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CONSUMER PROTECTION

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HEARINGS

BEFORE THE

CONSUMER SUBCOMMITTEE

OF THE

COMMITTEE ON COMMERCE

UNITED STATES SENATE

NINETY-FIRST CONGRESS

SECOND SESSION

ON

S. 2246

TO AMEND THE FEDERAL TRADE COMMISSION ACT, AS AMENDED, BY PROVIDING FOR TEMPORARY INJUNCTIONS OR RESTRAINING ORDERS FOR CERTAIN VIOLATIONS OF THAT ACT

S. 3092

TO AMEND THE FEDERAL TRADE COMMISSION ACT TO EXTEND PROTECTION AGAINST FRAUDULENT OR DECEPTIVE PRACTICES, CONDEMNED BY THAT ACT, TO CONSUMERS THROUGH CIVIL ACTIONS, AND TO PROVIDE FOR CLASS ACTIONS FOR ACTS IN DEFRAUD OF CONSUMERS

AND

S. 3201

TO AMEND THE FEDERAL TRADE COMMISSION ACT TO PROVIDE INCREASED PROTECTION FOR CONSUMERS, AND FOR OTHER PURPOSES

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PART 2

MARCH 17, 18, 19, AND APRIL 9, 1970

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CONSUMER PROTECTION

TUESDAY, MARCH 17, 1970

U.S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE FOR CONSUMERS,
Washington, D.C.

The subcommittee met at 10:25 a.m. in room 6202, New Senate Office Building, Hon. Frank E. Moss, (chairman of the subcommittee) presiding.

Present: Senators Moss and Hart.

OPENING STATEMENT BY THE CHAIRMAN

Senator Moss. The subcommittee will come to order.

It is a pleasure to welcome you to the first of 3 days of hearings this week on the consumer protection bills, S. 2246, S. 3092, and S. 3201. These hearings will be the last on measures designed to increase protection of consumers against fraud and deception. Our hearings on this subject have now extended over the course of 3 months and have received coverage and discussion in both the general and trade press. We have had time to hear all parties who have indicated an interest in appearing before us. I believe that we have a good record so far and that this week's hearings will finish off that record by filling in the details of class actions. At the conclusion of our hearings on Thursday, the subcommittee will begin to work on the bills to put what we have learned into legislative language.

Let me review briefly the course of our hearings on consumer protection.

In December, the Federal Trade Commissioners presented extensive testimony containing ideas for strengthening the Commission in its role as protector of consumers. Based in part on their testimony, I advanced a number of proposals at our hearings in February setting forth measures essential to any legislation claiming to offer comprehensive protection against fraud and deception. Among those proposals were formation of an Office of Consumer Protection within the FTC to initiate Commission action for violation of the FTC Act; authorization of the Commission to award damages to consumers injured by fraud and deception; imposition of civil penalties by the Commission for violation of well established law and regulations; creation of criminal penalties against perpetrators of hardcore fraud.

Staff members assigned to this hearing: John Cary.

In testimony before the House of Representatives, Chairman Weinberger of the FTC presented the unified position of the FTC on the House companion bill to S. 3201 and subsequently submitted draft legislation embodying the Commission's position. The Commission's position is similar to a number of the measures I suggested. So far we have received little adverse comment about either my proposals or those of the FTC. I assume there is general agreement that agencies of the Federal Government need to be strengthened on behalf of the consumers.

The main issues during our hearings have centered around the consumer class action concept. Millions of consumers with valid claims arising out of fraudulent or deceptive transactions ranging up to a thousand dollars or more have no practical means of realizing on their claims. The costs of bringing individual legal action are simply greater than potential recoveries. Thus, the fraudulent operator knows that he is free from retribution so long as he keeps his ill-gotten gains below the cost of litigation.

As Mrs. Bess Meyerson Grant pointed out: fraud is illegal, but it is not unprofitable. Businesses do not face the same problem. Their transactions are generally of great enough size to warrant litigation.

If not, they can afford to prosecute the small case for its deterrent effect or to establish a precedent. Not that businesses resort to litigation frequently, but its ever-present possibility serves to keep commercial parties to their respective bargains.

Consumer class actions offer consumers equality with business; that is, practical opportunity to seek redress of wrongs in court.

Business has opposed consumer class actions, raising the fear of an unmanageable burden on the Federal courts and a flood of harassing litigation or strike suits. The administration retreated from its early support of class action in the face of industry's argument. Its bill, S. 3201, permits private action for damages only after prior, successful Government action.

Consumers say that the administration's triggering requirement destroys the very value of class actions; namely, the opportunity for consumers to protect themselves when the Government does not act to protect them.

Our hearings in the next 3 days will focus on class actions to learn in detail how they work. We hope to determine the validity of arguments raised for and against them and to find solutions for real problems that come to light. But the solutions we seek must not destroy the value of class actions for consumers. I will insert the bills and any agency comments in the record.

(The bills and agency comments follow:)

91ST CONGRESS
1ST SESSION

S. 2246

IN THE SENATE OF THE UNITED STATES

MAY 26, 1969

Mr. MOSS (for himself, Mr. CANNON, Mr. HART, Mr. INOUYE, Mr. MAGNUSON, and Mr. PASTORE) introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To amend the Federal Trade Commission Act, as amended, by providing for temporary injunctions or restraining orders for certain violations of that Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Deceptive Sales Act of 1968".

SEC. 2. That section 13 (a) of the Federal Trade Commission Act (15 U.S.C. 53 (a)) be amended as follows:

"SEC. 13. (a) Whenever the Commission has reason to believe—

"(1) that any person, partnership, or corporation

is engaged in, or is about to engage in, the dissemination or the causing of the dissemination of any advertisement in violation of section 12, or any act or practice in commerce within the meaning of section 5 which is unfair or deceptive to the consumer, and

"(2) that the enjoining thereof pending the issuance of a complaint by the Commission under section 5, and until such complaint is dismissed by the Commission or set aside by the court on review, or the order of the Commission to cease and desist made thereon has become final within the meaning of section 5, would be to the interest of the public,

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States or in the United States court of any territory, to enjoin such dissemination or the causing of such dissemination or any act or practice in commerce within the meaning of section 5 which is unfair or deceptive to the consumer. Upon proper showing a temporary injunction or restraining order shall be granted without bond. Any such suit shall be brought in the district in which such person, partnership, or corporation resides or transacts business."

91ST CONGRESS
1ST SESSION

S. 3092

IN THE SENATE OF THE UNITED STATES

OCTOBER 29, 1969

Mr. TYDINGS introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To amend the Federal Trade Commission Act to extend protection against fraudulent or deceptive practices, condemned by that Act, to consumers through civil actions, and to provide for class actions for acts in defraud of consumers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Consumer Class Action Act".

SEC. 2. Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) is amended by adding at the end thereof the following:

"(m) Consumers who have been damaged by unfair or deceptive acts or practices in commerce are hereby authorized to bring consumer class actions for redress of such

damages. Such actions shall be brought as consumer class actions in accordance with section 4 of the Consumer Class Action Act."

SEC. 3. (1) Congress hereby declares that the protection afforded under the existing Federal Trade Commission Act is not sufficient to prevent unfair and deceptive acts perpetrated against consumers and that consumers should be allowed to sue directly for redress in the case of such practices. Congress, therefore, finds and declares that class actions are the most effective machinery for redress of consumer rights.

(2) Congress further finds and declares that many substantive rights to protect consumers are established in the laws of the States, but there is no remedy by which many persons, each having a small claim, can obtain effective redress under State law. Therefore, it is in the public interest to embrace as Federal law certain State recognized rights and afford a uniform Federal process, by consumer class actions, as an effective remedy.

(3) Congress further finds that the lack of an effective process and remedy in these respects impairs the free flow of consumer goods in commerce and that there is an overriding Federal interest in achieving candor and fair dealing in the marketplace, an interest which, if not protected, clogs the entire economy.

SEC. 4. (a) (1) An Act in defraud of consumers which affects commerce is unlawful and the district courts of the United States shall have original jurisdiction without regard to the amount in controversy to entertain civil class actions for redress of such unlawful acts.

(2) For the purposes of this section an "act in defraud of consumers" is—

(A) an unfair or deceptive act or practice which is unlawful within the meaning of section 5(a)(1) of the Federal Trade Commission Act, or

(B) an act that gives rise to a civil action by a consumer or consumers under State, statutory or decisional law for the benefit of consumers.

(3) "Consumer" means any natural person who is offered or supplied goods, services, interests in land, or intangibles primarily for personal, family, household, or agricultural purposes.

(b) In the case of any class action brought upon the basis that a deceptive Act or practice which is unlawful within the meaning of section 5(a)(1) of the Federal Trade Commission Act has violated consumers' rights, the court shall in construing the terms "unfair or deceptive", give great weight to the interpretation given such terms by the Federal Trade Commission and by the Federal courts in applying section 5(a)(1) of the Federal Trade Com-

mission Act; except that nothing in this Act or the amendments made by this Act, shall be construed to require the court to await administrative action by the Federal Trade Commission before applying Federal law to the facts of the case.

(c) In the case of any class action brought upon the basis of a violation of consumers' rights under any State law the court shall, in deciding such action, apply the following criteria:

(1) State law relating to the consumers' rights under State statutory or decisional law is adopted as Federal law.

(2) Federal law applicable to each class shall be fashioned upon the law of the State and the State statutory and decisional construction shall be applied as if jurisdiction of the Federal court were based on diversity of citizenship.

(3) In cases of conflict between State statutory and decisional construction and Federal law the latter shall prevail, and Federal law governing the case shall be fashioned from State law not in conflict, as near as may be, and from Federal law.

(4) If, prior to the date of enactment of this Act, a cause was not subject to removal under section 1441 of title 28, United States Code, the adoption of State law as Federal law by this Act shall not authorize the removal of such a cause on the jurisdictional basis of a Federal question.

(d) Whenever a class of consumers prevails in a class action under this Act, including the amendments made by this Act, the court shall award to the attorneys representing such class a reasonable fee based on the value of their services to the class. An award of attorney's fees is to be made in addition to the damages or relief recovered by the class except that attorneys' fees may be awarded from money damages or financial penalties which the defendant owes to members of the class who cannot be located with due diligence. Such attorneys' fees awarded by the court shall not exceed 10 percent of the total judgment unless failure to award a greater amount would be manifestly unjust and not commensurate with the efforts of counsel.

91ST CONGRESS
1ST SESSION

S. 3201

IN THE SENATE OF THE UNITED STATES

DECEMBER 3, 1969

Mr. MAGNUSON (for himself, Mr. BAKER, Mr. GRIFFIN, Mr. PROUTY, and Mr. SCOTT) (by request) introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To amend the Federal Trade Commission Act to provide increased protection for consumers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Consumer Protection Act of 1969".

TITLE I—DECEPTIVE SALES AFFECTING COMMERCE

SEC. 101. Section 5 of the Federal Trade Commission Act, as amended (38 Stat. 719; 15 U.S.C. 45) is amended by changing the words "in commerce" wherever they appear to "affecting commerce".

SEC. 102. Subsection (a) of section 13 of the Federal

Trade Commission Act (52 Stat. 115; 15 U.S.C. 53 (a)) is amended to read as follows:

"(a) Whenever the Commission has reason to believe—

"(1) that any person is engaged in, or is about to engage in, the dissemination or the causing of the dissemination of any advertisement in violation of section 12, or any act or practice which is unfair or deceptive to a consumer and is prohibited by section 5, and

"(2) that the enjoining thereof pending the issuance of a complaint by the Commission under section 5, and until such complaint is dismissed by the Commission or set aside by the court on review, or the order of the Commission to cease and desist made thereon has become final within the meaning of section 5, would be to the interest of the public—

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin the dissemination or the causing of the dissemination of such advertisement or any such act or practice. Upon proper showing of need, a temporary restraining order or preliminary injunction may be granted without bond: *Provided, however,* That if a complaint under section 5 is not filed within sixty days of the issuance of the restraining order or preliminary injunction, the order or injunction shall be dissolved and of no further force and effect."

TITLE II—ENFORCEMENT OF CONSUMER INTERESTS

UNFAIR OR DECEPTIVE ACTS OR PRACTICES

SEC. 201. As used in this title—

(a) "unfair or deceptive practice" means any of the following acts or practices—

(1) offering goods or services intending not to sell them as offered;

(2) advertising goods or services intending not to supply reasonably expectable public demand, unless the advertisement discloses a limitation;

(3) stating that services, replacements, or repairs are needed with knowledge that they are not;

(4) representing that the consumer is legally obligated to pay for, safeguard, or return unsolicited goods knowing that the consumer is not;

(5) representing that the consumer will obtain any rights, privileges, or remedies knowing that the consumer will not;

(6) representing that goods are new knowing that they are not;

(7) representing that goods are of a particular standard, grade, quality, style, or model knowing they are not;

(8) making statements of fact concerning (i) the reason for, existence of, or amounts of price reductions, or (ii) savings in comparison to prices of competitors or one's own price, knowing that such statements are false;

(9) representing that goods or services are those of another, knowing they are not;

(10) failing to return or refund a deposit or advance payment for goods not delivered or services not rendered, when no default or further obligation of the person making such deposit or advance payment exists; and

(11) knowingly representing that goods or services have sponsorship, approval, origin, characteristics of safety or performance, ingredients, uses, benefits, or quantities that they do not have, or that a person has a sponsorship, approval, status, affiliation, or connection that he does not have: *Provided, however*, That an affirmation by the supplier merely of the value of the goods or services or a statement of his opinion of the goods or services, or similar statements, which do not take unfair advantage of the level of knowledge, ability, experience, or capacity of the consumer shall not be deemed an

unfair or deceptive act or practice within the meaning of this paragraph.

(b) "knowing", "knowingly", and "knowledge" refer to actual knowledge, knowledge presumed where objective circumstances indicate that the supplier acted with knowledge, or knowledge presumed where circumstances indicate that the supplier acted in disregard of reasonable safeguards or care in ascertaining the truth of representations made;

(c) "consumer" means any natural person who is offered or supplied goods or services for personal, family, or household purposes;

(d) "supplier" means any person who makes goods or services available to consumers, either directly or indirectly;

(e) "goods" includes real property, but does not include securities or interests in securities; and

(f) "services" includes insurance services and similar provisions of intangibles, but not the providing of credit.

DECEPTIVE ACTS AND PRACTICES UNLAWFUL

SEC. 202. It shall be unlawful for any supplier to commit any unfair or deceptive act or practice as defined in section 201 of this title.

RESTRAINING VIOLATIONS

SEC. 203. The district courts of the United States have jurisdiction to restrain violations of this title upon application by the Attorney General. The court may at any time grant such injunctive relief as it deems appropriate. Whenever it appears to the court that the ends of justice require that other persons should be parties in the action, the court may cause them to be summoned whether or not they reside in the district in which the court is held, and to that end process may be served in any district.

SUITS BY CONSUMERS ADVERSELY AFFECTED

SEC. 204. When a supplier, (i) in any action brought by the Attorney General under section 203 of this title, has been enjoined from committing any act or practice, whether after final adjudication or by consent decree, or (ii) in any proceeding brought by the Federal Trade Commission under section 5 of the Federal Trade Commission Act with respect to acts or practices alleged to be unfair or deceptive within the meaning of section 201 of this title, has been ordered to cease and desist from that act or practice, and the order shall have become final within the meaning of section 5, either after adjudication or by consent decree, any consumer claiming to have been adversely affected by the act or practice giving rise to such injunction may bring suit against said supplier, and may recover actual damages, and the costs

of suit, including reasonable attorneys' fees, and, when appropriate, restitution, reformation, recision, and other equitable relief.

Irrespective of whether an attorney's fee is assessed against a defendant, the court may inquire into the reasonableness of the fee agreed upon between the consumer and his counsel, and revise that fee as the circumstances warrant.

JUDGMENT IN FAVOR OF THE UNITED STATES AS EVIDENCE

SEC. 205. A final judgment or decree rendered in any proceeding brought by the United States under section 203 of this title to the effect that a defendant has engaged in an unfair or deceptive practice within the meaning of this title shall be prima facie evidence against that defendant in any action or proceeding brought by any other person against the defendant under section 204 of this title, as to all matters respecting which said judgment or decree would be an estoppel as between the defendant and the United States: *Provided, however*, That this section shall not apply to consent judgments or decrees entered before any testimony has been taken.

VENUE

SEC. 206. An action under this title may be brought in any district in which the claim arose or in which the defendant resides, is found, has an agent, is licensed to do business, or is doing business.

LIMITATION OF ACTIONS

SEC. 207. Any proceeding under section 204 of this title shall be brought within one year after the termination of the proceeding under section 203 of this title or the proceeding under section 5 of the Federal Trade Commission Act on which it is predicated.

CIVIL INVESTIGATIVE DEMANDS

SEC. 208. (a) Whenever the Attorney General has reason to believe that any person under investigation may be in possession, custody, or control of any documentary material, or may have knowledge of any fact, relevant to an unfair or deceptive act or practice within the meaning of this title, he may, prior to the institution of a proceeding under section 203, issue in writing, and cause to be served upon such person, a civil investigative demand, requiring such person to produce the documentary material for examination or to answer in writing written interrogatories pertaining to such knowledge.

(b) Each such demand shall—

(1) state the nature of the conduct alleged to constitute the unfair or deceptive act or practice which is under investigation;

(2) describe the class or classes of documentary material to be produced thereunder with such definite-

ness and certainty as to permit such material to be fairly identified;

(3) propound with definiteness and certainty the written interrogatories to be answered; and

(4) identify the custodian to whom such material shall be furnished, or the person to whom such answers shall be made.

(c) No demand shall—

(1) contain any requirement which would be held unreasonable if contained in a subpena duces tecum issued by a court of the United States in a proceeding brought under section 203 of this title or if propounded in an interrogatory directed to a defendant in any such proceedings; or

(2) require the production of any documentary evidence, or the disclosure of any information, which would be privileged from disclosure if demanded by a subpena duces tecum issued by a court of the United States, or by an interrogatory propounded, in any proceeding under section 203 of this title.

(d) Demand may be served at any place within the territorial jurisdiction of any court of the United States.

(e) The provisions of sections 4 and 5 of the Antitrust Civil Process Act (76 Stat. 549, 551; 15 U.S.C. 1313,

1314) apply to custodians of material produced pursuant to any demand and to judicial proceedings for the enforcement of any such demand made pursuant to this section.

REPORT BY THE ATTORNEY GENERAL

SEC. 209. As part of his responsibility to protect consumers against unfair or deceptive acts or practices, the Attorney General shall annually report to the President and the Congress on the effectiveness of this title.

OTHER LAWS NOT AFFECTED

SEC. 210. This title shall not annul, alter, or affect in any manner the meaning, scope, or applicability of any Federal or State law, including but not limited to laws concerning the provision of goods and services to consumers, or limit in any way the availability of rights or remedies under such law.

GENERAL COUNSEL OF THE DEPARTMENT OF COMMERCE,
Washington, D.C., March 10, 1970.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in further reply to your request for the views of this Department concerning S. 3092, a bill "To amend the Federal Trade Commission Act to extend protection against fraudulent or deceptive practices, condemned by that Act, to consumers through civil actions, and to provide for class actions for acts in defraud of consumers."

The bill would amend Title 15 of the United States Code to permit consumers to file civil class actions in Federal District Courts to obtain redress for unfair or deceptive acts or practices in commerce. Such suits would be authorized regardless of the amount in controversy, for: (a) an unfair or deceptive act or practice which is unlawful within the meaning of Section 5(a)(1) of the Federal Trade Commission Act; or (b) an act that gives rise to a civil action by a consumer or consumers under State, statutory or decisional law for the benefit of consumers. The bill defines a consumer as any natural person who is offered or supplied goods, services, interests in land, or intangibles primarily for personal family, household or agricultural purposes.

The Department of Commerce recommends against the enactment of S. 3092 but instead strongly supports the provisions of the Administration bill, S. 3201, the Consumer Protection Act of 1969. Advances in technology, growth of marketing, and the expanding range of consumer products and services have made it more difficult for consumers to assure themselves of quality and safety in the products they purchase. Thus, comprehensive legislation in this area is seriously needed.

The Federal Trade Commission Act currently makes unlawful unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce, and authorizes the Federal Trade Commission to issue cease and desist orders against such acts or practices and obtain enforcement of its orders in the courts. Provision is made for administrative hearings; and the Commission's findings of facts, if supported by evidence, are deemed conclusive on the courts. The law also safeguards the rights of the parties through provision for appeals and judicial review. However, the Act does not authorize recovery of damages by consumers who have been adversely affected by deceptive or unfair practices.

S. 3201 would provide additional statutory protection to consumers in various ways, including provision for class action suits. Specifically the bill would: (A) amend the Federal Trade Commission Act to include acts and practices "affecting commerce" rather than "in commerce"; (B) grant the Commission authority to bring suit to temporarily restrain any unfair or deceptive act or practice; (C) specify the types of unfair or deceptive practice covered by the bill; (D) authorize distict courts to restrain violations of the bill; and (E) authorize any consumer or class of consumers, claiming to have been adversely affected by a supplier who: (1) in any action brought by the Attorney General has been enjoined from committing any act or practice; or (2) has been ordered by the Federal Trade Commission to cease and desist any act or practice found to be unfair or deceptive, to bring suit against the supplier and recover actual damages and the costs of suit including attorney's fees.

S. 3092 on the other hand lacks two important safeguards. First, it does not clearly define for the legitimate businessman what conduct will expose him to potentially large damage actions. For example, one of the definitions of "act in defraud of consumers" is "an act that gives rise to a civil action by a consumer or consumers under State, statutory or decisional law for the benefit of consumers". This definition is so sweeping and vague as to provide virtually no guidance at all to the legitimate businessman. Second, it provides for direct class action law suits without safeguards against the harassment and nuisance of an unfounded claim.

