complicated by the fact that many malicious Internet schemes involve groups of companies, affiliates, and individuals acting together to defraud consumers. Not only must the identities and locations of all of these actors be traced, but the business arrangements and relationships between them must also be sorted out before law enforcers can act. The Internet's distributed nature lends itself to arrangements wherein multiple parties each contribute to form a complete operation or business plan. This characteristic has helped to provide a wide range of new services, but it may be exploited just as easily for malevolent purposes as for benevolent ones. The complexity of these arrangements will likely continue to grow as malicious Internet users realize that working with many different parties complicates enforcement and spreads liability to multiple entities.

The global nature of the Internet further complicates the task of apprehending malicious online actors. Internet scams are increasingly based overseas or in multiple countries at once, adding a whole new dimension to enforcement investigations. Law enforcers must cultivate relationships with their foreign counterparts in order to increase cooperation when it comes time to conduct investigations. The same is true for domestic enforcement across multiple states. The FTC has always had the authority and the willingness to cooperate with state attorneys general on enforcement matters, and the Internet makes these cases ever more likely since consumers from many different states may be affected by a single online scam.[6] In order to be fruitful, this cooperation requires all parties to expend extra resources.

Because of the rapid changes involved with Internet scams, investigations of Internet fraud are becoming increasingly technologically intensive. Although vast resources may not have been required when the FTC first began investigating online scams, technological advances over the past few years have heightened the level of sophistication necessary for successful investigations. If the FTC is to continue as a leader in online enforcement, it must keep pace with these changes. The Internet revolution also complicates FTC oversight of completed cases. Before digital technologies became pervasive, it was much easier for the FTC to monitor whether former defendants were complying with the provisions of their settlement agreements or court orders. The Internet provides simple means for such actors to quickly and easily setup new schemes under new monikers in new locations, making it difficult for the FTC to draw links to former businesses or identities and determine compliance.

All of this technological evolution impacts FTC resources in four ways:

- Training and consultations with outside experts may be necessary in order to strengthen the knowledge base of FTC investigators.

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[5] Krebs, Brian, "The Computer Bandit," *The Washington Post Magazine*, Feb. 19, 2006.

[6] *See, e.g.,* "FTC, Washington Attorney General, Sue to Halt Unfair Movieland Downloads," Federal Trade Commission, Aug. 15, 2006, *http://www.ftc.gov/opa/2006/08/movieland.htm.*

- Sophisticated equipment may be needed in order to track and understand the intricacies of online schemes, and also for the purposes of evidence gathering.
- The amount of time necessary to conduct investigations may increase due to the technical complexities of determining and proving how a particular malicious enterprise works and who is behind it. The same is true for oversight, where monitoring functions may become increasingly resource-intensive.
- The pool of resources dedicated to consumer education must be expanded. Frequent and rapid changes in technology can be difficult for consumers with minimal technical expertise to comprehend, and the FTC is a major source of guidance for consumers looking to protect themselves online.

In all of these ways, the fast pace of technological change demonstrates the need for the FTC to expend new resources in order to stay up to speed.

III. FTC's Leading Role in Spyware Enforcement: Setting An Example for the Future

Five years ago, very few people were familiar with the term "spyware." Consumers were just beginning to witness the effects of unwanted software that appeared unexpectedly on their home computers. Since that time, consumers have been increasingly deluged with programs that they never knowingly installed on their computers. Often these programs make themselves difficult to remove, expose users' personal data, open security holes, and undermine performance and stability of their systems. The FTC was one of the first law enforcement bodies to take note of this menace. Since then, the Commission has been leading the charge in the spyware fight in three key ways: engaging in enforcement actions, developing guiding principles for enforcers, and establishing industry standards.

The Commission filed the Nation's first spyware lawsuit by a law enforcement agency in late 2004 against a network of deceptive adware distributors and their affiliates.[7] This case struck at the heart of one of the most nefarious spyware schemes on the Internet. The scammers involved were secretly installing software that left consumers' computers vulnerable to hackers, and then duping those same users into purchasing fake security software to help repair their systems. Not only did the FTC succeed in the case—obtaining a $4 million order against the primary defendant and over $300,000 in disgorgement from the other defendants—but the investigations in the case opened up several additional leads that contributed to the FTC's pursuit of other malicious software distributors. In the 3-years since launching this first suit, the FTC has engaged in a total of 11 spyware enforcement actions, all of which have ended with settlements or court orders that benefit consumers.

In prosecuting these cases, the FTC has used its broad authority to challenge unfair and deceptive practices, recognizing that many spyware behaviors are illegal under existing law. However, the FTC has not been haphazard in choosing which cases to pursue. As the common characteristics of spyware began to reveal themselves, the FTC established three principles to guide its spyware enforcement efforts: [8]

- A consumer's computer belongs to him or her, not to the software distributor. This means that no software maker should be able to gain access to or use the resources of a consumer's computer without the consumer's consent.
- Buried disclosures do not work. Communicating material terms about the functioning of a software program deep within an End-User License Agreement (EULA) does not meet high enough standards for adequate disclosure.
- Consumers must be able to uninstall or disable software that they do not want. If a software distributor places an unwanted program on a consumer's computer, there should be a reasonably straightforward way for that program to be removed.

In addition to serving as a guide for the FTC, these principles have helped to direct state law enforcers who have begun to take on spyware cases. The spyware space is fraught with gray areas—software behaviors that may be perfectly legitimate in one circumstance may be considered highly malicious in another. Some states have passed specific spyware statutes to help clarify these distinctions, but

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[7] *FTC* v. *Seismic Entertainment, Inc., et al.,* No. 04–377–JD, 2004 U.S. Dist. LEXIS 22788 (D.N.H. Oct. 21, 2004).

[8] Remarks of Deborah Platt Majoras, Chairman, Federal Trade Commission, Anti-Spyware Coalition Public Workshop, Feb. 9, 2006, *http://www.ftc.gov/speeches/majoras/060209cdtspyware.pdf.*

several of the states that have been most active in spyware enforcement have no such laws in place. The FTC's guiding principles provide a simple, understandable baseline for current and future law enforcers as they wade into spyware issues with which they may be unfamiliar. In this way, the leadership of the FTC has been a vital component in expanding the nationwide pool of law enforcement resources dedicated to combating spyware.

The FTC has also played an integral role in establishing standards for the software industry as a whole. In two of its most recent enforcement efforts, the FTC reached settlement agreements with adware distributors that required the distributors to clearly and conspicuously disclose material terms about their adware programs *outside of any End-User License Agreement (EULA).*[9] With these requirements the FTC has set a disclosure guideline that can be applied across the software industry, for the benefit of consumers. Not only were the adware distributors themselves forced to abandon deceptive or nonexistent disclosures, but software vendors throughout the industry were also put on notice about what constitutes legitimate behavior. The FTC's leadership in this respect has helped to curb uncertainty in the software industry while creating a better online experience for consumers.

The FTC has also played key roles in other areas that have helped to quell the rise of spyware infections. For example, Chairman Majoras has been actively supportive of the adoption of user-control technologies such as anti-spyware programs.[10] The Commission, under the leadership of Commissioner Liebowitz, has warned companies about advertising with nuisance or harmful adware programs.[11]

Consumers have already seen the benefits of the FTC's action against spyware working in concert with improved anti-spyware technology, self-regulatory programs and work by other law enforcement officials such as the state attorneys general. *Consumer Reports* magazine estimates that consumers will lose $1.7 billion from spyware in 2007 as opposed to $2.6 billion in 2006.[12] While these figures are still astoundingly large and consumers are still very much at risk, spyware is one of the few areas of Internet fraud that is clearly headed in the right direction.

The effectiveness of the FTC's spyware enforcement program in all of these regards—pursuing spyware purveyors, developing guiding enforcement principles, and establishing industry standards—has been made possible by two important characteristics of FTC consumer protection operations. The first is that the Commission had the freedom to delve into uncharted territory when the threat of spyware first became apparent. This flexibility allowed the FTC to build its knowledge of spyware early enough to keep pace with the evolution of the threat that it posed. Second, the FTC was afforded sufficient resources to engage in the complex, technology-intensive investigations that were necessary to identify unfair and deceptive practices and track down the perpetrators of those practices. Having the training and technological expertise to identify and locate spyware purveyors has been critical to the FTC's success in this area.

Freedom to chart a new course and sufficient resources to engage in technology-intensive investigations will undoubtedly be essential to the FTC's consumer protection mission as new online threats arise. Internet scams are increasingly complex, multi-national, and financially motivated. This makes enforcement an even greater challenge that will require the FTC to think, act, and use its resources in new ways. The success of the FTC spyware enforcement program shows what a strong leader the Commission can become when it is afforded the flexibility and resources necessary to tackle an emerging enforcement problem. As the FTC budget and performance plans are set for the coming years, these two aspects of FTC consumer protection operations should be fully supported and augmented as necessary to ensure that future enforcement efforts may be as successful as the spyware program has been.

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[9] *See In the Matter of Zango, Inc.,* formerly known as 180solutions, Inc., Keith Smith, and Daniel Todd, FTC File No. 052 3130 (filed Nov. 3, 2006), available at *http://www.ftc.gov/os/caselist/0523130/index.htm; In the Matter of DirectRevenue LLC, DirectRevenue Holdings LLC, Joshua Abram, Daniel Kaufman, Alan Murray, and Rodney Hook,* FTC File No. 052 3131 (filed Feb. 16, 2007), available at *http://ftc.gov/os/caselist/0523131/index.htm.*

[10] I applaud the efforts that industry has made to develop and deploy new technologies to combat spyware, and I hope that these efforts are just the beginning." Chairman Majoras, ASC Public Workshop, Feb. 9, 2006.

[11] Cindy Skrzycki, "Stopping Spyware at the Source," *Washington Post,* March 6, 2007, D01.

[12] "State of the Net 2006," *ConsumerReports.org,* Sept. 2006, *http://www.consumerreports.org:80/cro/electronics-computers/online-protection–9–06/state-of-the-net/0609__online-prot__state.htm,* and "State of the Net 2007," *ConsumerReports.org,* Sept. 2007, *http://www.consumerreports.org/cro/electronics-computers/computers/internet-and-other-services/net-threats-9-07/overview/0709__net__ov.htm.*

IV. International Cooperation is Essential

The profusion of global commerce over the Internet complicates enforcement of online consumer protections. A victim of Internet crime might reside in the United States, but the perpetrator might be overseas, outside the reach of U.S. law enforcement. To protect against global fraud, the FTC was recently granted special authority to work with its counterparts in other countries by the U.S. SAFE WEB Act.

Collaboration with other countries requires a staff that is knowledgeable about cross-border issues, foreign legal regimes and processes, and broader international issues pertinent to resolution of fraud questions. Building this knowledge base may necessitate staff exchanges, so that staff become familiar with foreign operations and build relationships with overseas counterparts. Domestically, the FTC will need to develop similar partnerships with U.S. investigative organizations—including the Department of Justice—that work on cross-border fraud.

It is important to note that these partnerships also can be applied to address privacy violations that occur both within and outside of the United States. Privacy principles developed by the Asia Pacific Economic Cooperative (APEC), for example, anticipate the resolution of privacy violations that occur between the United States and countries in Asia.[13] The resources, authority, and staff expertise required to address cross-border fraud will be similarly required to address privacy violations across international borders.

The U.S. SAFE WEB Act requires the FTC to undertake a comprehensive reporting plan and deliver updates to Congress within 3 years of the Act's passage. Because there has been no public reporting of the Commission's use of the Act to date, these Congressional reports will be essential in understanding how these powers are being used and if they are effective.

V. Increased Privacy Threats Will Require Congressional Action

Privacy is at the heart of online consumer protection. Since the advent of widespread computing, the Internet and distributed databases, it has become far easier for businesses to collect, store and exchange information about their customers. Frequently, the information collected includes sensitive or personally identifying data, which, if not properly secured, can become a tool for identity theft. Companies also may use this data to track consumer preferences and behavior, often without the consumer's knowledge or permission.

Despite this unprecedented threat, there is still no single comprehensive law that spells out consumer privacy rights. Instead, a confusing patchwork of distinct, and sometimes inadequate or nonexistent, standards has developed over the years, producing more than a few oddities. For example, we reserve our strongest privacy protections for cable and video records, while travel records and online purchasing data are left disturbingly vulnerable, financial privacy laws have major exceptions, and some important uses of "public records" are left unregulated.

Over the past 9 years, CDT has urged Congress to enact a single consistent regime, based on fair information practice principles. Specifically, consumers should be able to:

- know which companies are collecting information from them;
- provide only information necessary for a transaction;
- find out what companies are doing with this information beyond the original transaction;
- know who else might have access to their personal data;
- check to ensure that the data held about them is timely, accurate and complete; and
- obtain assurance that their information is held securely by all third parties.

We believe that these protections are crucial to address the new threats faced by online consumers. Consumers need to be put back in control of their personal information, so that privacy is preserved and fraud and abuse prevented.

We urge the Senate Committee on Commerce, Science, and Transportation to once again take up this issue to ensure that consumers are adequately protected. The FTC will need greater resources to take the lead on implementing such legislation, but first Congress will need to provide the Commission with the backing authorization to move forward.

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[13] APEC Privacy Framework, 16 APEC Ministierial Meeting, Nov. 2004, *http://www.apec.org/apec/news__media/2004__media__releases/201104__apecminsendorseprivacyfrmwk.html.*

VI. Addressing the Common Carrier Exemption

Another issue of growing concern that CDT raised at the last FTC reauthorization hearing has also remained unaddressed.

The FTC for many years has asked that the exemption that prevents the Commission from exercising general jurisdiction over telecommunications "common carriers" be rescinded. The idea of creating a level playing field is appealing, particularly when some communications services fall within the jurisdiction of the FTC. In particular, lifting the restriction in certain areas—such as billing, advertising and telemarketing—would ensure that the agency with the most expertise in these areas is taking a leading role.

However, rescinding the exemption completely could lead to duplication of government regulation and/or confusion for consumers in certain areas. For example, telecommunications companies are already subject to the Customer Proprietary Network Information (CPNI) rules administered by the Federal Communications Commission, which limit reuse and disclosure of information about individuals' use of the phone system including whom they call, when they call, and other features of their phone service. At this point, we are not sure it would be wise to take this issue away from the FCC. Similar questions may arise with other issues: Which agency would take the lead? By which rules would a complaint about deceptive notice be addressed? How will these decisions be made?

The FTC has been thoughtful in these areas in the past, so it is likely that any concerns could be addressed. If this proposal should move further, the Commission would need to be able to have a detailed examination and plan for dealing with similar areas of overlap including the kind of resources needed to dispatch its newly expanded duties in the telecommunications space. Congress should also take part in studying this issue further.

VII. Conclusion

CDT strongly urges the Congress to finally reauthorize the Federal Trade Commission.

The Internet has touched every sector of the FTC's consumer protection mission, and although digital innovations have simplified some tasks, they bring their own new challenges in training, education, oversight, and—perhaps most intensely—enforcement. The Commission has aptly demonstrated its leadership in online consumer protection, and yet it is surviving with pre-Internet staffing.

As privacy threats increase and become more international, demands on the Commission will only grow. The Committee's oversight of the FTC's consumer protection mission increases in importance as more individuals move their activities online and we thank the members of the Subcommittee for recognizing its importance and inviting us to address these issues today. We look forward to working with you on these issues in the near future.

Senator DORGAN. Mr. Schwartz, thank you very much.

Next we will hear, finally, from Martin Abrams, who is the Executive Director of the Center for Information Policy Leadership.

Mr. Abrams, thank you very much.

STATEMENT OF MARTIN E. ABRAMS, EXECUTIVE DIRECTOR, CENTER FOR INFORMATION POLICY LEADERSHIP, HUNTON & WILLIAMS LLP

Mr. ABRAMS. Thank you, Mr. Chairman. I am honored to be asked to testify on FTC reauthorization.

I lead the Center for Information Policy Leadership, a think tank that develops policy solutions in an information age. We are located at the law firm of Hunton & Williams, and supported by 40 leading companies. My comments, though, are my own, and do not necessarily reflect the views of the Center's members, Hunton & Williams, or its clients. And we will be looking forward to the questions.

Mr. Chairman, information policies' complexity will accelerate over the next 5 years like a race car on the first lap of the Indian-

apolis 500. And if we start now in developing governance structures, we will be lucky to catch up. We will collect more data in ways we never anticipated, just yesterday. More of that data will be usable by analytic systems, and those analytic systems will be used by more people in more places to answer more questions than we ever thought possible. Business analytics will be critical to business success, international competitiveness, and meeting consumer expectations. Global teams will use the same data set in 15 different locations all at the same time without worry about national borders, and consumers need to be protected in this information-driven economy.

The FTC, without explicit mandate from Congress, has done a laudable job over the past decade as the government's information policy development agency. They have anticipated issues, held hearings, workshops, town halls, and requested comments necessary to assure a fair market where consumers' privacy and security is protected. Mr. Chairman, we can no longer develop information policy as an inferred responsibility related to a consumer enforcement mandate. Information policy in an information age is as important as monetary policy in a capitalist society. The FTC reauthorization must include information policy development as an explicit responsibility for the agency. It must be funded at a level proportionate to its importance to our economy.

Information policy needs to be staffed by a mixture of expertise necessary to work with the best and the brightest in business, civil society, and academia. And, last, the function needs Congressional oversight to assure the FTC does the job necessary to protect consumers while maintaining a platform for successful commerce. This policy development function needs to look at new enforcement models where the FTC gives oversight to bodies empowered to resolve consumer issues. This function needs the stature to interface with foreign officials on equal footing. This function is critical to a safe and growing economy over the next 10 years.

Thank you, and I would be pleased to respond to questions.

[The prepared statement of Mr. Abrams follows:]

PREPARED STATEMENT OF MARTIN E. ABRAMS, EXECUTIVE DIRECTOR, CENTER FOR INFORMATION POLICY LEADERSHIP, HUNTON & WILLIAMS LLP

Distinguished Chairman, honorable Committee Members, I am Martin E. Abrams, Executive Director of the Center for Information Policy Leadership. I am honored to testify on information policy, and the opportunities and risks to maintaining a safe marketplace for American consumers raised by new developments in the information economy.

The Center for Information Policy leadership was founded in 2001 by leading companies and Hunton & Williams LLP. The Center was established to develop innovative, pragmatic solutions to privacy and information security issues that reflect the dynamic and evolving nature of information intensive business processes and at the same time respect the privacy interests of individuals. Since its establishment, the Center has addressed such issues as conflicting national legal requirements, cross-border data transfers, and government use of private sector data, with a view to how the future direction of business practices and emerging technologies will impact those issues.

The Center and its forty-one member companies believe that difficult information policy issues must be resolved in a responsible fashion if we are to fully realize the benefits of an information age. Center experts and staff, however, speak only for themselves. My comments today reflect my views, and do not necessarily reflect the views of the Center's member companies, Hunton & Williams LLP, or any firm clients.

I. Summary

The Federal Trade Commission is charged with many responsibilities as it carries out its mission of maintaining a safe marketplace for American consumers. The Center has been privileged to work with the FTC on issues related to consumer protection and information policy development, and my comments today focus on that aspect of the Commission's work.

The FTC is to be applauded for undertaking serious work to helping policymakers and the public understand issues around information privacy and security and for its thoughtful, rigorous enforcement that improves the safety of the digital marketplace. The FTC has taken on complex, fast-emerging issues and taken important steps to address those issues through policy development and consumer education. Going forward, however, information privacy and security issues will only become more complex and surface more quickly.

- The FTC must be equipped to address issues related to information security and privacy that are more challenging than ever. Emerging technologies for data collection, rapid advances in business analytics, and the international nature of data flows challenge traditional frameworks of governance and make new demands on enforcement mechanisms.
- FTC's role in enforcing legal requirements for privacy and information security remains critical. Moreover, to foster consumer trust, the FTC must be prepared to undertake oversight of alternative methods of enforcement that respond to immediate consumer complaints regarding information use and resolve consumer disputes with companies.
- The FTC activity in development of information policy internationally is key to the protection of American consumers in the global marketplace. The Commission's work in this area should be recognized and supported.

Congress' Reauthorization of the FTC should specifically acknowledge the growing importance of the Commission's information policy development mission, and fund its expansion to match the complexity of the information marketplace. As part of that mission, it should encourage FTC work on alternative mechanisms to address consumer disputes related to information misuse as an adjunct to its traditional enforcement role. Congress's Reauthorization should recognize and encourage the FTC's prominent role in international information policy development. Having charged the agency with this mission, Congress should also provide oversight to ensure that it is successfully carried out.

II. The FTC must be equipped to address increasingly complex and challenging issues related to information security and privacy that arise from rapid developments in technology, business analytics and international data flows

The Commission plays a key role in the enforcement of laws governing the privacy and security of information and in the development of forward-looking public policy—both domestically and internationally—to address emerging information governance issues. The FTC has done an admirable job in helping policymakers and the public understand and respond to issues surrounding information privacy and security through its enforcement actions and through its extensive work in workshops, requests for comments and hearings to explore how best to act on these questions. It has provided clear guidance to the market while still allowing time for the market and self-regulation to respond.

In this role, the FTC has taken on difficult issues related to companies' compliance with privacy policies, data security and data breach, emerging technologies such as RFID, and how to write privacy notices that effectively communicate to consumers.

The complexity of these issues, however, will pale in comparison to those on the horizon, when digital personally identifiable information is ubiquitous, the marginal cost of collecting and aggregating it approaches zero, and society relies even more heavily on it for business, government, education, and health care.

This complexity is driven in large part by three developments: the emergence of new technologies for data collection, the rapid advances in business analytics, and the international nature of data flows.

A. The Emergence of New Technologies for Data Collection

The collection of information about people is not new. Companies have collected data by phone, at points of sale, online, and through credit applications. Public record information collected and sorted by the government is used by companies; businesses and organizations also purchase information compiled by other companies about consumers.

New data collection technologies, however, dramatically change the way and the places from which information about consumers is gathered. They vastly increase the amount of information available to businesses. Radio devices such as mobile telephones, global positioning systems, radio frequency identification tags and wireless sensor networks collect information about an individual's location, and often their activity when they are at that location. Data accessed through search engines from social networks identify relationships between people, their interests and other individuals. Information collection often occurs in ways that do not involve the active engagement of the consumer, through highway toll tags, keystroke monitoring, and security cameras.

In many cases these technologies make it unnecessary for businesses to engage in collection, compilation and organization of data as we traditionally think about it. Rather, information can be immediately useful as it is accessed through the search of online, publicly available resources and websites. The search, matching and use of this information can occur dynamically and in real time.

This ability to gather information in new environments, in real time, and without consumer engagement significantly changes the interaction between the data collector and the individual, and strains our traditional notions of how best to protect the privacy interests of individuals in information that pertains to them. Increasingly the FTC will need to understand this new dynamic and to consider creative, more effective approaches to protecting the consumers' interest in the privacy of their personal information.