S. 3201 is clearly more comprehensive and more desirable than S. 3092. By providing for proceedings by the Federal Trade Commission or Attorney General prior to entertainment of class action suit by the courts, such suits would have the support of the Administration's investigations and actions against the defendants. In addition, this procedure, in the words of the President in his "Protection of Interests of Consumers" message of October 30, 1969, would prevent "harassment of legitimate businessmen by unlimited nuisance law suits".

We have been advised by the Bureau of the Budget that there would be no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

JAMES T. LYNN,
General Counsel.

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, February 13, 1970.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for our views on S. 3201, a bill "To amend the Federal Trade Commission Act to provide increased protection for the consumer, and for other purposes."

This bill would effectuate recommendations of President Nixon in his Consumer Protection Message to Congress. It would extend the Federal Trade Commission's jurisdiction to industries "affecting" interstate commerce as well as those which are "in" interstate commerce, and permit the Commission to seek injunctive relief against an unfair or deceptive practice.

In addition, the bill would allow consumer suits for damages after successful litigation initiated by either the Attorney General or the Commission.

I support this legislation in the belief that it will greatly strengthen the consumer's position against unfair and deceptive trade practices. However, I defer for specific comments to those agencies more directly involved in this field.

The Bureau of the Budget advises that there is no objection to the submission of this report and that enactment of this bill would be in accord with the President's program.

Sincerely,

GEORGE P. SHULTZ,
Secretary of Labor.

FEDERAL TRADE COMMISSION,
Washington, D.C., March 12, 1970.

Hon. JOHN E. MOSS,
Chairman, Subcommittee on Commerce and Finance, Committee on Interstate and Foreign Commerce, House of Representatives, Washington, D.C.

DEAR CHAIRMAN MOSS: On February 4, 1970, I appeared before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce to present the Commission's views on H.R. 14931 and H.R. 14832. At that time I stated that the eleven categories of unfair or deceptive acts or practices enumerated in section 201 of H.R. 14931 were not sufficiently comprehensive; that many acts or practices unfair or deceptive to consumers would not be included with the enumerated categories.

I further stated that the requirements in certain categories that the deceptions be knowingly made, or intentionally made, effectively eliminated other unfair or deceptive acts or practices from the scope of the bill. The standard of proof required by these prerequisites of illegality seem unnecessarily strict and will be difficult to meet in many cases.

You have requested that I furnish to the Subcommittee a listing of categories of unfair or deceptive acts or practices which, in the Commission's opinion, would provide more adequate protection to consumers.

The Commission has given this matter considerable study and has concluded that it is impractical to attempt to categorize the acts or practices which are unfair or deceptive to consumers. Any listing that is complete today would be incomplete at the time of enactment into law. If complete at the time of enactment, it would soon be outdated through the ingeniousness of the unscrupulous businessman.

It was for these very reasons that the Congress intentionally left flexible the Federal Trade Commission Act's ban on unfair or deceptive acts or practices. In

the legislative view, "[N]ew or different practices must be considered as they arise in light of the circumstances in which they are employed." *Federal Trade Commission* v. *R. F. Keppel & Bros., Inc.*, 291 U.S. 304, 314 (1934). In passing the Federal Trade Commission Act, Congress was clearly aware of the difficulties of defining and categorizing all unfair or deceptive acts or practices:

"It is impossible to frame definitions which embrace all unfair practices. There is no limit to human inventiveness in this field. Even if all known unfair practices were specifically defined and prohibited, it would be at once necessary to begin over again. If Congress were to adopt the method of definition, it would undertake an endless task . . . H.R. Rep. No. 1142, 63rd Cong., 2d Sess. 18–19 (1914)."

A further difficulty, which would be encountered in now attempting to define or categorize unfair or deceptive acts or practices for the purposes of this bill, is the probability that it will take years of litigation and consequent judicial interpretation to ascertain with any degree of certainty the exact acts or practices included within each category, or conversely, the acts or practices not included within the scope of the bill.

The Commission, therefore, proposes that an unfair act or practice for purposes of H.R. 14931 be defined simply as "any act or practice which is unfair or deceptive to consumers and is prohibited by section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1))."

The meaning of these terms must be found by the Federal Trade Commission to be within the legislative framework of section 5 of the Federal Trade Commission Act. As the Supreme Court noted in the case of *Humphrey's Executor* v. *United States*, 295 U.S. 602, 628 (1935):

"The Federal Trade Commission is an administrative body created by Congress to carry into effect legislative policies embodied in the statute in accordance with the legislative standard therein prescribed, . . ."

The meaning of these terms must also be construed in the light of such legislative standards and policies as are set forth in the various cases of the body of law developed by the Commission and the courts in the 55 years since the Commission's creation.

No supplier need be in doubt as to the acts or practices declared unlawful by the suggested definition in view of the large body of law compiled over the years by the Commission and the Federal courts interpreting the Federal Trade Commission Act. Further, to the extent any supplier is in doubt as to the lawfulness of a future course of action, the Commission renders upon request an advisory opinion service.

The Commission's recommendation to expand the scope of the bill would not be to declare unlawful acts or practices now lawful, since such acts or practices, if unfair or deceptive to consumers, are already condemned by the Federal Trade Commission Act.

The effect of including the more comprehensive language of section 5 of the Federal Trade Commission Act in H.R. 14931 would be to offer substantial additional protection to consumers by making two resources available to prohibit all unfair or deceptive acts or practices—those of the Commission which are presently available, and those of the Consumer Protection Division, to be created in the Department of Justice.

A further significant effect of the Commission's recommendation would be to give consumers a right of private action to seek redress for all unfair or deceptive acts or practices, not just the acts or practices encompassed within the eleven enumerated categories. Since the bill provides for a recovery of actual damages only, plus reasonable attorney's fees, the consumer would seem to be entitled to this right of redress as to all unfair or deceptive acts or practices, not just the presently enumerated acts or practices. This enlargement of the right of private action would, however, still be subject to the bill's condition precedent of a prior Government action.

In the Commission's view, it would be incongruous to offer consumers the substantial additional protection which will be afforded by this bill as to only a few unfair or deceptive acts or practices out of the vast multitude of acts or practices which have been held to be unlawful by the Commission over the years.

In my statement of February 4, 1970, I also presented the Commission's belief that it needed additional powers, not included in the provisions of H.R. 14931, to provide consumers prompt and effective protection. These additional powers were stated to be (1) a clarification of the Commission's rulemaking authority, (2) authority to assess civil penalties for existing violations of law, (3) author-

ity to assess civil penalties for violations of existing Commission orders, and (4) authority to award damages to consumers injured by acts or practices found by the Commission to violate the law.

The Commission also proposed that its final orders enjoining any supplier from engaging in any unfair or deceptive act or practice enumerated in H.R. 14931, entered on the facts after an adjudicative hearing, constitute prima facie evidence against such supplier in any subsequent consumer proceeding.

I am attaching hereto proposed amendments to H.R. 14931 which incorporate the Commission's views in these respects. It will be observed that the Commission's authority to award damages under these proposed amendments would be limited to proceedings involving acts or practices deceptive to a consumer. The Commission's authority to assess civil penalties for existing violations of law would be limited to proceedings involving the knowing use of acts or practices deceptive to a consumer. Further, the Commission's authority to assess civil penalties for violation of an existing Commission order would be limited to orders entered after the effective date of the new legislation.

The Commission expresses its sincere appreciation for the opportunity to present these matters to the attention of the Subcommittee.

I hope this information meets your request, and if I may be of further assistance, please do not hesitate to let me know.

With kind personal regards,

Sincerely,

CASPAR W. WEINBERGER,
Chairman.

PROPOSED AMENDMENTS TO H.R. 14931

Sec. 102. Strike from subsection (a)(2), line 14, the words "to cease and desist".

Sec. 103. Subsection (a)(6) of section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45(a)(6)), is amended by adding at the end thereof the following:

"The Commission is hereby further empowered and directed to order such persons, partnerships, or corporations engaged in, or engaging in, any act or practice which is unfair or deceptive to a consumer and is prohibited by subsection (a)(1) of this section, to take any other action necessary to redress the injury caused by such acts or practices to consumers, including, but not limited to, payment of damages, refund of money or property, restitution, reformation or recision of contracts, repair or replacement of goods, proper servicing, and public notificatiton of violation. The Commission is also empowered and directed to order such persons, partnerships, or corporations knowingly engaged in, or engaging in, any act or practice which is unfair or deceptive to a consumer and is prohibited by subsection (a)(1) of this section, in addition to any other action ordered under this section, to pay a civil penalty of not more than $10,000 for each violation not to exceed $500,000, or not more than ten percent of the total annual profits of such persons, partnerships, or corporations, whichever is larger. If such penalty is unpaid, the penalty plus accumulated interest may be recovered in a civil action brought by the Commission in any district court of the United States."

Sec. 104. Subsection (b) of section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45(b)), is amended by striking the period at the end of the second and fifth sentences thereof and adding at the end of each sentence the following:

", or requiring such person, partnership, or corporation to take such other action as may be authorized by this Act and determined by the Commission to be necessary in order to remedy the violation or violations of law found by it."

Sec. 105. Subsection (c) of section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45(c)), is amended by adding to the first sentence thereof after the words "act or practice" and before the word "may" the following:

", or to take any other such action as may be authorized by this Act,".

Sec. 106. Subsection (g) of section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. 45 (g)), is amended by striking out of the first sentence the words "to cease and desist" so that this subsection shall read:

"An order of the Commission shall become final—"

Sec. 107. Subsection (1) of section 5 of the Federal Trade Commission Act, as

amended (15 U.S.C. 45 (1)), is amended by designating existing section 5(1) as 5(1)(1), and adding at the end thereof the following subsection:

"(2) Any person, partnership, or corporation who violates an order of the Commission issued on or after the effective date of this provision, after said order has become final and while such order is in effect, shall forfeit and pay to the United States a civil penalty of not more than $10,000 for each violation. Each separate violation of such an order shall be a separate offense, except that in the case of a violation through continuing failure or neglect to obey a final order of the Commission each day of continuance of such failure or neglect shall be deemed a separate offense. Whenever the Commission shall have reason to believe that any person, partnership, or corporation has been or is in violation of a Commission order issued on or after the effective date of this provision, after said order has become final, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect, and containing a statement of the violations of said order and the amount of civil penalties sought. Said complaint shall contain a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person, partnership, or corporation so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered requiring such person, partnership, or corporation to pay the civil penalties set forth in said complaint. The testimony in any such proceeding shall be reduced to writing and filed in the office of the Commission. If upon such hearing the Commission shall be of the opinion that said order has been violated, the Commission shall enter an order requiring such person, partnership, or corporation to pay a penalty for each such violation in an amount deemed appropriate to the Commission in accordance with the provisions of this subsection. Any person, partnership, or corporation ordered by the Commission to pay any civil penalty pursuant to the provisions of this subsection may obtain a review thereof in an appropriate court of appeals of the United States, in the manner provided for other orders of the Commission in subsection (c) of this section. After such order shall have become final as provided in subsection (g) of this section, if such penalty is unpaid the penalty plus accrued interest may be recovered in a civil action brought by the Commission in any district court of the United States."

Sec. 108. Subsection (g) of section 6 of the Federal Trade Commission Act (15 U.S.C. 46(g)) is amended to read as follows:

"(g) From time to time to classify corporations and to make substantive and procedural rules and regulations for the purpose of carrying out the provisions of this Act. Whenever it appears to the Commission to be in the public interest, the Commission shall promulgate rules and regulations defining unfair methods of competition and unfair or deceptive acts or practices. Such rules and regulations shall be promulgated in accordance with section 553 of Title 5, United States Code, after reasonable notice and opportunity for interested persons to participate in the rulemaking through submittion of written data, views, or arguments with opportunity to present the same orally in an appropriate manner; and, after consideration of all relevant matter presented, the Commission shall incorporate in any rule or regulation adopted a concise general statement of its basis and purpose. When any such rule or regulation is validly promulgated and becomes effective in accordance with the provisions of this Act, a subsequent violation thereof shall constitute an unfair method of competition or an unfair or deceptive act or practice in violation of section 5(a)(1) of this Act.

Sec. 205. (a) (The existing provision of the bill.)

(b) Any order entered by the Federal Trade Commission in any proceeding brought by the Commission under section 5 of the Federal Trade Commission Act enjoining any supplier from engaging in acts or practices declared to be unlawful by this title, having become final within the meaning of section 5, shall be prima facie evidence against that supplier in any action of proceeding brought by any other person against the supplier under section 204 of this title, as to all matters respecting which said order would be an estoppel between the supplier and the Federal Trade Commission: *Provided, however*, that this section shall apply only to orders entered after an evidentiary hearing, and not to consent orders; and provided further, that any damages or relief actually granted by the Federal Trade Commission to any such person shall bar, pro tanto, the recovery by such person of damages or relief from the same supplier for the same acts or practices.

Senator Moss. Let us now begin with the witnesses that we have for this morning. I am pleased to welcome as our first witness, my colleague, the vice chairman of the Consumer Subcommittee, Senator Philip A. Hart of Michigan.

Senator Hart has long been a leader in this consumer legislation field, and we are glad that he will lead off the discussion today.

Senator Hart?

STATEMENT OF HON. PHILIP A. HART, U.S. SENATOR FROM MICHIGAN

Senator HART. Mr. Chairman, thank you very much.

For the record, we should state that we began our day on time. The first meeting was your executive session on the markup of the Poison Prevention Packaging Act. I think we have amended it in there to improve it, and I hope the committee will act favorably on it. But that took about 20 minutes longer than we had hoped, and it is now 10:30.

At 10:30, the Senate Antitrust and Monopoly Subcommittee resumes hearings on auto repairs.

With that explanation, may I file my statement with you. It urges favorable action on a bill not listed among the three you enumerated as before the subcommittee, but it is a bill that has been referred to the Commerce Committee, and I think under normal practice properly would be considered before this subcommittee.

Senator Moss. We are very happy to have you file your statement, and we will consider it as we consider the other matters that are before us.

Senator HART. May I inquire if S. 3338 is before us?

Senator Moss. Yes, it is before us.

Senator HART. I urge favorable action on that, for reasons included herein, which are very persuasive.

Senator Moss. Thank you, Senator, and we appreciate your coming to file your statement.

We wish that time had permitted you to discuss it fully with us, but we know you will be sitting with our subcommittee further as we do mark up these bills that are before us.

(The statement follows:)

TESTIMONY OF HON. PHILIP A. HART, U.S. SENATOR FROM MICHIGAN

Mr. Chairman, two years have passed since the Kerner Commission Report underlined the frustration and alienation of vast numbers of citizens caused by inadequate protection from practices of sharp merchants, landlords, and the like. Yet, today this frustration still persists. It still serves as a catalyst in the dissatisfaction of consumers with our private enterprise system.

If the business of these hearings—namely, the safeguarding of consumer rights—is not acted on by this Congress, historians may very well cite this failure as a significant contributor to loss of faith in the free enterprise system. If the system dies, its replacement, I fear, would be a system of pervasive government regulation.

As ominous as this sounds, it gains credibility when one considers that just last month the Federal Trade Commission recommended actions that would, in effect, make the auto industry a public utility. These hearings, therefore, are extremely timely and action by Congress should be considered a must. At the least, failure to act now could result in future "crises legislation" that in the long run will disfavor both business and consumers.

Four basic proposals are before the committee: S. 3201, the Administration's proposal; S. 3092, the Tydings' bill; S. 2246, introduced by Senator Moss and S. 3338, which I introduced.

The Administration's proposal disappointed me. I thought that the "in" posture of "new federalism" was to return the flow of power to the people. Having introduced or supported numerous bills which would do just that, the idea appealed to me. But, examining the Administration measure, we find that the consumer can sue only after the government has won a lawsuit against the unfair trade practice. Practically, this means that the barrier which consumer legislation attempts to remove—the need to rely on the slow, cumbersome machinery of government—would still be the principal consumer protection. This approach doesn't recognize a reality of life—that in this rapidly expanding economy these agencies, often understaffed and underbudgeted, must concentrate their efforts on only the most serious and flagrant violations. Where then, does this leave the consumer whose grief is major to him—but not to the antitrust agencies?

My second criticism of the Administration proposal is that it limits consumers' right of action to only those unfair or deceptive practices enumerated in the bill. The FTC through years of litigation has defined trade practices which are inimical to the public interest. Yet, under this proposal, those precedents which don't fit into the 11 categories would be useless to consumers. Commissioner Dixon listed several unfair trade practices for you which he contends would not be covered by the Administration's 11 categories so I will not repeat them. But, I do caution that we must not start off by limiting the type of action a consumer can bring.

Under section 205 of the Administration's proposal, only a final judgment or decree under section 203 would be prima facie evidence in a consumer action against that defendant.

Thus, FTC cease and desist orders are excluded from having a prima facie effect. This makes little sense because this agency up to now has carried the burden of these cases and has developed the expertise.

S. 2236

Having co-sponsored S. 2236, introduced by Senator Moss, I am naturally in complete agreement with its goal—to give the FTC authority to seek temporary injunctions for violations of the unfair or deceptive portion of the FTC Act.

A case before the FTC—with all the built-in protection—is a long, long procedure. Five years is not at all uncommon. Yet, there is no compelling reason for a company to stop the complained-of practice before the suit's conclusion.

In fact, he might be though foolish to do so because a Commission win will result only in a cease and desist order regardless of whether the businessman profited little or greatly. "Get while the getting is good" might be the motto of that businessman. So, without the proposed injunction power, the consumer will continue to be damaged while the case drags out. (In passing, it should be noted that section 101(b) of the Administration's bill providing for temporary injunction would limit its applicability to "any person" whereas the original language of section 13 of the FTC Act as well as the Moss bill utilizes the language "person, partnership, or corporation." It seems that the broader language of the Moss bill would be the safest way to insure adequate coverage.) As I shall later indicate, I also believe that practices coming under the restraint of trade portion of section 5 are just as harmful to the public, if not more so than those under the unfair and deceptive side. Therefore, consideration should be given to extending injunctive authority to the whole of section 5.

S. 3092

S. 3092, the Tydings' bill, is much more meaningful than the Administration's version. The proposal provides for consumer class actions for "acts in defraud of consumers." These acts are defined as:

(A) an unfair or deceptive act or practice which is unlawful within the meaning of section 5(a)(1) of the Federal Trade Commission Act, or

(B) an act that gives rise to a civil action by a consumer or consumers under State, statutory or decisional law for the benefit of consumers.

The proposal removes the jurisdictional amount, thus does away with the aggregation of claims problems raised in the decision of *Snyder* v. *Harris* 394 U.S. 332 (1969).

The bill would not require the consumer to await the result of a government action.

Mr. Chairman, this is a good bill but I believe it can be made a better bill. To begin with, I recommend joining this bill with S. 2246, authorizing the issuance of temporary injunctions by the Federal Trade Commission. I also would think that the proposal should make a FTC cease and desist order prima facie evidence in a private action.

Moreover, I believe that we should view realistically the types of business practices which damage the public. All proposals before you, except the one I offer, deal with deceptive acts and practices and not with the trade-restraining unfair methods of competition encompassed by section 5 of the FTC Act.

The proposals also would give only consumers a cause of action, and not businessmen who well may have lost their entire business due to the identical practice. This extracts a terrible penalty from the vast majority of honest businessmen.

Since assuming the chairmanship of the Antitrust and Monopoly Subcommittee six years ago, it has become clear to me that the independent businessman often is not adequately protected from unfair business practices of less scrupulous competitors. He, like consumers, suffers because there is no adequate private legal remedy and because of overload of the government agencies.

The marketplace reflects this lack of protection through high prices, sharp business practices and other competition-destroying devices, all to the detriment of consumers.

If the independent businessman could protect himself from unfair methods of competition, it seems this would go a long way toward sharpening the competitive process for the benefit of consumers.

S. 3338

S. 3338 introduced by me, permits individual and class actions on behalf of the consumer and the businessman for violation of section 5 of the FTC Act. It also provides for treble damage awards and makes cease and desist orders of the FTC prima facie evidence in a private action.

Mr. Chairman, I am aware that the Federal Trade Commission Act is often referred to as an "incipiency statute." Under that interpretation, the Commission may attack unfair trade practices which—if left unattended—would become full-blown Sherman Act violations. Because of this view, I anticipate there will be those who argue that the enforcement of the Act should be left to that body of experts who can pick and choose those cases to pursue. But let's not kid ourselves. If we review the restraint of trade cases brought under section 5, we will find that many could have been brought under the "antitrust statutes" and the treble damage provision would apply.

The Supreme Court has recognized this fact in *Fashion Originators Guild* v. *Federal Trade Commission* 312 U.S. 457, 463 (1941) stating:

". . . if the purpose and practice of garment manufacturers and their affiliates runs counter to the public policy declared in the Sherman and Clayton Acts, the Federal Trade Commission has the power to suppress it as an 'unfair method of competition'. . ."

Again in *Federal Trade Commission* v. *R. F. Keppel & Brothers* 291 U.S. 304, 310 (1934) the Supreme Court said:

". . the [FTC] act undoubtedly was aimed at all familiar methods of law violation which prosecutions under the Sherman Act had disclosed . . ."

In *Federal Trade Commission* v. *Cement Institute, Inc.* 333 U.S. 638, 691, 692 (1948) the Supreme Court stated:

". . . thus it appears that soon after its creation the Commission began to interpret the prohibitions of section 5 as including those restraints which also were outlawed by the Sherman Act, and that *this Court has consistently approved that interpretation of the Act.*" (emphasis added)

Thus, we find ourselves in the anomalous position that, in certain circumstances, the businessman's and consumer's right of action depends on whether the FTC or Department of Justice initiates the case.

Mr. Chairman: violations of section 5 seem to fall into three categories. First are the Sherman Act-types which the courts have held can be reached under section 5 but which up to now carry treble damage potential only if Justice brings the case.