B. The Rapid Development of Business Analytics

The application of analytics enables businesses to use information to create value. Business analytics includes data warehousing, data mining, business intelligence, enterprise performance, management and data visualization. The analysis applied by credit reporting organizations to the data they received was an early application of data analytics about people, allowing credit grantors to offer credit to consumers of more widely varied credit backgrounds while still managing and making appropriate decisions about risk.

Today, businesses of all sizes use information analytics to predict response, profitability, return visits, and price tolerance. Government agencies use analytics to predict risk and evaluate passengers for flight security and safety, and to manage fraud related to health care reimbursement.

In his paper, "The Future of Business Analytics," Bruce McCabe [1] describes a 10-year view of emerging analytics technologies and how they will impact industries, organizations and the workplace. The paper offers detailed predictions about the way in which we will analyze and use data to predict consumer behavior, enhance marketing, and meeting consumer needs. He predicts that analysis of the information gathered through location tracking devices will enable organizations to gain entirely new insights about their assets, staff, customers, and products. Analysis of information gathered through audio and video will quickly grow in importance. Business analytics systems will be able to take advantage of new algorithms to draw inferences from material in discussion forums, customer feedback, and e-commerce and auctions sites, to infer overall positive or negative sentiment about companies and products.

McCabe asserts that analytic applications—now only in their infancy—will grow significantly because of three factors. First, the cost of technology will continue to go down as its power increases. Second, the volume of data available for analysis will continue to grow. Finally, unstructured data that is not usable today, such as digital pictures, will feed analytic engines as a result of improvements in natural language processing, search, inference and categorization.

C. The International Nature of Data Flows

Almost all business processes have become international. Consumer services are supplied out of India, accounts payable out of Costa Rica, software development is conducted in the Ukraine, and clinical trials are conducted in as many as twenty countries all at the same time. One global team meeting might require twenty professionals to an look at the same data sets originating from servers in twenty different countries. Industries as diverse as pharmaceuticals, automotive, software development and cosmetics all rely on global teaming and global sourcing. These busi-

[1] Bruce McCabe is the managing director of S2 Intelligence Pty Ltd, a company he founded in 2002 to research technology issues for Australian executives and policy-makers. Before founding S2, McCabe held senior research positions at Gartner and IDC. His paper, sponsored by Business Object Australia, is attached for the Committee's review.

ness processes require massive flows of data across international borders in order to work.

All of this data must be protected from loss and alteration, and all of it must be used appropriately no matter where in the world it is accessed. The FTC has applied the Gramm-Leach-Bliley safeguards rule [2] to global sourcing whether managed by the company or outsourced to a third party company.

The U.S. SAFE WEB Act [3] passed by the last Congress gives the FTC authority to work with privacy enforcement agencies in other countries to protect American consumers. Criminals in other countries use the Internet to prey on American consumers, and the SAFE WEB Act gives the FTC the authority to pursue those criminals.

Because of the international nature of these data flows, the FTC must be involved in development of international frameworks for data protection. It must be empowered within those frameworks to protect American consumers when their data is overseas.

The FTC's international office and FTC Commissioners have also participated in meetings at the Asia Pacific Economic Cooperative (APEC) and the Organization for Economic Cooperation and Development (OECD). This will be a growing function for the FTC if the Commission is to effectively promote American interests in providing balanced protections for information and ensure that consumers have redress when their privacy has been compromised.

III. The FTC must continue its enforcement under Section 5 of the FTC Act, and begin to undertake an oversight role for alternative consumer complaint and dispute resolution mechanisms.

The FTC has a well deserved reputation in the United States and around the world as a tough enforcer of privacy and information security requirements. The Commission has used its power under the Federal Trade Commission Act,[4] as well as specific laws such as CAN–SPAM,[5] Fair Credit Reporting Act,[6] and the Gramm-Leach-Bliley-Act.[7]

This enforcement role is key to fostering consumer trust in the marketplace. Using its authority under these laws, the FTC protects consumers by enforcing the law against bad actors for their specific illegal practices. In doing so, it sends a clear message about appropriate business practices related to information privacy and security, encouraging the reliability and trustworthiness of the information marketplace. However, as a fairly small agency with limited resources, the FTC cannot investigate every occurrence of market abuse. Moreover, it has neither the authority nor the resources to resolve individual consumer complaints.

However, trust in the marketplace remains an important issue to consumers and critical to the health of the information-fueled market. Research conducted by Yankelovich in 2004 [8] about consumer attitude toward industry information practices demonstrates that consumer trust in the information-driven marketplace is limited. At the core of these trust issues is the consumer's inability to resolve disputes about instances of misuse or mishandling of their personal information.

While the FTC is not the place to bring consumer complaints, it is well positioned to oversee market mechanisms to resolve consumer complaints about information practices. In the future accountability agents—entities to oversee business practices and assist consumers who are unable attain satisfactory resolution of complaints—will likely fill the gap of consumer dispute resolution. For example, industry safe harbors, will incorporate mechanisms not only to enforce safe harbor provisions, but also to resolve complaints brought by consumers related to inappropriate use or failure to protect their information.[9] This new FTC role as a regulator of accountability agents could be substantially similar to the oversight of the Securities and Exchange Commission for self-regulatory bodies that enforce securities regulations.

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[2] 15 U.S.C. § 6801 through 15 U.S.C. § 6809.
[3] Pub. L. No. 109–455.
[4] 15 U.S.C. §§ 41–51.
[5] 15 U.S.C. 7701., et seq.
[6] 15 U.S.C. § 1681 et seq.
[7] 15 U.S.C. Sec. 6801–6809.
[8] Yankelovich, Re-building the bonds of trust: state of consumer trust, crisis of confidence Presented to: 10th Annual Fred Newell Customer Relationship Management Conference 2004 available at *www.compad.au/cms/prinfluences/workstation/upFiles/955316.State__of__Consumer__Trust__Report__Final for Distribution.pdf*.
[9] Accountability agents will likely be very similar to self-regulatory enforcement bodies that currently exist for securities regulation and that are overseen by the Securities and Exchange Commission.

This Commission's role is anticipated in the APEC Privacy Framework, adopted by APEC leaders in 2004. The APEC Framework calls for the transfer of data in the Asia Pacific region based on corporate cross-border privacy rules. Under the current vision for the Framework's implementation, rules would be approved by accountability agencies in the various APEC economies, including the United States. The FTC and other privacy regulating agencies in the United States would oversee these accountability agencies. In the context of the APEC discussions, the FTC has been considering how it would best execute that role.

IV. The FTC must continue its role in policy development, both domestically and internationally

The FTC plays a key role in the development of effective, forward-thinking information policy in the United States and around the world. The FTC embraced this role when it held its first workshop on privacy-related issues more than a decade ago. Its domestic policy development work continues with its recent request for comments on the issue of public sector use of the Social Security number and the town hall meeting on behavioral marketing on the Internet scheduled for November 1 and 2.

While policy development is not explicitly articulated in the FTC Act as a role for the Commission, continued FTC involvement in this work is critical to the successful development of sound public policy and effective, efficient consumer protection related to information issues.

This policy development role is especially necessary as the United States and the world economy continues to move more deeply into an economy fueled, structured and motivated around the collection, use, analysis and sharing of information. This transition fundamentally challenges application of laws and regulations originally enacted to respond to the demands of an industrial economy and the early years of computerization. The FTC has become, and should continue to be, a key venue for development of policies to address new developments in the information economy.

The FTC has been significantly involved in the development of global processes to protect consumers in global markets. Just as data flows and valuable uses of data occur across borders, criminals also can act regardless of national boundaries. The FTC has been actively participating in alliances to develop international governance structures for international data flows. Led by Commissioner William Kovacic, it works through the OECD Working Party on Information Security and Privacy (WPISP) to develop protocols to enable cooperation between law enforcement bodies of various countries to promote privacy protection. The FTC also works with the Canadian Federal Privacy Commissioner to foster cooperation with this leading trade partner.

Additionally, the Commission has been deeply involved in development of the APEC Global Framework. The FTC is an active participant in the APEC Data Privacy Subgroup, and part of the Subgroup's Working Party on Cross-border Privacy Rules. Ministers of APEC countries, including the United States, approved a project to develop protocols for approving corporate rules covering the transfer of data across borders just 2 weeks ago. Once developed, these mechanisms would protect American consumers as data that pertains to them moves throughout the Asia Pacific region. Under Commissioner Pamela Harbor's leadership, the FTC has taken a leadership role in developing these protocols, demonstrating to other APEC economies the serious commitment of the United States to ensuring the privacy and security of its citizen's data and the APEC Privacy Framework.

To facilitate these efforts, the FTC restructured its staff this year to merge all international activities into a common office that reports to the Office of the Chairman. The FTC's work in international forums should be acknowledged as part of the reauthorization and supported in future FTC budget requests.

V. Conclusion

The challenges raised by the fast approaching developments in the information economy cannot be met with yesterdays solutions. Protecting the privacy and security of consumers' information will require robust information policy that responds quickly and effectively to the issues raised by emerging technologies, business analytics and international exposure. The FTC began the information policy process in the United States over a decade ago. That effort has been an adjunct to its consumer protection mission, and while admirably carried out, not sufficient for tomorrow's challenges.

Development of solid information policy guidance requires a better-funded FTC with a defined mission to develop information policy guidance for the United States and to participate in international policy development related to privacy and secu-

rity. It also requires research into new, creative mechanisms for enforcing privacy and security requirements in a rapidly evolving marketplace. It means staffing with technologists and other experts who will work with academia, industry and civil society to develop tomorrow's answers. The FTC must find ways to delegate and oversee mechanisms to resolve consumer disputes. Finally, this mission must include participation in international policy forums in a capacity co-equal to international data protection authorities. Congress' role in this effort is to clearly charge the FTC with this mission and encourage its success through regular oversight.

Thank you again for the opportunity to testify. The Center looks forward to working with the Committee and the Commission to develop innovative, balanced solutions to information privacy and security issues that foster a vital, safe marketplace.

ATTACHMENT

S2 Intelligence—May 2007

THE FUTURE OF BUSINESS ANALYTICS

Bruce McCabe

The rate at which digital information is being produced is increasing exponentially. At the same time, computer scientists are making it possible for machines to navigate new information landscapes, conduct deeper and more sophisticated analysis of what they find, and deliver the results in more usable and timely ways to managers. This paper looks at how business analytics will change over the next 10 years, the impact of these changes on organisations, and how this will lead to new opportunities and challenges in the workplace.

Introduction

In recent years, business analytics has become a topic of particular interest for managers; the combination of new software capabilities and large amounts of usable data has been delivering consistently good results for organisations in every industry. A study of IT projects delivering greatest value in Australia identified business analytics as one of three dominant themes [1] and global companies such as Amazon, Capital One, Marriot International, UPS and Proctor & Gamble have secured substantial competitive advantages through superior analysis of their data assets.[2] Analytics solutions (there is usually more than one) can be found in every corporation and every major government agency, and IT managers are discovering, to their surprise, that the investment needed is often relatively modest compared to the value returned. Common applications of analytics in organisations are listed in Table 1.

Table 1.—Common Applications of Business Analytics

Sales trends and forecasts	Production scheduling
Cross-sell/up-sell recommendation	Inventory optimisation
Marketing campaign effectiveness	Supply chain bottlenecks
Product mix in stores	Product quality analysis
Retail layout, shelf allocation	Predictive machine maintenance
Contextual placement of advertising	Manufacturing process costing
Website structuring and linking	Asset deployment/utilisation
Shopping patterns, purchasing triggers	Human resource benchmarking
Capacity utilisation in airlines, hotels	Salary/productivity benchmarking
Service priority in call centres	Warranty trends
Call centre efficiency	Network security/threat detection
Frequently asked questions generation	Assessing operational risk
Expense budgeting	Fraud detection
Procurement optimisation	Money laundering detection
Distribution channel selection	Credit risk for loan approvals
Logistics modelling	Loss risk in insurance
Scheduling and routing of vehicles	Likelihood of future illness

This paper sets out to examine the future and answer the question: *How will emerging technologies shape the way analytics are used in business over the next 10*

[1] McCabe, B., 2003, *High Value Projects in Australian Enterprises,* S2 Intelligence.

[2] See Davenport, H., 2006, "Competing on analytics," *Harvard Business Review,* vol. 84, no. 1, pp. 98–107.

years? It is written for business people. The main focus, therefore, is on business outcomes, not IT projects; all managers can use it as they plan for emerging opportunities, challenges and changes through to 2017.

Sponsorship

The publication of this paper was kindly sponsored by Business Objects Australia Pty Ltd, a supplier of business analytics solutions. More information can be found at *www.australia.businessobjects.com.*

Using this document

The discussion in this paper is presented in two parts. Part I describes the key technology trends shaping the future of analytics. Part II describes how analytics will shape the future of business.

Predictions are made throughout this paper. Predictions are valuable for planners because they force the researcher to distil complex ideas into best guesses, based on what is known now, and give the lay person a single crystallised picture of a likely future. They offer a point that can be communicated and debated, and which can trigger new ideas.

To get the most out of this document, managers are encouraged to discuss these predictions with colleagues in the context of the products, services, markets, competitors and goals applicable to their own organisation.

While the predictions are written as if factual statements about the future, they are, of course, nothing of the sort. Many assumptions—about the pace of technology development, commercial value, social acceptance and rate of deployment—lie behind each. The only prediction that can be made with absolute certainty is that real outcomes will vary in scale, detail and timing—especially timing.

Managers are encouraged, therefore, to also read through the underlying technology trends described in Part I. By being conscious of these trends, they can equip themselves to adjust their plans when they encounter new technologies and hear about new breakthroughs.

Terminology

The most useful way to discuss the future is to set boundaries broadly enough to capture everything that matters. For the purposes of this document, therefore, S2 Intelligence defines *business analytics* as *computer analysis of information to assist managers with business decisions.*

This definition includes data warehousing, data mining, business intelligence, enterprise performance management, date visualisation, executive dashboards, supply-chain analytics and many other themes current in business today. It is also broad enough to include future, yet to be seen analytics methods and applications.

When the word *routine* is used in predictive statements (*e.g.,* "managers will routinely track online sentiment ratings") it refers to when a technology or practice has been adopted by a wide range of organisations (*i.e.,* not just leaders and early adopters) for everyday use.

A *knowledge worker* is a person that works primarily with information (as opposed to applying physical or manual skills) in their day to day activities.

When referring to the size of organisations, the following Australian Bureau of Statistics derived conventions are used: *small* enterprises employ 1–19 people; *medium* enterprises employ 20–200 people; *large* enterprises employ 200 or more people.

Methods

The primary source of data for this report was the repository of approximately 700 face-to-face and telephone interviews conducted by S2 Intelligence with computer scientists, IT practitioners, researchers, business executives, policy-makers and technology leaders since 2005.

Secondary sources include academic journals, conference proceedings, websites relating to emerging analytics products and services, and previous S2 Intelligence research where business analytics has emerged as a theme. These are referenced in the text.

On completion, a draft copy of this paper was sent to 18 computer scientists, researchers and product managers with expertise in various aspects of business analytics. Feedback received from them was incorporated into the final version before publication.

Feedback

S2 Intelligence continuously revises and updates its forecasts: all comments, ideas and alternative viewpoints on this document are warmly welcomed and can be sent to *Info@s2intelligence.com.au.*

Part I: Technology Trends

The key technology trends shaping the future of business analytics relate to the information that can be analysed, the sophistication of analysis that can be performed, and improvements in how results can be delivered. These may be thought of as analogous to the same three themes that define the capabilities of all computer applications—input, processing and output.

1. Processing and storage hardware

The cost of processing power and computer storage will continue to fall steadily. This is a fundamental trend that underpins advances in all types of computer applications. It will be driven in part through continuing advances in design sophistication and manufacturing processes. It will also be driven by increasingly efficient use of hardware as organisations move to server and storage farms and apply new techniques to allocate workload more evenly across these assets.

2. Information volume

The volume of digital information being produced will continue to grow at an extremely rapid rate. No-one can quantify this exactly, but we can get some sense of scale from a 2003 study that estimated the amount of new information being created every year, and stored on print, film, magnetic, and optical storage media, to be 5 exabytes per annum—an amount equal to the information contained in 37,000 libraries the size of the U.S. Library of Congress.[3] The majority of this is stored on hard disk drives, and annual production is estimated to be growing by 30 percent year-on-year. These calculations, it should be noted, apply only to new information-they exclude duplication of existing information.

Wherever new pools of business information are created in digital form, new analytics opportunities will follow closely. An example of this has been in the creation of purchasing data. Early adopters of electronic requisitioning and procurement systems reported their biggest financial benefit came not from efficient use of supplier discounts or fewer purchasing errors, but from analysing the new data they had on their purchasing.[4] Other new pools of data include audio, video and spatial data, described in the pages below.

Not all digital information, however, is analysable by computers. We can think of this in terms of the illustration in Figure 1. The outer cloud represents the total pool of digital information-growing fast but much of it off limits to computer-based analysis. The inner cloud represents the pool of analysable information, which is expanding as (a) software gets better at dealing with unstructured data, and (b) machine-friendly structure is added to some types of information.

3. Unstructured information

Most new digital information exists in the form of text, images, audio and video that has little structure or organisation. While it is relatively easy for humans to analyse small portions of it (by browsing the web, reading through documents and making notes, for example), computers run into difficulties because they are best at processing information that is highly structured (organised, for example, using standardised formats, fields, records, labels and hierarchies).

An especially important trend, therefore, will be steady improvement in the ability for computers to navigate and process unstructured information through natural language processing, search, inference and categorisation.[5]

4. Structured information

Separately, more structure is being added to various information landscapes through wider application of machine-readable labels, tags and rules (metadata) that act as signposts for computers, enabling them to contextualise the information that they find.

Adding structure data in this way is powerful, but it also requires agreement on labels, tags and rules by all interested parties. Consequently, industry wide standards initiatives—which must factor for competing needs across thousands of organisations—will remain slow. Faster progress will be concentrated where there is especially strong value in undertaking this work, and where a few dominant players can force the pace. Where industry wide initiatives gain traction (the strongest

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[3] See *How much information? 2003* at *http://www2.sims.berkeley.edu/research/projects/howmuch-info-2003/*.

[4] McCabe, B., 2003, *Supplier Relationship Management in Australia and New Zealand,* S2 Intelligence.

[5] GeneWays is an example of natural language processing applied to analyse unstructured research articles (in this case to identify molecular pathways for healthcare, bioinformatics, and pharmaceuticals purposes). See *http://geneways.genomecenter.columbia.edu/*.

candidates are health and life sciences) they will significantly boost the possibilities for computer-based analysis.[6]

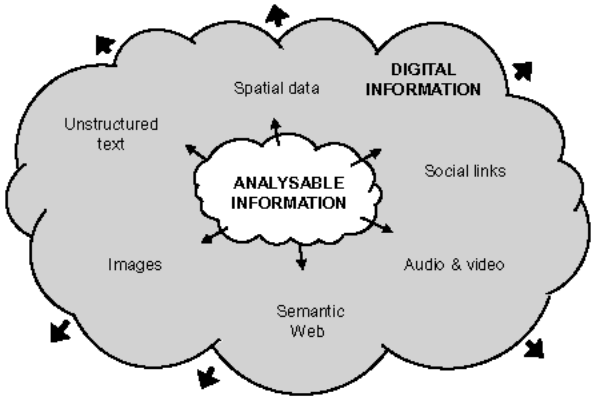

Figure 1: Pool of analysable information

5. Location

Location-based (spatial) digital information will increase exponentially. Much of this will be accompanied by time-based information. A key driver is the proliferation of spatially aware radio devices—mobile telephones, WiFi, GPS, radio-frequency identification (RFID) tags, wireless sensor networks—as the costs of these technologies fall. Other drivers include the dramatically improved usability of online location-based services (especially via spatial browsers such as Google Earth/Maps). These enable businesses to "mash-up" information, services and maps and publish these to any employee or customer that has access to a browser, for almost no cost. As location-aware devices and services proliferate, so too will the amount of useful data stored within organisations, most of it in a structured form that lends itself well to analytics.

6. Images, audio and video

The ability to interpret the contents of digital images will improve steadily. Analytics software will move beyond mining textual metadata associated with images (*i.e.,* the descriptions and tags stored with them) to analysing the content of many images on the fly.[7,8]

Continuous media, in the form of audio and video files, are extremely rich in information. At the same time, however, they are notoriously difficult for computers to navigate and interpret. Business analysis is typically limited to what human operators can watch/listen to and write up in reports. For most businesses this means audio and video is excluded from computer-based analysis.

Steady progress is being made in technologies to navigate and analyse continuous media files. The quantity and value of this information, especially collected via the call centre, and posted on the web, provides a strong imperative to apply it in business.

Developments in the application of natural language technologies to transcribe the speech found within continuous media files are especially important. When soundtracks are converted to text they can be much more easily searched and analysed. A ready benchmark for progress here is the quality of current online services for searching video.[9]

Structure is also being added to continuous media files. Researchers have developed new languages for describing and time-stamping events within clips, and new

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[6] The Semantic Web is an important set of initiatives aimed at applying more structure to the web to make it easier for computers to navigate. See *http://www.w3.org/2001/sw/* for information on current activities.

[7] See Polar Rose, *www.polarrose.com,* for an application of analytics to online images today.

[8] A recent paper about the cutting edge of image search and retrieval is Carneiro, G., Chan, A.B., et al, 2007, Supervised Learning of Semantic Classes for Image Annotation and Retrieval, *IEEE Transactions on Pattern Analysis and Machine Intelligence,* Vol 29, No 3, pp 394–410.

[9] See, for example, *www.blinkx.tv.*

containers for keeping descriptions with the audio or video component.[10] As these mature, continuous media files will be transported across the web with fully transcribed, time-sequenced audio tracks, and will become as easy to analyse as ordinary text.

7. Social links

Social networks are important targets for analysis. Identifying relationships between people, their interests, and other people is extremely valuable in business, and the proliferation of websites offering services built around sharing, collaboration and networking, a phenomenon sometimes labelled "Web 2.0" is driving an exponential increase in information relating to connections between people.

This type of information is already associated with structures that can help computer navigation, including e-mail directories, links through citations, dates on blog entries, and common membership of online communities[11] and business workgroups. Semantic web initiatives will play a role in providing structure as well.[12]

Computer scientists are making rapid progress in analysing this type of data for business purposes. An example is conflict of interest detection, where experimental systems are detecting potential conflicts by analysing multiple online social networks together.[13]

8. Search

The link between developments in search technologies and developments in business analytics will get stronger. Computers must be able to find data before they can analyse it. Each step forward in refining the outputs of search engines also represents an improvement in the data that can be sourced for analytics engines. Specialist audio mining tools already allow, for example, keyword searches of news clips, earnings announcements and recorded briefings. This also applies to search within organisations: enterprise search is rapidly improving in scale and sophistication and soon every knowledge worker will have the contents of their PC indexed by a desktop search engine. The parallels with search extend to interfaces, with analytics software progressively adopting the flexibility and familiarity of search interfaces to improve accessibility by non-specialist employees.

9. Broader, deeper insights

Computer scientists are pushing ahead in a range of fields—machine learning, data modelling, simulation, categorisation, abstraction, inference engines, heuristics and constraint programming—that will make computer analysis deeper, more accurate, and more useful.

Analytics systems will be able to consider more variables when producing recommendations. Advances in constraint programming will see business computer systems consider more variables when producing recommendations. The quality of analysis of the complex, multivariate problems common in logistics, scheduling, and rostering will improve steadily.

The emphasis in analytics systems will steadily shift from measuring to modelling business trends and processes. Machine learning methods will help computers generate their own data models, instead of being constrained to human-generated models when trying to identify correlations and relationships.[14] Analytics systems will progressively incorporate the ability to identify gaps in their own knowledge.

10. Presentation and usability

In business situations, timely approximations can be invaluable, while analysis that arrives after a decision has been made is worthless. As the scale and complexity of information fed into business analytics increases, so too will the importance of abstraction, summarisation, delivery and presentation. The most valuable systems will be those that distil data from many sources into simple pictures that managers can digest and act on quickly. Technology developments will produce systems that become progressively better at:

- Producing simpler and more visual data views and reports.

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[10] An important example is *www.annodex.org.*

[11] *E.g.,* LinkedIn and MySpace at *www.linkedin.com* and *www.myspace.com.*

[12] See, for example, The Friend-of-a-Friend (FOAF) Project, *www.foaf-project.org.*

[13] See, for example: Alaman-Meza, B., Nagarajan, M., et. al,, 2006, "Semantic Analytics on Social Networks: Experiences in Addressing the Problem of Conflict of Interest Detection," *Proceedings of the 15th international conference on the World Wide Web,* pp 407–416, Edinburgh.

[14] The STaRControl project exemplifies advanced modelling and machine learning in the context of traffic analysis. See *http://nicta.com.au/director/research/projects/s__to__z/star/starcontrol.cfm*.

- Allowing data views and reports to be generated by non-specialist employees.
- Abstraction and summarisation, to give managers more concise output and more specific recommendations.
- Learning from previous requests so that information is displayed in the order and priority that individual users prefer.
- Assessing timing, so that software fades into the background during "business as usual" periods but actively pushes information to users when it is of high relevance or urgency.
- Tailoring output to suit the device (*e.g.,* phone, PDA, laptop, web browser) and context (static, mobile, making a tactical decision or preparing a strategic plan).
- Being easily accessible from familiar and everyday applications such as Microsoft Office.

11. Software as a service

An increasing proportion of all business software will be provided to customers in the form of a service that is accessed over the web, as opposed to a product installed in the customer's business. This is a gradual, but fundamental IT trend. The important technical drivers are improvements in software architecture, integration technologies (see Section 12) and network infrastructure.

Economic drivers are equally important. Decision makers are attracted to the notion of no upfront investment, predictable annual costs, and leaving the management of software, including upgrades and patches, to providers. Pricing and service models will mature rapidly through the next 5 years.

12. Web services

Global take-up of web services—ubiquitous web based standards for software integration—will make connecting software applications within and between organisations dramatically more cost effective. As the cost of integration falls, and major software suppliers gradually move to supply their products in more modularised form, it will become easier to connect analytics engines with financials, office productivity software, specialised purchasing software, planning and collaborative tools, CRM packages other analytics systems and any number of applications and information services available on the web.

This trends applies to individuals as well as organisations: it will become steadily easier for any individual to put together and publish their own integrated combinations of web applications, as we are seeing with mash-ups of mapping services today.

13. Privacy preserving technologies

The maturation of technologies that allow rapid analysis of distributed data will make it much easier for organisations to analyse shared information. Shared analysis will get easier for individuals, collaborating workers, and public communities of interest.[15]

An especially important driver will be privacy preserving technologies that automatically strip identifying data from customer records. These are already being applied in the healthcare domain to help researchers locate, aggregate and simultaneously analyse patient data residing in many different hospitals, institutions and laboratories.[16] Advances in software integration (Section 12) will also be important.

There is a strong imperative to do this better: shared analysis is important between trading partners that collaborate closely (between big retail chains, for example, and their suppliers of fast moving consumer goods), but is slowed by negotiations and manual data preparation and cleaning procedures.

14. Human inputs

Analytics systems will incorporate more inputs directly from humans. When workers combine on-the-spot observations with what they know about the global picture their personal analysis is very valuable. Steady improvements in interfaces, machine learning and inference-making will see more of this captured by systems to refine reports, forecasts and recommendations. Community effects, as pioneered in blogs, wikis and other collaborative models on the web, will also be harnessed this way.

Sophisticated combinations of human and machine analysis are already found in hybrid share trading systems that combine algorithmic trading with decisions made

[15] Swivel and Many Eyes are examples of open websites for shared exploration and analysis of data. See *www.swivel.com* and *http://services.alphaworks.ibm.com/manyeyes/home.*

[16] See the Health Data Integration project at *http://e-hrc.net/hdi/* and the CSIRO's Privacy Preserving Analytics at *http://www.csiro.au/science/ps59.html.*

by human brokers in the securities industry. Specialist solutions are also emerging to analyse combinations of objective and subjective data for human resource management.[17]

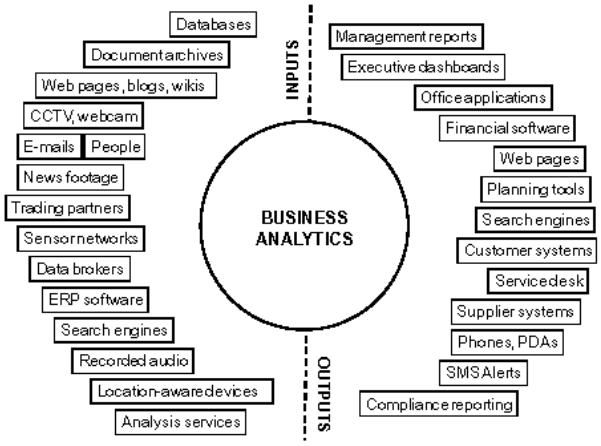

Figure 2: Business analytics ecosystem

15. Affordability

Research and development of new analytics technologies will continue to be driven in sectors where there is highest value. As with most information technologies, broader adoption will follow as technologies mature, fall in price, and become available from more providers.

The very large relative research and development investments mean that defense and healthcare in particular will continue to provide leading indicators for technologies that will eventually find their way into all businesses.

New technologies will generally follow a top-down progression from initial adoption by corporations to adoption by medium and then finally small businesses. Some will become consumer technologies. A similar progression will apply within organisations as it becomes cost effective to deploy analytics to more departments, employees and devices.

16. An expanding ecosystem

Based on many of these trends, we can picture analytics systems as ecosystems, as illustrated in Figure 2, that are accepting inputs from an ever wider range of sources, and producing outputs for an ever wider range of destinations.

Part II: Business Impacts

This section describes how analytics will shape the future of business. The discussion moves back and forth between three levels: *industry*—changes to interactions between organisations; *organisation*—how organisational capabilities, routines and norms will change; and *individual*—changes that individual workers will experience.

17. Embarrassment of riches

Through 2017 the data coming online and made available for businesses will outstrip the capacity to analyse it.

All organisations will continue to balance infrastructure investments against the analytics capabilities they would like to build. Falling costs in storage, servers and network bandwidth will be insufficient to keep up with demand to perform complex analysis more often, on more data, by more employees. Companies will constantly be surprised by the sheer volume of data they are generating and collecting.

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[17] An example of this combination is found in the Mentor system (*www.corporate knowhow.com*).

By 2010, the notion of the information lifecycle, with limits placed on how long some types of information should be retained, will become very important.

Today, on average, companies only utilise 42 percent of internal data that relates to their customers.[18] In 2010, because the data pool is so much larger, they will struggle to improve on this figure.

By 2011, almost all large organisations will have dispensed with "keep everything" strategies for business data. Managers will routinely consider one of their major IT challenges to be choosing what data to throw away, lest they use up storage capacity too rapidly.

More and more companies will turn to service providers (see Section 18) so they can access storage and processing power on an on-demand basis.

Through 2013, at least one in two organisations that invest in business analytics as a key corporate strategy will experience problems with projects that attempt too much too fast.

By 2014, industry leaders will be defined as much by the data they choose not to use as by the data that they use.

In 2017, even leading proponents of business analytics will rarely exploit more than 10 percent of the quality business data that is both available and relevant to their context.

18. The analytics economy

We will see rapid shifts as businesses capitalise on opportunities to provide data services, and perform data analysis, on behalf of other companies. Many of these "analytics service providers" will aggregate data and translate it between formats as part of the value they deliver.

The most successful analytics service providers will offer access to deep expertise, specialist skills and experience. Their value proposition will be further enhanced by superior IT infrastructure and the processing power they can bring to bear on a problem, and they will invest in (or partner with providers of) large-scale server and storage facilities.

Through 2009, most online analytics services will be aimed at people who will manually navigate to them and access their analysis using browsers.

By 2011, significant online data brokers will be found in every industry sector. Many will have a background in market research, consulting or finance where they built up rich repositories of specialist data. Online retailers will also be pioneers in online analytics services.

By 2012, most specialist research companies (*e.g.,* automotive, demographic, building, real-estate research firms) will be online analytics service providers.

By 2013, almost all analytics services with business value will be computer accessible, where customers can connect their software directly to the service over the web. Very sophisticated services will have emerged. All competitive market research, news, media and advertising businesses will be analytics service providers. Leading finance companies will have adapted in-house market analysis systems to make them available externally as online services to customers. Much of the value provided by advertising companies will be in pre and post advertising analysis.

By 2015 there will be a substantial global economy built up around merchants that buy, sell and rent out their accumulated data on the web.

At this time, dominant trading partners in every industry will make healthy profits from providing analytics services for other organisations. Specialist insurers will sell data and risk analysis services to companies in other sectors. Transportation companies will sell data and analysis to other companies for logistics planning purposes.

By 2016, organisations will routinely blend collections of internal analytics engines and hosted analytics services in such a way that the sources are indistinguishable to users.

19. Collective insights

Organisations that work closely together in partnerships and alliances will steadily find themselves pooling more of their data for combined analysis. These networks will be underpinned by commercial arrangements that specify rental fees and reciprocal rights. These will lead to additional revenues for data-rich companies and new costs for data poor companies.

Through 2011, data sharing arrangements will expand between large retail chains and manufacturers with strong consumer brands. Early adopters of multi-organisational analytics will also be found in the insurance industry (*e.g.,* sharing

[18] CIO Insight, *The 30 most important IT trends for 2007,* November 17, 2006, *www.cioinsight.com.*

across insurance alliances), finance (*e.g.,* sharing between finance companies and mortgage brokers), and business services (*e.g.,* sharing between providers of complementary services).

By 2013, conducting cross-organisational data analysis will be as routine as conducting cross department data analytics is today.

By 2014, data sharing networks will exist that span industries, and facilitate aggregated analysis of information owned by hundreds of organisations at a time. Manufacturers will analyse data owned by retailers, airlines will access datasets distributed across many travel agents, and automotive manufacturers will access datasets distributed across car dealerships. Allied groups of insurance brokers will generate significant new business through the combined analysis of their social networks.

By 2016, data sharing will be taking unusual forms and coming from unexpected places. Taxi companies, toll operators and courier companies, for example, may pool analysis of vehicle movements to gain deeper insights.

By 2017, industry networks will exist that routinely analyse data stored in more than a thousand small businesses.

20. From microscopes to telescopes

Although the customer data owned by an organisation will remain one of its most valuable assets, the vast amounts of external information available, and increased capacity for systems to analyse it, means that the external data pool will quickly outstrip the internal one in scale. All businesses will end up analysing significantly more data residing outside their organisations.

By 2011, managers in leading organisations will understand that competitive business insights depend more on how they interact with an ecosystem of external service providers than on how they process internal data.

By 2013, managers in large enterprises will routinely receive computer generated recommendations based on a thousand times more external than internal data.

By 2017, managers in large enterprises will routinely receive computer generated analysis and recommendations based on a million times more external than internal data.

At this time, companies in the travel industry will monitor cost trends for all destinations they service by crawling massive numbers of web-based data points on room prices, vacancy rates, retail prices and bus and train fares.

21. David becomes Goliath

Medium and small businesses will rarely own as much information as large corporations. Nor will they be interested in the same types of analysis because there is less scope for optimisation in less complex organisations.

Many kinds of analysis will be valuable, however, regardless of business size, including customer profiling, sentiment analysis and market trends analysis. Smaller businesses will also have access to the same data ecosystems, and the same tools as these become accessible as services over the web.

New opportunities for small businesses will also come from "scaling down" the cost and complexity of systems that are only practical for large organisations today.

By 2010, managers in one in five mid-sized companies will access computer analysis of customer and sales data on a daily basis.

By 2013, managers in mid-sized companies will routinely access computer analysis of sales, production, and supply-side information on a daily basis.

At this time, managers in a third of small businesses will routinely access at least one online analytics service on a weekly basis.

By 2014, small business managers will routinely reference benchmarks developed by pooling data from hundreds of their peers. These benchmarks will typically be accessed from within their regular accounting software.

22. Location-aware enterprise

The explosion in location-aware chips, tags and devices will see organisations gain entirely new insights on their assets, staff, customers and products.

By 2010, analysis of real time spatial data for mobile and in-the-field assets such as vehicles and heavy equipment will be routine in transportation, logistics, mining and agriculture.

By 2013, medium and large manufacturers will routinely analyse data on the location, distribution and utilisation of containers, palettes and roll cages.

By 2015, organisations in supply chains for big retail chains will routinely analyse the movements of hundreds of thousands of fast moving consumer goods.

By 2017, asset managers in large finance and business services companies will routinely analyse, from a single console, the distribution and movement of all corporate assets worth more than ten dollars.

23. Walls have ears

Audio and video will quickly grow in importance. Sources will come from within the organisation as well as from outside. An especially widely used source will be audio data from the call centre.

Images will begin to constitute an important source of business data, especially where they are associated with identifying events or changing conditions in a building or commercial environment, or with identifying people and places.

By 2009, insurance companies will routinely use systems that analyse speech for stress and produce real-time risk indicators during calls into claims processing centres. These systems will substantially reduce fraud rates.

By 2011, personal voice risk analysis will be routinely used by sales representatives in all industries to help verify customer buying intentions over the phone. Many of them will do this without the knowledge of clients or their managers.[19]

By 2014, more than half of large businesses will routinely analyse recorded audio in call centres to zero in on anomalies, problem products and customer gripes.

By 2015, the automated analysis of foot traffic via CCTV, once only available to managers in casinos and supermarket chains, will be available as a cheap webcam plug-in and routinely used by small retailers routinely to optimise window and shelf displays.

By 2016, audio data mining will be used by one in two large organisations to tune the methods of tele-sales and over-the-counter sales people.

By 2016, large organisations will routinely use software that recognises voice patterns to produce rich insights on when and how customers contact them.

24. Sentiment tracking

Business analytics systems will be able to take advantage of new algorithms to draw inferences from material in discussion forums, customer feedback, e-commerce and auction sites, news clips and analyst reports to infer overall positive or negative sentiment about companies and products.

As sentiment analysis develops and becomes more realistic, it will turn into a key metric that is monitored daily in all businesses and industries. Investors and consumers will change their behaviours based on the sentiment analysis available to them.

By 2010, online sentiment analysis will be routinely offered as a service by market research and advertising companies.

By 2012, sentiment analysis will be routinely used by companies to analyse customer feedback and recorded audio from the call centre, to improve customer service outcomes.

By 2013, managers working in companies with high profile consumer brands will routinely perform sentiment analysis of audio, video and textual news feeds. During periods of adverse publicity (*e.g.,* product recalls) they will benchmark impact against preceding months, and monitor progress as public relations campaigns try to repair the damage.

By 2014, corporate sentiment analysis will incorporate continuous crawling of blogs, product rating websites, news services and social networking websites for mentions of the company and its products, scoring relevant comments as they go. Managers will routinely monitor changes in goodwill and market sentiment on a weekly basis, not only for their company but also for their biggest competitors.

At this time, brokers will routinely use sentiment analysis in valuations and share trading. Sentiment analysis will be widely applied by individuals to score online feedback posted about hotels, restaurants, airlines and travel destinations.

By 2015, high profile professionals and executives will routinely monitor "personal brand awareness" based on how frequently their name is mentioned and in what context.

By 2016, random online searches for information on products will be returned with customer satisfaction "meter readings" for both the target item and nearest equivalent products from alternative suppliers.

By 2017, executives and company spokespeople will routinely face shareholders that call up, with a few mouse clicks, an overall analysis of everything they have ever said publicly on a topic.

25. Reputation wars

The developments described above will lead companies to move beyond monitoring to using technology to actively manage and influence online sentiment.

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[19] AVS is an example of a commercial voice risk analysis solution (*www.digilog.com*), and Kishkish is another, available as a downloadable plug-in for Skype users (*www.kishkish.com*).

By 2014, companies in the public relations industry will routinely offer automated services to help skew online sentiment results and boost online reputations.

By 2015, the "reputation wars" between reviewer and reviewed will take on the resemblance of a subtle but ongoing arms race. Leading providers of sentiment analysis services will be continuously refining their methods for detecting manipulated data, and for assessing the trustworthiness and integrity of online sources. They will routinely exploit social networking data to detect relationships between the reviewer and the reviewed.

26. Knowing who you know

Managers will get very powerful outcomes from social network analysis. Early applications will continue to have an inward facing flavour, but sophisticated online tools will also open up a world of new insights. This will produce new social challenges.

By 2009, large organisations will routinely analyse the structured information in e-mail and internal directories to help find people with specialised knowledge, or social connections relevant to a task.

By 2010, a variety of services will be available online that automatically produce social network analyses on any person for anyone that wants it—for free.

By 2011, entrepreneurs will routinely use web-profiling to find social connections to secure deals. Sales reps will automatically profile prospects before calling. Managers and employment companies will profile job candidates as a matter of course.

At this time, managers in companies of all sizes will routinely use online tools to mine people and associations from news stories, blogs and company websites.

By 2012, online conflict of interest detection will be undertaken routinely and automatically during legal disputes, company acquisitions, hiring and selecting contractors.

By 2013, online social network analysis will routinely incorporate information on the identity of people that appear in digital photographs.

At this time, job candidates will often find themselves confronted with interview questions about associations with "undesirable" people or organisations, even if these associations were made accidentally.

By 2017, large companies will routinely mine digital recordings of internal seminars, training sessions and planning meetings to improve the mapping of social networks and knowledge associations between employees.

The analysis of social network and unstructured data within organisations will produce new workplace challenges. Many organisations will experience disruption as employees object to having their e-mail archives mined for associations. Other challenges will come from increased scrutiny of personal activities and connections. Companies that execute well will be careful to preserve privacy and give individuals strong personal control over information sources that are analysed.

27. ROI-per-customer

The notion of being able to quantify the value of individual customers, something that already exists in many organisations, will become much more comprehensive. Analytics systems will produce insights on cost, risk and profitability for individual customers, taking into account such things as call volumes, preferred communication channels, product mix, location and sentiment analysis.

By 2011, dashboards used by customer service and sales personnel in banks will routinely emphasise predicted customer value over current/historical value.

By 2013, large organisations will routinely use data from their customer base to model projected take-up, rate of return and profitability for new products and services.

By 2017, businesses will routinely use projected ROI-per-customer as inputs to their long term planning.

These developments will create new social challenges as ROI-per-customer metrics change the behaviour of service and contact centre personnel. Many organisations will experience customer backlash and adverse publicity as the service levels begin to mirror customer scores. Advanced organisations will quickly learn to accompany deployments with new procedures and significant training and education programs.

28. Bottom-up optimisation

Local analytics systems will connect and collaborate with one another across complex supply chains and business networks. Such arrangements will allow managers to make decisions based not only on rich local information, but also armed with insights about the impact of their decisions on other links in the chain. By empowering local decision-makers this way, connected analytics systems will help optimise trading systems from the "bottom up."

By 2012, supply networks in transportation, fresh food distribution, and fast moving consumer goods will routinely employ distributed analytics systems that interact and exchange information with one another. Businesses in these networks will significantly improve profit outcomes during adverse events and changeable conditions.

By 2016, distributed analytics systems will be deployed in all types of collaborative trading networks (including in services sectors) that are complex or changeable and cannot be modelled from the top down.

29. People meters

While human resources (HR) management will remain a domain dominated by subjective assessments of factors such as morale, job congruence, performance, skill levels, leadership and peer collaboration, computer analysis will play a growing role.

By 2009, managers in large organisations will routinely reference computer analysis when reviewing sales performance, salaries and expenses.

By 2012, comprehensive H.R. analytics solutions will be routinely deployed by management consulting companies as part of their organisational change methodologies.

By 2013, managers in large enterprises will routinely use dashboards that combine quantitative and qualitative human resource metrics for individual departments and projects. These will provide actionable insights on where to invest in training, where reporting structures are inefficient, and where changes to work allocation and staff roles need to be made to address bottlenecks.

By 2016, as H.R. benchmarking becomes more sophisticated, and bigger datasets are collected, large enterprises will build whole-of-company models to analyse human resources allocation and performance, and senior managers will routinely access cost versus return estimates for individual employees.

In organisations where these tools are applied well, employees will find themselves in a more attractive workplace where managers are armed with new and creative ideas, where there is a feeling of constant refinement of management practices, and where individual strengths are better recognised and utilised.

Considerable learning will be required, however, and many organisations will apply these metrics poorly. In these workplaces, employees will find themselves stifled by managers that frequently defer to standardised benchmarks at the expense of a deeper understanding of individual strengths and motivations.

30. 360° performance reviews

Performance reviews will progressively become more realistic. The notion of scoring performance and paying bonuses based solely on targets set at the beginning of the year will disappear. This will impact the way performance is measured for all managers and employees, but through the next 10 years the main focus will be on sales representatives and senior executives.

As these practices become more common they will transform expectations. Top performing executives and sales people, for example, will only want to work for organisations where performance is analysed realistically.

By 2015, sales representatives will be routinely compensated for performance against a basket of metrics that include the performance of peers, competitors, and the market as a whole.

By 2018, customer service personnel will be routinely compensated for performance against a basket of metrics including indices of customer satisfaction before and after calls, overall satisfaction across the client base, and an online sentiment index.

31. Latency and velocity

Analysis will become more tightly linked to information sources over time, with fewer instances of people having to manually write-up, summarise or reenter information.

The automation of information collection will be one factor. Examples include palettes and containers broadcasting their location and status in warehouse, loading bays or trucks via RFID chips, and moisture, salinity and temperature data feeds from distributed sensor networks in agriculture. Additionally, as integration becomes easier and cheaper, we will see more connections between machines that supply information and machines that analyse information.

Managers will receive insights that are progressively more timely. By exploiting information much sooner after it is created, they will make earlier and more effective decisions. Delays in critical business information will, however, remain a fact of life.

Outside the organisation, shareholders and analysts will receive increasingly timely analysis and will also embed this in their decisionmaking. A side effect will

be a further shift toward "day trading" and some increased volatility in financial markets.

By 2009, executives in the mining sector will routinely access, on a daily basis, accurate analysis of the profitability of each mine site. This will be calculated from continuous monitoring of data on input costs, deployment of assets and personnel, excavation rates and processing yields.