Second are the unfair or deceptive practices—the type enumerated as practices reached by the Administration bill.

There seems to be general agreement that these unfair and deceptive practices are detrimental and should be reached with private class actions.

My bill would also open up the possibility of class actions—for consumers and businessmen—for violations sometimes considered "incipient."

Frankly, I am hard put to see the difference in impact on consumers if they are touted away from a low-priced product—as in bait-and-switch advertising—or if he is touted off it because "push money" was given to the sales person by a competitor.

Yet the first would be reached as an unfair practice by the Administration's and Tydings' bills and the second is left unreachable by the private plaintiff.

The bill I have introduced provides for treble damages and I can already hear the cries of despair over abusing the businessmen. It seems to me time that there was some of the same furor about businessmen abusing consumers and competitors.

If we are to re-establish an orderly marketplace, we must recognize that the time is now for strong deterrents to disabuse those who believe that sharp practices are profitable.

Senator Moss. Our next witness is Mr. George P. Lamb, who is the general counsel of the Association for Home Appliance Manufacturers. Mr. Lamb has been with us before. We are happy to welcome him back and we look forward to hearing his testimony this morning.

STATEMENT OF GEORGE P. LAMB, GENERAL COUNSEL, ASSOCIATION OF HOME APPLIANCE MANUFACTURERS

Mr. LAMB. Merely because I do not have a green tie this morning, it doesn't necessarily mean that I am not an Irishman. As a matter of fact, I am a rare bird, I am a fullblooded Irishman.

Senator Moss. Congratulations on this great day.

Mr. LAMB. I intend to celebrate before the day is over.

My name is George P. Lamb. I am a partner in the law firm of Lee, Toomey & Kent, and I serve as general counsel for the Association of Home Appliance Manufacturers.

This association is made up of the companies that manufacture refrigerators, ranges, home laundry equipment, air conditioners, disposers, and certain portable appliances.

We appreciate the opportunity to address ourselves this morning to particularly S. 3092 and related bills that would broaden the authority of the Federal Trade Commission and permit consumer class suits in the Federal courts. Appliance manufacturers recognize that many consumers are victimized in the marketplace by fraud and other deceptive practices. Means must be provided to curb these practices before the consumer can be harmed, and to redress the consumer who has been injured. The means to accomplish these goals must be able to move swiftly, without unduly burdening either the judicial system or the economy.

In the words of Assistant Attorney General McLaren, "New consumer protection must be effective. It must be workable. And it must not carry with it major undesirable consequences." In fewer words, Mrs. Virginia Knauer has said that remedies for consumers must be "convenient, expeditious, and effective."

To permit unlimited class suits for consumers in Federal courts, as a means of curbing fraud, does not meet these criteria. Class suits are

seldom an expeditious mechanism for settling any kind of controversy. They inevitably burden the judiciary. They can have undesirable, even disastrous economic consequences.

To oppose class suits as a means of correcting evils that exist in the marketplace is not to sanction those evils. There are alternatives that can be "convenient, expeditious, and effective," without "undesirable consequences."

I would like to say here, Senator, that in the last 5 or 6 years the home appliance industry has become keenly aware of the evils in the marketplace and has on its own taken many steps to try to correct those evils, and we will continue to do that, and later on in my statement I would like to point out to you how we have effectively established a complaint exchange in order to answer these complaints of consumers very expeditiously.

Class suits come in under rule 23 of the Federal Rules of Civil Procedure, as amended in 1966. The rule permits one individual to file a complaint on behalf of himself and unnamed members of a class, when he avers that he and the class have a claim against the defendant or defendants that presents a common question of law or fact. Members of the class must be so numerous that it is impractical for them to be joined; the claims of the active plaintiffs must be typical of the claims of all; and it must be shown that the active plaintiffs will adequately protect the interests of the class. A complaint may be filed without the knowledge or consent of the members of the class. Unless, after receiving "notice" in the manner provided by the rule, a member of the class takes affirmative action to withdraw from the suit, he is thereafter bound by the outcome—even though he may not appear or be represented by counsel of his choosing.

The amended rule 23 was recognized as a racial departure from established principles that had long governed spurious class actions. Caution against large scale use where common questions are at issue was expressed in the Supplemental Report of the Committee on Federal Rules of Civil Procedure.

The rule has not been thoroughly tested. It is open to abuse. It presents questions of due process. Has, for instances, a person been afforded due process when, through ignorance or carelessness, he fails to understand the meaning of a notification from the court that a suit is pending on his behalf—or fails to see a newspaper in which notice is published, fails to withdraw his name from the list of plaintiffs, and later finds himself foreclosed from asserting a legitimate claim because the class suit was lost by the active litigants? No doubt this question will some day be litigated.

Until the rule has been more thoroughly tested, through experience and court rulings and opinions, it would seem very unwise to thrust upon it the added burden of unlimited consumer class suits.

A class suit under rule 23 is neither an efficient nor expeditious means of settling a controversy. The rule requires an initial determination of the propriety of the class action, and an identification of the members of the class. These processes can be time consuming and burdensome. For example, a class suit, alleging a violation of the Sherman Act, was filed in 1966 after rule 23 was amended, by one Eisen against two odd lot dealers on the New York Stock Exchange, on behalf of him-

self and 3,750,000 purchasers of odd lots of stock. On September 26, 1966, the trial judge granted the defendants' motion to dismiss the class action. Dismissal was based primarily on the ground that the plaintiff had not established that he would "fairly and adequately protect the interests of the class."

I might say, Senator, that in 1963, I had the privilege of defending a class action which was brought by the Utah Pie Co. in Salt Lake City against the Pet Milk Co. This case was heard before Judge Ritter. I made a motion to dismiss and a motion for summary judgment and argued it before Judge Ritter in the middle of the winter 1963, and I had it dismissed.

During the course of that argument, Judge Ritter reviewed for us his experience in dealing with the *Union Carbide* case. As you probably recall, the Union Carbide class suit was brought on behalf of 13 named uranium miners and 350 unnamed uranium miners on the southern slope of the Colorado Plateau. The jury brought in a verdict of $3,500,000, and earmarked $1 million for the uranium miners on the southern slope of the Colorado Plateau, and Judge Ritter said he had that million and he couldn't find those unknown miners on the southern slope of the Colorado Plateau.

I don't know eventually what disposition was made of that money, but at that time it was still in trustee account for the U.S. District Court in Salt Lake City.

In the course of that argument, Judge Phillips, a member of the Tenth Circuit, was quoted in his dissenting opinion in the *Union Carbide* case. I think it is interesting what Judge Phillips said. He said "While, as pointed out by Judge Murrah some students and writers have advocated that rule 23 should be applied as it was by the trial court in this case, so far the courts have not looked upon the theory with favor, and we will be the first to fully accept and apply this novel interpretation. And so aptly put by our chief judge on another occasion "It sounds very well but questions of law should not be disposed of in this manner.

"I am convinced that the adoption of this concept of the rule will not only lead to its unfair use but will be conducive to the undesirable solicitation of claims in courts cases in which there are multiple injuries."

We have seen this happen, and I would like to offer, Senator, for the record a tabulation of class actions which have recently been brought, such as *State of New Mexico* v. *General Motors and the Automobile Manufacturers Association*, the class, listen to this, all other governmental bodies and all people of the State of New Mexico, the injury, the environment and economy of the state by virtue of the defendant's violation of section 1 of the Sherman Act.

There is one over here, *Keane* v. *General Motors*. The class, all residents of the city of Chicago, claim injuries to businesses, professions and property by virtue of violations of the Sherman Act. It seeks damages in the amount of $1 billion.

State of Illinois v. *General Motors*, all people of the State of Illinois, and all political subdivisions of the State. The claim is exactly the same as in the *Keane* case.

Here is a case in the Eastern District of Pennsylvania. *Philadelphia, Baltimore, Pittsburgh, and Erie, et al*, v. *General Motors*. Class: All governmental bodies and the entire citizenry of the United States.

This is getting to ridiculous proportions.

Subsequent to the *Utah Pie* case, I intercepted a letter which was written by one of the attorneys in that case soliciting a class action on behalf of all frozen fruit pie companies contiguous with the Safeway stores throughout the United States.

This class action type of legislation lends itself to stimulating the unscrupulous member of the legal profession into making a money-making scheme of it. It doesn't deal with the specific problem that you want to get to. You want to get expeditious relief for the person who was defrauded. You want to get expeditious relief if a person has purchased a defective product.

This class action thing I suppose in the long run may be because so many of these actions are brought and are so ridiculous, rule 23 itself will probably eventually be attached by the bar association, and it will be done away with.

Rule 23 didn't exist when my first case, the *Utah Pie* v. *Pet* came up; it was the spurious class action rule, and it was later amended in 1966 to allow you to bring one of those suits without even the consent of the defendants.

To me this is a very dangerous thing to grow up in our judicial system. I feel that effective relief cannot be obtained in the Federal courts. Our Federal courts are already overburdened with litigation. Just a look at the calendar of the U.S. District Court in the District of Columbia would tell you that the U.S. District Court would be almost stopped in its tracks if this kind of litigation were permitted.

That doesn't mean that we shouldn't do something about these problems. I think that the appropriate form for relief for an aggrieved consumer is in the local courts. I believe that the efforts that are being made by the Office of Economic Opportunity, by the bar association, by some of our enlightened law firms in furnishing lawyers to file small claims for an aggrieved consumer are all in the right direction. As a matter of fact, I have sometimes thought that we probably should have a mobile small claims court that would go right into the areas with the judge sitting in the court, with a clerk there, and with a volunteer attorney, or an appointed attorney to aid a consumer in filing a small claim—the $70, the $100, or the $25 claims, where action could be taken on them, where the defendants could be notified and could come and appear before the court, and an expeditious handling could be had.

I think anything that the Senate can do in strengthening these small claims courts will go a long way toward actually getting to the problem, and the problem is immediate and effective redress for somebody who has had some wrong done to him as a consumer.

I think in some of these other areas that you have moved rather expeditiously in the consumer protection area, and we certainly think it is in the public interest to do that, and we think there are still some things that you can do such as the preliminary injunction, giving the Federal Trade Commission powers of the preliminary injunction with the rules of equity properly applying. Those preliminary in-

junctions should not be granted easily by the court, but if it appears there is going to be a severe injury against safety or health or the destruction of property, and if it appears that the Federal Trade Commission has a very good chance of winning, then it should be permitted to go into the U.S. District Court in the District of Columbia, or any of the other Federal courts throughout the country to seek an injunction, and preferably with a complaint in hand—not with any delay.

They should be able to present the court with a complaint and it should be able to say that the Trade Commission has reasonable cause to believe that this injury is one that is irreparable or will do very serious harm, and, therefore, should be granted pending a full hearing by the Federal Trade Commission on the merits of the case.

Our association supports the idea of that type of legislation. We think the jurisdiction of the Federal Trade Commission should be broadened to handle those matters that affect interstate commerce.

We think there is a possibility that they could go in and reach those cases that are on a local level more than they can now under their restrictive jurisdiction.

We feel that a statutory base for the President's Special Assistant on Consumer Affairs should be set up with certain powers to investigate and report to the Congress on the progress that is being made, not only by the Federal Trade Commission but also such voluntary action as industry might take.

In the Home Appliance Manufacturers Association, the association that I represent, we have instituted a complaint exchange, and as the Senator will recall when I testified on the warranty-guaranty bill, you indicated you had received some complaints, and I offered to process those complaints if you would send them to me. And I would like to tell you this morning a little more—I have a tabulation of the complaints, and what has happened to them since 1968 through March 9, 1970. I will be glad to give you this tabulation for the record. It shows that the association has received 1,216 complaints, 1,027 of which were AHAM products, 834 were AHAM members, and 193 were nonmembers.

Non-AHAM products was 173, and miscellaneous was 43. We still have 200 complaints open, but we have satisfactorily settled 836 complaints; 76 percent of those that have been forwarded to us have been satisfactorily settled. We get these complaints from writers such as Sidney Harris, Margaret Dana, Good Housekeeping. We get them from magazines like Changing Times, from the Federal Trade Commission, from the Department of Commerce.

And it is amazing to me, Senator, that when you hear these rounded-out figures, 30,000, 100,000, 75,000 complaints over a period of the last 4 or 5 years, some of these round figures leak out in speeches, and we have developed the policy of going to the person who makes that kind of a comment and say, "All right, give them to us. We want them right now, because we want to process them and we want to do something about it." And believe it or not, this is what is comes down to.

I'm not saying we get all the complaints, but we have had all kinds of publicity on this program, and it works something like this:

A complaint is sent in to the Association of Home Appliance Manufacturers, whether it be a member or not a member. The association sends a copy of that complaint to the manufacturer. The manufacturer—most of our manufacturers now have departments set up for quick processing of complaints of that sort. They send a fieldman to find out precisely what the facts are, and some times it can be done without too much difficulty right on the spot.

This complaint exchange is only 2 years old, and we think a voluntary effort of this sort goes to the roots of the problem that you're trying to solve.

You want to have this consumer who has been defrauded—you want him to get quick redress. And we think that if this can be stimulated, if we can stimulate Government into sending these complaints to us, we will be able to do a good job of processing.

The association has received—listen to some of these letters. This is from San Carlos, Calif.:

> Words cannot express my gratitude for your help in solving my refrigerator problem. How wonderful for the consumer to be able to turn to people of your caliber for help. You are rare gems. Thanks again for your tremendous help. It is gratefully appreciated.

Here is one from Palmer Heights, Ohio:

> Many thanks for your assistance in routing my complaint to the proper authority, and now I have a refrigerator that is performing like a new one. I am glad to have the Association of Home Appliance Manufacturers.

Here is another one, from Oklahoma:

> In reply to your letter dated September 22, I appreciate the attention and help given me in regards to the refrigerator repair. Thanks again for your assistance.

Here is another one from Texas:

> Thanks for your letter of January 9. I appreciate the interest shown in my problem and the efforts taken on my behalf.

We are beginning to get letters of this sort.

Now, in order to improve on this system of complaint exchange, we have set up the Major Appliance Consumer Action Panel. That's a long name. I think it is probably going to end up being called MACAP.

MACAP will be a panel of nine people who are not members of the appliance industry. There will be an announcement here shortly that this panel will be headed up by a very prominent former dean of one of the schools in your area, Brigham Young.

Senator Moss. I know her very well.

Mr. Lamb. She is going to be the chairman of this, and she is going to have eight very prominent members of this panel who are either in the newspaper world or who are people who have demonstrated profound interest in consumer affairs; and she will be in a position to audit what AHAM is doing in the complaint exchange area. She will be able to take a look at some of the hard cases. We've got about 20 or 25 of them that have turned out to be very difficult to resolve. She will not be an arbiter of those, but her panel will be able to consider the facts on both sides and will be able to point out improvements that the Association of Home Appliance Manufacturers might take to make this system work even more effectively.

As I told you in the earlier hearings, we have a lot of other programs that are in the consumer protection area, particularly guidelines on advertising of refrigerator freezers and home laundry equipment, and so on. And we are continuing to improve on those.

We, therefore, feel that this type of program, the injunctive relief, beefing up the small claims courts, doing everything we can to aid the Office of Economic Opportunity and the legal professions in having neighborhood assistance to get redress—quick redress—we feel if the office in the White House, Mrs. Knauer's office, gets statutory authority, we feel you have made exceptional progress. And we believe that you should wait on this class action thing. I frankly believe that you ought to have a study made of it to see what impact it is going to have on our court system, and I believe that you should call some representative of the judicial conference to discuss this. This is too serious, and in my humble opinion will have such a tremendous impact on our court system, that you had better not rush into it.

I have seen this thing develop in 1963 from the spurious class action suit I defined, through the change in the rule in 1966 where you could bring the suit without anybody's consent, and frankly, I think our profession has a bad enough name already, without giving it a tool to go out and solicit lawsuits.

Frankly, I hope you will go slow as far as class action is concerned, and I urge upon you the desirability of either getting some foundation or some law school, or perhaps call on the Bar Association to make a real serious study of this to make sure of the economic impact as well as the impact on the calendar of the courts.

Senator Moss. Thank you, Mr. Lamb.

I assure you we don't want to rush into it until we have given it mature consideration. We are examining it with great care. We are glad to have your testimony and your suggestions on it.

You, like several others, have expressed the fear that class actions would be used for so-called strike suits by unscrupulous members of the bar, who would go out and solicit an action and try to force a settlement. That is what I gather is a strike suit.

Doesn't rule 23, however, prohibit the settlement of a suit without the consent of the court? Doesn't the court have to consent to the settlement?

Mr. Lamb. Yes.

Senator Moss. To that extent, the court could control the strike suit that is aimed simply at forcing the settlement to get the funds. If it felt it was spurious or contrived or solicited, the court, of course, could control that.

Mr. Lamb. There could be a limited amount of control over it; yes.

Senator Moss. I am glad to have you refer to this Major Appliance Consumer Panel, because I have known Virginia Knauer for many years and admire her greatly, and I am sure she will do a very fine job, and this is indeed a step forward by the industry on its own that is most commendable, and I am happy to see the step is being taken. We have high hopes that it will work out well.

It still doesn't however, supply the consumer with any kind of legal basis on which he may proceed—other than his usual right to go into the small claims court—does it?

Mr. LAMB. We hope we will solve his problem and there won't be any necessity of having litigation.

I mentioned before in my previous testimony that a great deal of this problem is at the local level, and it is in these areas of consumer finance, home repairs, resale of television sets, actual repair of appliances, that sort of thing, and we think if that cancer were cured, that it would go a long way toward solving the problem.

Now, that doesn't mean there isn't some other problems elsewhere, but I think the main problem is in that area.

Senator Moss. I am in agreement with you on that.

I always, or I try anyway, always to point out that the problem exists in really a very small segment of the industry—those who take advantage of the freedoms they now have in order to deceive and bilk the consumer—that this is certainly not general at all. The vast majority of business is very anxious to settle complaints and take appropriate steps. Therefore, what we are directing our legal sanctions at, if we can keep them on the target, is again this small segment that does not try to practice good business ethics and is causing loss in the marketplace.

Do you think there will be a large number of class suits filed if this bill were enacted and it became possible to file a class suit?

Mr. LAMB. I do.

Senator Moss. You think there would be a large number?

Mr. LAMB. Yes; I do, and I think there would be some very zealous solicitation of business by lawyers to try to bring class actions. The possibility of legal fees that could be gotten from a class suit are tremendous.

I think in the *Union Carbide* case, the fee was something like $1,500,000 out of the $3½ million recovery.

Senator Moss. What would be the expense to business in defending these class action suits?

I mean, aside from whatever judgment might come out of it, just the filing of the suit would set in motion a lot of machinery.

Mr. LAMB. In the *Utah Pie* case, it started in 1961, September of 1961. We got to trial in February of 1963. Pet was being sued for $2¼ million. The jury brought in a verdict of $40,000 plus $20,000 in attorney fees.

I appealed the case to the circuit court, and it was wiped out 3 to 0.

My opponent took it to the Supreme Court, and he won it 6 to 2.

I took it back to the Tenth Circuit Court and it was wiped out again, and ordered retired.

This took 8 years, and when the case ended, it was settled for $29,000. The total cost of that case was over $400,000.

Senator Moss. That, of course, is the sort of thing I am concerned about.

If we get a large volume of class action cases and if they stimulate a great deal of litigation, that is very expensive and has to be paid for by the manufacturers, or somebody.

Mr. LAMB. The thing I fear the most is that the unscrupulous operator, the one that is cheating, it is a fleeting character and the class action won't be brought against him. These class actions will be

brought against business that tries hard to do the right thing, because they will be just like sitting ducks, they have got the money to pay the verdicts, whereas the unscrupulous operator doesn't have it.

Senator Moss. The fly-by-night man, of course, is judgment proof, even if you get him served.

Mr. LAMB. That is right.

Senator Moss. Of course, I suppose you would agree that the large, solvent business should not be immune from suit; he should answer if indeed he has——

Mr. LAMB. Very definitely, he should, and, as a matter of fact, he will have to defend, because if he loses one of these cases, what would the loss of a verdict of $1 billion do to the General Motors Corp.—$1 billion with all these other actions pending in other cases?

Senator Moss. I understand that you urge that we go ahead with the idea of preliminary injunction as the main source of protection against fraud and deception in the marketplace?

Mr. LAMB. That is right, with the proper equity protection. I am sure that the courts will be very slow to grant injunctions of that nature. There will have to be a serious injury or an irreparable damage done before they will be granted.

Senator Moss. You pointed out that some of these class actions that have been recently filed have had a broad class as plaintiffs in them, that they were somewhat ridiculous. Are you citing that really for the cumbersomeness of it, or is it because there was an imaginary grievance?

Mr. LAMB. No; I am citing it to show you what is going on right now under rule 23 and what will go on if you add the jurisdiction of the Federal courts in a case involving less than $10,000.

If you can bring a class suit in the Federal court—let's take an example, an aggrieved owner of a washing machine brings a suit for $300 against the "X" washing machine manufacturer, and he brings it on behalf of all owners of washing machines of that series, and let's say there are 500,000 of them. Look at the extent of that suit.

Senator Moss. The jurisdictional amount, then, isn't too important; even if we dropped the provision in the bill and retained the $10,000 amount limitation, that is easily circumvented by alleging a wide class, isn't it?

Mr. LAMB. That is right, even if you drop that out.

What I am saying is that rule 23 is a bad rule right now, without adding anything more to it, without adding this legislation to it.

Senator Moss. Let's take this fellow with the washing machine, who has a $300 suit. Suppose he has a good claim and he could establish it for himself in a small claims court, or in a State court of some kind, what about those other 499,999 people?

Mr. LAMB. If they have a problem, they should go ahead and have it litigated the same as he did.