By 2012, managers will routinely access analysis on the status of manufacturing, warehousing, transportation and direct sales operations that is accurate to within 5 minutes.

By 2013, more than 65 percent of Australian Stock Exchange trades will be executed by autonomous and semi-autonomous dealing systems.

By 2015, leading organisations will see more than half of the digital information created in an organisation imbedded in analysis used by senior managers within 48 hours of it being created.

In 2017, near real-time analytics will be widely available in specific operations, but no large organisation will have achieved a capability where senior managers can access up-to-the minute assessments of financial position for the business.

Much is made of the goal of the "real time enterprise," so why won't it happen? Some of the inhibiting factors have been described below in Section 34. Additionally, it will be impossible to eliminate human delays—in updating information like progress reports, new hires, expense claims, etc—and also delays in receiving information from channel partners and contractors. More importantly, the imperative to have real time access to the "big picture" is imaginary. Senior managers don't need (and won't pay for) systems that tell them the financial status of a business on an hourly basis: at that level of granularity they cannot distinguish between fluctuations and trends, and the organisation is incapable of reacting that quickly to decisions.

32. Bottlenecks within

As speed of information becomes an ever greater competitive necessity, analytics will increasingly be applied to the efficiency of information systems themselves.

By 2010, businesses will routinely benchmark the time it takes for sales and service staff to access key information (including analytics outputs) while in the field.

By 2011, large enterprises will routinely use computer analysis to isolate unnecessary/problematic traffic to improve e-mail practices and reduce "e-mail overload" problems.

By 2014, top-100 companies will routinely embed analytics in business process outsourcing arrangements. Software will continuously monitor request and response times. Partner managers will review service performance metrics on a daily basis. The same metrics will be mirrored to the customer relationship manager working for the outsourcer.

33. Goodbye to budgets

Organisations will move slowly toward budget-less management, where fixed annual budgets are abandoned and replaced by continuous analysis of spend versus return. This will progressively free personnel from onerous bottom-up budgeting, and will make organisations more adaptable and responsive to change.

By 2011, large companies will routinely analyse whole-of-enterprise procurement data to identify opportunities to consolidate purchases and get additional discounts "on the fly." These insights will be imbedded in requisitioning systems and accessed by purchasing officers when they place orders.

By 2014, at least a quarter of large businesses will routinely use budget-less management in selected projects.

By 2017, at least a quarter of large businesses will routinely use budget-less management in one or more business units. In advanced organisations, accounting departments will morph into support services, spending most of their time providing on-demand ROI projections to managers.

34. Cultures of confidence

Data quality, and ensuring managers can trust the outputs of analytics systems, will continue to be an important challenge.

A contributing factor will be the continuous addition of new sources of information (especially external sources where there will be duplication, and big variations in quality and consistency). Mergers and acquisitions will play a role as well.

At the same time, analytics systems will become better at calculating and communicating confidence levels and probabilities associated with their outputs. Greater transparency of confidence levels in computer analysis will build trust in them, which will in turn accelerate adoption.

By 2009, large services organisations will routinely offer company-wide training on best practices in information management.

By 2011, many businesses will have simple, organisation-wide, terms for describing quality and confidence levels associated with reports and forecasts.

By 2013, these will be routinely institutionalised in policies and decision processes. Certain product decisions will only be allowed, for example, if predictions reach a "Level 1" (high) confidence level, while market communications will be adjusted mid-campaign on "Level 3" recommendations if they are the best available.

By 2013, the proliferation of external analysis services being used by different departments will make selecting and quality controlling external data resources a key focus in large businesses.

By 2014, specialist knowledge workers will routinely look up the confidence and quality levels for their business reports with a few mouse clicks.

Managers in retailers, logistics centres and mine sites will routinely click through reports to see archived CCTV and web cam footage that provides a deeper understanding of the causes of changes or adverse events.

By 2016, senior executives will routinely view aggregated confidence levels for top-level financial analysis with a few mouse clicks.

In 2017, large companies will still be striving for, but never achieving, "one version of the truth" where everyone in the organisation references the same analytics derived from the same high-quality and universally consistent sources.

35. Silicon and cerebrum

Organisations will get steadily better at combining analysis made by people with analysis made by computers. Human inputs will become an important way to improve quality of analysis. Analysis and collaborative planning tools will merge. Differentiating between human and machine contributions will become impossible.

By 2011, knowledge workers will routinely share insights with one another by posting ad hoc analysis, data visualisations and comments on web pages. Popular, useful creations will then be adopted widely within organisations.

At this time, organisations will routinely link software to websites that exploit "wisdom of crowds" principles via popular tagging or voting, or facilitate analysis mash-ups, to create new sources of business intelligence.

By 2013, when managers get together to make quarterly sales projections, they will not only take into consideration computer predictions, but their projections will also become inputs to the analytics system. Each will inform the other to improve accuracy over time.

By 2015, managers in leading organisations will routinely submit new monthly reports in forms designed to be read as easily by machines as by people.

By 2016, workers will routinely note any discrepancies between what computer analysis is telling them and what they are actually seeing. Their inputs, along with comments on likely causes, will be used to continually refine quality of analysis. A point of sale manager in a retail chain may note that sales of some items go up when it rains and others only when petrol prices are high; shortly afterwards, an administrator will be prompted to add 24-hour weather and fuel price data feeds into the system.

By 2017, top level managers will routinely use combined human and machine projections to model industry scenarios for long term strategic planning.

By 2018, one in five large enterprises will combine the management of human and computer knowledge in the organisation into one strategy.

36. Knowing what you don't know

Self-learning capabilities will be progressively incorporated into mainstream business systems, moving them beyond predictions based on static models.

By 2012, managers in telecommunications companies will routinely access systems that become better at predicting profitability for handset/plan combinations by self modelling handset cost, network cost, call volumes, call times, mix of local and long distance, use of non-voice services, credit risk, handset upgrades, and network upgrades.

By 2013, managers in transportation, logistics and distribution companies will routinely use systems that automatically accumulate knowledge about the effects of urgency, loading times, different types of goods, traffic congestion, vehicle reliability and weather.

By 2017, analytics systems will routinely send suggestions to the IT department for trials, experiments and new data sources that can fill knowledge gaps, produce deeper insights and generate better predictions.

37. Securing information experts

The new opportunities presented by business analytics will have an effect on roles and responsibilities at all levels in the organisation.

The role of the most senior IT executive will progressively see more emphasis on information over technology, making the title of "Chief Information Officer" a more accurate reflection of the role. We will see a trend toward multiple senior technology managers, each specialising in either strategic innovation, systems operations, and information management.

Although systems will become vastly more usable by non-specialist personnel, demand for specialist skills will still rise. Information and knowledge management experts will enjoy a higher status as the quality and relevance of computer analysis becomes more business critical. The responsibility for finding, evaluating, selecting and managing external data services will grow in importance, as will the need to institutionalise procedures to continuously improve data quality.

At all levels we will see growing emphasis on analytical, mathematical and software skills associated with managing information. The average knowledge worker will not be asked to become a statistician, but experience relating to information management will become more valuable on any resume.

Like their counterparts in larger organisations, small business managers will also find that new skills are required to compete effectively. The ability to bring together diverse information sources quickly and effectively will become a more significant asset.

By 2011, most large companies will have established competency centres to help business units extract more value from analytics.

By 2013, the analytics capabilities of a large organisation will be limited more by its ability to find and keep suitable staff than by its ability to maintain quality data and software.

At this time, analytics experts will rank among the highest paid IT specialists employed by large organisations.

By 2014, competition for people will see senior analytics roles most often filled by crossing traditional boundaries. Services companies will hire logistic specialists from transport companies, retailers will employ spatial information experts from mining companies, and manufacturers will source social network analysts from media companies. Experts in defence intelligence and health analytics will find lucrative career paths in mainstream business.

By 2016, organisations will routinely employ experts in knowledge management, collaboration and human-computer interaction as they try to blend human and computer knowledge practices, achieve continuous quality improvements, and promote a culture of good information practices at all levels.

38. Insights at your fingertips

Analytics applications will become a factor in all aspects of business operations. At the same time, however, they will not be an intrusive or dominant part of working life. They will become progressively better blended into the everyday working environment and hidden behind the scenes.

Workers will use analytics more often in their personal decision-making, although they will not always be aware of it. Websites will provide richer analysis to support buying, financial planning and career decisions, and social analytics will help careers by connecting them to more people and communities with the same interests.

Life will be as complicated as ever: 10 years from now, knowledge workers will still be complaining about "information overload" and will rate the inability to manage information as one of their most significant challenges.

Some organisations will fail to appreciate the importance of blending analytics into the background. A common mistake will be promoting "metatag cultures" by encouraging employees to add descriptive tags to everything they produce—documents, spreadsheets, web pages, bookmarks, images and e-mails. This onerous approach will produce poor results. More advanced organisations will concentrate on using software to scan documents, monitor how they are used, and automatically append meaningful metadata.

By 2009, sales representatives will routinely call up customer analysis while working onsite.

By 2011, one in ten knowledge workers, in all businesses and industries, will access analytics software on a daily or weekly basis.

By 2013, sales representatives will routinely access customer analysis as they are driving to meetings, and more than two-thirds of analytics queries in organisations will be made from within the familiar environments of the spreadsheet, browser or word processor.

By this time, instead of always working to make computer analysis more accessible, leading organisations will be spending equal time assessing where analytics are distracting or counterproductive.

By 2014, one in five knowledge workers will access analytics software on a daily or weekly basis.

By 2016, nineteen out of every twenty analytics queries will be made with free form text entered into interfaces that are as simple as Google's is today. Workers will retrieve even highly structured reports by entering a few keywords—enough for systems to suggest a likely match.

By 2017, senior executives will routinely access analysis that has been distilled into one line recommendations (*e.g.,* "initiate a clearance sale to run down inventory on Product A") with the option to drill down to the metrics underneath.

39. Ministry of metrics

Developments in analytics technologies will impact governments as much as businesses. Dominant themes will remain improving service delivery (in all types of services, but healthcare will continue to merit special focus), making government operations more efficient, reducing welfare and tax fraud, and national security.

Information boundaries will gradually come down between departments and between levels of government. Whole of government analytics will eventually become routine. Despite public concerns, citizen data will be routinely analysed across departments and this will produce new challenges.

By 2012, hospitals will routinely offer services that blend continuous home health monitoring with analysis capabilities hosted at the hospital.

By 2013, the government will be an important player in the provision of external analytics services for businesses. Agencies with trade, customs and industry development responsibilities will routinely offer hosted online services relating to markets, trends, opportunities, environmental monitoring, social and economic data.

At this time, most agencies will institute strong internal access policies for analytics systems because of new exposures relating to privacy and unauthorised/illegal use.

By 2014, computer analysis of e-health records will produce dramatic improvements in early diagnosis and early outbreak detection, and will be applied intensively to improve quality of care.

At this time, a variety of online services will continuously track public sentiment relating to policy and politicians. Changes to baseline metrics (*e.g.,* after new policies are announced, interest rates rise, etc.) will be monitored on a daily basis in government. These services will compliment, but not replace, formal polling of the electorate.

Purchasing officers will routinely access whole-of-government analytics to improve sourcing and procurement practices.

By 2016, workers in security agencies and police forces will routinely generate automated risk profiles for individual citizens based on data in the public domain.

By 2017, a national health network will exist that allows researchers to routinely analyse pooled health data sets spanning all public and private hospitals, all health research institutions and all government health departments.

40. Environmental analytics

An important new application for businesses will be environmental sustainability reporting, involving measurement and analysis of information relating to such things as energy utilisation, water usage and carbon emissions.[20]

Governments will steadily raise the bar for detailed and timely reporting. Environmental analytics systems will be increasingly direct-connected to regulatory authorities and energy companies.

By 2010, agricultural businesses will routinely use computer analysis to optimise water use and distribution across land assets.

By 2012, analytics systems drawing upon distributed sensor networks will be adopted by a wide range of government agencies, councils, farmers and manufacturers.

By 2014, all types of organisations will routinely use combinations of analytics, sensors and smart meters to monitor and optimise energy use in office buildings.

By 2016, governments will consolidate and standardise the electronic sustainability reporting requirements for businesses across state, local and Federal jurisdictions.

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[20] An early example of a carbon tracking and reporting tool is CarbonView. See *www.supplychain.com.au.*

Conclusion

The value of analytics systems will continue to rise rapidly through the next decade. This will be driven by new data sources, continuing improvements in computer methods and the development of richer and more convenient ways of accessing the outputs.

For large businesses, the application of analytics to sales, finance, operations, purchasing, quality control and even human capital is already a universal competitive necessity. Within a few years, sophisticated analysis will be equally indispensable in medium sized companies, and before long to many small businesses. At the same time, business analytics will become an enterprise-wide phenomenon where all types of managers and knowledge workers benefit from richer methods of analysing digital information.

A strange and exciting new world awaits. By 2017, audio, video, image and spatial information will be incorporated in mainstream business analysis everywhere. Social network information will be aggressively mined for patterns and relationships, and the vast pool of commentary and news found on the web will be trawled daily by machines that benchmark sentiment and monitor reputations. Many companies will have taken steps toward eliminating annual budgeting altogether.

An analytics economy will spring up. Data rich organisations will enjoy lucrative revenues from renting out their information assets, and combined analysis of customer data will be routine between business partners in every sector. In complex supply chain networks, analytics solutions will communicate across company boundaries to help optimise the ebb and flow of products from the bottom up.

These shifts will mean that some aspects of IT management will be turned upside down. Managing information will itself become much more critical than managing the technology that processes it, and the volume of data sourced externally will dwarf the amount owned by the organisation. By 2017, it will become quite impossible, in many business situations, to distinguish between human and computer generated insights.

The future of business analytics will bring with it new human, social and cultural challenges. The detailed insights about us that can be gleaned from public data will often make us uncomfortable. Roles and workplace routines will everywhere need to adapt to accommodate and exploit new capabilities. For organisations, having the right skills will be most critical, and leading companies will always stand out more for the qualities of their people than the raw power of their information systems.

Analytics leaders will do a lot of learning. This learning will define competitive advantage because it will be context specific and impossible to buy. Late starters may be able to tap into vast quantities of external data, and will certainly access powerful solutions, but they will find no short cuts to building a culture that understands data quality, knows the limitations of machine analysis, and strives to continuously improve how the outputs are used to support everyday business decisions.

Senator DORGAN. Mr. Abrams, thank you very much.

All of you have provided interesting and, in some cases, provocative, and certainly useful information to us.

The task of reauthorizing the Federal Trade Commission requires us to take a look at what works and what doesn't, what kinds of things might be necessary to add to the responsibilities of the Federal Trade Commission. I started, today, asking about the resources. I think the resources are a problem we need to resolve, this is clear from the testimony that some of you have provided. And with respect to the common carrier exemption, we do need to respond, because times have changed, and there is no reason to prevent the Federal Trade Commission from working and being aggressive in those areas.

I think much of the success of an agency, whether it is FERC, as I've described it earlier, or the Federal Trade Commission, or any number of agencies, has a lot to do with the interest that they have in pursuing issues aggressively. Frankly, I've been here long enough to see some people assume the leadership of certain organizations who don't believe in the organizations, don't like government, believe there should be no referee or no regulatory authority,

and all of a sudden they're appointed to head the agency. So, what happens? The agency dies from the neck up, does nothing except collect paychecks and strut around and act like it's important. And especially given these days and these times, I think we need something much, much more. The Federal Trade Commission is a commission under the jurisdiction of this Committee, and—I'm not asserting, by the way, that my example was the FTC, but I am saying that I think it's very important that the regulatory authority be exercised aggressively and with some impatience toward practices that disadvantage and injure our consumers.

Mr. Calhoun, the point you've made is really pretty stunning, about subprime lenders not disclosing, and not required to disclose, the escrow requirements that will have to be borne by the consumer. I mean, that clearly, it seems to me, is deceptive. Would you agree?

Mr. CALHOUN. Yes. And it's also counterintuitive, because, for example, if you look in the prime market, Fannie Mae and Freddy Mac typically require escrows on prime loans, unless there is a very large downpayment, and prime borrowers usually have a greater capacity to absorb payment——

Senator DORGAN. Right.

Mr. CALHOUN.—shocks. In the subprime market, these would be the last loans where you would not escrow. But we talk to brokers and lenders, and they say, "Well, if we do include the escrow, other people come out and deceptively undercut us by excluding the escrow."

Senator DORGAN. Let me ask—because I am not as knowledgeable about this area as perhaps you are, you've done a lot of research—for a company like Countrywide, which I think was the largest lender—is that the case?

Mr. CALHOUN. They're the largest mortgage lender——

Senator DORGAN. Yes.

Mr. CALHOUN.—in the country.

Senator DORGAN. And if they're engaged in the subprime area—and I understand they were—you're saying that a large, established company is presenting mortgage information to consumers and is not describing the escrow requirements? And I think you also testified they are not actually ascertaining or proving the income of the potential borrower. Is that correct?

Mr. CALHOUN. In the subprime market, almost half of those loans were so-called "no-doc" stated-income loans. And doubly deceptive is that the borrowers typically did not realize that they would pay a full interest point extra for having it a "no-doc" loan, that they could save a full 1 percent on their loan just by bringing in their W–2 statement.

Senator DORGAN. "No-doc" means no documentation?

Mr. CALHOUN. I'm sorry, yes, no documentation of your income, no verification of your income. You just state what your income is, and that's used to qualify you for the loan.

Senator DORGAN. So, one would, as a consumer, appear before—or make known your interest to the largest mortgage company in our country and say to them, "I'd like to get a loan. Here's my income," with no verification of the income, and, for no verification, you pay a higher rate. And, when they tell you what this mortgage

is going to cost, they're free to tell you what it will cost without your monthly payment, which would include escrows and other matters. It seems to me, that, on its face, is deceptive.

Mr. CALHOUN. And it becomes even more so, because these loans were typically sold—the majority of the subprime loans are originated by a mortgage broker initiating the contact with the borrower, rather than the borrower, for example, calling Countrywide. Countrywide does a lot of direct solicitation, themselves. And so, the broker is coming in, saying, "You can borrow X dollars. Here's what the payment will be," not telling you that it doesn't include your taxes and insurance, the payment's going to go way up——

Senator DORGAN. Right.

Mr. CALHOUN.—and that you could save $1,000 or more a year just by bringing in your W–2 statement.

Senator DORGAN. It's just almost unbelievable that this bubble could be created by people who felt that somehow this would work out in the end. You indicated that 35 to 50 percent increases in payments would ensue, notwithstanding the escrow issues. But, in several years—2, 3, 4 years—you're going to see your payments jacked up 35, 50 percent, because your interest rate is going to substantially increase. Your written testimony doesn't describe it quite as clearly. It's not at variance with what you've just said. But what you said, I think, is clear as a roadmap to what are clearly, to me, deceptive practices by some very large companies.

Others of you have talked about the telecommunications areas, about net neutrality, about other related issues—the oil and gas industry. Dr. Cooper, you have previously testified before this committee on related issues. Your testimony is very helpful to remind us that there's a need to have some passion in pursuing truth here with respect to big interests. Big is not always bad, and small isn't always beautiful, but it is the case that, the clogging of the arteries of this marketplace is a serious problem for consumers, and we see that clogging of the arteries through mergers in virtually every area, but none really any more aggressively than in the oil industry, although perhaps telecommunications is a close second. Both industries are substantially concentrated. And I appreciate very much your testimony on these matters. As we think through how we structure and write a reauthorization bill trying to provide additional authority to the FTC, but also trying to stimulate and encourage additional activity I will certainly consider your testimony, as well.

Dr. COOPER. Frankly, Mr. Chairman, the other parts of this body and this Committee have actually done the—taken the most important steps to start to deal with this problem. As you've pointed out, the—it's fascinating, the big mergers are gone. The double name—and you heard about a few small local mergers that the agency actually tried to stop. Of course, in a certain sense, the horse is out of the barn. The only way that we will restore some sanity to this market is by delivering to the President an energy bill that contains what this body passed, a dramatic increase in the supply of non-oil alternatives, a dramatic reduction in the demand for gasoline. That's the only way we're ever going to seize back this market from the domestic oil companies. And also, in the long run it's fascinating, from OPEC, the—the Chairwoman pointed out that

OPEC sets the price of oil. That may be the case, but they get an awful lot of help, these days, from the domestic oil companies.

And let me briefly explain why, because it really does reinforce a point. Three years ago, OPEC was defending $40 a barrel. When they met, as they just did recently, they were talking about $40 a barrel. In the intervening 3 years—and you quoted from the article in *The Wall Street Journal* that made the point—in the intervening 3 years, domestic U.S. refiners increased their margins dramatically, showing that there was more rent to be had. As an economist, you know that term. There was more money to be taken out of consumers' pocketbooks. And OPEC is a rent-seeking cartel. And so, when OPEC sees the price of gasoline lose touch with the price of crude oil, they know that the American consumer can be made to pay more, and they want a larger share of that rent. And *The Wall Street Journal* article explicitly said that. This is competition between American refiners and OPEC crude oil producers over the rent that they want to extract from American consumers.

And so, there's a very real sense in which what happens in the domestic U.S. oil market influences, dramatically, the price of crude oil. The Chairwoman can no longer say, "OPEC sets the price," because what we do here—we consume one-quarter of the gasoline in the world—what we do in this market, what domestic refiners do, actually sends a strong signal to OPEC about where the price of oil can go.

Senator DORGAN. Dr. Cooper, thank you very much.

Because we started nearly an hour late, I have an inability to ask as many questions of this panel as I had wished to ask. I have to be somewhere at 12 o'clock. I hope you will understand.

I, again, regret the inconvenience to all of you, but I do want to tell you that, as we put together a reauthorization bill, your testimony, your comments, your thoughts about how we do that, about the Federal Trade Commission, about what is happening in our economy, and the role of its regulatory authority are going to be very helpful to us.

So, I appreciate your being here today. And this hearing will now adjourn.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM ALASKA

I would like to thank Chairman Majoras and all the witnesses for being here today. This is the Committee's second opportunity this year to hear from the FTC Chairman concerning the Commission's current activities.

I appreciate the Chairman's willingness to testify today, and know that the entire Committee is grateful for the Commission's hard work on the recent "Broadband Connectivity Competition Policy Report" and the "2006 Spring and Summer Nationwide Gasoline Price Increase Report."

In addition to the written testimony provided to the Committee, I trust that all the witnesses will provide their vision for the FTC and how best the Commission can protect consumers.

Practical recommendations on how best the Committee can assist the FTC in fulfilling its mandates will benefit the members of this Committee when the FTC reauthorization legislation is taken up.

By working in a bipartisan fashion the Committee will have the best opportunity to reauthorize the FTC since its authorization expired in 1998. Once again, I thank the witnesses for being here.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO HON. DEBORAH PLATT MAJORAS

Question 1. The Commission has recently updated its identity theft website to include information about state "security freeze" laws, which give consumers the right to freeze access to their credit files to prevent new account fraud. Thirty-nine states have now passed such laws. The state laws usually require consumers to pay a small fee to freeze, temporarily lift, or remove the freeze. In addition to state freeze rights, under Federal law, consumers have the right to opt-out from pre-approved credit card offers; to place, at no cost, a temporary fraud alert on their credit files; and to receive a free credit report annually from each of the three credit bureaus.