I daresay you wouldn't find that degree of similarity between one and the other. There are so many variances in the use of a machine, if you take an automatic washing machine that is used in a family of three, that is one thing. If you take an automatic washing machine that is used in a family of 12, that is something else. The one where

there is 12 people, it is probably running 7 days a week, and the possibility of it having something wrong with it because of its vigorous use is very real.

Senator Moss. This is what bothers us a great deal. The buyer is reluctant to try to do anything to recover for a defective machine of some kind or on ineffective machine, because, the complexity of it, the necessity of getting counsel and all, are extremely burdensome.

Mr. LAMB. What the home appliance industry is trying to do is, No. 1, the individual company, when a complaint is brought to its attention, will process it immediately. Either his dealer will process it, if the dealer cannot process it, it will go through the distributor or wholesaler, and if that cannot be done, it goes back to the manufacturer.

That is a definite policy in the appliance industry today to give rapid attention to any of these complaints; so, it is our intention to correct the error so there won't be any need for any lawsuit.

In addition to that, adding this complaint exchange with the supervisory power of Mrs. Cutler, we hope that we are going to have about as close to perfect operations as we can get. We will see that the person that has got a real beef will get redress rapidly. That is what we want to do.

We are trying to design our products so that they will do those things for which they were intended, that they will wash your clothes, that they will dry your clothes, they will cook your food, and in the design engineering area, the manufacturers have been stimulated to put forth even a greater effort to make more efficient products that will function and more durable products that will function for the consumer.

Senator Moss. Have you thought of the possibility of including in the warranty or guaranty some reference of access to this process and assurance of prompt action or something of the sort?

Mr. LAMB. No. As a matter of fact, we stay away as an industry from any standardization of warranties. The warranties are left up to the individual companies.

As an antitrust lawyer, I have advised against the standardization of warranties, and I have advised to stay away from anything which deals with the duration of the warranty or the cost of repair, because, notwithstanding some differences of opinion on this subject, I frankly believe that that would violate section 1 of the Sherman Act and section 5 of the Federal Trade Commission Act.

Senator Moss. I am just trying to think of some way of giving the buyer really a little more——

Mr. LAMB. I think we can answer your question, Senator. We are putting literature in all of these machines. We are putting care and use manuals with the machines. We are putting tell tags with them, telling you what you can do if something happens to the machine, and they are done up in a form that is practical and readable, and if they are not misplaced they will certainly be useful in trying to solve a problem.

Senator Moss. Returning to this problem of the FTC and giving it additional powers, do you approve of permitting the FTC to obtain temporary restraining orders as well as preliminary injunctions?

Mr. LAMB. I think using those terms interchangeably sometimes is overlegalistic.

I do think the important thing is they should have the power to get an injunction, a preliminary injunction or temporary restraining order when there is an irreparable damage done, where the trade commission has reason to believe that there will be a serious damage or an irreparable damage done, that they can go into court and get this injunction pending the trial of the case on its merits.

One time I represented a client that was a little worried about some of its competitors' advertising on television, and I went up to New York to look at the "Today" program, and I saw a man down in front of the table put an object up on the platform which was photographed on the television set; they were mixing, and it looked as though it was an instant mix, and the truth of the matter, it wasn't. Instead it was a glass already stirred. I tried to do something about that and I wasn't very successful.

That is the type of thing that wouldn't really warrant a temporary injunction, but it is the type of advertising that ought to be stopped. The trade commission ought to be able to reach it instantly rather than waiting until the advertising year is over, and frequently that presents a problem.

But where there is no real injury, no serious injury, I don't think we should have injunctions. That, of course, would be purely within the discretion of the court, and if I know anything about the court's attitudes toward temporary restraining orders, or preliminary injunctions, they are very loathe to grant them.

Senator Moss. I have proposed authorization for the FTC to award damages where it finds a violation of the law resulting in injury to customers.

Do you agree in this principle?

Mr. LAMB. No, I don't.

I think the original intention of the FTC Act was to reach certainly these illegal practices at their inception in order to prevent the growth of monopoly. I think throughout the history of the Federal Trade Commission, they have assumed jurisdiction that wasn't originally intended, but I think the cease and desist order method is the proper one for this kind of law, because it is not black and white. There are some tremendous gray areas.

Trying to define what is an unfair method of competition has been an extremely difficult thing throughout the years. It was fairly simple in price-fixing cases. The Sherman Act violations became violations of section 5 of the Trade Commission Act. As you know, price fixing violates both section 1 of the Sherman Act and section 5 of the Federal Trade Commission Act.

Senator Moss. The criticism that is leveled against limitation of power on the FTC is that it gives industry one free bite. They are told to cease and desist and do it no more, but anybody that has been injured thereby has no remedy with FTC. He must go elsewhere to get a remedy.

Mr. LAMB. He can sue in the small claims court or he can sue in inferior courts where they have jurisdiction over it. I don't think that

the Federal Trade Commission Act should have the power to levy fines.

Senator Moss. On this new adjustment system you have, does that provide for redress to injured customers in any monetary sense, or is this simply repair of the appliance?

Mr. LAMB. In some instances it is the replacement of the appliance and in some instances it is the repair of the appliance. It is to give the customer full satisfaction.

Senator Moss. Thank you very much, Mr. Lamb. You have a very fine paper, and we are glad, as always, to have your testimony.

We recognize we are in a complex area and we are talking about changes that will be very far reaching, indeed, and we want to be as fully informed as we can be on it.

Mr. LAMB. I am handing the reporter a tabulation of class action litigation, and also a tabulation of our complaint exchange.

Senator Moss. They will be included in the record.

(The statement and tabulations follow:)

STATEMENT OF GEORGE P. LAMB ON BEHALF OF THE ASSOCIATION OF HOME APPLIANCE MANUFACTURERS

This statement is presented on behalf of the Association of Home Appliance Manufacturers (AHAM), whose members manufacture such home appliances as refrigerators, home laundry equipment, air conditioners, humidifiers, dehumidifiers, and automatic dishwashers. A list of the members and the products with which the association is concerned is attached to this statement as Exhibit A.

We appreciate having an opportunity to comment on S. 3092 and related bills that would broaden the authority of the Federal Trade Commission, and permit consumer class suits in the federal courts. Appliance manufacturers recognize that many consumers are victimized in the market place by fraud and other deceptive practices. Means must be provided to curb these practices before the consumer can be harmed, and to redress the consumer who has been injured. The means to accomplish these goals must be able to move swiftly, without unduly burdening either the judicial system or the economy.

In the words of Assistant Attorney General McLaren, "New consumer protection must be effective. It must be workable. And it must not carry with it major undesirable consequences." In fewer words, Mrs. Virginia Knauer has said that remedies for consumers must be "convenient, expeditious, and effective."

To permit unlimited class suits for consumers in federal courts, as a means of curbing fraud, does not meet these criteria. Class suits are seldom an expeditious mechanism for settling any kind of controversy. They inevitably burden the judiciary. They can have undesirable, even disastrous economic consequences.

To oppose class suits as a means of correcting evils that exist in the market place is not to sanction continuation of evils. There are alternatives that can be "convenient, expeditious and effective," without "undesirable consequences."

Class suits are neither swift nor effective instruments for redressing consumer wrongs

Class suit procedures.—Rule 23 of the Federal Rules of Civil Procedure, as amended in 1966, governs the filing and conduct of class suits in the federal courts. The rule permits one individual to file a complaint on behalf of himself and unnamed members of a class, when he avers that he and the class have a claim against the defendant or defendants that presents a common question of law or fact. Members of the class must be so numerous that it is impractical for them to be joined; the claims of the active plaintiffs must be typical of the claims of all; and it must be shown that the active plaintiffs will adequately protect the interests of the class. A complaint may be filed without the knowledge or consent of the members of the class. Unless, after receiving "notice" in the manner provided by the rule, a member of the class takes affirmative action to withdraw from the suit, he is thereafter bound by the outcome—even though he may not appear or be represented by counsel of his choosing.

The amended Rule 23 was recognized as a radical departure from established principles that had long governed spurious class action. Caution against large scale use where common questions are at issue was expressed in the Supplemental Report of the Committee on Federal Rules of Civil Procedure, Judicial Conference—Ninth Circuit, 37 F.R.D. 71, 79 and in letters that follow the report. See also Frankel, Some Preliminary Observations Concerning Civil Rule 23, 43 F.R.D. 39.

The rule has not been thoroughly tested. It is open to abuse. It presents questions of due process. Has, for instance, a person been afforded due process when, through ignorance or carelessness, he fails to understand the meaning of a notification from the court that a suit is pending on his behalf—or fails to see a newspaper in which notice is published, fails to withdraw his name from the list of plaintiffs, and later finds himself foreclosed from asserting a legitimate claim because the class suit was lost by the active litigants? No doubt this question will some day be litigated.

Until the rule has been more thoroughly tested, through experience and court rulings and opinions, it would seem very unwise to thrust upon it the added burden of unlimited consumer class suits.

A class suit under Rule 23 is neither an efficient nor expeditious means of settling a controversy. The rule requires an initial determination of the propriety of the class action, and an identification of the members of the class. These processes can be time-consuming and burdensome. For example, a class suit, alleging a violation of the Sherman Act, was filed in 1966 after Rule 23 was amended, by one Eisen against two odd lot dealers on the New York Stock Exchange, on behalf of himself and 3,750,000 purchasers of odd lots of stock. (*Eisen* v. *Carlisle & Jacquelin*, 66 Civ. 1265, S.D. N.Y.) On September 26, 1966, the trial judge granted the defendants' motion to dismiss the class action. Dismissal was based primarily on the ground that the plaintiff has not established that he would "fairly and adequately protect the interests of the class." (41 F.R.D. 147, 150) Eisen appealed, and in December 1966 the Court of Appeals for the Second Circuit denied the defendants' motion to dismiss the appeal. (370 F. 2d 119, cert. den. 386 U.S. 1035, 1967.)

Fifteen months later, in March 1968, the Court of Appeals decided the appeal on the merits and reversed the lower court's dismissal of the class suit. The case was remanded "for a prompt and expeditious evidentiary hearing, with or without discovery proceedings, on the questions of notice, adequate representation, effective administration of the action and any other matters which the District Court may consider pertinent and proper." (391 F. 2d 555, 570) A recent check with the clerk of the District Court indicated that the parties are now attempting to identify the 3,750,000 members of the class, to determine how the members should be notified of the pending suit, and to decide who should pay for the notice. None of this can be done expeditiously. The preliminary task of identifying 350 uranium miners on the Colorado plateau, unnamed members of a class in a treble-damage antitrust action, is said to have taken three years. (*Union Carbide and Carbon Corp.* v. *Nisley*, 300 F. 2d 561, 587, 10th Cir. 1961).

Recent class actions in the so-called *Smog* cases against the automobile manufacturers have been filed on behalf of all residents of the United States, all people in several states, all crop farmers in the United States, and all purchasers of automobiles using gasoline. Billions of dollars in damages are sought. This, it is submitted, is litigation run wild. Attempting to bring these complaints into focus and determining whether there is an identifiable class will require a tremendous amount of judicial and administrative work, and can keep the courts and the lawyers busy for years.

The time-consuming procedures do not stop with preliminary steps. After a class has been determined, a common interest must be found, a finding that may be difficult to make with a group of consumers. Thereafter, the usual trial procedures must be followed—testing the sufficiency of the complaint, discovery, preparing witnesses, the trial itself, with each member of the class having to prove the amount of damage he suffered as a result of the defendant's act.

The mere testing of the sufficiency of the complaint has absorbed 14 years in one treble-damage antitrust action, which is not a class suit. The original plaintiff is now deceased, but the case continues. The plaintiff's executor was recently given permission to file a third amended complaint. (*First National Bank of Arizona* v. *British Petroleum Co., Ltd.*, 1970 Trade Cases ¶73, 059, S.D. N.Y. 1970. See also *First National Bank* v. *Cities Service Co.*, 391 U.S. 253, 1968.)

Ineffective relief, undesirable consequences.—Class suits, moreover, will not give effective relief against the kinds of practices described by many witnesses as creating the primary need for opening the federal courts to such suits. These are such practices as bait-and-switch advertisements, home improvement frauds, fraudulent credit practices, selling repossessed products as new, dunning letters, the "freezer meat bargains," and so on.

These offenses are perpetrated locally by dishonest businessmen, usually in low income areas. After sales are made, the perpetrators may move on, so they may not be available to be named as defendants. If they are available, they are likely to be judgment proof at the conclusion of litigation.

To have even a remote possibility of being successful, plaintiffs' attorneys, in filing a suit against one of these entrepreneurs, will be forced to include as defendants wholesale distributors who merely supplied the offenders their goods, or producers whose brand names appear on the goods that have been sold. These defendants may eventually be able to extricate themselves, but only at high cost to themselves, through attorneys' fees, and to the courts in time-consuming procedures.

Even if a small enterprise is able to extricate itself, disastrous consequences might meanwhile have befallen it. Imagine, for instance, a small manufacturer struggling to introduce a new product. He has been named as a defendant in a consumer class suit with 1,000 plaintiffs. His potential liability, according to the court records, is $500,000. Few banks would extend him credit and his good will and public acceptance of his product could be severely eroded while the suit is pending.

Federal courts are not appropriate forums.—Federal courts are not appropriate forums for litigating the kinds of illegal practices cited above as creating a need for unlimited consumer class suits in the federal courts. These practices, except as they may violate Section 5 of the Federal Trade Commission Act, are made illegal by state law. The federal courts were created to administer federal law. Their orientation and experience is in federal law. They have jurisdiction over disputes between individuals that arise under state law only in diversity of citizenship cases. The increase in jurisdictional amount for diversity suits—from $500 in 1789, to $2,000 in 1887, to $3,000 in 1911, and to $10,000 in 1958—indicate Congressional recognition that the federal district courts should not become tribunals in which smaller claims arising under state law may be litigated. The class suit bills open the federal district courts to such claims.

Assistant Attorney General McLaren has pointed out that class "actions could be based not only upon [state] unfair trade practices laws, but also on state public utility laws, state health and safety laws, usury laws, landlord-tenant laws, and the like." To require federal courts to entertain litigation in these fields, Mr. McLaren says, "would be a substantial departure from the basic division among the federal and state courts, and could impose a very substantial burden on the federal judiciary." He urges that "we apply federal action primarily to interstate and national problems, and deal with state and local problems with *adequate* state and local machinery."

To enable you to explore this matter more thoroughly, we respectfully suggest that the subcommittee invite a representative of the Judicial Conference to comment on the effect the proposed legislation would have on the federal courts: administratively, financially, and in taking the jurists into fields of law in which they are not experienced. The burdens the legislation would impose would fall not only on federal district courts, but also on the courts of appeals and on the Supreme Court, as decisions would be appealed and certiorari sought.

Alternatives to class suits: federal action

Objections voiced by the Association of Home Appliance Manufacturers to proposals for consumer class suits in federal courts are not based on any disagreement with the objectives of those who sponsor or support the proposals. Expedient means must be available both to curb deception and fraud before the consumer is injured, and to redress injuries after they occur. Some means are available to meet these objectives. They can and must be strengthened. New means can be created. Both would be more effective and less disastrous in their consequences than permitting unlimited class suits in federal courts.

To the extent that problems to which the pending legislation is addressed have an impact on interstate commerce, and can thus be reached by the Federal Trade Commission, the Commission's authority and jurisdiction should be

broadened. The office of the Special Assistant to the President for Consumer Affairs can also be strengthened by giving it statutory authority.

Authority for FTC to seek preliminary injunctions.—The association endorses proposals to give the Federal Trade Commisison authority to obtain preliminary injunctions to restrain unfair or deceptive acts and practices. A petition for such an injunction must be subject to the traditional principles of equity. These are that the plaintiff (the Commission) demonstrate to the court that it (the plaintiff) is likely to succeed on the trial of the issues; and hat the injury to the plaintiff (i.e., the public) would be certain and substantial if a restraining order is not issued. To these should be added a requirement that the Federal Trade Commission file a formal complaint against a respondent before or at the time it files a petition for a preliminary injunction.

Actual fraud or deception and its probable effect are not difficult to identify and prove. Consequently, no burden would be placed on the Commission by requiring that the usual rules of equity be followed, and by requiring that the Commission be ready to file a complaint when it seeks an injunction.

On the other hand, some practices businessmen honestly believe not to be deceptive are questioned by the Federal Trade Commission. Although ultimately the Commission and the courts may rule against the practices, their continued use, pending litigation, does little harm to anyone. Hence an injunction would be inappropriate, and unnecessary.

The use of mock-ups in television advertising (*Colgate-Palmolive Co.*, FTC Dkt. 7736), the description of a medicament as "Carter's Little Liver Pills" (*Carter Products, Inc.*, FTC Dkt. 4970), Mary Carter's advertising of two cans of paint for the price of one (*Mary Carter Paint Co.*, FTC Dkt. 8290) are instances. The Commission's absolute order against the use of mock-ups was eventually modified. (*Colgate-Palmolive Co.* v. *FTC*, 310 F. 2d 89, 1st Cir. 1962; 326 F. 2d 517, 1st Cir. 1963; 380 U.S. 374, 1965) Carter had for more than 60 years before the Commission's complaint was filed described its product as "Little Liver Pills," with no record of injury to the public. (*Carter Products, Inc.* v. *FTC*, 268 F. 2d 461, 9th Cir. 1959) Mary Carter sold two of her cans of paint for the price of one of her competitors; but she erred because she always sold her cans in pairs, not singly. (*FTC* v. *Mary Carter Products Co.*, 382 U.S. 46, 1965)

Few consumers could have been seriously, or even slightly, injured by these practices. The business firms using the practices were entitled to full litigation under Section 5 of the FTC Act, without the interference of a preliminary injunction.

Enlarge FTC's jurisdiction to practice "affecting" commerce.—The Association of Home Appliance Manufacturers endorses proposals to broaden the Federal Trade Commission's jurisdiction to enable it to reach activities that are essentially local, though they have an effect on interstate commerce. This can be done by changing the words "in commerce," used in Section 5(a)(1) and (b) of the Federal Trade Commission Act to "affecting commerce."

Create an Office of Consumer Affairs.—AHAM endorses giving statutory authority to the Office of the Special Assistant to the President on Consumer Affairs, by creating an Office of Consumer Affairs in the Executive Office of the President. One duty of this office would be to receive complaints directly from consumers, and to direct them for resolution to appropriate government or private agencies, including manufacturers and retailers. The office could also analyze the content of the complaints and the available responses, to determine the need, if any, for future action. The results of these studies should be fully and fairly available to the public, with identification of the complainant and similar information removed.

Alternatives to class suits: state and local action

State legislation.—With increasing frequency, the state legislatures are enacting statutes to declare false advertising and other deceptive practices unlawful. The states are also establishing programs for consumer protection. Bills to create state consumer agencies are pending in at least 16 state legislatures. Where such agencies exist they are being successful. The Illinois Attorney General announced last December that the Consumer Protection Division of his office had recovered nearly half a million dollars for consumers between January and November 1969. He also reported that in addition to trying to recover money and services, the Consumer Protection Division tries to educate the consumer to avoid future problems.

These state activities should be encouraged by the federal government, perhaps financially and through the supplying of information on federal experience.

Small claims courts.—Unfortunately local judicial machinery such as the small claims courts have too often been the courts in which offending retailers have pressed their claims against disillusioned consumers. This use of the courts can and must be reversed, for they could be very effective tribunals for the settlement of consumer claims. The filing fees are low. Attorneys are not necessary. Procedures are informal. The judges assist the parties through questioning. Decisions come immediately from the bench.

Neighborhood services, the Philadelphia plan.—Neighborhood services, with and without attorneys, are being used successfully in several localities to seek and obtain redress from finance agencies and local retailers for defrauded consumers. These services can move quickly and effectively to secure the settlement of consumer grievances and to attack consumer frauds as they are being practiced.

The program conducted in Philadelphia was described during the Federal Trade Commission's National Consumer Protection Hearings in November 1968. (Transcript of Hearings, pp. 136–143, 211–215) A local campaign to force a finance company to make restitution to an aged couple was described by the head of the city's Consumer Education and Protection Association. The couple, unable to read or write, had been led into signing a confession of judgment on a note for $1,600 to cover home repairs costing $300. When they failed to make payments, their furniture was sold under the confession of judgment. (Transcript, p. 138) The Commissioner of the Office of Consumer Affairs, Nassau County, New York, described the work of his office and told of securing refunds and adjustments of $25,000 on behalf of consumers in 1968. (Transcript, p. 164)

The Federal Trade Commission recently announced a program to use its field offices to establish a closer relationship between federal, state and local governments in stimulating consumer interest projects. These projects, which can respond immediately to consumer complaints, can do more than any number of class suits to achieve satisfaction for disillusioned and defrauded consumers.

Trade association exchanges.—The Association of Home Appliance Manufacturers conducts two "exchanges" to assist consumers. One is the funneling of complaints about retail advertisements to manufacturers whose products are the subject of an ad thought to be deceptive. This exchange was initiated in 1960 by the American Home Laundry Manufacturers Association, one of AHAM's predecessor organizations. The earlier association drew up a set of Recommended Advertising Practices for the Home Laundry Appliance Industry, a copy of which is attached as Exhibit B. These set forth in lay language advertising practices found by the Federal Trade Commission to be deceptive, as well as practices the association's members thought to be misleading. These include bait-and-switch advertising, deceptive advertising of prices or warranties, and deceptive product claims. More than 100,000 of these Recommended Practices have been distributed to retailers, for whose use they were designed.

When an advertisement thought not to comply with the Recommended Practices is sent to the association's office, it is transmitted to the manufacturer whose product is the subject of the ad. The manufacturer then takes whatever steps it thinks appropriate to eliminate the misleading advertising. While the association has no enforcement powers, reports indicate that the exchange has worked well. Recommended Practices have been written for the Refrigerator-Freezer Industry (Exhibit C), and are being written for other product lines now within the new association.