The Committee is aware of new web-based businesses providing identity theft prevention services that offer to provide consumers with the above services (freeze, fraud alert, opt-out, and annual credit reports) as part of a bundle of prevention services, without disclosing that consumers may on their own access these services at lower or no cost.

Is the Commission examining whether such services and promotions comply with Section 5 of the Federal Trade Commission Act? Has the Commission evaluated whether state laws allow the placement of a security freeze through intermediaries? Has the Commission evaluated whether these intermediaries can properly assure the identity of their clients seeking to place a freeze? What information should these businesses disclose In order to ensure that consumers are not led to believe they can only receive services, such as a security freeze, by using such businesses' services?

Answer. As consumer concerns about identity theft have proliferated, a number of products and services intended to help consumers avoid being victimized have become available. Some of these prevention products and services are mandated by state or Federal law. For example, under the Fair and Accurate Credit Transactions Act of 2003 (FACT Act),[1] which amended the Fair Credit Reporting Act, consumers have a number of new rights, including the right to place a fraud alert on their credit files, thus signaling creditors and other potential users of the report to exercise caution in verifying the identity of an applicant. Consumer also have the right to a free annual credit report from each of the nationwide consumer reporting agencies (CRAs). Other prevention products and services are not mandated by law, but are sold commercially by CRAs and other businesses. For example, the nationwide

[1] Pub. L. 108–159, 117 Stat. 1952 (December 4, 2003).

CRAs and others sell credit monitoring services, which alert consumers to changes in their credit reports that might indicate the presence of identity theft.

The Commission is aware of the potential for consumer confusion about which of these products are available by law and which are commercial products, and about the cost of the products. The Commission actively monitors the practices of businesses selling these products to ensure that they are not deceptive or unfair. In August 2005, the agency filed a complaint in Federal district court against Consumerinfo.com, Inc., a subsidiary of Experian and creator of the "freecreditreports" promotion.[2] The complaint alleged that Consumerinfo deceptively marketed "free credit reports" without disclosing that its reports were not associated with the FACT Act free annual report program. The complaint also alleged that Consumerinfo deceived consumers by not adequately disclosing that consumers who ordered the "free report" were automatically enrolled in a credit monitoring service, and that those who failed to cancel the service within 30 days would be charged an annually renewing membership fee of $79.95. To settle the charges, Consumerinfo agreed to a court order requiring them to make clear and prominent disclosures (i) that their free reports are not affiliated with the FACT Act program, and (ii) of all of the material terms and conditions of the offer. In addition, Consumerinfo agreed to offer refunds to deceived consumers, and to pay an additional $950,000 as disgorgement of ill-gotten gains.

In February 2007, the Commission alleged that Consumerinfo had violated the terms of the court order by not making sufficient disclosures about the terms of the offer, and the company agreed to pay an additional $300,000.[3] The Commission also sent warning letters to over 130 Internet firms that purported to be offering "free" credit reports, many of which used common misspellings or variants of the approved free annual credit report website, *annualcreditreport.com*. In addition, to help consumers avoid deceptive "free report" promotions, the Commission has published a number of educational materials that are available in print and on the FTC website. For example, the Commission has disseminated two consumer alerts warning consumers about "imposter" free report websites.[4]

With respect to "credit" or "security" freezes, as you note 39 states have enacted laws giving some or all consumers the right to freeze their credit file to prevent access by third-parties. In addition, the three nationwide CRAs recently announced plans to offer credit freezes to consumers nationwide. The laws and programs differ in many respects, including who is eligible (all consumers or only identity theft victims), the means by which consumers can place a freeze, and the fees charged for placing, temporarily lifting, and removing a freeze.

As you know, President Bush issued an Executive Order on May 10, 2006, establishing an identity theft task force.[5] Comprised of 17 Federal agencies, the mission of the task force was to develop a strategic plan to marshal the resources of the Federal Government in a comprehensive effort to combat identity theft. On April 11 of this year, the Task Force issued its strategic plan, with 31 recommendations on actions that should be taken to prevent identity theft, ameliorate its impact on victims, and prosecute the criminals.[6] I am pleased to note that most of these recommendations have already been implemented or are well along in the process of being implemented.

Among the recommendations of the Task Force was that the FTC, with support from other member agencies, conduct an assessment of the impact and effectiveness of state credit freeze laws and report the results in the first quarter of 2008.[7] The Commission staff has made substantial progress in carrying out the assessment and is on track to report its results in early 2008.

In response to your question about the propriety of intermediaries offering to place security freezes on behalf of consumers, the Commission is not aware of any state law that would prohibit such practices, so long as they are offered in a non-deceptive manner. The Commission will continue to monitor the marketplace for these products and services, and is prepared to investigate and act against businesses that make false or misleading claims. In addition, the Commission has and will continue to educate consumers on their FACT Act and credit freeze rights so

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[2] *FTC* v. *Consumerinfo.com, Inc.,* No. SACV050–801 AHS (MLGx) (C.D. Cal. August 15, 2005).

[3] *FTC* v. *Consumerinfo.com, Inc.,* No. SACV050–801 AHS (MLGx) (C.D. Cal. January 8, 2007).

[4] *See http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt156.shtm; http://www.ftc.gov/bcp/conline/pubs/alerts/fakealrt.shtm.*

[5] Executive Order 13402 (May 10, 2006).

[6] The President's Identity Theft Task Force, *Combating Identity Theft: A Strategic Plan,* available at *www.idtheft.gov.*

[7] *Id.* at 52.

that they can make informed decisions about whether to seek the help of an intermediary in exercising those rights.

Question 2. According to recent press reports, unscrupulous olive oil producers have been branding oils as "extra virgin olive oil," the highest and most expensive grade, even if it is of lesser quality or not even olive oil. In February 2006, Federal marshals seized about sixty-one thousand liters of what was supposedly extra-virgin olive oil and twenty-six thousand liters of a lower-grade olive oil from a New Jersey warehouse. Some of that oil turned out to be mostly soybean oil even though it was labeled olive oil. Consumers are willing to pay a significant premium for "extra virgin" olive oil for perceived health and taste benefits. Bad actors should not be able to take advantage of this by fraudulently marketing soybean oil or lesser grades of olive oil as "extra virgin olive oil" in order to overcharge consumers. What steps is the Commission taking to examine whether manufacturers and retailers are violating Section 5 of the Federal Trade Commission Act when they market oil as "extra virgin olive oil" when it is not? Does the Commission intend to take enforcement action if it determines that manufacturers and retailers are acting in violation of Section 5?

Answer. Issues of adulterated or misbranded food products are primarily within the jurisdiction of the Food and Drug Administration (FDA), rather than the Federal Trade Commission.[8] Manufacturing and labeling of olive oil must comply with FDA's general provisions on misbranding and adulteration. Under the Federal Food, Drug, and Cosmetic Act, olive oil is adulterated if another oil is substituted for the olive oil in whole or in part.[9] In addition, the FDA has issued specific regulations governing the common or usual name permitted for olive oil and other vegetable oils and requiring that mixtures of oils must be labeled to show all oils present in order of predominance.[10] To enforce these standards, FDA has the authority to conduct field investigations of manufacturing facilities. When FDA identifies olive oil products that are adulterated or mislabeled, the agency can pursue a seizure action or product recall.

The FDA has taken repeated action to recall or seize adulterated olive oil products over the past several years. The Federal seizure in New Jersey in February 2006, to which you refer, was the outcome of an FDA investigation. In addition, in 1996, FDA obtained a consent decree for the destruction of misbranded olive oil that had been adulterated with canola oil.[11] The agency also took seizure action in 1997 against Krinos Foods for using sunflower oil in place of olive oil, and in 2000 against Cheney Brothers Inc. for using sunflower and soybean oil in place of olive oil.[12] FDA staff has advised us that the agency continues to follow up as resources permit on specific instances in which it has received information that "olive oil" products are adulterated with other vegetable oils.

We recognize that the passing off of other vegetable oils as olive oil raises issues of economic harm to consumers and competition. It may also present potential health implications. We believe, however, that the FDA has the investigatory tools and enforcement powers best suited to address this problem. As in all matters involving our overlapping authority, the two agencies will coordinate closely to ensure effective enforcement.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BYRON L. DORGAN TO HON. DEBORAH PLATT MAJORAS

Question 1. As we look to reauthorization legislation, can you tell me what your priority would be to include in the legislation? What would be the priorities of your fellow Commissioners?

Answer. As noted in the Commission's September 12 testimony, the Commission continues to support the repeal of the telecommunications common carrier exemption to address the consumer protection challenges posed by technology convergence.

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[8] The FTC shares jurisdiction with the FDA over the marketing of food products pursuant to a regulatory scheme established by Congress through complementary statutes. Under a long-standing liaison agreement governing the division of responsibilities between the two agencies, the FTC has primary responsibility for claims in advertising and the FDA has primary responsibility for claims on product labeling. Working Agreement Between FTC and Food and Drug Administration, 4 Trade Reg. Rep. (CCH) ¶ 9,850.01 (1971).

[9] Federal Food, Drug, and Cosmetic Act, Sec. 402(b)(2). 21 U.S.C. § 342(b)(2).

[10] 21 C.F.R. § 101.4(b)(14).

[11] *See* Greco-Roman, Inc., Civil Action No. 96–1834 CIV-Davis (S.D. Fla. 1996).

[12] *See* FDA Enforcement Report for October 12, 2005, available at *http://www.fda.gov/bbs/topics/enforce/2005/ENF000921.html.*

Currently, the FTC Act exempts common carriers subject to the Communications Act from its prohibitions on unfair or deceptive acts or practices and unfair methods of competition. This exemption dates from a period when telecommunications were provided by government-authorized, highly regulated monopolies. The exemption is now outdated. Congress and the Federal Communications Commission ("FCC") have dismantled much of the economic regulatory apparatus formerly applicable to the industry, and in the current world, firms are expected to compete in providing telecommunications services. Technological advances have blurred the traditional boundaries between telecommunications, entertainment, and information. As the telecommunications and Internet industries continue to converge, the common carrier exemption can frustrate the FTC's ability to stop deceptive and unfair acts and practices and unfair methods of competition with respect to interconnected communications, information, entertainment, and payment services.

Additional legislative priorities include: prohibiting brand name drug companies from paying generic companies not to compete at the expense of consumers, while allowing exceptions for those agreements that do not harm competition; ensuring that the Commission has authority to impose civil penalties in cases in which the Commission's traditional equitable remedies are inadequate, such as spyware and data security cases; and reauthorizing the National Do Not Call Registry and, if necessary, allowing for the permanent registration of phone numbers on the Registry.

Commissioner Harbour states that her legislative priorities include: repeal of the common carrier exemption, in recognition of the convergence dynamic of today's high-tech economy, so the Commission can make even better use of its unique combination of competition and consumer protection expertise for the benefit of American consumers; legislation that would repeal the *Leegin* decision, to the extent it has created per se legality for vertical minimum price fixing agreements, and clarify the application of the rule of reason to distribution restraints in the wake of *Leegin;* legislation to ensure that consumers reap the full benefits of competition by generic drugs, including generic pharmaceuticals as well as follow-on biologics or biosimilars; and legislation granting authority over cigarette testing to one of the Federal Government's science-based public health agencies, and prohibiting the use of claims based on the inaccurate Cambridge Filter Method (also known as the "FTC Method") for testing tar and nicotine.

Commissioner Leibowitz states his legislative priorities include consideration of the following: increasing FTC resources by ten to fifteen percent annually for the next 5 years, including adding fifty or more full-time equivalent employees ("FTEs") each year;[1] enhancing civil penalty authority, including authorizing the FTC to represent itself in civil penalty cases and authorizing the agency to seek civil penalties for certain violations of Section 5 of the FTC Act (where the FTC's equitable remedies are often inadequate to deter malefactors engaged in fraud); authorizing the FTC to promulgate rules under the Administrative Procedure Act to prohibit nonbank subprime mortgage brokers and financial service providers from engaging in unfair or deceptive acts or practices (the FTC Act's current "Magnuson Moss" rulemaking procedures are much more cumbersome and time-consuming than APA procedures); repealing the FTC Act's exemption for telecommunications common carriers; authorizing the FTC to initiate civil actions under the FTC Act against "aiders and abettors" of consumer fraud (the FTC may prosecute those who knowingly assist and facilitate Telemarketing Sales Rule violations, such as electronic payment processors and lead list brokers, yet in some instances it can be more difficult to pursue enforcement action against similar aiders and abettors outside the telemarketing context); amending the FTC Act to limit appeals of Commission administrative orders to jurisdictions where respondents reside or have their principal place of business, or to the U.S. Court of Appeals for the D.C. Circuit (to prevent the rampant "forum shopping" that all too often occurs when a party appeals a Commission decision); and modifying the requirement for reports on concentration in the ethanol markets from annually to every 5 years (all studies so far have shown that there is no market concentration). In addition, outside of the reauthorization, Commissioner Leibowitz's highest legislative priorities include: prohibiting brand name drug companies from paying their generic competitors to delay entering the market (such anti-competitive agreements cost both consumers and the Federal Government billions of dollars annually); and reauthorizing the Do Not Call Implementation Act,

[1] Today, the FTC has only 1,074 FTEs, far fewer than 25 years ago. Yet in the last few years alone, Congress has passed a variety of important new laws that the FTC is charged with implementing and enforcing, *e.g.,* the CAN–SPAM Act, the Fair and Accurate Credit Transactions Act, the Children's Online Privacy Protection Act, the Gramm-Leach-Bliley Act, and the U.S. SAFE WEB Act.

including providing for permanent registration of telephone numbers on the National Do Not Call Registry.

Commissioner Kovacic states that his legislative priorities include legislation prohibiting reverse payments from brand name drug companies to generic companies and legislation to repeal the common carrier exemptions, particularly the telecommunications exemption.

Commissioner Rosch states that he considers the following his legislative priorities: elimination of the requirement that consumers re-register for the Do Not Call Registry; enhanced civil penalty authority that would allow the Commission to pursue civil penalties under more circumstances and without providing a referral to the Department of Justice; elimination of the common carrier exemption; and prohibition of anticompetitive pharmaceutical patent settlements in which a brand drug effectively pays a generic drug to stay out of a market.

Question 2. You say in your testimony that you "would like to work with the Committee to help ensure that [your] reauthorization includes appropriate increases in resources to meet these growing challenges." In your testimony you do not state a specific number of employees that would be necessary for the FTC to be fully effective, and at the hearing you stated that it's difficult to bring in a large number of new staff. Could you not grow on an incremental basis over a number of years?

Answer. In my testimony, I highlighted the difficulties that a small agency like the FTC faces when it seeks to absorb a large number of new employees at one time, in addition to replacing FTE lost due to normal attrition and retirement. There are, of course, significant costs associated with such hiring, including the expenses related to recruitment and interviewing, training, facilities, furnishings, desktops, and equipment. With the addition of programmatic FTE comes the necessary increase in human resources, technology, facilities and records management staff to support those new hires. Nonetheless, I believe the FTC can, and should, grow incrementally, and I anticipate that the agency will need an additional approximately 100 FTE over the next five fiscal years to meet workload demands.

The FTC continues to face a demanding merger review workload as the volume of merger activity has increased significantly since FY 2004. Based on current trends, the FTC expects the high volume of merger work to continue to FY 2009 and beyond. The FTC needs to ensure that it has sufficient staff and resources to meet an increasing number of merger investigations. Identifying and stopping anticompetitive conduct also is a priority, and the FTC will continue to pursue aggressively nonmerger matters, particularly in the health care, pharmaceutical, energy, technology, and real estate sectors. The FTC also is committed to promoting convergence in competition policy so that foreign enforcement practices do not unfairly burden U.S. businesses and consumers participating in foreign markets. In sum, the FTC wants to make sure that it has the authority, personnel, systems support, and resources needed to ensure that it can vigorously protect American consumers and promote a robust and vibrant marketplace free of anticompetitive mergers and anticompetitive business practices. It also must have the necessary resources to educate consumers and businesses about the importance of competition and to conduct research and studies on complex legal and economic issues used in developing antitrust policy.

On the consumer protection side, over the course of the past few years, Congress has enacted a number of new laws that charge the FTC, at least in part, with their implementation and enforcement, including the CAN–SPAM Act, the Fair and Accurate Credit Transactions Act, the Children's Online Privacy Protection Act, the Gramm-Leach-Bliley Act, and the U.S. SAFE WEB Act. The FTC needs sufficient staff to meet these added obligations, as well as its continuing strategic goal to prevent fraud, deception, and unfair business practices in the marketplace. The FTC is committed to protecting consumers from unfair and deceptive practices in the financial services sector (mortgage lending and debt collection), the burgeoning area of "green" marketing, and with respect to the marketing and advertising of food to children. The agency will work hard to fight spam and spyware, and to understand and anticipate other high tech tools fraudsters have yet to exploit. The FTC wants to ensure that consumers are fully protected in the areas of privacy and identity theft and with respect to deceptive and unfair practices in mobile marketing. The agency intends to exploit the tools it has been afforded under the U.S. SAFE WEB Act to work with its foreign partners in combating cross-border fraud and to improve compliance with FTC orders. Finally, history has proven the value of a robust consumer education program to support each of our consumer protection enforcement initiatives. Accordingly, the FTC expects to expand dramatically efforts to keep U.S. consumers abreast of the many challenges posed by unscrupulous marketers in the marketplace.

Each of these programmatic areas and the many agency-wide initiatives described more fully in my testimony before the Committee, of course, require support in the areas of information technology, human resources, financial management, facilities expansion, equal employment opportunities, and records management.

I believe the FTC can meet these new and ongoing challenges with incremental staff growth and an overall staff increase over the next five fiscal years of approximately 100 FTE. The FTC will also need significant investment in information technology to: (1) support a more fully developed disaster recovery plan; (2) modernize large segments of FTC network infrastructure; (3) provide for increased computer storage capacity for e-filing and e-discovery; (4) upgrade litigation support tools and contract for forensic acquisition support; and (5) modernize FTC business systems components to improve financial management. With any increase in FTE, of course, comes a concomitant increase in cost for space/rent, furnishings, desktops, and equipment.

Question 3a. I have seen reports about Comcast cutting off the service of some of its customers who it alleges have used too much bandwidth, despite the fact that they advertise unlimited service. This sounds like a case of deceptive advertising (and a poor business practice). Is this something the FTC will be investigating?

Answer. Without commenting on the practices of a particular company, I can assure you that if an Internet service provider misrepresents, or fails to disclose, material aspects of its services in advertising or marketing to consumers, it would be liable for violations of Section 5 of the Federal Trade Commission Act, which prohibits unfair and deceptive acts and practices.

For over a decade now, the FTC has enforced the consumer protection and antitrust laws in numerous matters involving Internet access. In particular, the FTC has investigated and brought enforcement actions against ISPs for allegedly deceptive marketing, advertising, and billing of Internet access services. The FTC will continue to work to protect consumers in the important area of Internet access.

Question 3b. If this were a phone company classified as a common carrier, and not Comcast, could the FTC have trouble taking action due to the common carrier exemption?

Answer. That is entirely possible. On the one hand, there should not be any jurisdictional obstacle to enforcement of the FTC Act against a telephone company that is offering broadband Internet access, because an entity is a common carrier only with respect to services that it provides on a common carrier basis. Because broadband Internet access provided by a wireline, facilities-based entity, such as a telephone company (as in your example in part (b) above), is not provided on a common carrier basis, such access is subject to the FTC's general competition and consumer protection authority. On the other hand, in practice, as a result of the common carrier exemption, the issue of jurisdiction is often raised and litigated—even when FTC jurisdiction appears to be clear.[2] In such cases, the FTC is forced to expend substantial time and resources litigating a jurisdictional question, rather than enforcing the FTC Act, potentially at the expense of consumers.

Question 4. Do you believe the FTC should investigate whether the broadband providers' advertised speeds are the actual speeds or if consumers are getting overcharged and deceived?

Answer. As noted above, for more than a decade, the FTC has monitored the practices of Internet service providers and brought cases where we believe ISPs have engaged in deceptive marketing, advertising, and billing practices. As increasing numbers of U.S. consumers have chosen to subscribe to broadband services, the FTC has been closely monitoring the claims made by broadband providers in marketing their services to consumers. With respect to the issue of speed claims, last spring we issued a staff report on *Broadband Connectivity Competition Policy,* which noted that "speed is one of the primary qualitative features on which broadband providers are competing."[3] Therefore, it is important that any claims about speed made by Internet service providers be truthful and accurate. The FTC will investigate whether broadband providers are making claims about speed that violate FTC consumer protection laws.

Question 5a. Verizon has been cutting their copper wire after they switch their customers to fiber. This ensures that another competing company cannot offer service over this old wire. Would the FTC investigate this anti-competitive practice?

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[2] *See, e.g.,* Federal Trade Commission Staff, *Broadband Connectivity Competition Policy* 40–41 (June 2007) [hereinafter *Broadband Report*], available at *http://www.ftc.gov/reports/broadband/v070000report.pdf* (discussing enforcement difficulties posed by the common carrier exemption).

[3] *Id.* at 131.

Answer. Again, without commenting on the practices of a particular company, the FTC will continue to enforce the antitrust and consumer protection laws in the Internet access area. Whether Verizon's alleged practices are anti-competitive under the Federal antitrust laws is a question that I cannot answer in the abstract. As a general matter, the antitrust laws do not require a company to provide access to its proprietary facilities to its competitors.[4] In any case, the FTC will continue to enforce the antitrust laws in the Internet access area—as it does in other areas within its jurisdiction—by carefully analyzing the competitive effects of particular conduct and business arrangements within properly defined relevant markets.

Question 5b. Would the common carrier exemption prevent the FTC from handling this?

Answer. As indicated in my response to number three above, the FTC has jurisdiction over the provision of broadband Internet access. However, the FTC may encounter enforcement difficulties in this situation due to the fact that, as a result of the common carrier exemption, the FTC would have jurisdiction to address potential consumer ha= resulting from this practice in the provision of broadband Internet access but not in the provision of common carrier voice service, both of which may be transmitted over the same copper wire.

Question 6. You argue, along the talking points of the incumbent broadband providers, that nondiscrimination rules are not necessary because the broadband market is so competitive. Does the FTC currently have sufficient tools to even accurately determine whether Americans have access to broadband?

Answer. In the report, *Broadband Connectivity Competition Policy,* FTC staff observed that, on a national scale, the broadband market appears to be moving in the direction of more, not less, competition, as evidenced by fast growth in consumer demand for broadband, increasing access speeds, declining prices (particularly speed- or quality-adjusted prices), and new entrants poised to challenge the incumbent cable and telephone companies.[5] The report, however, did not conclude that any particular local broadband market regardless of how such market may be defined—is competitive.[6] In any case, the report acknowledged the existence of substantial agreement on the part of both proponents and opponents of network neutrality regulation that increased competition in the broadband area would benefit consumers. Based in part on this and other factors suggesting that the broadband marketplace remains a dynamic, unsettled environment, the report counseled caution in evaluating proposals to enact regulation at this time.