The other exchange is a Consumer Complaint Exchanger, which works in this way. Complaints about any aspect of appliance performance may be sent to us by consumers, by the Special Assistant to the President for Consumer Affairs, by Congressmen, or by whomever. Each complaint is transmitted to the manufacturer whose product is the subject of the complaint. The manufacturer is asked to let AHAM know how the complaint was resolved. We follow through until a mutually satisfactory solution is reached, or until we are convinced that no such solution can be reached. We failed to reach a satisfactory solution in 25 of some 925 complaints received against AHAM's members' products between March 1968 and January 1970.

The availability of this service has been publicized in the press, by word of mouth, by governmental agencies, and by any means at hand. The additional boost to be given this exchange is the establishment of a Major Appliance Consumer Action Panel. AHAM and the Gas Appliance Manufacturers Association (GAMA) are cooperating in this venture. The Panel is to be composed of nine persons nationally recognized for their interest in consumer affairs. The Panel will review the handling of complaints by AHAM and GAMA, and confirm its effectiveness or recommend improvements. An announcement of the establishment of the Panel and its membership will be made soon.

Probably few trade associations now have similar exchanges, but we hope others will follow AHAM's example. Mrs. Knauer recently asked the American Society of Association Executives to stimulate this activty among its member trade associations.

Alternatives should be strengthened

The idea of permitting class suits in federal courts on behalf of consumers for violations of an undefined body of state law, regardless of the amount of each claim or even the aggregated claims, is so radical an innovation that it shout be instituted only after the alternatives have been strengthened and tested. It is extremely doubtful that the woman who received a bill for $719 when she thought she had bought $62 worth of meat (reported in the *Sunday Star*, March 1, 1970, p. B–2, col. 2) is at all interested in a law suit, much less a class suit. She wants, and deserves, overnight assistance. Her neighbors need to be warned immediately that the meat firm from which she bought the meat is a bait-and-switch outfit.

Class suits will accomplish neither of these goals. They will burden the judiciary. They can place financial hardships on reputable retailers and manufacturers. They can be rightly called an exercise in futility, from which only the lawyers will benefit.

DATA ON AHAM CONSUMER COMPLAINT EXCHANGE (CUMULATIVE THROUGH MAR. 9, 1970)

	Yearend, 1968	1969 1st quarter	1969 2d quarter	1969 3d, 4th quarters	1970 through Mar. 9	Cumulative
Total received and forwarded to manufacturer	236	62	180	608	130	1,216
AHAM products	174	49	141	542	121	1,027
AHAM members	129	39	100	463	103	834
Nonmembers	45	10	41	79	18	193
Non-AHAM products	61	8	29	66	9	173
Miscellaneous	28	5	10			43
AHAM product complaints still open						200
Total AHAM product complaints closed						836
Cases closed unresolved						21
Percent of total AHAM product complaints closed						76
Source of reference to AHAM:						
Sidney Harris				213	3	126
Good Housekeeping	25	0	18	18		61
Margaret Dana	12	1	1	11	3	28
Special Assistant to the President on Consumer Affairs	15	17	37	24	9	102
Changing Times	49	14	14	1		78
Newspaper				33	17	50
Kay Valory				5	15	20
FTC				4	2	6
Department of Commerce				1	1	2
Miscellaneous					7	7
Not identifiable	135	30	90	308	73	736

CLASS ACTION LITIGATION—SMOG CASES

NORTHERN DISTRICT OF ILLINOIS

Action—State of New Mexico v. *General Motors, AMA, et al.*
Class—All other governmental bodies and all people in New Mexico.
Claim—Injury to the environment and economy of the State by virtue of defendants' violation of Section 1 of the Sherman Act.

Action—State of New Jersey v. *General Motors, AMA, et al.*
Class—All other governmental bodies and all people in New Mexico.
Claim—Same as in the New Mexico case.

Action—State of Connecticut v. *General Motors, AMA, et al.*
Class—All other governmental bodies and all people in Connecticut.
Claim—Same as in the New Mexico case.

Action—City and County of Denver v. *General Motors, AMA, et al.*
Class—All residents of these political subdivisions.
Claim—Same as in the New Mexico case.

Action—Kean, et al v. *General Motors, AMA, et al.*
Class—All residents of the City of Chicago.
Claim—Injury to business, professions and property by virture of violation of Sherman Act. Seeks damages in the amount of one billion dollars trebled.

Action—State of Illinois v. *General Motors, AMA, et al.*
Class—All people in the State of Illinois and all political subdivisions of the State.
Claim—Same as in the *Keane* case. Seeks mandatory injury directing defendants to install pollution control devices on all cars in the State back to 1953.

EASTERN DISTRICT OF PENNSYLVANIA

Action—Philadelphia, Baltimore, Pittsburgh and Erie, et al v. *General Motors, AMA, et al.*
Class—All governmental bodies and citizens in the United States.
Claim—Same as in the New Mexico case.

Action—Morgan v. *General Motors, AMA, et al.*
Class—All crop farmers in the United States.
Claim—Injury to crops by virtue of violation of the Sherman Act.

Action—County of Lackawanna, et al. v. *General Motors, AMA, et al.*
Class—All governmental bodies and citizens in the United States.
Claim—Same as in the New Mexico case.

SOUTHERN DISTRICT OF NEW YORK

Action—State of New York, et al. v. *General Motors, AMA, et al.*
Class—All political subdivisions and citizens of the State.
Claim—Same as in the State of New Mexico. Also seeks mandatory injury similar to the one sought by the State of Illinois.

CENTRAL DISTRICT OF CALIFORNIA

Action—Grossman, et al. v. *General Motors, AMA, et al.*
Class—All residents in the United States.
Claim—Same as in the State of New Mexico case.

Action—Handy, et al. v. *General Motors, AMA, et al.*
Class—All metropolitan areas of United States, the residents thereof and all purchasers of automobiles using gasoline.
Claim—Same as in the New Mexico case.

Action—Perlsweig v. *General Motors*
Class—All California purchasers of General Motors automobiles within the last four years.
Claim—Anti-pollution devices installed on vehicles do not comply with California law.

Action—Kaufman v. *The Dreyfus Fund, et al.* (D.C.N.J. 1968)
Class—All externally managed mutual funds.
Claim—Seeks damages against the investment advisors of all such mutual funds for violation of the Securities Exchange Act.

Action—Ralph Pfau d/b/a Victor Pharmacy v. *Charles Pfizer, et al.* and *Cronley* v. *Charles Pfizer et al.* (D.C.S.D. Ind. 1969).
Class—All consumers, retailers and other purchasers in the State of Indiana who have not filed a claim or otherwise requested inclusion in the New York Drug Settlement Proposal or any purported class action.
Claim—Injury for violation of the Sherman Act.

Action—Mangano v. *American Radiator* (D.C.D.C. 1969)
Class—All record owners of new housing units of four families or less built in the United States during the period 1962–1966.
Claim—Damages for overcharges on plumbing fixtures. It is alleged that damages of from $30.00 to $60.00 per housing unit were sustained by members of the class.

Action—Great Washington Chapter of Americans for Democratic Action, et al v. *District of Columbia National Bank, et al.* (D.C.D.C. 1969)
Class—All persons who have been extended personal loans, discounted in advance, by all lending institutions in the District of Columbia.
Claim—To recover damages for alleged violation of the usury laws of the District of Columbia.

Action—Robert A. Holstein, et al v *Montgomery Ward & Co., Inc.* (Illinois Circuit Court of Cook County, 1968)
Class—All charge account customers who did not request exclusion from Montgomery Ward's credit life and disability insurance coverage on their charge accounts. The class is alleged to exceed six million persons.
Claim—Unfair and deceptive practices.

Action—Yannacone v. *Montrose Chemical Co.* (S.D.N.Y. 1969 Civ. 4504).
Class—All people of the United States, not only of this generation but of of those generations yet unborn.
Claim—Injury to the full benefit, use and enjoyment of the environment and natural resources of the United States from the production, distribution and use of DDT.

Action—Cesar Chavez v. *Melvin R. Laird, Secretary of Defense* (D.C.D.C 1969)
Class—All migrant farm workers of Delano, California.
Claim—To enjoin the Department of Defense from purchasing table grapes in excess of the amount purchased in 1967.

Action—Siegel v. *Chicken Delight, Inc.* (D.C.N.D. California—Civil #46271, 1969)
Class—All persons, partnerships and corporations who are now or previously were Chicken Delight franchisees at any time after January 4, 1963.
Claim—To recover damages for violation of the antitrust laws.

Action—Twyman d/b/a Bill's Union Service Station v. *Blue Chip Stamp Co.* (D.C.C.D. California Civil Action 66–1522–F)
Class—12,000 independent service station operators throughout California who distribute blue chip trading stamps.
Claim—Alleged violation of the Sherman and Robinson-Patman Acts.

Action—Boshes et al v. *General Motors* D.C.N.D. Ill. E.D. 1968)
Class—All purchasers of General Motors automobiles in the past four years.
Claim—Alleges a conspiracy between the car divisions of General Motors resulting from the fixing of car prices by General Motors Central Office. Plaintiff's counsel states that the charges sought will exceed $12 Billion.

Action—Dayton v. *General Motors* (Madison Circuit Court, Kentucky 1969)
Class—All purchasers of approximately 695,000 General Motors cars in Kentucky from the year 1958 to July 3, 1969.
Claim—That "price stickers" attached to the cars were fraudulent under the Common Law of Kentucky in that they do not reflect the actual retail prices of the cars and are used wilfully, maliciously, fraudulently and inflate retail prices for General Motors dealers.

Action—Anthony, et al v. *General Motors, Kelsey Hayes Corp., et al* (Superior Court, Los Angeles County 1969)

Class—All owners of General Motors three-quarter ton trucks who received a May 28, 1969 letter from General Motors stating that a possible safety hazard could develop if the trucks were over-loaded beyond their recommended capacity.

Claim—For damages incident to wheel replacement.

Action—Kizer v. *General Motors et al* (Superior Court Arizona, County of Maricopa, 1969)

Class—Same as *Anthony* case.

Claim—Same as *Anthony* case.

Action—Heiserman v. *General Motors, et al* (Superior Court, Los Angeles County, 1969)

Class—Same as *Anthony* case.

Claim—Same as *Anthony* case.

Action—Rabuse v. *General Motors* (Superior Court, Los Angeles County, 1969)

Class—Owners of all vehicles subject to a carbon monoxide recall campaign.

Claim—Damages for loss of use.

Action—Heiserman and Rabuse v. *General Motors* (Superior Court, Los Angeles County, 1969)

Class—Owners of all vehicles that have been subject to a General Motors recall campaign.

Claim—Damages for loss of use.

Action—Bolton Oldsmobile, Inc. et al v. *General Motors* (D.C.E.D. Pa. 1969)

Class—All Oldsmobile dealers who have been terminated or not renewed and all dealers who were threatened with termination or non-renewal within the last three years.

Claim—Violation of "Dealers Day in Court Act" and antitrust laws and breach of contract and tort.

Action—Schneider v. *Associates Finance Co., et al.* (Superior Court, Los Angeles County, 1969)

Class—All borrowers from defendant Finance Company who purchased group creditor life or disability coverage in connection with their loan transactions.

Claim—To recover sums paid by co-defendant insurance company to defendant finance company out of the aggregate premiums collected from members of the class when loss experienced on MASTER GROUP CREDITOR LIFE AND DISABILITY INSURANCE POLICIES proved favorable.

Action—Stevens v. *Household Finance Corporation, et al.* (Superior Court, Los Angeles County, 1969)

Class—Same as in *Schneider* case.

Claim—Same as in *Schneider* case.

Action—Ratner v. *Chemical Bank New York Trust Company* (S.D.N.Y. 1969)

Class—All persons who have Master Credit purchase accounts with defendant, and whose accounts on the monthly billing date most immediately prior to the institution of this action required the payment of no finance charge applicable to the prior balance, but would require the payment of such a charge, applicable to a balance of $1.00 or greater owing on said billing date, if not paid in full within twenty-five days thereafter, and before receipt of the next billing statement.

Claim—Violation of the Consumers Credit Protection Act of 1969 (Truth-in-Lending).

Action—Andrucci, et al. v. *Gimbel Brothers, Inc.* (D.C.W.D. Pa. 1969)

Class—All revolving credit account customers

Claim—Violation of the Consumer Credit Protection Act of 1959 (Truth-in-Lending).

We understand that there have been five other truth-in-lending class actions instituted against national companies but we are unaware of the names of the cases.

Action—Dennis, et al. v. *Sears Roebuck & Co.* (Supreme Court of Tenn. 1969)

Class—All revolving charge account customers in Tennessee.

Claim—Violation of the Tennessee Usury Laws.

Senator Moss. Mr. Jay Dushoff, who is an attorney from Phoenix, Ariz., will be our next witness.

We are pleased to have you, and we look forward to hearing your testimony.

STATEMENT OF JAY DUSHOFF, ATTORNEY, PHOENIX, ARIZ.

Mr. DUSHOFF. Senator Moss, I am a trial lawyer. I am with the firm of Dushoff, Sacks and Corcoran in Phoenix. I stress that I am a trial lawyer. I am not a legal scholar. I am not an academician. I have spent my career as a trial lawyer handling relatively complex civil litigation.

In the last year we have become involved in class action litigation. We presently are handling a class action against General Motors involving 200,000 pickup trucks. We are also handling a class action against IBM involving the unbundling of computer sales from computer programing services.

So, I come before this subcommittee not talking about theory, but as a trial lawyer who knows what it means not to have a remedy for a client or a group of clients, and who knows that the industry, whatever the given industry is, is like Goliath saying to David "don't get in the ring with me, kid, I will murder you." Goliath can think of a zillion reasons why he doesn't want to get into the ring.

The irony, as I see it, is that we have a national mania for rooting for the underdog, whether it is the New York Mets or whether it is the individual. Yet in this area, the small guy doesn't have a chance. It is not a question of the small guy being given a fair chance against Goliath, where maybe he will win if he can convince the judge or the jury that he is right. He doesn't even have the chance.

Mr. Lamb in his testimony urged you not to rush into class action legislation. That amuses me. The irony is, Senator, that the class action rule, rule 23, was amended in 1966, after years of study by advisory committees to the Supreme Court on Federal rules. It was revised after long study, after many committee discussions, after it was referred to the local jurisdictions.

I serve on the Arizona Committee on Civil Procedure. When there are proposed new Federal rules, they are referred down to the States, and each State committee on civil procedure then analyzes the proposed changes and makes its recommendation. Each judicial conference makes comments on the proposed changes. Only after this exhaustive consideration of a proposed change in the Federal rules of civil procedure does it go back to the Supreme Court for eventual adoption or rejection of the new rule.

Therefore, rule 23 (which Mr. Lamb predicts will be limited or will eventually be thrown out when the courts realize it is a bad rule) is a rule that was adopted after thorough study.

The irony, Senator, is that the class action rule is a consumer rule. I shall not burden you with the details except that this is in the literature.

The advisory committee which revised rule 23 said that this was for the little man, that they knew full well that there was no redress for the little man, and they wanted to rewrite rule 23 so that the little man had a chance.

What stopped the use of the new rule 23 by the little man was the

decision in *Snyder* v. *Harris*, which on a technical point of Federal jurisdiction held that claims cannot be aggregated in a class action.

So we are left with the irony that if Sam Smith wants to sue Joe Jones and one lives in New Jersey and the other lives in New York, Federal court will have jurisdiction of their lawsuit over a $15,000 promissary note. But, Senator, when we bring a class action involving 200,000 trucks, alleging damages of $450 to each truckowner, that $90 million litigation, important litigation involving major questions of law, involving questions of product design and safety, the type of litigation that Federal courts should be dealing with, that case cannot be filed in Federal court.

Under the present law it is barred from Federal court.

I believe that one change only is needed, and that change is to remove the road block to the proper use and development of rule 23, the new Federal class action rule. That could be removed either by stating that there would be no jurisdictional amount whatsoever in rule 23 actions, or that aggregation of claims would be permitted in a rule 23 class action.

I believe the problem with the Tydings bill, which is S. 3092, is that it tinkers too much with the judicial system; in an attempt to create a consumer class action it makes too many changes.

For example, Senator, the Tydings bill says that there will be a consumer class action if there has been an unfair practice or act under the FTC Act.

Let me stop there for a moment. I believe I am a well-educated lawyer. I believe I am a bright lawyer. I don't have the slightest idea at the present time what is or is not a violation of the FTC Act, section 5. I believe that 99 percent of the lawyers in Salt Lake City, in Phoenix, in Chicago, are in the same bag.

If that is one of the things which triggers my right to bring the class action, I have to suddenly educate myself in a new esoteric field of law that the average general practitioner in Salt Lake or Phoenix doesn't understand.

To bring it down to the absolutely practical level, the practitioner has to go out and buy a new set of legal books, just to begin the research on that preliminary question.

The second device of the Tydings bill is reference to State decision or statutory law for the benefit of consumers.

Problem: Let us assume that a manufacturer of washers, the "X" Co. that Mr. Lamb referred to, enters into a written servicing contract with 200,000 purchasers of washing machines. After 3 months of servicing the machines, for whatever policy reason at the corporate level, "X" Co. sends a letter to each of the purchasers saying we are not going to service your machine any more. They couch the abrogation of the contract in clever words, but what it means is we are not going to live up to the contract. They rely, under present procedural law, on the fact that the 200,000 consumers may be angry, but what can they do? It is a $10 or $15 or $20 claim.

Now, Senator, there is no doubt of the fact under the hypothetical I have given that there has been a violation of the contract by the "X" Co.

I would pose this question to you: Is the contract law of Utah or Arizona, which has been violated, State law "for the benefit of consumers"?

I am quoting from the Tydings bill. I see this as a problem under the Tydings bill. My cynicism, born of experience in trial work, tells me that even though law school professors and Senators may quickly agree that state contract law is decisional law for the benefit of consumers, the "X" Co. will run me around in court for 3 or 4 years, litigating the threshold issue of whether I have the right to bring the class action at all.

The industry raises the question, "what about the harassing lawsuits?"

I will concede for purposes of the discussion only that there may be a problem. I think the problem is greatly overblown. Yes; there are abuses in lawsuits against automobile insurers, but the bulk of litigation is sound litigation. Yes; there are abuses of malpractice litigation against doctors, but thank goodness we have the right to sue doctors or lawyers or accountants when they are negligent.

But let us assume there is the specter of the harassing lawsuit. I would suggest that rule 23, with one minor modification, would handle it.

Rule 23 provides, if I may briefly paraphrase part of it, that after the district court has determined there is a class action, notice shall be given to the people who constitute the class, to the 200,000 purchasers of that washing machine. That notice becomes the practical crux of whether the class action is going to stay alive or not. Who pays to send the notice?

If the representative party is told you pay the notice and we will reimburse you later if you win, as a practical matter, that may end the lawsuit, for the cost of notice is large.

I would agree the defendant should not be made to pay the cost of notice in the harassing lawsuit, in the strike lawsuit, in the trivial lawsuit.

I would suggest, therefore, that there be a probable cause hearing at an early stage of the Federal class action. In that probable cause hearing the first thing the judge would do is decide whether the lawsuit states a claim upon which relief can be granted, and I would refer you to rule 12 of the existing Federal rules.

In other words, Senator, it may very well be that class action or not, there is not a viable claim before the court. For example, I read that a nationally renowned lawyer brought a lawsuit against Secretary Hickel and others on behalf of certain Alaska Indians alleging violation of certain treaty rights concerning oil and oil exploration. I am not mocking that lawsuit at all, but the Senator knows that there are many instances where a group has a moral claim but doesn't have a legal claim.

It may very well be that a judge would look at that lawsuit, whether it is brought by an individual Indian or whether it is brought by 100,000 Indians in a class action, and say you do not state a claim, period. Lawsuit dismissed.

Secondly, if it does state a claim upon which relief can be granted, the district court would then make a determination as to whether

there was a reasonable likelihood that the class would prevail on the merits. If the determination is that there is not a reasonable likelihood of the class prevailing, the judge turns to the plaintiff and says "Fine, you pay for the notice. I am not throwing you out of court. It is not a ruling on the merits. This is a preliminary ruling."

To the extent that there may be harassing and unwarranted lawsuits, the probable cause hearing will eliminate the large bulk of them. If the plaintiff in that class action would have to pay for notice, subject to later reimbursement if he prevailed on the merits.

But if the court at the probable cause hearing found that there was reasonable likelihood of prevailing on the merits, then the court would order the defendant to pay for the notice. In that situation I don't think that the defendant could cry, as we have heard from the industry, that we are being subjected to huge expenses defending unwarranted and harassing lawsuits.

My suggestion would be this, that for every harassing lawsuit which cannot be filed due to the lack of a class action procedure, there are thousands of viable and nonharassing lawsuits that cannot be filed. I am sure that every practicing lawyer can tell you of cases which wrench your insides out, where people come to your office and say "Help me," but you cannot help them due to the economics of the case.

A man was in my office last week with a legitimate complaint that he was overcharged $24 in service charges by a bank. He was right. He had been taken advantage of. But that is not the type of litigation that even the class action will help. Unfortunately, there will always be that minimal value law suit which cannot be economically processed.

Mr. Lamb refers to the local and State courts. It won't do. We are talking about national class actions. If we are suing General Motors concerning 200,000 trucks with defective wheels, we have to sue General Motors, for better or worse, to redress a national problem.

I believe that the Tydings bill has another defect. Senator Hart points out in his statement that the businessman is excluded from the Tydings bill. In other words, if John Jones as an individual buys a GM pickup truck, he would have the right to bring a consumer class action. If John Jones as a small building contractor buys a couple of pickup trucks for use in his business, he is just as much damaged and yet under the Tydings bill he would not have the right to file a class action.

The cost of the litigation was raised by Mr. Lamb. He said that the eventual settlement in the *Utah Pie* case—and I know nothing of the merits; I will take it just on the basis that it was presented—was $29,000 and that the cost of defending that litigation was $400,000.

It would be interesting to know how much of the $400,000 represented the legal cost of plodding up and down from the court of appeals to the Supreme Court, and how much of it was the Goliath refusing to fight on the merits but using every dilatory procedural device which is now permitted under the present system to keep from a ruling on the merits.

I also wonder whether the settlement of $29,000 accomplished a public good and private good by serving as a deterrent against the business practice which was the subject of the complaint in the *Utah Pie* case.

Let's go further, because, Senator, this is the type of thing which sounds silly and yet it is totally realistic to raise it. You asked Mr. Lamb if the individual brings a case in small claims court against the X washing machine company, what about the other couple hundred thousand people who are not redressed. His answer was they can bring a lawsuit too.

Let me speak lawyer to lawyer. Which would be more expensive for the X washing machine company: To hire legal counsel in 400,000 actions brought in small claims courts across the country, or would the total legal expenses be lower in one national class action?

That to me shows the smokescreen device which is raised by industry. If the individual did and could go into small claims court, it would be more expensive for the defendant. But small claims court, Senator, is a potential alternative in only some of the class actions, because many times the class action involves legal and factual issues of amazing complexity. The legal literature shows that one purpose of the consumer is to prevent class action the corporate defendant from making each and every plaintiff prove liability.

We are fighting IBM on a complicated factual and legal issue. The small businessman wouldn't have a chance if he had to go it alone. It is one thing to sue in small claims court on a small breach of contract, but how would the individual truckowner develop the expertise, both legally and factually, to prove that GM had defective wheels on the truck and to handle all of the other issues raised by that type of products liability litigation?

The statement by Mr. Lamb, and I would tell the Senator that I have also read the statement submitted by the NAM, keeps referring to the fact that the class action is not a speedy remedy. I agree. But I do not believe that the class action is going to be the panacea. It is not going to solve every problem. The class action, as I see it, is going to assist certain classes of consumers to redress certain grievances. The type of bait-and-switch advertising where the food freezer company pulls the local fraud, I agree with that that cannot be reached by the class action. But I see the class action bill as one weapon of the consumer in an entire arsenal of weapons.

To use a medical parallel, if a man is suffering from a kidney ailment, a kidney transplant will not give him immediate relief, but is that any reason to abandon the program of research and medical experimentation in kidney transplants? Of course not.

Therefore, it is no answer when Mr. Lamb and the NAM say the class action is not a speedy remedy. Speaking as a trial lawyer, I only want one thing. I want the chance to get into the ring with Goliath. I may lose. I will still be outmatched. But give me a chance on the merits.

I would suggest to the Senator that the existence of a viable class action, a meaningful class action, will not stir up litigation. I would suggest that it will have the effect of goading industry in various cases to realistically deal with problems.

For example, Senator, let's take personal injury litigation. I don't know the exact statistics, so let me make some up which are approximate. Of all the automobile accident cases, a remarkable number are settled at the adjuster's level. Of those that are not settled at that level,

yes, many have lawsuits filed. Of the ones that have lawsuits filed, many of them are settled before they get to actual trial.

I am cynical enough to believe that were it not for the plaintiff's right to go to court and obtain a meaningful jury trial, that the insurance industry would not be so quick to settle the cases out of court.

The existence of the meaningful legal remedy constitutes the goad, the goad to deal fairly with the consumer complaint before them.

I appreciate the opportunity for having testified. I will be glad to answer any questions that the Senator might have.

Senator Moss. Thank you, Mr. Dushoff. That was a very forceful and eloquent presentation. Your written statement in full, of course, will be in the record, along with the illustrative material you have appended to that.

What kind of claims do you foresee are the most likely to be raised under this class action statute if we have it? Would it be mostly in the appliance field?

Mr. DUSHOFF. No, it will be in many fields. For example, there is presently litigation against racetracks in New England. This is under the present class action rule, for they don't have the jurisdictional amount problem. There is a group of owners of racehorses who claim that the tracks over a period of years have not been paying them the proper percentage of the purses. A $4 million class action. Is it valid? I don't know. It is a class action. The individual racehorse owner wouldn't have a chance.

I see as the type of class action that will be brought the type of case we have against General Motors on the 200,000 trucks. By the way, Senator, to refer back to something earlier, that case dramatically proves what I mean about the goad.

Before the class action was filed in May, General Motors sent out a letter to the 200,000 truckowners saying that the wheels may be defective, and take them into your local Chevy dealer, and he will be glad to replace them at your expense.

Class actions were then filed, ours in Arizona and a companion case in California, in August and September of 1969. In October of 1969 General Motors recalled 50,000 of those 200,000 trucks and replaced the wheels at General Motors' expense.

Now, mind you, General Motors has already said in court, in legal proceedings, and I am sure they will continue to claim, that their decision to recall those 50,000 trucks had nothing to do with the class action. Except they didn't recall the trucks until after the class action was filed. This is an example both of the type of class action that will be filed and what I meant when I said that it will deter litigation. It will suddenly make the manufacturers realize that they are going to have to deal fairly when they are presented with a claim, because the consumer will have redress.

Senator Moss. I was interested in your discussion of a probable cause preliminary finding, and its effect on the expense of notice and so on. But how much cost of litigation would have to be incurred to get up to the probable cause stage?

Mr. DUSHOFF. When you view that in relationship to the amount in issue, I would suggest very little. In other words, I don't think

it would be very difficult for us right now to go in on the General Motors litigation and satisfy a probable cause standard.

In our lawsuit against IBM, it is a vast lawsuit which may take for all I know 18 years to process, but going in on the basic question of whether there is a viable underlying claim and whether there is probable cause that we will prevail on the merits, I think we could reach that quickly.

So, this threshold determination of probable cause (which I think would answer the industry complaint that they are going to be bothered by harassing lawsuits which would cast expense upon them—every time a lawsuit is filed there is expense to defend it, whether it is the individual action or the class action) would involve a minimal expense viewed against the entire litigation.

Senator Moss. Would you foresee that there ought to be some limitation on unit amount? What I am thinking about is that it has been suggested, perhaps, in a case where many thousands of people have been overcharged as to the matter of a few cents on an item——

Mr. DUSHOFF. I would agree, that to me would not be proper for a class action. That is the type of case which, referring to the entire arsenal of weapons, could be handled best at the FTC level or some other governmental level. Could it be avoided under the present class action rule if you were to take away the roadblock that is presently there? Yes, I think it could be avoided, because there is an overriding doctrine of case law that cases which are de minimis are not entertained. Or that could be disposed of under the class action rule on the ground that it would be unmanageable to have a class of 10 million people, each of which were overcharged 2 cents on a pack of razor blades.

So, that specter which is raised by industry could be handled within the confines of the present class action rule.

Senator Moss. This matter of notice again and the cost of notice, what is the requirement of notice? What are we talking about?

Mr. DUSHOFF. To go to the most common type of class action under rule 23, which is called the (b) (3) type of class action, the rule says:

"The court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort."

That rule, I think, was wisely drafted. The advisory committee notes indicate that they did not want to try to restrict the discretion of the Federal courts. There are some cases where there would be a class of 4,000 purchasers of, let's say, a farm tractor; 4,000 people can be sent certified letters.

If you are dealing with a class of 200,000 or 500,000, perhaps the court would direct some less expensive form of notice, such as newspaper publication or other dissemination. Let me go beyond your question and point out another area where I believe the industry in general is not in good faith. They always raise the cost of notice, always crying how expensive it is going to be.

The General Motors litigation was filed in August and September in California and Arizona, and immediately they began to talk about the cost of notice.

On October 7, General Motors sent out the letter dealing with the

partial recall of 50,000 trucks. They didn't tell the court that they were going to send out that notice, they didn't tell the attorneys for the class that they were going to send out that notice. If they had, we might have had the opportunity to go to the court and say, "Hey, let us tag along. Give us the right to insert a flyer advising the members of the class of the pendency of the class action."

Let us assume you were filing a class action, and I mention it because there is one pending, against Montgomery Ward. Notice there is not a big bugaboo, because if the court finds that there is otherwise a class action, enclose a notice as part of the monthly billing that is going out anyway.

So, there are some cases where the notice problem, Senator, could be solved easily and inexpensively. There are cases under the class action rule where I agree there might have to be an innovative approach by the court and the lawyers as to how to realistically and with reasonable expense solve the notice problem.

But that ties back to my suggestion of the probable cause hearing because the defendant would not be hit with the cost of notice unless the court were to find that there were probable cause that this was a class action with some reasonable degree of success.

Senator Moss. What was involved in the Montgomery Ward case that you alluded to?

Mr. DUSHOFF. If I recall, it involves service charges that were imposed by Montgomery Ward, allegedly without the contractual consent of the people they were charging. I think that is what the issue was, and it is a large class and it is a multi-State class.

Unfortunately, it is not in Federal court. The logical place for this type of litigation is Federal court, which is why it is so laughable when industry tells us that the answer is to expand the State procedure and let it be handled there.

We are dealing with national marketing campaigns; we are dealing with national corporations; and this is the area where the Federal courts have the power and the genius.

For example, I am sure the Senator is aware that in recent years the Federal courts, through very imaginative rulemaking promulgated rules on how to handle complex multidistrict litigation. The courts are experimenting with it. They don't have all the answers yet, but at least they are beginning to learn to manage these class actions, these antitrust actions, which span many, many States and many, many parties.

Senator Moss. Mr. Lamb seems to have asserted in his statement that class action law has not been well worked out. It is still experimental; and we should, therefore, not encourage greater use of it until it has reached fuller development.

Do you agree with that?

Mr. DUSHOFF. Absolutely not. Rule 23 fits in with the concept of the Federal Rules of Civil Procedure in general; rule 23 provides a meaningful outline of a class action. Instead of having rules imposed from above by fact, which govern each and every detail of a class

action, the decision was made, "Let's let the District Courts in the Federal system work out the details."

There is already a body of decisional law. The commentators have said, and I agree, that in most cases the Federal Judges have approached rule 23 litigation with wisdom and common sense. They are beginning to work out the details.

So I believe that a monster is being raised about what "might" happen under rule 23 litigation. I think the fears are unwarranted.

Rule 23, as I mentioned earlier, was adopted after careful consideration and drafting. To return to my legislative suggestion, Senator, if you take away Snyder V. Harris, the procedural roadblock to rule 23, either by waiving the jurisdictional amount or by permitting aggregation, then lawyers can use rule 23 for consumer class actions. Case-by-case decision will begin to expand this procedural device to help consumers, both rich and poor, which is why I believe the Tydings Bill is defective in excluding the businessman and the business transaction from the consumer class action.

Senator Moss. Perhaps one final question. When there has been recovery on a class action, how is the distribution handled? Who does this? We heard about the money that Judge Ritter had tied up out in Utah, and I'm wondering how it ought to be divided up?

Mr. DUSHOFF. Since 1966 very few of the class actions that have been in court have reached that stage, so it is hard to answer it. I can answer it in part, because antitrust litigation often has the class action aspect. The drug case against the pharmaceutical companies has been settled. I think there is a fund of several hundred million dollars which under the settlement was deposited in the Federal district court in New York. I am on the mailing list of the district court rulings, and what they have done is to allocate the entire settlement fund among States and municipalities which are within the ambit of the antitrust action—they are parceling it out, $3 million to Philadelphia, $500,000 to Louisville, and on down the line. As I understand it, those individual jurisdictions will then work out the distribution of that pharmaceutical recovery in their jurisdictions.

That, of course, is a problem, where there are millions of people who were overcharged due to the antitrust violation by the pharmaceutical companies.

Frankly, it would be easier when we are dealing with the 200,000 people who buy the washing machine, with the 200,000 people who buy the GM truck. There will be problems in working out the damages, but I don't regard them as insuperable problems. I think the district courts have the wisdom, the techniques, and the expertise to handle those problems on a case-by-case basis.

Senator Moss. Mr. Dushoff, I certainly appreciate your testimony. As one who is a practitioner and working with class action problems actively, and who has done a lot of thinking about it, I think you have contributed very greatly to our record. We are especially appreciative of your traveling this far to come and appear before us today, and thank you for that.

(The statement and attachments follow:)

STATEMENT OF JAY DUSHOFF, ESQ., DUSHOFF, SACKS AND CORCORAN, PHOENIX, ARIZ.

The average consumer is a David in a world of corporate Goliaths. In the biblical story, David slew Goliath, for he had the opportunity to fight Goliath "on the merits". In Twentieth Century America, the consumer who wishes to do battle with the corporate giant rarely has the chance to win his battle; there is no realistic court remedy available to him.

The consumer dissipates his energy and money in procedural wrangles with the corporate giant. He rarely, if ever, receives a meaningful "day in court" on the merits of his dispute with the corporation.

The corporation is quite aware, through excellent legal advice, that the consumer doesn't have any meaningful legal remedy. Thus, there is no goad to force the corporation to a fair and reasonable settlement of a consumer claim, and there is rarely a court victory for the consumer which acts as a deterrent to future unfair and deceptive acts or practices.

Why doesn't the consumer have a meaningful remedy? Because in most instances the financial loss to the individual consumer is not large enough to make individual litigation practicable.

The slingshot which can give meaningful assistance to the small consumer against the corporate Goliath is the "class action". A class action enables a group of consumers, with small but similar claims to lump their claims together in one lawsuit. The group claim which is presented by one or more representatives of the group is generally large enough to permit a meaningful legal battle between the consumers and the corporation against whom they are making a claim.

Until 1966 the procedure for bringing a class action in federal court was difficult and cumbersome; even a Philadelphia lawyer would have problem with it. Accordingly, the United States Supreme Court in a wise use of its rule-making power in 1966 revised Rule 23 of the Federal Rules of Federal Procedure. Rule 23 now provides a broad and effective class action in the federal courts. To the best of my knowledge only two states, Arizona and Minnesota have adopted a state court rule of procedure in line with Federal Rule 23.

However, state court procedure for class actions, even when it is fair and reasonable is not fully adequate to redress consumer complaints. In this day of ever larger corporations and national sales campaigns, we need a class action for consumers in federal court. Federal court provides the machinery for effectively handling consumer class actions of national scope.

Unfortunately, the new federal class action rule did not furnish the federal procedure which the consumer desperately needs. The "promise" of the federal class action was nipped in the bud by the unfortunate[1] decision in *Snyder* v. *Harris*, 394 U.S. 332 (1969). In *Snyder* v. *Harris* the U.S. Supreme Court held that the claims of the individuals in the class action cannot be aggregated toward the $10,000 jurisdictional amount which is required in diversity of citizenship cases.

HOW DO WE PROVIDE THE CONSUMER WITH THE "SLINGSHOT" OF THE FEDERAL CLASS ACTION?

Let's assume that all reasonable men are agreed on the need to provide a consumer class action in federal court. What is the best way of doing the job?

Before I set forth my proposed solution, let me explain my credentials. I am not a law school professor; I am not a legal scholar; I am not a theoretician. I am a trial lawyer, with a good law school education, and with reasonable experience in complex civil litigation. Our firm is presently handling two national class actions,[2] and we know at first hand what are the practical procedural problems.

I want to accomplish the task of providing a consumer class action in federal court with a minimum of changes in the present federal court system. I want the consumer class action to have a minimum of procedural problems to be

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[1] For unfavorable law review comment on *Snyder* v. *Harris*, see Note, The Supreme Court, 1968 Term, 83 Harvard Law Review 7, at 202–212 (1969); Kaplan, A Prefatory Note, 10 Boston College Industrial and Commercial Law Review 497 (1969).

[2] We are attaching newspaper resumes of the class litigation we are involved in. Exhibits 1 and 2 relate to the General Motors case. Exhibits 3 and 4 relate to the IBM case.

solved through case by case litigation; I want the consumer class action to give me a fair chance, now and not ten years from now, to fight the corporate Goliath *on the merits!*

Therefore, I would propose one single and solitary change in the federal court system. I would overrule the decision in *Snyder* v. *Harris*, and permit the aggregation of individual claims to satisfy the $10,000 jurisdictional amount. (Or, if it is important to maintain the principle of non-aggregation, then I would provide that class actions under Federal Rule 22 could be brought via diversity jurisdiction "without regard to the amount in controversy".)

This change would then permit the innovative lawyer to utilize the Rule 23 class action for consumer cases. There would be no need for erudite law review articles to explain the changes in the federal court system. There would be no opportunity for the corporate Goliaths to delay decisions on the merits by arguing over the meaning and scope of the consumer's right to utilize a federal class action.

THE PROBLEMS WITH S. 3092

Unfortunately, in my view, the approach taken by S. 3092 (and similar bills) does not afford a simple solution. Instead of merely sweeping away the procedural roadblock of *Snyder* v. *Harris*, S. 3092 tinkers considerably with the federal court system, and may create as many problems as it solves.

To compare my proposal with S. 3092:

(a) Under my proposal, a consumer could file a class action if he came within the scope of Federal Rule 23, if he had a viable substantive claim under state law, and if his action satisfied the requisites of diversity jurisdiction. The consumer's lawyer would not have to do any fancy legal research to determine whether he had a viable substantive claim. He would be handling the litigation like any other state cause of action which is in federal court due to diversity jurisdiction.

(b) Under S. 3092, a consumer can file a class action if he has been victimized by an "act in defraud of consumers", i.e. an unfair or deceptive act or practice under Section 5(a)(1) of the Federal Trade Commission Act. The average state practitioner is not familiar with the Federal Trade Commission Act, and therefore legal research will be needed before he can determine that he has the right to bring the federal class action.

Or, alternatively under S. 3092, a consumer can file a federal class action if he has the right to file a civil action "under State, statutory or decisional law for the benefit of consumers." The problem with this standard is that it requires me to research and litigate before I even get to the "starting line", for it is not crystal clear precisely what is a "law for the benefit of consumers."

For example, if a corporation enters into a contract with a group of consumers, and then flagrantly ignores the contractual rights of their customers, obviously the customers have a right to sue the corporation under the state law of contracts. Would this come within the ambit of S. 3092? Would the law of contracts be "law for the benefit of consumers"?

We might consider contract law to be a body of law for the benefit of consumers, but I can cynically assure you that the corporate giants when faced with class action litigation will not concede the point so readily. Thus, valuable time and energy will be dissipated while the corporate defendant insists on litigating the threshold question in each consumer class action, whether or not there has been an "act in defraud of consumers".

HOW DO WE PROTECT AGAINST HARASSING OR UNWARRANTED CLASS ACTIONS?

There is a justifiable concern that removal of the present roadblocks to effective federal class actions could lead to harassing and unwarranted litigation. This concern exists whether the federal class action gets its impetus from S. 3092 (the creation of a new federal question) or from my suggested approach (overruling the decision of *Snyder* v. *Harris*). (The present roadblocks kill the good class actions, as well as the harassing and bad class actions.)

It is my suggestion that this potential problem of harassing or unwarranted class actions be controlled by a "probable cause" procedure at an early stage of the class action. The federal district court would determine if the group of plaintiffs who comprise the class have a claim upon which relief can be

granted, and if there is a reasonable likelihood of the plaintiff prevailing on the merits:

(1) If the district court determines that there is no claim upon which relief can be granted, then the case is dismissed, class action or not. (This is existing procedural law. Rule 12, Federal Rules of Civil Procedure.)

(2) If the district court determines that there is a claim upon which relief can be granted, and that there is a reasonable likelihood that the plaintiff will prevail on the merits, then the defendant will be ordered to bear the cost of any and all notices that the court requires to be sent to the class of individuals which is represented in court by the representative party or parties.

(3) If the district court determines that there is a claim upon which relief can be granted, but determines that there is *not* a reasonable likelihood that the plaintiff will prevail on the merits, then the plaintiff will be ordered to bear the cost of any and all notices. The case will not be dismissed; the plaintiff can continue to prosecute his class action if he pays for the necessary notices. If the plaintiiff, contrary to the district court's estimate, prevails on the merits, then the defendant will be ordered to reimburse the cost of the necessary notices.

I suggest this solution, because my pragmatic and realistic view of litigation tells me that if "all systems are go" for a federal class action, the class action will nonetheless be a meaningless remedy unless the defendant is ordered to bear the large expense of providing one or more notices to the members of the class. If the federal district court finds "probable cause" that the plaintiff will prevail on the merits, then almost by definition we are *not* dealing with a harassing or unwarranted class action.

If the federal district court does not find probable cause, then effectively the litigation is swept away, because in the normal case the representative parties will be unable to finance the notice. The bulk of the cases which fair minded men would label "harassing" or "unwarranted" will not be able to pass the "probable cause" test.

This "probable cause" approach has some support in the case law of federal class actions. In Dolgow v. Anderson, 43 F.R.D. 472, 501 (1968) the district court stated:

> "A case such as the present one should not be allowed to proceed as a class action unless the plaintiffs are able to convince the Court that there is a substantial possibility that they will prevail on the merits. Something more than the certification of good ground by an attorney is required. See Fed. Rules Civ. Proc. Rule 11 ('The signature of an attorney [on a pleading] constitutes a certificate by him that * * * to the best of his knowledge, information and belief there is good ground to support it.'). In this case, an evidentiary hearing at which the plaintiffs will be required to make such a preliminary showing should be held before the class action motion is decided."

OTHER PROBLEMS WITH S. 3092

(1) S. 3092 would exclude from the proposed Consumer Class Action any individual or firm who is victimized in a business transaction. I do not think it is wise to so limit the class action device. If John Jones has purchased a pickup truck from General Motors, John Jones should have the right to join in a class action if the truck is equipped with unsafe wheels. Should the rule be different for Joe Smith, who bought a pickup for his general contracting business?

Should the class action device be unavailable to the businessman victimized by the business conduct of a corporate giant? See our IBM litigation, which is described in Exhibits 3 and 4.

I think the class action remedy is needed by the individual businessman or business firm. When the businessman deals with IBM for computer services, he is a consumer. When the general contractor buys six pickup trucks, he is a consumer.