The FTC has not engaged in a broad inquiry into the state of broadband infrastructure deployment throughout the United States. However, in implementing its statutory mandate, the Federal Communications Commission periodically assesses and reports on the state of such deployment. I understand that you are cosponsoring legislation that would, among other things, require the FCC to revise its methods for assessing broadband deployment.[7]

Regarding the application of the antitrust and consumer protection laws to specific conduct and business arrangements, the FTC currently has sufficient tools to investigate and determine whether violations of such laws may be occurring. In fact, the FTC will work to ensure competition and protect consumers in the broadband Internet access marketplace.

Question 7. I understand the Consumer Product Safety Commission is overwhelmed right now with unsafe products and recalls. Can you tell me the history of how the Consumer Product Safety Commission grew out of the Federal Trade Commission? And are there areas where the FTC has Jurisdiction and could step in to help to ensure consumers are not being deceived or that products are accurately labeled?

Answer. Following a report by the National Commission on Product Safety, in 1972, Congress created the CPSC with the specific mission of protecting consumers against unreasonable risk of injury from hazardous products.[8] In so doing, Congress

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[4] *See, e.g., Verizon Communications Inc.* v. *Law Offices of Curtis* v. *Trinko, LLP,* 540 U.S. 398 (2004).

[5] *See Broadband Report, supra* note 757, at 155–56.

[6] *Id.* at 156 ("This Report and the findings herein do not reflect a case-by-case analysis of the state of competition in each of the localities that may represent relevant markets under the antitrust laws.").

[7] Broadband Data Improvement Act, S. 1492, 110th Cong. (2007).

[8] Consumer Product Safety Act, Pub. L. 92–573 (1972), H.R. Conf. Rpt. No. 92–1593 (1972), *reprinted* in 1972 U.S.C.C.A.N. 4596; *see also www.cpsc.gov/about/faq.html* (visited Oct. 18, 2007); Testimony of Hon. Nancy A. Nord, Acting Chairman, U.S. Consumer Product Safety Commission, before the Senate Subcommittee on Consumer Affairs, Insurance, and Automotive Safe-

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transferred authority from a number of existing Federal agencies, including the then-Department of Health, Education and Welfare, the Department of Commerce, the Environmental Protection Agency ("EPA"), as well as the FTC, to the CPSC.[9] From the FTC specifically, the CPSC received only the Commission's authority relating to flammable fabrics and refrigerator safety.[10]

Congress directed the CPSC to protect the public against physical injury and harm. The CPSC's tools are directly focused on ensuring that products introduced into the stream of commerce and used by consumers are not unreasonably hazardous. These tools include issuance and enforcement of mandatory safety standards, product bans where adequate safety standards cannot be developed, and recalls of products already in the marketplace or purchased. Its jurisdiction applies specifically and strictly to consumer product safety.[11]

Although the FTC also works to protect consumers, it plays a different role than. the CPSC. The FTC is primarily a law enforcement agency whose statutory authority allows us to take action against "unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. § 45(a) ("Section 5"). A representation, omission, or practice is *deceptive* if (1) it is likely to mislead consumers acting reasonably under the circumstances; and (2) it is material—that is, likely to affect consumers' conduct or decisions with respect to the product at issue.[12] An act or practice is *unfair* if the injury to consumers it causes or is likely to cause (1) is substantial; (2) is not outweighed by countervailing benefits to consumers or to competition; and (3) is not reasonably avoidable by consumers themselves.[13]

Accordingly, the FTC has taken action against deceptive advertising and labeling[14] of products, including deceptive claims that a product is safe.[15] In addition, in particular factual circumstances, the Commission has challenged the failure to disclose safety risks as an unfair practice.[16] The Commission's actions can result in consumers' receiving accurate and important information. However, the CPSC is the agency tasked with addressing products that pose unacceptable safety risks and keeping them out of the hands of consumers.

Question 8. The FTC identified ads with claims for very low monthly payment amounts or interest rates, without adequate disclosure of other important loan terms. And the FTC is now advising more than 200 advertisers and media outlets that some mortgage ads are potentially deceptive or in violation of the Truth in Lending Act. Your letters are a good step, but I wonder what more the FTC could have done or could do in the future.

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ty, Oct. 4, 2007 (available at *http://commerce.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=1902&Witness_ID=4134).*

[9] Consumer Product Safety Act, Pub. L. 92–573, § 30, reprinted in 1972 U.S.C.C.A.N. at 4621–4622.

[10] *Id.* at § 30(c), (d), 1972 U.S.C.C.A.N. at 4621.

[11] See *www.cpsc.gov/about/faq.html* (visited Oct. 18, 2007).

[12] *Stouffer Foods Corp.,* 118 F.T.C. 746, 798 (1994); *Kraft, Inc.,* 114 F.T.C. 40, 120 (1991), *aff'd and enforced,* 970 F.2d 311 (7th Cir. 1992), *cert. denied,* 113 S. Ct. 1254 (1993); *Cliffdale Assocs.,* 103 F.T.C. 110, 164–65 (1984); *see generally Federal Trade Commission Policy Statement on Deception, appended to Cliffdale Assocs.,* 103 F.T.C. at 174–83.

[13] 15 U.S.C. § 45(n); *see also generally Federal Trade Commission Policy Statement on Unfairness, appended to International Harvester Co.,* 104 F.T.C. 949, 1070–76 (1984).

[14] With respect to certain products, the FTC shares jurisdiction over labeling with other agencies. For example, for more than 30 years the FTC and FDA have operated under a Memorandum of Understanding that gives primary responsibility over the advertising of food, over-the-counter drugs, medical devices, and cosmetics, to the FTC, and primary responsibility over labeling of these products to FDA.

[15] *See, e.g., FTC* v. *National Urological Group, Inc.,* Civ. No. 1:04–CV–3294 (N.D. Ga. Nov. 10, 2004) (challenging safety claims for dietary supplements containing ephedra and yohimbine, which in fact create safety risks by increasing blood pressure); *FTC* v. *Christopher Enterprises, Inc.,* Civ. No. 2:01 CV–0505ST (D. Utah Nov. 29, 2001) (challenging safety claims for products containing comfrey, when in fact internal use or application to external wounds can cause serious liver damage; consent order required warning to consumers); *Panda Herbal Intl, Inc.,* C–4018 (F.T.C. 2001) (consent order) (challenging marketing claim that dietary supplement could be used safely to treat diseases such as HIV/AIDS, when in fact St. John's Wort ingredient has potentially dangerous interaction with drugs used to treat HIV/AIDS; settlement required warning on product); *FTC* v. *Figgie, Inc.,* 994 F.2d 595 (9th Cir. 1993) (challenging representations that heat detectors provided sufficient warning in residential fires to allow occupants to escape safely, and responded more quickly than smoke detectors to hot, flaming fires).

[16] *E.g., Consumer Direct, Inc.,* 113 F.T.C. 923 (1990) (consent order) (challenging failure to disclose that "Gut Buster" product, a spring-tension exercise device, could break and cause serious injury to user; requiring marketer to notify purchasers regarding serious safety risk); *International Harvester Co.,* 104 F.T.C. 949, 1056 (1984) (challenging failure to disclose risk that fuel caps on tractors could result in geyser of hot fuel and severe injury or death to tractor operator).

Answer. The Commission takes deceptive mortgage advertising very seriously, and has undertaken several initiatives to address it. Of course, the FTC can and will do more to address deceptive mortgage advertising. We continue to monitor the marketplace and will take enforcement action as appropriate.

The FTC has developed a multi-pronged approach to address mortgage deceptive advertising concerns. First, as you note, the Commission recently advised over 200 advertisers and media outlets that some mortgage ads with claims for very low monthly payment amounts or interest rates, without adequate disclosure of other important loan terms, are potentially deceptive or in violation of the Truth in Lending Act. Letters to advertisers are advising them to review their ads, and to read business and consumer education materials on the FTC's website to learn about relevant laws and requirements. Letters to media outlets are advising them about the potentially deceptive advertising, with guidance on screening ads for questionable claims.

Second, the Commission has brought and will continue to bring appropriate cases against mortgage advertisers who violate Section 5 of the FTC Act or the Truth in Lending Act. In the last decade, the agency has brought 21 actions alleging deceptive or unfair practices against companies in the mortgage lending industry, focusing in particular on the subprime market. Several of these landmark cases have resulted in large monetary judgments, collectively returning more than $320 million to consumers. We are continuing our law enforcement activity, with several nonpublic investigations involving mortgage advertisers who may have violated the FTC Act or the Truth in Lending Act.

Third, to help consumers recognize deceptive mortgage ads, the Commission has published a Consumer Alert, "Deceptive Mortgage Ads: What They Say; What They Leave Out." The brochure alerts consumers about mortgage ads that offer low rates or payments without disclosing the true terms of the deal as the law requires. In addition, this June, the Commission issued a brochure for consumers facing the possibility of losing their home because they cannot make their mortgage payments, and warning them about foreclosure scams. These new publications, as well as several previously released materials are available online at *www.ftc.gov*.[17]

Question 8a. Mr. Calhoun testified of no disclosure of escrow requirements and no disclosure of the penalty for not showing a proof of income. How can the FTC help in this area?

Answer. The Commission believes that it is critical for consumers to understand the terms of their loans and the implications of these terms. Subprime borrowers can make better-informed decisions if they are made aware that their mortgage payments will not include an amount to be placed in escrow for taxes and insurance and that therefore they will have to pay these amounts themselves. Subprime borrowers similarly can make better-informed decisions if they understand that their mortgage payments are higher than they otherwise would have been because they have not been required to document their income.

The FTC uses two primary means to help subprime borrowers who do not receive this information. First, in some factual circumstances, a lender's failure to disclose information related to escrows and no-documentation loans may be an unfair or deceptive act or practice in violation of Section 5 of the FTC Act,[18] and the FTC can commence a law enforcement action to challenge those acts and practices. For example, the FTC has brought enforcement actions against brokers and lenders who represented to consumers that their monthly payment included amounts for a tax and insurance escrow, when it did not.[19] More generally, the Commission has been aggressive in challenging unfair or deceptive acts and practices in mortgage lending,

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[17] *See, e.g.,* Mortgage Servicing: Making Sure Your Payments Count, available at *http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea10.shtm*. Home Equity Loans: Borrowers Beware!, available at *http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea11.shtm*.

[18] An act or practice is deceptive if (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that representation is material to consumers. *See generally Federal Trade Commission Policy Statement on Deception, appended to Cliffdale Assocs.,* 103 F.T.C. 110, 174–83 (1984). An act or practice is unfair if (1) it causes, or is likely to cause, substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers; and (3) the injury to consumers is not outweighed by countervailing benefits to consumers or to competition. 15 U.S.C. § 45(n).

[19] *FTC* v. *Mortgages Para Hispanos.Com Corp.,* No. 06–00019 (E.D. Tex. 2006); *FTC* v. *Diamond,* No. 02–5078 (N.D. Ill. 2002); *United States* v. *Mercantile Mortgage Co.,* No. 02–5079 (N.D. Ill. 2002); *FTC* v. *Associates First Capital Corp.,* No. 01–00606 (N.D. Ga. 2001).

focusing in particular on the subprime market.[20] Second, the FTC engages in substantial consumer education efforts to assist subprime borrowers in understanding the terms of their loans and the implications of these terms so that they can make better-informed decisions.

The Commission also notes that the Federal Reserve Board (FRB) is considering escrow and no-documentation loans issues in its ongoing rulemaking under the Home Ownership and Equity Protection Act.[21] The FRB has said that it intends to take action by the end of the year. The FTC will monitor developments in this area, and will consider what changes, if any, should be made to its strategy to help subprime borrowers make better-informed choices in this context.

Question 8b. If you had the authority to create rules of disclosure in this area, what could you do?

Answer. Federal agencies other than the Commission currently have the authority to promulgate rules specifying mortgage disclosure requirements. These rules are for the entire industry and are enforceable by all relevant agencies. The FRB has responsibility for disclosure of certain loan costs under the Truth in Lending Act.[22] The Department of Housing and Urban Development (HUD) also has responsibility for disclosure of settlement costs under the Real Estate Settlement Procedures Act.[23] I believe that the public interest would be best served if the FRB and HUD continued in their role of promulgating and implementing mortgage disclosure rules, including any reforms that are needed, rather than having the FTC impose additional mortgage disclosure requirements.

It has been recognized for many years that federally-required mortgage disclosures need to be improved. In 1996, Congress directed the FRB and HUD to simplify and improve mortgage disclosures and create a single mortgage disclosure form.[24] The FRB and HUD provided Congress with formal recommendations for mortgage disclosure reform in 1998.[25] Since that time, various parties have advanced other proposals for improving mortgage disclosures, including substantial efforts to develop a single mortgage disclosure form.

Nevertheless, the Commission has a role to play in mortgage disclosure reform. Building on prior work, the FTC staff has used its expertise in consumer research methodology to test mortgage disclosures to determine which convey to consumers the information they need to make better-informed decisions. In particular, the Commission's Bureau of Economics ("BE") recently conducted a study of mortgage lending disclosures that examines how consumers search for mortgages, how well consumers understand current mortgage cost disclosures and the terms of their own recently obtained loans, and whether better disclosures could improve consumer understanding of mortgage costs, consumer shopping for mortgage loans, and consumers' ability to avoid deceptive lending practices. The BE research included thirty-six in-depth interviews with recent mortgage customers, and quantitative testing with over 800 mortgage customers to explore their understanding of mortgage costs and terms disclosed in both current forms and a prototype disclosure form developed for the study.

The BE study found that: (1) the current federally required disclosures fail to convey key mortgage costs to many consumers; (2) the prototype disclosures developed by the FTC staff significantly improved consumer recognition of mortgage costs; (3) both prime and subprime borrowers failed to understand key loan terms when viewing the current disclosures, and both benefited from improved disclosures; and (4) improved disclosures provided the greatest benefit for more complex loans, for which both prime and subprime borrowers had the most difficulty understanding loan terms. The study also suggests that, in actual market transactions, subprime borrowers may face even greater difficulties understanding their loan terms than found in the study, and may benefit the most from improved disclosures. The study results are consistent with the FTC's view that consumer testing often is critical in the development and evaluation of consumer disclosures.

Comprehensive mortgage disclosure reform is needed. The best role for the FTC in enhancing the mortgage disclosures consumers receive is not to issue more mort-

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[20] The Commission's June 13, 2007 testimony before the House Committee on Financial Services described in detail the agency's activities in the financial services sector. The Commission's statement is available at *www.ftc.gov/os/2007/06/070613statement.pdf*.

[21] Home Equity Lending Market; Notice of Hearings, 72 *Fed. Reg.* 30380 (May 31, 2007).

[22] 15 U.S.C. § 1604.

[23] 12 U.S.C. §§ 2603–04.

[24] Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Pub. L. 104–208, 110 Stat. 3009), Section 2101.

[25] Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act (July 1998).

gage disclosure rules but to assist the Federal agencies who have issued such rules in revising and developing better disclosures. In particular, the FTC can assist in providing its expertise to determine whether proposed disclosures under development would be effective. The Commission would be pleased to work with the FRB and HUD in their efforts to improve mortgage disclosures.

Question 8c. Do you agree with Mr. Calhoun that Section 5 of the FTC Act should be expanded related to mortgage lending? He believes this would enhance the capacity for appropriate Federal regulatory response. What expansion would you seek?

Answer. Mr. Calhoun testified that Section 5 of the FTC Act should be expanded so that the FTC had jurisdiction over banks. While the Commission has an important role in ensuring compliance with the FTC Act for financial services companies that are not banks, it does not have experience in applying Section 5 to banks themselves. The Federal banking regulators, which closely supervise the banks, thrifts and credit unions under their respective jurisdictions, have broad expertise with respect to those depository institutions. I believe the public interest is best served if the Federal banking agencies continue to have jurisdiction over those institutions under Section 5.

Question 9. In May, this committee passed important price gouging legislation. One of those tools would give the President the authority to declare a *national energy emergency* and makes it illegal for any supplier to sell, or offer to sell, crude oil, gasoline, or petroleum distillates at an *excessive* price for use in the emergency declared area. I understand that the FTC opposes that additional authority. Why?

Answer. Federal antitrust law is designed to prevent the abuse of private market power that may empower sellers to charge prices other than those that they would charge in a competitive market. This is based on the long-standing premise that competition—and market prices—provide the best choices in quantity, quality, and prices of goods and services for consumers. Thus, law makers should hesitate to make it illegal for sellers to charge a price that results from the interplay of market conditions—even if that price may seem high.

During times of unusual product shortage—such as occurred in many parts of the country after Hurricanes Katrina and Rita, and undoubtedly will occur in a period of any significant emergency—market prices will rise as demand temporarily outstrips supply. These rising prices help clear the market—that is, equalize supply and demand—without the need to resort to long lines or other inefficient methods of product allocation. Indeed, high or rising prices provide the incentive for suppliers to take the financial risk to bring extra product into the affected market—as the petroleum companies did by shipping additional supplies of gasoline from Europe and other foreign locations into the United States after the 2005 hurricanes—while encouraging consumers to conserve gasoline by forgoing or postponing unnecessary automobile trips while product is short. Any price gouging law runs the risk of dulling both of those incentives and exacerbating and prolonging the emergency conditions.

I would anticipate especially serious consequences from any price gouging legislation that failed to take account of factors addressing costs and market conditions. Such legislation would severely restrict price flexibility in times of market disruption stemming from a natural disaster. This could extend the period of supply/demand imbalance beyond what it would have been if businesses were able to price according to market conditions. In addition, some price increases by firms in the face of temporary product shortages are reasonable or even necessary for the firms; even some advocates of price gouging legislation have recognized that a wholesaler or retailer needs to recover its increased costs and must be able to respond to unusual market conditions. Any legislation that prohibits "excessive" prices without allowing for increased costs (including reasonably anticipated replacement costs) or temporary market dislocations may have especially harmful effects in emergency conditions.

Another problem raised by price gouging legislation is how to define the offense clearly so that wholesalers and retailers can comply with the law—especially when such firms face potential criminal penalties for violating the prohibition against gouging. Because price flexibility is crucial for the efficient functioning of the economy (perhaps even more so during emergency disaster periods), defining an offense of price gouging has proved particularly challenging. Price gouging legislation would entail the difficult policy decision of how to draw a line between legal and illegal conduct—particularly conduct subject to criminal sanctions—in an area where any line is difficult to discern and where it is important not to discourage conduct that ultimately is benign or procompetitive, and in particular where such conduct may help to alleviate shortage conditions.

Although it is impossible to predict exactly how affected businesses may react, price gouging legislation that does not define the violation clearly or does not account for increased costs or market conditions may impel firms—especially small businesses lacking sophisticated legal counsel, such as many gasoline retailers—to shut down temporarily or stay out of the affected market rather than risk violating the price gouging statute, especially if the offense is punishable as a serious crime and offenders are subject to imprisonment and large fines. That result would benefit no one.

Question 10. I have noted in Mr. Cooper's testimony an interesting line of argument from this Administration and from industry. Prices go up because of a list of seemingly reasonable unnatural events. This includes fires floods, hurricanes, and other events. Other surprises include a larger than expected driving season, increased consumer demand, refinery outages, the increased price of ethanol, and more.

a. If industry continues to consolidate to capture a larger and larger share of the market and then we experience consistent "surprises" that impact prices, is there not something about this situation that is more systemic that the FTC needs to investigate and act on?

b. What is it about the nature of this oil and gas industry that we simply accept these price fluctuations due to "surprises" as business-as-usual?

Answer. In addition to reviewing all major petroleum industry mergers, Commission staff has looked at both merger and nonmerger issues at all levels of the petroleum industry and published their findings in a series of reports that help explain the workings of the industry.[26] The empirical work contained in these reports forms a picture of an industry that has restructured substantially in recent years, as well as an FTC program of vigorous antitrust enforcement that has maintained competition as that process unfolded.

Our economists' work demonstrates that, despite some increases over time, concentration for most levels of the U.S. petroleum industry has remained low to moderate, and there is compelling evidence that the industry has become more efficient in recent years, to the ultimate benefit of consumers. For example, economies of scale have become increasingly significant in shaping the petroleum industry. The United States has fewer refineries than it had 20 years ago, but the average size and efficiency of refineries have increased, along with the total output of refined products. Overall crude oil distillation capacity in the U.S. petroleum. industry increased from 15.3 million barrels per day in 1996 to 17.1 million barrels per day in 2005—equivalent to the addition of approximately 15 average-sized refineries. Moreover, today the petroleum industry is less vertically integrated than in past years. Several significant refiners have no crude oil production, and integrated petroleum companies today tend to depend less on their own crude oil production, while a number of independent retailers purchase refined products on the open market. Finally, some significant independent refiners have built market share by acquiring refineries that were divested from integrated majors pursuant to FTC enforcement orders.

Despite these efficiency gains, there are two fundamental reasons why unpredictable market disruptions—such as fires, floods and hurricanes may cause large swings in the prices of refined petroleum products. First, consumer demand for gasoline and other petroleum products is highly inelastic. That means that, on average, consumers do not reduce demand much when prices for these goods rise, particularly in the short run, because many consumers lack adequate short-run substitutes for gasoline to power their cars. This facet of consumer demand can lead to sharply higher prices during periods of market disruption. Illegal conduct does not have to be present for this phenomenon to occur. Moreover, in the case of refined petroleum products, variability in the prices of key inputs—crude oil since the 1970s, and ethanol more recently—has contributed significantly to fluctuations in the prices of gasoline and other refined products. Refiners, however, have no significant control over crude oil and ethanol markets.

Second, the supply of refined products also is inelastic in the short run. Therefore, over a short period of time, it is costly or difficult to increase output significantly

[26] In 2004, the FTC's Bureau of Economics published the third in a series of reports on mergers in the petroleum industry. In 2005, the Commission issued a report on the factors that determine the prices of gasoline. In May 2006, the Commission delivered its report to Congress on its investigation of possible gasoline price manipulation and the pricing of gasoline following Hurricane Katrina. And in August 2007, the Commission delivered to the President a report on the causes of gasoline price increases during the spring and summer of 2006. In addition, the Commission's economists have conducted several petroleum industry merger retrospectives and have engaged in individual research on pricing and other competition issues in the industry.

in response to higher prices. Redundant facilities and systems are expensive to build and maintain, and modem business practice is to keep inventories low in order to enhance efficiency (thereby keeping prices lower because maintaining inventory is expensive). These factors sometimes impose limitations on the responsiveness of supply all along the distribution chain immediately following market disruptions. Thus, when an unexpected contingency occurs—such as a pipeline break, a disruption in the supply of crude oil from a foreign country, or an extreme weather event—it may take some time for the distribution system to adjust and supply product in alternative ways so as to bring prices down. Similarly, when demand is stronger than anticipated, it takes time for refiners to readjust their output slates and production schedules in response to higher prices, for additional shipments to flow from one part of the country to another, or for imports to arrive from abroad. For example, it takes several weeks for pipeline shipments from Gulf Coast refineries to reach the Midwest. One way to eliminate this problem might be to require building additional capacity, or to require higher inventory levels that would be available during disruptions even if they sat idle during normal times. But these would be expensive strategies, particularly because, even if there are many unexpected contingencies every year, they do not occur in a smooth and predictable pattern; rather, they tend to affect different areas, have differing effects, and last different lengths of time. To be sufficient to eliminate price spikes stemming from all of these contingencies, additional capacity or inventory levels would need to be adequate to handle all possible events at all locations and times. Thus, in return for a damping of price spikes during emergencies, consumers would experience higher prices over the longer term stemming from the need to cover the costs of these redundancies.