In short, the minnow needs protection from the whale, but the trout and the salmon also need protection from the whale.

(2) S. 3092 deals with attorneys fees, and provides for a 10% fee "unless failure to award a greater amount would be manifestly unjust and not commensurate with the efforts of counsel." I think this is unwise. The bill should provide that the court shall award reasonable legal fees. There is a body of case law

which gives some guidance on the percentage amount of the legal fees; I would let this case law continue to evolve. Reference to a 10% legal fee will tend to have a depressing effect on the legal fees which the courts will award.

(3) The provision on attorneys fees should make it clear that the court has the power to award legal fees even though there is no monetary recovery. For example, the result of a closs action may be that General Motors is ordered to perform certain acts. The Court should also have the power to award fees when the defendant, under pressure of a class action but prior to court order, performs certain acts which benefit the class.

A BILL OF RIGHTS FOR PLAINTIFFS IN CLASS ACTION CASES

Assume we are now at the point where the consumer has the "slingshot" of the federal class action. Will this solve the problem? I hope so, but cannot be sure. It depends almost entirely on the judicial wisdom of the federal courts in interpreting the new class action rule which was adopted in 1966.

After all, the best laws can be emasculated by a hostile judiciary, and there are instances in the past few decades when judges indulge in judicial pruning, by nitpicking and restrictive interpretation, of "newfangled" procedural devices. Wise pruning leads to healthy growth. Unwise and hostile pruning may kill or stunt the growth of the new procedural device.

Thus, I urge this Committee to view the legislation before it as a beginning, an experiment if you will, in the wise and imaginative use of federal judicial machinery. If it turns out that the federal class action as described above creates more problems than it solves, then subsequent legislation can right the balance. If it turns out that there are additional roadblocks to an effective and meaningful federal class action, that also can be cured by subsequent legislation.

I would urge this Committee, and the federal judiciary, to treat federal class actions as requiring *new* techniques and *new* rules and *new* guidelines to fully implement the class actions. I would hope that we would evolve, by a combination of legislation and court decision, a Bill of Rights for plaintiffs in Class Action cases.

As several illustrations of what could be covered in the Bill of Rights for Class Actions:

(1) In a class action only the citizenship of the representatives of the class should be relevant in determining diversity of the citizenship. That is, the citizenship of the member or members of the class made a party to the suit governs, and the citizenship of other members of the class is ignored. (This is the general case law at the present time, See 32 Am.Jur.2d 506, Federal Practice & Procedure § 93, but it should be codified.)

(2) In a class action the court shall consider only the status of the parties at the time of the commencement of the suit. If the requirement of diversity of citizenship is satisfied at that time, the subsequent deletion or addition of parties cannot serve to oust the court of diversity jurisdiction. (This is the general case law at the present time, see 32 Am.Jur.2d 506, Federal Practice & Procedure § 93, but it should be codified.)

(3) If the representative party has standing to represent the class at the time of commencement of the suit, then subsequent events will not disqualify him from representing the class. (This would solve the problem of having an otherwise valid case mooted by the mere passage of time, or the individual claim of the representative party, in situations where the group claim is still unresolved. As an example of the problem, see the recent decision of the Arizona Supreme Court in *Supervisors* v. *Robinson*, January 9, 1970, a copy of which is attached hereto as Exhibit 5.)

(4) The defendant, after commencement of the suit, shall be permitted to communicate with the members of the class only with approval of the court. This would prevent the defendant from undercutting a valid class action by dealing directly with the members of the class, rather than through the representative party. This would also prevent the defendant from sending an expensive notice to members of the class, without first giving the representative party the right to seek a court order that the expensive notice be used as a vehicle for furnishing notice of the pendency of the class action.

CONCLUSION

There is a major problem confronting consumers. What judicial machinery do they have that will provide them with a meaningful day in court? Nothing. *Snyder* v. *Harris* destroys the practical utility of a federal class action for consumers. Legislation is a necessity. I urge that the curative legislation be as simple as possible, with as few changes as possible to the federal court system. I urge that the curative legislation be creative, with the realization and anticipation that further legislation may be necessry after we have had an opportunity to view the practical results of our efforts.

EXHIBIT 1

[From the Arizona Republic, Sept. 3, 1969]

LOCAL COUPLE SUES GM FOR $90 MILLION

A Phoenix couple filed a $90 million suit against General Motors yesterday in behalf of themselves and "about 200,000" other owners of 1960 to 1965 GMC and Chevrolet pickup trucks.

The couple, Algird S. and Rida Bizer of 2841 E. Polk, allege in the suit filed in Maricopa County Superior Court that "the wheels and perhaps other component parts installed on the trucks were negligently designed, manufactured and inspected."

A certified letter dated May 28 received by the couple from the Chevrolet Motor Division and attached to the complaint said:

"The problem is serious under conditions of heavy loading, such as when the truck is equipped with an over-the-cab type camper. Specifically, if one of these trucks is overloaded and the tires are overinflated, these wheels are subject to sudden fracturing and breaking apart during use. Such occurrences result in immediate loss of air from the tire, which can come off the wheel, possible loss of control of the vehicle, and substantial risks of serious harm to persons and property in the vicinity."

The letter urges owners of the trucks to "replace the wheels as soon as possible . . . your nearest authorized Chevrolet dealer . . . will be glad to assist you in making your purchase of the stronger wheel replacements."

The suit was filed by attorneys Jay Dushoff and Stephen L. Weiss.

Dushoff said the letter from Chevrolet marked the first time a manufacturer had attempted to notify purchasers of an unsafe condition without ordering a recall and paying for the cost of correcting the defect.

He said it also was possible that General Motors was seeking to protect itself from product liability lawsuits stemming from the defective wheels by warning customers in advance of possible failure.

A similar suit was filed last week in California, Dushoff said, but has not yet been designated a "class action" to include all other owners by the courts.

Damages were computed at $250 on each truck to replace the defective wheels, $100 for loss of use of the truck before inspection and replacement and $100 for depreciation in the market value of the trucks. With 200,000 trucks, Dushoff said, it totals $90 million.

EXHIBIT 2

[From the Arizona Republic, Phoenix, Oct. 11, 1969]

GM ACTION MAY RESOLVE LAWSUIT HERE

(By Howard E. Boice, Jr.)

An announcement by General Motors that it will recall certain 1960 to 1965 model pickup trucks to replace defective wheels may lead to the settlement of a $90 million lawsuit filed here, an attorney said yesterday.

The suit was filed Sept. 3 by a Phoenix couple in behalf of some 200,000 others alleging that some Chevrolet and GMC truck models "were negligently designed, manufactured and inspected."

The company had advised owners of the trucks by letter in May of the defective wheels and urged the owners to replace them at their own expense.

"Your nearest authorized Chevrolet dealer—will be glad to assist you in making your purchase of the stronger wheel replacements," the letter stated.

Jay Dushoff, an attorney for Algird S. and Rida Bizer of 2841 E. Polk, plaintiffs in the action, said he had "been informed by attorneys for General Motors that GM has now reversed its position concerning the defective wheels on Chevrolet and GMC trucks built between 1960 and 1965, and is notifying owners that GM will pay for the replacement of wheels on any 1960 to 1965 trucks with camper attachments."

Dushoff added, "We have not seen the exact text of the recall notice, but we believe that the notice will also state that GM will reimburse any owner who purchased replacement wheels as a result of the May 1969 warning letter (and that) GM will also pay for the replacement of the wheels if any owners decide to put camper bodies or special bodies on their trucks in the future."

The "class action" suit in Maricopa County Superior Court was a companion to a similar $427.5 million lawsuit filed in Los Angeles. The Federal Highway Administration had also brought pressure against General Motors to correct the defective wheels at company expense, Dushoff said.

In its announcement Thursday in Detroit, GM said it considers itself under no obligation to replace the wheels, but is offering to do so "in the interest of reducing the safety hazard resulting from overloading."

Dushoff said, "Hopefully GM's action will lead to a full settlement of the case."

He added, however: "Before we can determine whether the full demands of our suit are met, we will have to examine the full text of the notice that GM has sent out, and also make further investigations into the engineering of the trucks."

In its warning letter to the truck owners, GM stated:

"Specifically, if one of these trucks is overloaded and tires are overinflated, these wheels are subject to sudden fracturing and breaking apart during use. Such occurrences result in immediate loss of air from the tire, which can come off the wheel, possible loss of control of the vehicle, and substantial risks of serious harm to persons and property in the vicinity."

Dushoff said he believed it was the first time a manufacturer had attempted to notify purchasers on an unsafe condition without ordering a recall and paying for the cost of correcting the defect.

EXHIBIT 3

[From the Wall Street Journal, Nov. 3, 1969]

TWO SUITS ARE FILED AGAINST IBM'S POLICY OF "UNBUNDLING" PRICES

MOTOR REPLACEMENT ALLEGES IBM PLANS TO DROP SOME SERVICES, GREYHOUND UNIT ACTION DISCLOSED

Two court suits protesting International Business Machines Corp.'s "unbundling" price policy have been filed.

One action, a $5 billion breach-of-contract suit was filed in Federal district court at Phoenix, Ariz., by Motor Replacement Co. The other action was filed by Greyhound Computer Corp., a subsidiary of Greyhound Corp., in a state court at Aurora, Ill.

IBM's unbundling policy, announced in late June, provides for separate prices for machines and various services. Previously, the giant computer maker had charged a single price for all machines and all related services.

Motor Replacement's suit is a class action on behalf of itself and other owners of IBM computers. The suit alleges that IBM intends to rescind an agreement to provide "lifetime programing service" to computer owners who bought IBM equipment before June 23, 1969.

An IBM spokesman said the company hadn't had time to study the complaint in detail, but was acquainted with the allegations. He termed the action "without merit." The spokesman added, "Contrary to Motor Replacement Co.'s assertions IBM never has offered a 'lifetime programing service' to computer users. Those services that IBM (currently) offers for a charge historically had been part of IBM's marketing effort." He said the company has instituted a six-month transi-

tion period, during which it will provide "all mutually planned support to users without charge."

Motor Replacement's president, Everett Warner, said the company paid $43,000 for its computer five years ago, and has received programing and other services without charge. An attorney for Motor Replacement told the Associated Press that IBM has lowered its computer sales prices because they no longer include a service charge. He contended IBM should make cash rebates to customers who bought the computers under the old terms.

IBM identified Motor Replacement's computer as a 6400-series electronic accounting machine. A spokesman said this type of computer uses handwired programs.

In response to a question, IBM disclosed the existence of a similar suit by Greyhound Computer. Further details weren't available.

IBM announced its unbundling policy after the Justice Department and four competitors filed antitrust suits against the giant computer concern. When the policy was announced, computer users generally said they expected it would boost their total data processing costs.

EXHIBIT 4

[From the Arizona Republic, Nov. 1, 1969]

$5 BILLION SUIT NAMES IBM FIRM

A Phoenix auto engine rebuilding firm yesterday filed a $5 billion breach of contract damage suit against International Business Machines, Inc., of New York, on behalf of itself and thousands of other owners of IBM computers.

The suit was filed in U.S. District Court by Motor Replacement Co., 2222 N. 23rd Drive, whose president, Everett E. Warner, charged that IBM intends to go back on its agreement to provide lifetime programming service to computer owners.

Last June, the suit states, IBM advised customers that beginning Jan. 1 it no longer will honor its service commitment. Instead, said Seymour Sacks, attorney for Motor Replacement, IBM will begin charging $22.50 an hour for such service.

Motor Replacement, said Sacks, paid $43,000 for its computer five years ago. Ever since then, it has received necessary programming and other services without cost, which was included in the purchase price, Sacks asserted.

IBM's decision to discontinue inclusion of lifetime service with the cost of computers was prompted earlier this year by an order issued by the Justice Department, which contended the practice violated a federal antitrust law.

Subsequently, Sacks said, IBM's computer sales prices were substantially lowered, because they no longer include the service charge.

Although IBM has no alternative than to change its original service policy, the attorney maintained, the company should be obligated to make cash rebates to the thousands, "perhaps hundreds of thousands," of customers who bought computers under the old terms.

Sacks said the $5 billion damages claimed in the suit is a "modest figure of the actual money involved."

The suit also asks that the court schedule a hearing Dec. 22 on an injunction that would prevent IBM from "communicating directly or indirectly with the members of the class (other computer owners) except by leave of the court."

EXHIBIT 5

[From the Arizona Weekly Gazette, Jan. 13, 1970]

SUPERVISORS VERSUS ROBINSON

No. 9790 PR—Board of Supervisors, Pima County, et al., Appellants, *v.* Roy Alan Robinson, for himself and others similarly situated, Appellee.

Appeal from the Superior Court of Pima County.

Honorable John P. Collins, Judge.

Decision of Court of Appeals is Vacated, and Cause is Remanded to the Superior Court of Pima County with directions to Vacate the Injunction and to dismiss the Case as Moot.

Gary K. Nelson, the Attorney General, by Sandra D. O'Connor, Asst. Att'y Gen'l, Phoenix, and Wm. J. Schafer III, Pima County Attorney, by Rose Silver, Chief Civil Deputy County Attorney, Tucson, Attorneys for Appellants.

Anthony B. Ching, Chief Trial Counsel, Legal Aid Society of the Pima County Bar Association, Tucson, Attorney for Appellee.

UDALL, Justice:

This is a class action brought by plaintiff to enjoin the Pima County Board of Supervisors for enforcing the one-year residency requirement to qualify for non-emergency medical care of indigents under A.R.S. 11-297. Plaintiff came to Arizona from California in August, 1967, and had lived here approximately eight months before filing this action.

A.R.S. 11-297 provides that free medical attention (including hospital care) should be denied to indigents who have not resided in the state for one year, except in emergency situations where such care is needed "for the preservation of life and limb."

The court declared the statute to be unconstitutional and granted the plaintiff an injunction against its enforcement. The Board of Supervisors appealed.

On appeal, the Court of Appeals agreed that the law was unconstitutional, modified the injunction (in a manner not material to this review), and affirmed the judgment. The case is now before us on a petition for review, requested by the defendants.

The constitutionality of the residence requirement in this case has been challenged as a violation of: The Commerce Clause, The Privileges and Immunities Clause, The Equal Protection Clause, The Due Process Clause, of both the U.S. Constitution and the Constitution of Arizona. Plaintiff argues that his position has been completely vindicated by Shapiro v. Thompson, ... U.S. . . . ., 89 L.Ed. 1322, ... S.Ct. . . . ., decided last April, just prior to the argument in the Court of Appeals.

The record indicates that prior to the final order of the Superior Court, plaintiff had already completed his first year of residence in Arizona. It is therefore obvious that the case was moot even before it reached the Court of Appeals, and long before it reached this Court. It is our policy not to decide a case before us which does not and cannot affect the plaintiff therein. Cf..Hall v. Beals, ... U.S. . . . ., ... L.Sd. . . . ., 90 S.Ct. 49 (1969). In accordance with that policy, the decision of the Court of Appeals is vacated and the case is remanded to the Superior Court of Pima County with directions to vacate the injunction and to dismiss the cause as moot.

JESSE A. UDALL, *Justice,*
LORNA E. LOCKWOOD, *Chief Justice,*
FRED C. STRUCKMEYER, JR., *Vice Chief Justice,*
ERNEST W. McFARLAND, *Justice,*
JACK D. H. HAYS, *Justice.*

Senator Moss. This hearing will now be recessed until tomorrow at 10 o'clock, in room 1318.

(Whereupon, at 12 noon, the committee was adjourned, to reconvene at 10 a.m., Wednesday, March 18, 1970.)

CONSUMER PROTECTION

WEDNESDAY, MARCH 18, 1970

U.S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE FOR CONSUMERS.
Washington, D.C.

The subcommittee met at 9:35 a.m. in room 1318, New Senate Office Building, Hon. Frank E. Moss (chairman of the subcommittee) presiding.

Present: Senator Moss.

Senator Moss. The subcommittee will come to order.

We will continue today with our hearing on various acts that are pending before the subcommittee and the full committee, including S. 2246, S. 3092, and S. 3201. We have several very fine witnesses to hear this morning, and we will proceed at once with that testimony.

Our first witness is Mr. Milton Handler, who is an attorney from New York. We are very glad to have you, Mr. Handler, and you may proceed, sir.

STATEMENT OF MILTON HANDLER, ATTORNEY, NEW YORK; ACCOMPANIED BY MICHAEL BLECHMAN, NEW YORK

Mr. HANDLER. Mr. Chairman, I know that time in the practical world is finite, however infinite it may be to philosophers, and I propose to go through my prepared statement briefly, reading parts only and leaving ample time for questions.

Senator Moss. Thank you, sir.

The full statement will be in the record after you highlight and emphasize the parts you want, that would be helpful to us.

Mr. HANDLER. I first set forth in my prepared statement my credentials and background in the field of consumer protection. That runs through the first four pages.

I then note that I have read with enthusiasm the President's message on consumerism and I applaud the social objectives which he seeks to achieve.

I strongly endores those provisions of the administration bill which will confer upon the Federal Trade Commission the right to obtain preliminary injunctive relief in the courts and in unfair advertising and deceptive price cases.

I might note that a generation ago I was one of the draftsmen of the Wheeler-Lea Act which conferred that power in the field of food,

drugs and cosmetics, and I see no reason why the power shouldn't be broadened to include all products.

If you haven't as yet read my prepared statement, Mr. Chairman, I might refer to the fact that in these initial pages I review the vast experience I have had in this field, both in and out of Government, in my scholarly work, in my teaching, and in my professional activity.

I then turn to the reasons why I question the wisdom of conferring on the Attorney General the responsibility for bringing court suits to prevent the very acts which it is now the duty of the Commission to forbid, and I develop that at some length.

I then express my serious doubts as to the wisdom of limiting the scope of sections 201, 202, and 203 of S. 3201 to the 11 enumerated deceptive acts and practices, and I propose a broadening of the bill. Having included in the previous part of my testimony my endorsement of the purposes of this legislation and of the provisions conferring power on the Federal Trade Commission to seek immediate, temporary relief by court injunction, and having dealt with the first of the two major problems that one confronts in legislating in this area—namely, the correct definition of the offense—I now turn to the problem of effective remedy.

I wish, Mr. Chairman, to register my basic disagreement with the reliance placed on private consumer actions in the Federal courts, and particularly with the consumer class action procedure for remedying infractions of both State and Federal law which are provided by S. 3092.

As I hope to demonstrate later in my testimony, there are far better ways of safeguarding the consumer interest.

I have three difficulties with S. 3092.

First, unlike S. 3338, which applies the provisions of rule 23 of the Federal Rules of Civil Procedure to consumer suits, S. 3092 sets forth no guidelines whatsoever as to the circumstances in which a consumer class action should be allowed.

Second, the bill would permit class actions to be brought in Federal courts to vindicate any rights which individuals may have under any State law deemed to be "for the benefit of consumers"—regardless of how small the amount in controversy may be.

And third, unlike S. 3201, there is no requirement that such a consumer suit be preceded by an adjudication of illegality or a consent order in a suit or proceeding brought by the Federal Government.

The net effect of these provisions, I submit, would be to impose an intolerable burden on the Federal courts and subject accused wrongdoers to unjust harassment without resulting in any commensurate benefit to consumers.

Let me develop that.

The purpose of class suits has traditionally been to allow the courts to deal with a multiplicity of claims in an economical manner by permitting the actual parties to a litigation also to represent the interests of persons who are not before the court but who occupy substantially the same legal positions with respect to the controversy in question. The reasons for caution in the utilization of such a device are readily apparent. On the one hand, there is a danger to potential defendants, since a plaintiff with even a minuscule claim may increase the *in ter-*

rorem effect of his action by invoking the claims of untold numbers of other persons; on the other hand, since absent claimants are, in effect, made to stand or fall with their purported representatives, it is essential that there be every assurance that their interests are in fact being adequately represented.

Under this bill any Tom, Dick, or Harry can select himself to be the representative of all of the consumers of the United States without any check whatsoever by the courts.

In addition—as the courts have shown themselves to be acutely aware—the class action procedure can have the effect of instantly transforming an orderly lawsuit into a gigantic litigation burdening the court's resources beyond its capacity to manager or effectively control.

For these reasons, the draftsmen of rule 23 under the aegis of the Supreme Court took great pains to insure that class actions would be permitted only under carefully prescribed conditions.

In my prepared paper, I outline what those conditions are.

The necessity of applying the safeguards provided by rule 23 is particularly acute in the case of consumer claims. Here, the homogeneity which justifies such wholesale adjudication will often be lacking. Purchases are made by consumers at different times and places and from different sellers.

This is on the assumption that the suit will be allowed against the manufacturer, which is not always clear. The ultimate purchaser does not buy normally from the manufacturer. If the producer is being sued in a consumer class action, it will be on the basis of multiple purchases from multiple sellers under varying conditions and frequently varying prices.

Furthermore, there is every likelihood that a consumer-plaintiff's claim may be very small—under S. 3092 the defrauded purchaser of a $1 item could presumably bring suit on behalf of all other purchasers of that product in the United States.

Where there are thousands, millions, tens of millions, and even hundreds of millions of claimants, I ask: How are these claims to be processed by the courts? And what happens if the defendant insists upon its constitutional right to a jury trial on the issue of the amount of damages suffered by each individual claimant?

If this committee believes I am exaggerating, let me tell you there are pending in the Federal courts suits on behalf of every inhabitant of these United States. The bill you are presently considering would not only permit, but encourage and invite class actions on behalf of untold numbers of people.

The burden S. 3092 would impose on the Federal judiciary is further aggravated by the provision in the bill permitting class actions to be brought for claims based on any State statute or decisional law which may be found to be "for the benefit of consumers." Since the word "consumer" is defined to include anyone offered or supplied "interests in land" as well as goods, services, and intangibles, the effect of the bill is to extend Federal jurisdiction to all landlords and tenant disputes as well as to all contract and fraud cases affecting consumers.