Of course, the fact that supply and demand conditions in the oil and gas industry can give rise to significant price fluctuations in response to a natural disaster, other potential disruptions, or input cost changes does not necessarily mean that pricing in this industry uniformly results from competitive forces. Nevertheless, previous FTC studies of specific periods of relatively high gasoline prices, or of possible price manipulation more generally, did not uncover evidence of conduct that might be actionable under the antitrust laws or of inappropriate conduct that might have arisen from industry consolidation. Although the results of those past studies do not guarantee that future examinations of pricing in the industry would reach the same conclusions, there is no question that a careful investigation will always be a prerequisite to properly ascertaining the causes of unusual price movements.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. OLYMPIA J. SNOWE TO HON. DEBORAH PLATT MAJORAS

Question 1. The National Do Not Call Registry has been incredibly successful. However, this success hasn't really migrated over to other areas under the FTC jurisdiction—primarily with identity theft and SPAM e-mails. Approximately 15 million Americans were victimized by some sort of identity-theft related fraud during a twelve month period ending in mid-2006. And an estimated 12.4 billion spam e-mails are sent a day, which clog our inboxes and waste our time due to reading and deleting them.

Why this disparity—why has the DNC registry been so successful in curtailing unwanted telemarketing calls but yet other laws in place and the enforcement of those laws have not produced similar results with identity theft and SPAM e-mails?

Is it primarily the Commission's limited ability to seek civil penalties as you mention in your testimony or are there additional factors that exist?

What additional resources are necessary to curtail the growing trends of these activities—the number of identity theft victims has increased 50 percent over a 3 year period and SPAM e-mails are expected to increase over 60 percent from 2006 to 2007?

Answer. The National Do Not Call Registry has significantly reduced the number of unwanted telemarketing calls received by consumers. Its success hinges on high compliance rates and effective enforcement against those who illegally place calls to registered telephone numbers. Unfortunately, spam and identity theft present far more vexing problems for which there is no simple solution.

Spam

Unlike in telemarketing, where the Commission can more readily identify the telemarketer or seller responsible for a telephone call, spammers use a variety of techniques to hide their identities, including spoofing (the falsification of an e-mail's header information), open relays (unsecured mail servers through which spammers can have their messages forwarded), open proxies (misconfigured servers that per-

mit unauthorized users to send mail as if it is originating from the misconfigured server), and zombie drones (computers infected with malware that causes the computers to become part of a botnet through which spam can be sent). Each of these spamming techniques makes it difficult, if not impossible, to identify spammers through e-mail headers and significantly impedes law enforcement.

To combat the threat of spam, the Commission has been a leading advocate of domain-level authentication technologies that would help ISPs and law enforcement identify the domain from which an e-mail was sent. While not a panacea, these technologies could vastly improve the effectiveness of other anti-spam technologies (such as reputation and accreditation services) and hold significant promise in reducing the effectiveness of phishing campaigns. The Commission is encouraged that these technologies are beginning to be widely deployed.

In addition, spam can be sent from anywhere in the world to anywhere in the world. This international nature of spam often presents challenges for law enforcement. Congress enacted the U.S. SAFE WEB Act last year to give the FTC additional tools to combat cross-border fraud, including spam, spyware, and other online threats. Among other things, the U.S. SAFE WEB Act makes it easier for the FTC to cooperate and exchange information with foreign counterparts in combating spam and other cross-border consumer problems. The Commission is actively using the tools provided by the U.S. SAFE WEB Act in its fight against spam.

The Commission is also doing its part to combat spam through law enforcement and consumer education, as outlined in its September 12 testimony. CAN–SPAM added civil penalties to the Commission's arsenal in spam enforcement actions. 15 U.S.C. § 7706(a). This authority has proven especially useful in spam cases where the Commission's traditional equitable remedies would have provided inadequate relief. For instance, in seven cases alleging violations of CAN–SPAM and the Adult Labeling Rule, 16 C.F.R. § 316.4, the Commission obtained more than $1.1 million in civil penalties. Civil penalty authority enabled the Commission to obtain significant monetary judgments without having to demonstrate and attempt to monetize the intrusion suffered by consumers who received pornographic e-mail.

Identity Theft

Unlike telemarketers who are often legitimate marketers trying to comply with the law, identity thieves are criminals who deliberately flout it. Further, identity theft is a far more complex problem than receiving telemarketing calls. Indeed, because identity theft can be committed in a variety of different methods, can be tremendously lucrative, and can go undetected for significant periods, its eradication requires nothing short of major changes in how we tackle this devastating crime. Although the Commission itself does not have criminal prosecutorial authority, I served as co-chair of the President's Identity Theft Task Force,[1] which released several recommendations this spring to improve criminal prosecution of identity theft. FTC staff is involved in the implementation of some of these recommendations. For example, one of the Plan's major recommendations is to increase coordination among law enforcement agencies to facilitate identity theft investigations and prosecutions. The Commission will continue to support that goal through its Identity Theft Data Clearinghouse, the Federal Government's central repository of identity theft victims' complaints. The Commission is also participating in several training sessions for law enforcement such as regional identity theft training seminars for local police and investigators on victim assistance and identity theft investigations and the development and expansion of training for Federal prosecutors on how to develop an effective identity theft prosecution. For example, just last month, the FTC worked with DOJ, the Secret Service, the U.S. Postal Inspection Service, and the American Association of Motor Vehicle Administrators to provide training for local law enforcement in the Chicago area; in December, we will conduct similar training in North and South Carolina. In addition, the Identity Theft Task Force forwarded legislative recommendations to Congress that seek to close existing loopholes for the prosecution of some types of identity theft.

In addition to criminal prosecution, the Identity Theft Task Force's recommendations focused on identity theft prevention through improved data security and victim recovery. The FTC is also leading efforts to develop a comprehensive record on the use of Social Security numbers in the private sector, with the goal of developing recommendations on how we can limit the availability of this valuable information to criminals, while at the same time preserving the many beneficial purposes for which SSNs are collected, used, and shared. The Commission solicited and received more than 300 public comments on this issue and will hold a workshop on SSN usage

[1] Established by Executive Order in May, 2006. Exec. Order No. 13,402, 71FR27945 (May 10, 2006).

on December 10 and 11. In addition, this past spring, the Commission hosted a workshop on authentication, bringing together academics, business groups, consumer advocates, and others to explore new developments in the rapidly changing field of identity management. FTC staff is working on a report that will describe what we learned at this workshop, such as information about technological and policy requirements for developing better authentication processes, which will assist all policymakers addressing this pernicious crime.

With respect to victim assistance, the Commission has already implemented many of the Task Force recommendations, including publishing a "Victims' Statement of Rights," and launching a standard police report *http://www.idtheft.gov.* for identity theft victims. The FTC and DOJ are coordinating with the American Bar Association to support more victim assistance through *pro bono* programs and are developing a training curriculum for victim assistance counselors in the court system.

Your question asks about civil penalties. Currently, the Commission does not have authority to seek civil penalties in data security cases unless a special statute, such as the Fair Credit Reporting Act, has been violated. The Commission recommends that Congress pass legislation to provide the Commission with civil penalty authority in data security cases. We believe the threat of civil penalties will serve as an important incentive for companies to maintain data security, thus deterring identity theft.

In terms of resources, the Commission has requested 10 additional FTE for FY08 to work on data security and identity theft issues.

Question 2. Last year, the FTC published the "Business Opportunity Rule" as a Notice of Proposed Rulemaking. It is my understanding that the Commission will report later this year on the NPRM's status and likely make recommendations regarding next steps. The proposed rule would eliminate some existing requirements as well as many of the current disclosures. However, it would then propose new waiting periods and disclosure requirements for sales of "business opportunities." Some concerns have been voiced regarding these new rules. Primarily, that the new waiting period might delay legitimate business efforts and apply a cumbersome administrative process to business's recruiting efforts. Also additional privacy concerns have been raised regarding the new disclosure requirements. Can you elaborate on the current status of the regulation and how the FTC plans to address the concerns that have been voiced?

Answer. Currently, FTC staff is carefully considering the many thoughtful comments received in response to the NPRM for the business opportunity rule—including several from Members of Congress—on all the issues implicated by this rulemaking proposal.

Among the issues under careful consideration is whether the proposal goes too far in its attempt to curb abuses inflicted on the public by pyramid schemes that purport to be business opportunities, and whether this proposal, if adopted, would result in unintended and unnecessary compliance burdens on legitimate multilevel marketing companies. The concerns about the proposed waiting period and privacy concerns implicated by the disclosure of prior purchasers have been articulated clearly and in detail in the comments the Commission received.

While it would be premature to comment on the Commission's views on these issues, the Commission's aim has been to craft a business opportunity rule that is narrowly tailored to address the abusive practices of business opportunity promoters that result in substantial consumer injury. The goal is to reduce unnecessary compliance costs by having a narrowly-focused rule that requires only the most essential material disclosures and that prohibits the unfair or deceptive practices identified over the course of the FTC's many years of law enforcement against bogus business opportunity sellers.

The Commission staff is giving careful consideration to the concerns articulated by legitimate MLM companies and Members of Congress as it formulates recommendations to the Commission on the next steps in this rulemaking proceeding. Rulemaking under authority of the FTC's special rulemaking statute, 15 U.S.C. 57a, provides numerous opportunities for public comment and oral participation with respect to any rulemaking proposals. Further, without prejudging this matter in any way, it should be noted that the final rule adopted at the end of an FTC rulemaking proceeding is often considerably refined, as compared to the initial proposal put forth at the start of the proceeding.

Question 3. There is growing concern about a form of identity theft, phishing—where a fraudulent e-mail is sent in order to deceive the recipient into giving personal or financial account information.

Consumer Reports found in 2006 that approximately 2.4 million Americans have been victims of phishing attacks and the total losses associated with phishing is

more than $600 million, just in 2006 alone. A report from ICONIX indicates that approximately 59 million phishing e-mails are sent a day and the number one country were most of the phishing e-mails/websites originate is the U.S.

There was even a recent account of one phishing attack that fraudulently utilized the name of the FTC, which is a tad ironic since the Commission is responsible for prosecuting e-mail fraud. What can the government do to curtail this e-mail and website based fraud? Could current law be changed to better address this issue in providing more explicit tools for law enforcement to prosecute the bad actors that are behind these phishing schemes?

Answer. Phishing spam—e-mail that attempts to trick recipients into providing personally identifiable information to scam artists posing as legitimate businesses—has increased significantly in recent years. To combat phishing, the Commission has maintained an aggressive anti-spam and anti-phishing program by hosting public workshops to gain new insights from experts, disseminating consumer education, spurring the development of industry-driven technology, and pursuing law enforcement actions.

This summer the Commission hosted a workshop, "Spam Summit: The Next Generation of Threats and Solutions," to examine how spam has evolved and what stakeholders can do to address it. Workshop participants described how spam is being used increasingly as a vehicle for more pernicious conduct, such as phishing and the delivery of viruses and spyware. This spam goes beyond mere annoyance to consumers—it can result in significant harm by shutting down consumers' computers, enabling keystroke loggers to steal identities, and undermining the stability of the Internet. The Spam Summit illustrated that criminal law enforcement, industry-driven technologies, public/private partnerships, and international cooperation are paramount for managing the spam problem.

The FTC also fights phishing by maintaining a vigorous consumer education program. The Commission's consumer education materials (located at *www.onguardonline.gov*) aim to inform consumers of the dangers of phishing and urge them not to reply to an e-mail or pop-up message that asks for personal or financial information, use anti-virus and anti-spyware programs and a firewall, and forward suspected phishing messages to the FTC at *spam@uce.gov*. The FTC's consumer alert, "How Not to Get Hooked by a Phishing Scam" has been visited over 1.1 million times since 2003, and the OnGuard Online article on phishing has received over 600,000 unique visits in the last 2 years.

The Commission is redoubling its efforts to stop illegal spam and phishing schemes. First, in the upcoming months, we plan to convene a half-day anti-phishing roundtable with the goals of identifying opportunities for outreach and securing commitments from key stakeholders in the anti-phishing community, including consumer and industry groups. Second, we plan to produce a video with important information about phishing. Third, we are working with the anti-phishing community to mobilize members of the financial sector and revitalize consumer education outreach efforts, including promotion of the OnGuard Online materials. Working with the financial sector will be critical, given that financial services is the industry sector most targeted by phishers.[2]

Finally, we continue to encourage the industry's adoption of domain-level e-mail authentication as a significant anti-spam and anti-phishing tool. Domain-level authentication would ensure that a message that purports to be from an e-mail address at a domain actually came from an address at that domain. In other words, if a phishing message purported to be from a financial institution's domain, but actually came from an IP address not associated with the financial institution, the message would not be properly authenticated. As a result, the message would not reach the consumer's in-box. At our Spam Summit this summer, we learned that industry has made great strides with e-mail authentication—50 percent of legitimate e-mail is now authenticated.[3] A recent study indicates that Internet Service Providers are now applying negative scoring to unauthenticated messages.[4] We look forward to working with industry as they continue to advance in their e-mail authentication efforts.

The Commission has not recommended any modifications to current law to cover phishing e-mails. The FTC already has the necessary legal authority to pursue civil actions against phishers. On the underlying behavior in phishing scams is often criminal and covered by criminal statutes.

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[2] According to the Anti-phishing Working Group, the financial services sector was the most targeted industry sector at 95.2 percent of all attacks in the month of June.

[3] *See http://www.ftc.gov/bcp/workshops/spamsummit/draft_transcript_day2.pdf.* At 85.

[4] *See http://www.dmnews.com/cms/dm-news/e-mail-marketing/42251.html.*

Question 4. With respect to consumer education about identity theft and how to avoid becoming a victim, the FTC has distributed close to 3 million brochures and tens of thousands of educational kits as well as created the OnGuard Online website, which has received some 3.5 million visits to date. Have you been able to gauge the success of your outreach and educational efforts? Are you performing surveys on consumer knowledge about identity theft and ways to protect themselves?

Answer. Education and outreach are core elements of the FTC's campaign against identity theft. The FTC's product distribution figures are one measure of the success of the FTC's educational campaigns. As you allude to in your question, the FTC has distributed more than 2.6 million *Deter, Detect, Defend* brochures since 2006, recorded more than 3.2 million visits to the program's website, and disseminated 55,000 kits. The Commission, which directs its education efforts to businesses as well, introduced a new data security guide in March 2007 to help businesses secure customers' sensitive personal information. The Commission has distributed more than 120,000 copies of the guide. In fact, it's initial printing (22,000 copies) was exhausted in 5 days. The guide also has been accessed 25,000 times online since its release.

The FTC develops its advice for consumers based on its enforcement experience, information it collects during FTC conferences and workshops, and consultation with industry representatives, consumer advocates and academics. The FTC occasionally conducts original research, such as its fraud survey, which informs its messages for consumers.

Another measure of the success of FTC efforts is how many consumers it reaches. The Commission receives about 15,000 to 20,000 contacts each week from consumers seeking information on how to recover from identity theft or how to avoid becoming a victim. We provide these consumers with important educational information.

A third way to gauge the Commission's outreach efforts is to consider the willingness of the private, public, and non-profit sectors to use the campaign materials without changes. Hundreds of industry, consumer advocacy, law enforcement, and community groups distribute the Commission's identity theft materials. Several prominent national groups, including the National Association of Realtors and the Direct Marketing Association, have co-branded and reproduced copies of the materials to distribute among their members.

We have also conducted surveys on identity theft generally. In September 2003, the FTC released a survey which described the extent of identity theft in the United States and detailed the Commission's ID Theft program from its inception in 1998. *See http://www.ftc.gov/opa/2003/09/idtheft.shtm.* The FTC expects the results of a follow-up survey to be released later this year.

Question 5. In a recent survey, 80 percent of Internet users voiced concern about being victims of online identity theft. But yet, most identity theft actually takes place offline through the stealing of paper bills, account statements, credit cards, etc. and only about 9 percent of identity theft crimes occur online. In fact, many recommend that utilizing online banking and bill paying services would reduce the threat of identity theft given the encryption and authentication technologies used, as well as the lack of any paper billing or statements to steal.

How can we effectively make sure people protect themselves online but at the same time assuage their concerns and reluctance about conducting business with or purchasing products online from legitimate businesses? Or is this concern of online identity theft not a major hindrance to the growth potential of e-commerce?

Answer. Identity thieves use various techniques to steal consumer data in order to commit identity theft.[5] With respect to the online environment, certainly, consumer concerns about online identity theft can be a potential obstacle to the growth of e-commerce. Our message to consumers has been that computers and the Internet offer tremendous benefits in terms of choice, convenience, and competition. They should continue to take advantage of these benefits, while exercising caution to secure their information and their money. Our consumer education contains action-oriented advice in plain language. Our goal is to educate consumers about sound computer security practices, and we believe that this goal is best accomplished with a positive message that empowers consumers, rather than one that scares them. In-

[5] Some have suggested that consumers have a greater risk of identity theft in the paper environment. In most surveys, including those conducted by the FTC and Javelin Research, roughly half of all victims do not know precisely how their data was captured by the thief. (*See www.ftc.gov/bcp/edu/microsites/idtheft/downloads/synovate_report.pdf; www.javelinstrategy.com/products/99DEBA/27/delivery.pdf.*) Among those who do know how their data was obtained, most of them can point to a specific incident where their purse, wallet, or postal mail was taken.

deed, all of the materials we discuss in our September 12 testimony, adopt this approach—from our nationwide *Deter, Detect, Defend* campaign to our materials on *OnguardOnline.*

In addition, our business outreach efforts recognize that identity theft undermines consumer trust in the marketplace. Part of our outreach message to industry has been that safeguarding consumers' information from identity theft is simply good business. If businesses do not protect such information, they will lose consumer trust. We continue to promote this message in encouraging businesses to implement sound data security procedures.

Question 6. The 2006 FTC study on the price of gasoline and price gouging in the aftermath of Hurricane Katrina concluded that market forces were exclusively the drivers in price increases. Since that time the U.S. Senate's Permanent Subcommittee on Investigations as well as report from the Attorney Generals of Illinois, Iowa, Missouri and Wisconsin have concluded that derivatives trading activity placed upward pressure on energy prices. Do you believe that the two separate reports, the Permanent Subcommittee on Investigations and the State Attorneys Generals were accurate?

Answer. I understand that this question refers to the June 27, 2006, report by the staff of the Senate Homeland Security Permanent Subcommittee on Investigations entitled "The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat," and to the report entitled "The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral," prepared in March 2006 by Dr. Mark N. Cooper for the Midwest Attorneys General Natural Gas Working Group. Although FTC staff reviewed those reports when they were issued, I am not in a position to opine on their accuracy. Both reports appear to address issues largely outside of the FTC's primary areas of expertise, and any questions regarding the accuracy of those reports should be addressed to their authors or to the CFTC and FERC, which have the relevant expertise.

Question 6a. Does the FTC work in conjunction with CFTC to ensure that the futures markets are not manipulated?

Answer. The FTC does not work regularly in conjunction with the CFTC on questions of futures market manipulation. The two agencies have significantly different missions: the FTC is an antitrust and consumer protection law enforcement agency, while the CFTC is a sectoral regulatory agency with a different statutory mandate. To the extent that issues within the purview of the CFTC also indicate that there may be a violation of the laws that the FTC enforces, we would, of course, seek relevant information from the CFTC and, as appropriate, would provide the CFTC with information relevant to that agency's mission. With regard to manipulation of the futures market, however, the FTC generally lacks regulatory or law enforcement authority with particular reference to futures trading. If it appears that arguably anticompetitive conduct may affect, or may be affected by, futures trading—for example, an anticompetitive merger that impedes the proper functioning of futures markets—the FTC itself would conduct any appropriate investigation pursuant to the antitrust laws that it enforces. I note, for instance, that our 2006 report to Congress on our investigation of possible gasoline price manipulation included a chapter that considered manipulation of futures prices through the use of physical assets and also considered possible manipulation of bulk spot futures prices through the inappropriate reporting of transactions to price reporting services.

Question 6b. Does the FTC need additional authority to ensure that these markets are being fairly conducted?

Answer. Congress entrusted the CFTC with the authority to police manipulative and other unlawful conduct in commodity futures markets. I note that the CFTC has brought enforcement actions recently involving alleged manipulation in markets for propane, and the Department of Justice obtained a guilty plea from an official of BP for manipulation of propane futures. I do not believe that the FTC, which does not have substantial familiarity with futures markets, should duplicate or intrude on the CFTC's mandate.

Question 6c. Will the role of speculation be considered in future reports?

Answer. The FTC's May 2006 report to Congress on our "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases" considered whether control of certain physical assets, such as product storage facilities, might be used to manipulate gasoline futures prices by creating "squeezes" in the related commodity markets. Such squeezes could force short sellers to offset their futures contracts at inflated prices. In fact, this concern was one reason why the FTC challenged BP's acquisition of ARCO in 2000 and obtained relief to address the specific concern about the transaction's possible adverse effects in crude oil futures. Although future FTC reports may revisit this type of futures market manipulation—

particularly insofar as mergers might enhance the potential for such behavior—we are unlikely to address purely speculative behavior in futures markets. Rather, we would defer on that topic to agencies such as the CFTC, which has more expertise and a direct enforcement interest in that area. Similarly, as the FTC's case involving the BP/ARCO merger illustrates, the FTC would take prompt and strong action if any attempt to manipulate futures markets constituted an antitrust violation (including a referral to the Department of Justice if we uncovered evidence of criminal conduct). Absent evidence of an antitrust violation, however. I would expect the CFTC—the agency with primary jurisdiction in this field—to continue as the appropriate regulator of commodities futures markets. I also would expect the Federal Energy Regulatory Commission ("FERC") to continue to play an important role in markets for natural gas. For example, in "High Natural Gas Prices: The Basics," issued in 2006, FERC outlined what it is doing to prevent manipulation in natural gas markets, including implementation of a Memorandum of Understanding between FERC and the CFTC to facilitate the detection of such manipulation. *See http://www.ferc.gov/legal/staffreports/high-gas-prices.pdf.*

Question 7. There has been substantial debate over the proper definition of "price gouging." In your written testimony last year, Ms. Majoras stated that "although widely understood to refer to significant price increases (typically during periods of unusual market conditions), the term "price gouging" similarly lacks an accepted definition. It is not a well-defined term of art in economics, nor does any Federal statute identify price gouging as a legal violation." The Senate passed an energy bill that included a price gouging law. Specifically, the language of the bill makes it a Federal crime to sell energy products at "unconscionable levels." The bill also stipulates in section 604 that it is unlawful for any person, directly or indirectly, to use or employ any manipulative or deceptive device, in contravention of such rules and regulations as the FTC may prescribe as necessary for the public interest. How would the FTC define "unconscionable levels" if given authority by Congress?

Answer. "Unconscionable levels" has no established legal or economic meaning. The FTC would be guided first by the provisions of the enacted statute, and I note that legislation under consideration in both Houses sets forth a number of elements and factors to be considered.

Section 602(4)'s definition of "unconscionably excessive price," for example, requires reference to increased wholesale and operational costs, the prices charged by other firms in the same geographic market, and the impact of local, regional, national, and international market conditions. These are important considerations. I expect that, if the FTC were charged with defining "unconscionably excessive" pricing in the absence of other guidance, we also would take account of not only actual increases in replacement costs, but also the supplier's reasonable anticipation of rising costs as an emergency persists, as well as the risks that a supplier might take on in order to bring additional supply to the affected region.

Moreover, in determining whether price gouging has in fact occurred and should be prosecuted, the Commission likely would consider, among other factors, the elements currently set forth in Section 603(b), including whether the price at issue would reasonably exist in a competitive and freely functioning market, and whether the supplier actually increased the amount of gasoline supplied to the area during the emergency period.

Question 7a. Under section 604 what regulations or rules do you envision the FTC ratifying with this additional authority?

Answer. The Commission would consider carefully how best to implement whatever legislation is enacted. Although it may be premature to suggest any specific plan or conclusions at this point, I anticipate that the agency would begin implementing Section 604, if enacted, by identifying practices that might be viewed as market manipulation and examining the likely effects of a prohibition of such practices on prices, markets, and consumers. I anticipate that the FTC's approach would be informed in part by its examination of various possible forms of manipulation addressed in the above-referenced report that we submitted to Congress in May 2006. That report discussed, for example, practices related to gasoline production, transportation, inventory, spot pricing, and futures markets. Given the key roles that the CFTC and FERC play with respect to potential market manipulation, I would anticipate working closely with those agencies during this process. If the Commission identified any practices that manipulate, rather than respond to, markets to consumers' detriment, and if such practices were not already illegal, those practices presumably would be the focus of any regulation.

Question 7b. Do you believe that a Federal price gouging law should be enacted?

Answer. For the reasons discussed in my testimony last year, I remain unpersuaded that such legislation would produce a net benefit for consumers. Be-

cause prices play such a critical role in a market-based economy, attempts to cap or control prices can lead to the misallocation of resources to the detriment of consumers. In a period of shortage—particularly with a product, like gasoline, that can be sold in many markets around the world—higher prices create incentives for suppliers to send more product into the market, while also creating incentives for consumers to use less of the product. I f price signals are not present or are distorted by legislative or regulatory command, markets may not function efficiently and consumers may be worse off.

If Congress proceeds with price gouging, then I believe it should consider several factors in order to enact a statute that will be most likely to attack unwarranted price increases while having the smallest adverse impact on rational price incentives. Any price gouging statute should define the offense clearly. A primary goal of a statute should be for businesses—as well as law enforcers and courts—to know what is prohibited. An ambiguous standard would only confuse consumers and businesses and would make enforcement difficult and arbitrary.

The challenge in crafting a price gouging statute is to be able to distinguish gougers from those who are reacting in an economically rational manner to the temporary shortages resulting from the emergency. It seems beyond dispute—and acknowledged by those on all sides of the debate about price gouging legislation—that standards governing price gouging should incorporate important mitigating factors, such as an allowance for increased costs (including anticipated costs) that businesses face in the marketplace. Enterprises that do not recover their costs cannot long remain in business, and exiting businesses would only exacerbate the supply problem. Furthermore, cost increases should not be limited to historic costs, because such a limitation could make it uneconomic for retailers to purchase new product at the higher wholesale prices. There also should be consideration of local, national, and international market conditions that may be a factor in the tight supply situation. International conditions that increase the price of crude oil naturally will have a downstream effect on retail gasoline prices. Local businesses should not be penalized for factors beyond their control.

Question 8. There was a recent article in *The Washington Post* about Comcast and how the company disconnected broadband service to some its heaviest users. The company cited that these high usage customers were draining network capacity therefore slowing down the network and degrading Quality of Service of others customers. Yet it seems as if Comcast didn't utilize the best process or disclosure of its policy regarding this matter, given that some customers were unclear as to what the specific download limits were and the company continues to decline to reveal these limits. While this seems to be limited to just Comcast, does this type of business practice concern the Commission given the lack of appropriate disclosure as to what the bandwidth and download limits are for customers?

Answer. Without commenting on the practices of a particular company, I can assure you that if an Internet service provider misrepresents, or fails to disclose, material aspects of its services in advertising or marketing to consumers, it may be liable for violations of Section 5 of the Federal Trade Commission Act, which prohibits unfair and deceptive acts and practices.

For over a decade now, the FTC has enforced the consumer protection and antitrust laws in countless matters involving Internet access. In particular, the FTC has investigated and brought enforcement actions against ISPs for allegedly deceptive marketing, advertising, and billing of Internet access services. The FTC has devoted and will continue to devote significant resources to the important area of Internet access.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BYRON L. DORGAN TO MICHAEL D. CALHOUN

Question 1. Did FTC drop the ball on deceptive advertising due to lack of resources?

Answer. Congress has recognized that the FTC has insufficient resources to combat abusive and deceptive practices.[1] While we would prefer that the FTC do more, the simple fact is that the FTC is hard-pressed to address all of the widespread abuses in the mortgage market with its limited resources and current constraints of the FTC Act. Moreover, it must be remembered that it is also responsible for enforcement oversight of all other financial practices by all non-depositories: fair credit

[1] FTC had "insufficient resources to combat the abusive and deceptive telemarketing practices by itself" and the FTC "will continue to need the states' resource assistance in combating telemarketing fraud." H.R. Rep. No. 103–20, at 3 (1993).

reporting, debt collection practices, "credit card cramming" to name a few. And of course, its charge is not just in the financial practices sector in any event. Telemarketing fraud, health and food advertising—it is expected to do much with relatively little. Congress could help the FTC do more on mortgage abuses by providing the agency with increased funding to carry out the task.

To its credit, the FTC has been active in challenging lenders who are engaged in abusive lending practices with the limited resources it has. These efforts include filing complaints and consent orders for alleged violations of the Home Ownership and Equity Protection Act ("HOEPA"), the Truth in Lending Act ("TILA") and its implementing regulation, Regulation Z, and the FTC Act.[2] The Commission has also worked with states to increase and coordinate enforcement efforts. Additionally, the FTC has implemented consumer education efforts to help consumers avoid potential abuses.

The FTC should expand its efforts to eliminate deceptive advertising in the mortgage market, in part by compelling mortgage brokers not only to cease deceptive advertising, but also to engage in corrective advertising: (1) to dispel the residual effects of deceptive advertisements; (2) to help restore competition to the state that prevailed before unfair practices and deceptions influenced the market; and (3) to deprive lenders from falsely obtained gains to which advertising may have contributed.

Additionally, the FTC Act should be expanded and funding should be provided so that the FTC has the legal authority and the resources to do more.

However, as we discuss in connection with disclosures, below, deceptive advertising is only a part of the problem. Advertising that does not include deceptive statements do not protect consumers from deceptive statements at closing, nor from practices that are unfair, though not technically accompanied by deception. As we discuss below, certain acts should be specified to be unfair and deceptive—period. That makes a "bright line" that lenders have long claimed to want, reduces uncertainty, and makes compliance and enforcement much simpler.

Question 2. The FTC identified ads with claims for very low monthly payment amounts or interest rates, without adequate disclosure of other important loan terms. And the FTC is now advising more than 200 advertisers and media outlets that some mortgage ads are potentially deceptive or in violation of the Truth in Lending Act. These letters are a good step, but I wonder what more the FTC could have done or could do in the future.

a. You testified of no disclosure of escrow requirements and no disclosure of the penalty for not showing a proof of income. How can the FTC help in this area?

b. What are other disclosure problems the FTC should address?

c. If the FTC had the authority to create rules of disclosure in this area, what could they do?

Answer. CRL supports the FTC's efforts to require lenders to be more accurate in advertising mortgage loan products. In too many cases involving abusive loans, mortgage lenders initially used an illusory and deceptive monthly mortgage payment to lure in borrowers and convince them to accept loans with terms that were actually much more costly. However, increased disclosure will not be sufficient to address abusive lending practices. The FTC has extensive experience in addressing unfair and deceptive practices and we would recommend enhancing the FTC's power to address deceptive practices like the failure to escrow for taxes and insurance or the failure to document income directly, in addition to what it is already doing to address advertising and disclosure concerns.

A common fallacy is that borrowers consciously choose and accept the loan terms they get because they read and sign an array of disclosure documents during the loan closing. In fact, most terms on a standard mortgage contract are buried in preprinted loan documents, and are dictated by the lender, not negotiated by consumers. Further, the documents outlining critical loan terms are typically only three to five documents out of dozens in a standard loan closing.

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[3] See *FTC* v. *Capital City Mortgage Corporation* (D.D.C.) (announced 1998); *FTC* v. *Cooper* (C.D.Cal.);, *FTC* v. *Capitol Mortgage Corp.* (D.Utah), *FTC* v. *CLS Financial Services, Inc.* (W.D.Wash.), *FTC* v. *Granite Mortgage, LLC* (E.D.Ky.), *FTC* v. *Interstate Resource Corp.* (S.D.N.Y.), *FTC* v. *LAP Financial Serv., Inc.* (W.D.Ky.), and *FTC* v. *Wasatch Credit Corp.* (D.Utah) (Announced on July 29, 1999, these cases were part of "Operation Home Inequity," an FTC enforcement and consumer education campaign seeking to curb abusive practices in subprime mortgage lending); *United States* v. *Delta Funding Corporation and Delta Financial Corporation* (E.D.N.Y.) (Settlement by national subprime lender for asset-based lending, announced on March 30, 2000), *FTC* v. *Nu West, Inc., et al.,* (W.D.Wash.) (2000), *FTC* v. *First Alliance Mortgage Co., et al* (C.D.Cal.) (2000), FirstPlus Financial Group, Inc. Docket No. C–3984 (deceptive advertising consent agreement, 2000); *FTC* v. *Citigroup Inc., et al.,* (N.D.Ga.) (misleading and deceptive statements and claims case, 2001).

As former MBA President Robert M. Couch has explained, "Consumers rarely use these forms and disclosures to compare prices or identify the terms of the transaction because, quite simply, they cannot understand what they read nor what they sign. In addition, the mandated forms lack reliable cost figures, a fact that impedes prospective borrowers from ascertaining true total cost."[3]

Other issues that hinder disclosures from being effective include the complexity of many mortgage products and the difficulty of comprehending many disclosure forms that are allegedly in "plain English." For example, according to the commonly used Flesch Readability Score, the Truth in Lending form disclosures are comparable to reading *The Wall Street Journal* or *Harvard Business Review*. In short, improved disclosures are not likely to help borrowers, and in some cases they may make the situation worse.

Another factor is simply that people tend to trust professionals with whom they deal (and, of course, they should be able to do that). When there is an express or implied conflict between what is "disclosed" in a mass of papers and what the professional tells the consumer, it is the oral information that most consumers rely on. Disclosure has not proven to be an effective way to prevent this deceptive practice—many subprime loans do include a warning that escrows are not included in the monthly payment, but brokers have been effective at focusing borrower attention on the loan and away from additional costs that will arise later. While it is already a deceptive practice to mislead or deceive people with oral statements, or contradict written statements, that becomes a much more difficult case to prove. Typically, only after many consumers have been harmed—enough to establish evidence of a pattern and practice—can an enforcement action be brought.

Rather than disclosure, simple and easily enforced prohibitions are the preferred alternative. As you note in your question, two common subprime practices that contributed to the current high rate of subprime foreclosures were the failure to escrow property taxes and hazard insurance and the failure to properly document income in underwriting the borrower's ability to repay a subprime loan. Both of these deceptive practices should be prohibited for subprime and nontraditional mortgages.

Failure to escrow: Less than a quarter of subprime loans include escrows for taxes and insurance.[4] This deceptive practice gives the borrower the impression that the monthly payment is affordable when, in fact, there are significant additional costs that are not included in the loan payments. When lenders include escrow funds as part of the borrower's monthly house payment, they ensure that these funds are available when due, and they also make the true cost of the loan more transparent. Responsible lenders have always understood that establishing an escrow account is even more important for lower-income borrowers or those with high debt burdens and less disposable income. Yet, in stark contrast to the prime mortgage market, most subprime lenders make loans based on low monthly payments that do not escrow for taxes or insurance.[5]

When homeowners are faced with large tax and insurance bills they cannot pay, the original lender or a subprime competitor can benefit by enticing the borrowers to refinance the loan and pay additional fees for their new loan. In contrast, it is common practice in the prime market to escrow taxes and insurance and to consider those costs when looking at debt-to-income and the borrower's ability to repay.[6]

Low/no documentation: Inadequate documentation also compromises a lender's ability to assess the true affordability of a loan. Fitch Ratings, the international ratings firm, recently noted "loans underwritten using less than full documentation

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[3] Robert Couch testimony before the U.S. House of Representatives Financial Services Subcommittee (November 2003), cited in "Financial Education: No Substitute for Predatory Lending Reform," Issue Paper No. 7, Center for Responsible Lending (September 13, 2004).

[4] See, *e.g.,* "B&C Escrow Rate Called Low," *Mortgage Servicing News Bulletin* (February 23, 2005), "Servicers of subprime mortgage loans face a perplexing conundrum: only about a quarter of the loans include escrow accounts to ensure payment of insurance premiums and property taxes, yet subprime borrowers are the least likely to save money to make such payments . . . Nigel Brazier, senior vice president for business development and strategic initiatives at Select Portfolio Servicing, said only about 25 percent of the loans in his company's subprime portfolio have escrow accounts. He said that is typical for the subprime industry."

[5] See, *e.g.,* "Attractive Underwriting Niches," Chase Home Finance Subprime Lending marketing flier, at *http://www.chaseb2b.com/content/portal/pdf/subprimeflyers/Subprime_AUN.pdf* (available 9/18/2006) stating, "Taxes and Insurance Escrows are NOT required at any LTV, and there's NO rate add!", (suggesting that failing to escrow taxes is an "underwriting highlight" that is beneficial to the borrower). 'Low balling' payments by omitting tax and insurance costs were also alleged in states' actions against Ameriquest. *See, e.g., State of Iowa, ex rel Miller* v. *Ameriquest Mortgage Co. et al,* Eq. No. EQCE–53090 Petition, at ¶16(B) (March 21, 2006).

[6] In fact, Fannie Mae and Freddie Mac, the major mortgage investors, require lenders to escrow taxes and insurance.

standards comprise more than 50 percent of the subprime sector. . . .'' ''Low doc'' and ''no doc'' loans originally were intended for use with the limited category of borrowers who are self-employed or whose incomes are otherwise legitimately not reported on a W–2 tax form, but lenders and brokers have increasingly used these loans to inflate borrower incomes and put the borrower into an unaffordable loan.

The unwarranted, unnecessary, and widespread use of stated income, and lo- or no-doc loans facilitated the epidemic of unsustainable lending. Lenders may evaluate the risk of a loan before approving it, but without adequate documentation of income, a lender's approval of a loan is meaningless. Even as the problem became undeniable, too many loans continued to be made on this basis into 2007. Based on one CRL review of 10 mortgage-backed securities, we found that, on average, more than one-third—37 percent—of these recently securitized subprime loans were approved based on stated income or reduced documentation standards for verifying the borrower's income.[7] The vast majority of borrowers have readily documentable W–2 income; by putting them in low-doc loans, lenders are either charging them up to 1 percent higher interest for no reason, or inventing non-existent income in order to make them a loan that is doomed to fail.

As Comptroller of the Currency, John Dugan, has stated, ''Sound underwriting—and, for that matter—simple common sense—suggest that a mortgage lender would almost always want to verify the income of a riskier subprime borrower to make sure that he or she has the means to make the required monthly payment. Most subprime borrowers are salaried employees for whom verifying income by producing copies of W–2 forms is just not that difficult.''

We see no justification for lenders failing to use readily available data on a borrower's income, and do not believe that it would be sufficient for lenders to simply disclose to borrowers that other options are available. The financial incentives for lenders to offer and encourage borrowers to accept no- or low-doc loans are simply too great to see disclosure as a significant counter. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to *The New York Times,* ''The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans,'' he said. ''What would you do?''

Question 3. How should Section 5 of the FTC Act be expanded to mortgage lending?

Answer. Give the FTC enforcement authority for all matters arising under the FTC Act, and give consumers the power to protect themselves.

The FTC Act should be expanded in several ways. First, Congress should provide the Federal Trade Commission concurrent and independent rulemaking and enforcement authority over national banks and thrifts for *all* matters covered by the FTC Act. This would empower the FTC to bring enforcement actions against national banks and thrifts for unfair and deceptive practices. The FTC has nearly 70 years of extensive experience protecting consumers from unfair and deceptive practices by non-bank entities. But the FTC Act denies the FTC the essential authority to protect consumers from regulated financial institutions.

All four of the primary banking regulatory agencies have an inherent conflict-of-interest that has resulted in limited enforcement of those institutions within their regulatory authority. All four receive significant funding from industry sources, and no appropriated funds from Congress. The FTC Act already authorizes three Federal financial regulators (the OTS, the FRB and NCUA) to issue regulations prohibiting unfair or deceptive acts or practices. Perhaps due to the conflict-of-interest, the regulators have failed to issue such regulations and to exercise their authority under the FTC Act, except in the one instance where the law mandated it.[8] Indeed, the OCC did not even acknowledge the authority to bring enforcement actions against their regulated banks committing unfair and deceptive acts and practices until 2000. After waiting 25 years to bring any enforcement action, that agency has still

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[7] *See, e.g.,* Testimony of Michael D. Calhoun, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs; Subc. on Transportation, Housing and Urban Affairs, *Ending Mortgage Abuse: Safeguarding Homebuyers,* Appx. 1, (June 26, 2007), available at *http://www.responsiblelending.org/pdfs/senate-testimony-m-calhoun-june-26-2007.pdf.*

[8] Under 15 U.S.C. 57a(f), when the FTC issues a rule on a topic that relates to financial institutions, each of the agencies authorized to promulgate UDAP rules under that section *must* issue follow-up rules applying the FTC rule to its institutions, unless the agency finds that such acts or practices are not unfair or deceptive, or the Board of Governors of the Federal Reserve System finds that implementation of similar regulations with respect to banks, savings and loan institutions or Federal credit unions would seriously conflict with essential monetary and payments systems policies of such Board, and publishes any such finding, and the reasons therefor, in the *Federal Register.* This authority has been exercised only once only—in 1985, when the Federal Reserve Board adopted a version of the FTC's Credit Practices Rule and made it applicable to banks and thrifts. *See* 12 CFR § 227.

done little with it.[9] In view of the obvious conflict of interest in supervising the same institutions that fund their budgets, they should not be vested with sole enforcement power with respect to consumer protection matters.

Unlike the banking agencies, the FTC lacks the inherent conflict of interest that paralyzes the banking regulatory agencies. The FTC has no responsibility to protect the profitability of financial institutions. Its sole mandate is to protect consumers from the unlawful and deceptive practices prohibited by the FTC Act. As such, it is appropriate for the FTC to be vested with full authority under the FTC Act over all entities that engage in unfair and deceptive practices. The FTC should be given concurrent and independent enforcement authority with regard to all matters arising under the FTC Act, in the same way that state attorneys general have independent authority to enforce applicable state laws against state banks.

Concurrent rule-making authority, however, would also require a change to the FTC's own UDAP rule-making authority. Since 1975 Congressional amendments, the FTC's own UDAP-rule-making process has been made much more cumbersome, time-consuming, and resource-intensive than the standard "notice-and-comment" rule-making procedures that the bank regulatory agencies could use. Concurrent rulemaking would require that the procedures be harmonized, and permitting the FTC to use the notice-and-comment process permitted the banking agencies is the most sound.[10]

Giving authority to the FTC will be an imperfect solution: the FTC's record in recent years with respect to non-bank entities is less than perfect. As such, we recommend a third change to the FTC Act. Consumers, who currently have no right to enforce the Federal FTC Act, should be provided a private remedy under Section 5 of the Act. Currently, the Act permits only public enforcement. While state and Federal agencies must protect consumers, it is imperative that consumers not be denied the ability to protect themselves with a private right of action. Although consumers in many states can invoke their state unfair and deceptive acts and practices law, many state laws have significant gaps, such as exclusions for "regulated entities." Additionally, Federal banking regulators' overly aggressive assertion of preemption may hamstring consumers' ability to resort to their state UDAP laws. Because the FTC cannot pursue an action on behalf of any individual consumer, consumers should be allowed to protect themselves.

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[9] Williams, Julie L. and Michael S. Bylsma, On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks, 58 *Bus. Law.* 1243 (2003). According to one 2004 Congressional report, state banking agencies and state attorney generals' offices employ nearly 700 full time examiners and attorneys to monitor compliance with consumer laws, more than seventeen times the number of OCC personnel allocated to investigate consumer complaints. *See* Comm. on Fin. Servs., 108th Cong., *Views and Estimates on Matters to Be Set Forth in the Concurrent Res. on the Budget for Fiscal Year 2005,* at 16 (Comm. Print 2004), available at *http://financialservices.house.gov/media/pdf/FY2005Views_Final.pdf, cited in* Wilmarth, *supra* note 10, at 316 & n.359. In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions. By contrast, the OCC's record of consumer protection enforcement is an embarrassment. The agency lists only eight actions in a section on its website captioned "[a]ctions the OCC has taken against banks engaged in abusive practices." See OCC, Consumer Protection News: Unfair and Deceptive Practices, *http://www.occ.treas.gov/Consumer/Unfair.htm* (last visited Aug. 28, 2006). The OCC stayed its hand for *more than a quarter century* before bringing its first action in 2000 to address unfair and deceptive practices under Section 5 of the Federal Trade Commission Act. Even then, the action came only after a decade in which the target bank "had been well known in the . . . industry as the poster child of abusive consumer practices" and after "[a] California state prosecutor . . . embarrassed the OCC into taking action." *See* Duncan A. MacDonald (former General Counsel, Citigroup Inc.'s Europe and North American card business), Letter to the Editor, *Comptroller Has Duty to Clean Up Card Pricing Mess,* Am. Banker, Nov. 21, 2003, at 17; *See also Frontline: Secret History of the Credit Card* (PBS television broadcast Nov. 23, 2004) (transcript available at *http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/script.html*).

[10] Because the FTC has a much broader portfolio for enforcement—it has enforcement authority over the vast majority of actors in commerce doing business with consumers except for those expressly carved out, like financial institutions—and because it is primarily funded by appropriations, new responsibilities must be accompanied by additional resources if the agency is to be able to do its job properly.