I would like to ask this committee to consider how, as a practical

matter, the limited resources of the Federal judiciary can be expected to cope with this flood of litigation.

The number of Federal judges as contrasted with the number of State court judges is infinitesimal. The Federal courts have very heavy responsibilities in the administration of Federal criminal justice, in the trial of complex cases arising out of Federal statutes, such as antitrust, patents, trademarks, copyrights, and the like, in the interpretation of the host of new laws that go on the books each year, and in defending the constitutional rights of all of our citizens.

Just picture one of our district courts in which there is only a single judge, and let's suppose that one of these consumer class actions on behalf of millions of claimants were brought before him. He would be out of business for a year or 2 years or perhaps 10 years. What happens to all of his other judicial responsibilities?

It is no good for the Chief Justice of the United States to go around the country complaining about delays, it is no good for Members of Congress to complain about judicial delay, if, at the same time, we enact legislation which would destroy the judicial system because it would put burdens upon it which it is unable to discharge.

It is of no use to talk about crime waves if we don't give the judges time to try criminal cases.

The class action procedure proposed in S. 3092 may also result in great inequity for the potential defendants in such suits. In considering the interests of such persons—which would include virtually all of the businesses in America, both large and small—we should remember that we are talking about persons who, in the main, are not unscrupulous defrauders of the public. Many of the deceptive acts and practices which the Federal Trade Commission has dealt with in the past do not concern hard-core frauds. Whether or not the law has been violated is not always clear. To put a businessman to the expense of defending himself against a class suit may place him in a position where the costs of litigation by themselves can impose upon him a penalty completely disproportionate to the offense.

Moreover, these heavy expenses are incurred even if the defendant establishes his innocence. Ultimately these costs, like all costs of doing business, will be borne by the consumer.

It is for this reason, and others, that I think the idea of the consumer class suit will be self-defeating.

Let us consider for a moment the measured of damages which might be appropriate in the most common cases of consumer fraud. I suggest that the committee read the 11 enumerated practices in this bill and ask yourselves what will be the measure of damage applicable to each offense.

What, for example, would be the amount of damages which would be awarded to the victim of bait and switch advertising who was induced to purchase a product other than that advertised? How much should be awarded to the purchaser at a "going out of business sale" which in fact had been going on for 10 years?

Isn't it perfectly plain that in many of these situations a monetary recovery is unrealizable? Thus, for such cases, the effect of the proposed consumer class action would be nil. Zero multiplied by 100 million is still zero.

Lest I be charged with inconsistency, let me make clear that while in certain instances you are creating a remedy which would be meaningless because nobody can resort to it since there will be no recovery, I am also suggesting that you are creating a remedy for which, in other instances, there may be some recovery but at disproportionate cost to our society.

Let's examine the case where some definite amount of individual damage can be shown. It is reasonable to expect that such monetary claims will be relatively small—so small, in fact, that any recovery due to the consumer is likely to be largely eroded by the costs of litigation. In *Gas Service Co.* v. *Coburn*, a companion case with *Snyder* v. *Harris*, the plaintiff's claim amounted to $7.81.

Suppose you have a class action of thousands or millions of claims of that dimension and with the legislation overriding the decision of *Snyder* v. *Harris*, you permit the aggregation of all these small claims.

Now, the claims have to be processed. They don't process themselves. It is an easy matter under the bill to aggregate all the claims, but what happens after the aggregation? The cases have to be tried in court, liability has to be established, each claim has to be made out. This can be very costly.

There is first the cost of proving each claim. There is the cost of publishing or serving notice upon the class members. There is the cost of administration in the Federal courts. There are the fees of counsel. It is not likely that the administrative costs may well exceed the amount of claim itself?

How much of this $7.81 overcharge for each consumer would remain after all these costs are paid?

I ask whether, in view of the dangers inherent in the class action device and the miniscule benefit individual consumers can expect, it would not be more in the public interest if the resources to be expended in conducting such litigation were allocated to some other consumer purpose?

Now, I come to what I would regard as constructive suggestions for the committee to consider in lieu of a remedy which I think is neither feasible nor desirable.

Mr. Chairman, it seems to me, on the basis of my experience in this area, that the important thing is to keep the stable locked before the horse is stolen.

What does that mean?

With proper enforcement most fraudulent schemes could be thwarted by the prompt issuance of preliminary injunctions. If fraud is promptly thwarted, people will not be victimized. Prevention will advance the public interest to a much greater extent than compensation.

Under the new legislation the Commission will have the power to seek such preliminary relief. So do some of the States under State law and those that have no such legislation should follow the lead of the Federal Government and the States that provide such relief.

The enforcement agencies, whether they be the Commission or the Attorney General, need adequate appropriations for the purposes of detection, investigation and litigation. Given the tools, the en-

forcement agencies should be able to stem the tide of misrepresentation by prompt and effective action.

An additional and especially effective means of preventing consumer frauds is one which the President stressed in his message on consumer protection. I am referring to consumer education and the distribution of information which can aid consumers in making intelligent purchasing decisions. The President indicated that the nationwide network of community action agencies might be one instrument for extending such education to the poor—who are the group most seriously victimized by consumer deception.

He further stated that he had requested that a new consumer bulletin be published on a regular basis.

I feel that this is one area in which every dollar spent can only mean saving untold dollars which would otherwise have to be expended in the infinitely more expensive task of attempting to remedy harm which has already occurred.

In my prepared paper, I discuss the criminal remedy as a deterrent, and then suggest that the committee consider imposing a civil penalty for the violations of the new statute.

The Federal Trade Commission could be authorized when it requires the respondent to cease and desist to impose a reparation order in an amount to be prescribed by the Congress. The Commission would determine the amount of the reparation, within a minimum and maximum specified by law, in accordance with the gravity of the challenged act or practice. The sums so collected could be used to subsidize not only the Commission's efforts in behalf of consumers but also the other elements of the broad consumer program outlined by President Nixon in his message. Such a sanction, I believe, would be an infinitely more effective as a deterrent than the consumer class action.

In summary, Mr. Chairman, it is my judgment that the enactment of S. 3201, as revised in accordance with the suggestions I have ventured to make to this committee, coupled with the administrative measures proposed by the President in his message, when combined with the effective discharge by the States of their own responsibilities in this area, should go a long way in putting our consumer house in order.

Senator Moss. Thank you, Mr. Handler, for a very fine statement which you have summarized in part. You have addressed yourself primarily to the class action proposal that is before us, but you did have some comments to make about the President's proposal on increasing the functions of the Federal Trade Commission and involving the Department of Justice, are very interesting.

It is going to be necessary for me to step out for just a few minutes. I would like to have Mr. John Cary, who is on the staff, a professional staff member working on these bills, ask you several questions, some of which have occurred to me and I have made notes on here, and I will return as soon as I can. But, at least, Mr. Cary can help us fill in the chinks in the record to make sure we understand your proposal and your suggestions about the legislation.

We do appreciate your coming to testify.

Mr. HANDLER. Before you leave, Mr. Chairman, if I might just say this: I told Mr. Cary on the telephone that I would be delighted to be of help to the committee in translating these views into legislation. I am interested in seeing an effective measure come out of this committee and enacted by the Congress.

Senator Moss. Thank you. We appreciate that, too, because we are in an exploratory area; this is a new field, and, of course, we were examining all sides. We want to know the good parts and the bad parts and come up finally with just the good ones, if we can.

Thank you, sir.

Mr. CARY. Mr. Handler, to begin with, do I understand you correctly that you do not believe that the administration's bill sets forth measures adequate to make the Federal Trade Commission a truly effective consumer protection agency? In other words, you think more is needed than the preliminary injunction and the expansion of jurisdiction?

Mr. HANDLER. I did not intend to create that impression. I endorse the provisions of the statute which will enable the Commission to go into court and get a preliminary injunction. I oppose granting that power to the Department of Justice. The duality of enforcement will mean that both agencies will be starved and neither will be effective.

I do not see any need of having the Attorney General go into court to enjoin the very same conduct that may be enjoined by the Federal Trade Commission. Therefore, I would center the responsibility in the Federal Trade Commission, and if you do that, give them the injunctive power and give them adequate appropriations so that they can assemble a proper staff. I think then we shall have taken a constructive step forward.

Mr. CARY. Do you believe that the Federal Trade Commission should be empowered to seek temporary restraining orders?

Mr. HANDLER. Yes.

Mr. CARY. Do you think they should be required to file the complaint before they seek a temporary restraining order? The administration bill provides that they may issue the complaint 60 days after they have filed a temporary restraining order.

Mr. HANDLER. I deal with that in my prepared statement. I do not make an issue as to whether the complaint is filed immediately before, simultaneously with or shortly after. I think that is an immaterial matter. What is material is that a false advertising case should be promptly decided by the Commission, and I think it would be very wrong for the Commission to go into court and get an injunction, a temporary injunction on the ground that irreparable damage is threatened to the consumers, and then to sit on their hands with respect to the administrative proceeding.

I see no reason whatsoever why a false advertising case cannot be started and completed in 3 months, and, therefore, I would require that the proceeding be started and completed in 3 months; otherwise, the injunction is dissolved.

Mr. CARY. Some of the witnesses have testified to the effect that the Federal Trade Commission should be required to follow traditional equity practice in seeking temporary injunctions. By that they mean, as I understand it, that the Commission should be required to show

substantial possibility of success on the merits of the action and substantial damage to the public if the temporary injunction is not granted. They have suggested, as I understand it, that specific language to that effect should be put into the statute.

Do you agree with this or do you think the present language is all right?

Mr. HANDLER. I assume in reading the bill that when you apply to court, you apply to a court which will apply its established rules of procedure and its settled substantive law. No court is going to give any Government body an injunction automatically. The Government or any other suiter must establish a basis for preliminary relief which is an extraordinary remedy.

I had assumed that the issuance of injunctions would be in accordance with the established judicial practice. If there is any doubt about it, it is a very simple matter to add three or four words, and I can give you legislative precedents for that, which will make it abundantly clear that the courts are called upon here to follow their settled practice in the issuance of injunctive relief. But I believe that the courts would do it without any further language.

Mr. CARY. You mentioned briefly that you believe the Trade Commission should be empowered to assess fines for violation of the law; is that correct?

Mr. HANDLER. I would not call it a fine. I would call it a civil reparation order.

Mr. CARY. Could you go into that issue a little bit?

Mr. HANDLER. Yes; I think that much more effective than a consumer class action as a deterrent and as reparation would be an order made by the Federal Trade Commission within certain parameters which gives them adequate discretion to set an amount which is commensurate with the gravity of the offense. The punishment must always fit the crime.

This money would go into the Federal Treasury, but it should be charged or burdened with a mortgage, so to speak, in favor of consumer protection. This money would then be available to the Commission to subsidize its efforts on behalf of the consumer. It would be available for the various administrative measures which are suggested by the President.

Paper reforms are no reforms. Reforms cost money; and unless you have the money, the reforms will never be realized. This is the way of getting the money for the administration of these reforms embodied in the administration bill.

Mr. CARY. Have you in mind the parameters you spoke of, the minimum and the maximum?

Mr. HANDLER. No, I do not, because I do not think I have any expertise on that. I think that is a matter of judgment, and I would leave that to the judgment of the committee.

Mr. CARY. As I undersand it, then, what you have proposed is a penalty in essence. It is not a matter of reparations to the consumers injured by that specific practice; is that correct?

Mr. HANDLER. It is a civil penalty which would go to the Government and to nobody else; and I think it is much more important that

the Federal Government, which is legislating these changes, have the money than to give the money to the States. If the States want money, let them enact their own legislation, but let them not come to Congress and ask Congress to do their job and also permit them to collect money which they will use for nonconsumer purposes.

Mr. CARY. Would you favor the proposal that Senator Moss has made that the Trade Commission be empowered to award damages to consumers injured by violation of the Federal Trade Commission Act?

Mr. HANDLER. I would oppose that, and I will explain why. The President mentioned the backlog of matters before the Commission. The Commission has very serious responsibilities. I would prefer to have claims processed administratively than in the courts if this can constitutionally be done. But if you saddle the Commission with processing thousands or millions of claims, you have put the Commission out of business.

Mr. CARY. As I understand Senator Moss' proposal, it is not necessarily to process every consumer claim in the entire Nation, but rather, in those cases that come before the Commission, where they find a violation of the act, and where they find injury to the consumers, should they not then go ahead and award the damages, reparations, restitution, whatever is appropriate to the consumers injured by that violation?

Mr. HANDLER. Somebody has to do the processing. The money has to get—if you want the money to get to the consumers, somebody must do the processing, and that is a very heavy burden, and I think that the best way is to have the kind of deterrent that I have mentioned, which is simple and automatic.

You will have to have a bureaucracy here similar to what you had in price control if you are going to try to process millions of consumer claims. And the amount of the claim has to be determined in each case unless you are going to give consumers a windfall, and each consumer's claim will vary, depending upon where he purchased, what he paid, how many purchases he made and the like.

I would be thoroughly and completely and irreconcilably opposed to that proposal.

Mr. CARY. Another proposal has been that the Commission's power to make rules be explicitly set out so that, once the Commission had defined an unfair and deceptive act or practice by rule in detail, violation of that rule would be violation of section 5. Would you support such a proposal?

Mr. HANDLER. This is a procedure that can work well and can work badly, depending on how it is handled by the Commission. In view of the very serious criticisms that have been leveled against the Commission of late, some of which in my opinion are unfounded, some of which are well founded, I think that the Commission has to prove its capacity to do the job that it now has before it is saddled with any new responsibilities.

I would prefer to concentrate on the Commission streamlining its procedures in the consumer protection area and developing the proper

machinery for applying to the courts and nipping in the bud incipient frauds.

If they do that, this committee, the Congress, and the Commission will have made an enormous contribution. Let us do that first and see how this works before we put any more paper on the books which paper may not be very amenable.

I am not opposed irreconcilably to the rulemaking procedure, but I would like to move slowly in that area.

Mr. CARY. You mention that you brought out in your full statement the matter of criminal penalties for consumer deception. Could you explain your position on that for the record?

Mr. HANDLER. Yes. I considered this as early as 1929 which in view of the generation gap may appear to be a very long time ago. I have always felt that we have put undue reliance on the criminal law as a deterrent and as a means of regulating human conduct.

The printer's ink statute was put on the books more than 50 years ago. It has not proved to be very effective. The reason it has not proved to be effective is that it has to be enforced by prosecutors like all criminal laws. The prosecutor has crimes of violence to deal with.

In this recent wave of bombing, we certainly want him to concentrate on that. In the recent wave of crimes that are occurring on airplanes, we want him to concentrate on that. With the narcotics problem pressing upon us, we want him to concentrate on that.

Now, there are just so many things that he can do and it is fatuous for us to suppose that if you have more criminal laws, that they will be self-executing. They have to be enforced; there must be moneys that are appropriated for enforcement; you need money; you need manpower.

While I think that we ought not to abandon the criminal sanction, we should strengthen it, and this I did in New York State. I revised the printer's ink statute of that State to make it more effective substantially. I think this was a desirable reform. But by itself it does not add up to very much.

I would suggest that you could strengthen the Federal criminal statutes by way of revision, and have that as one of the weapons in the arsenal of government; but understand that its efficacy is likely to be quite modest.

Mr. CARY. I am sure that Senator Moss would have more questions for you, but I think we should probably move on to our other witnesses. I would like to thank you very much on behalf of Senator Moss and the subcommittee for appearing today, for making your statement. It contributed substantially to the record, and I hope the subcommittee may call on you in the future as it considers these measures.

Mr. HANDLER. Thank you, Mr. Cary, and I compliment you on the very sharp and penetrating questions that you put to me. It has been a pleasure to answer them.

(The statement follows:)

STATEMENT OF MILTON HANDLER

My name is Milton Handler.

I am presently a member of the faculty of law of Columbia University, where

I have been teaching Trade Regulation since 1927. I am also a senior partner in the firm of Kaye, Scholer, Fierman, Hays & Handler of New York City.

I am appearing to express some personal views on S. 3201, S. 3092 and other related measures which this Committee is now considering.

I have been deeply interested in consumer protection since the very inception of my professional career. In 1929 I published a pioneer study of False and Misleading Advertising in the Yale Law Journal,[1] in which I reviewed the substantive and procedural deficiencies of the law of that period in preventing untruthful advertising. In 1931 [2] I made a study in depth of the efforts of the Federal Trade Commission to curb improper advertising and other deceptive trade practices, with particular reference to the obstacles which the courts were then placing in the path of that agency. At the beginning of the Roosevelt administration in 1933, together with Professor Cavers of the Harvard Law School, I drafted, with the assistance of the Food and Drug Administration of the Department of Agriculture, a comprehensive bill intended to supersede the Wiley Act of 1906.[3] Experience over several decades had demonstrated the inadequacy of this enactment in safe-guarding the consumer interest in food and drugs.[4] The measure we wrote was known as the Tugwell bill.[5] It was enacted subsequently with substantial changes by the Congress as two separate statutes, the so-called Copeland Act, which is the foundation of our present food and drug legislation [6] and the Wheeler-Lea Act,[7] which conferred upon the Federal Trade Commission the power to prevent unfair or deceptive acts or practices and which defined the term "false advertisement."

I did a piece for the Duke University Law Review [8] in 1939, in which I analyzed and appraised the false advertising provisions of the Wheeler-Lea Act. In my writings I had criticized the courts for their restrictive interpretation of the Commission's powers over advertising practices and the decisional law which denied a right of action to businessmen in private litigation to restrain false advertising by their competitors. The Congress in 1946, in Section 43(a) of the Lanham Act, provided a statutory basis for such private actions and the course of decision since that time has upheld their maintenance.[9] Finally, in 1959, as chairman of a distinguished committee of the New York State Bar Association, established at the request of the then Attorney General and now Senator Javits, I supervised a comprehensive study of the law of New York on false advertising and other deceptive trade practices.[10] Our recommended legislation was enacted by the New York State Legislature.[11] Its basic theory was that the Attorney General should have the power to obtain equitable relief in the courts to prohibit false advertising of essentially the same character as that forbidden by the Wheeler-Lea Act. My scholarly efforts thus had to do with the proper definition of the conduct to be forbidden and with the creation of effective remedies for the enforcement of the statutory prohibitions—the two major problems with which this Committee is concerned.

I have read with enthusiasm the President's message to Congress on consumerism. I applaud the social objectives which he seeks to achieve. Having learned in a long lifetime of public service and private practice how difficult it can be to obtain public support for consumer legislation. I am much encouraged by the widespread interest today at all levels of government, federal, state and municipal, in the consumer cause. I come before the Committee neither as a proponent nor opponent of any specific bill but rather as one whose experience and views may be of assistance to the Committee in fashioning effective legislation.

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[1] Handler, "False and Misleading Advertising," 39 Yale L.J. 22 (1929).
[2] Handler, "The Jurisdiction of the Federal Trade Commission Over False Advertising," 31 Col. L. Rev. 527 (1931).
[3] 34 Stat. 768 (1906).
32 Col. L. Rev. 720 (1932).
[4] "Note, The Consumer's Protection Under the Federal Pure Food and Drugs Act,"
[5] Tugwell, "Recollections of 1933 and Later," FDA Papers, June 1968, at 4.
[6] 52 Stat. 1040 (1938), 21 U.S.C. 301 et seq., as amended.
[7] 52 Stat. 111 (1938), 15 U.S.C. c. 2.
[8] Handler, "The Control of False Advertising Under the Wheeler-Lea Act," 6 Law & Contemp. Prob. 91 (1939).
[9] 15 U.S.C. 1125a; see 1 R. Callman, "The Law of Unfair Competition, Trademarks and Monopolies," sec. 18.2(b) (2d ed. 1967).
[10] Second Report of the Special Committee of the Antitrust Section of the New York State Bar Association to Study the Antitrust Laws of New York (1959).
[11] New York General Business Law, Art. 22–A, secs. 350–350–e, as amended by act of March 4, 1970; see also Lewis, "Should New York Adopt a New State Law Prohibiting Deceptive Acts and Providing for Injunctive Relief?," 1968 Antitrust Law Symposium 103 (1968).

I strongly endorse those provisions of the Administration bill which will confer upon the Federal Trade Commission the right to obtain preliminary injunctive relief in the courts in unfair advertising and deceptive practice cases. Such power was conferred in the Wheeler-Lea Act in the case of false advertising regarding food, drugs and cosmetics.[12] There is no reason why the Commission's authority should not be broadened to embrace the advertising of all products purchased by consumers. I might mention in passing that I strongly opposed legislation which the Commission proposed several years ago under which it itself would have been able to issue preliminary injuctions in its own administrative proceedings without resorting to the courts.[13] The present bills rightly sanction such judicial relief in adversary proceedings in which the Commission as plaintiff will have to substantiate its charges and meet the customary standards governing the issuance of preliminary injunctions. With this new tool, an alert and vigilant Commission can nip in the bud the nefarious schemes that are practiced on an unsuspecting public by sharp and dishonest traders. The sooner the unscrupulous merchant is under a court injunction, the sooner the parameters of the injury he can inflict on the public will be substantially reduced. With the Office of Consumer Affairs acting as a sort of Ombudsman for consumers, the complaints which it receives after initial screening can be promptly referred to the Commission, which, after appropriate investigation, can promptly proceed in the courts for a preliminary injunction.

I have publicly stated on many occasions that the Commission has been the most potent force in the federal government in preventing improper business behavior. I believe that the nation should capitalize on the Commission's vast experience. It is not always an easy matter to determine whether a representation made in the sale of a product is true or false or otherwise misleading. Advertising claims cover the widest range. Technical studies frequently have to be undertaken and tests made before the facts can be properly assessed. The Commission possesses the expertise to discharge this responsibility. What is needed is that it streamline its procedures and improve its efficiency so that it can become an even more vital force in the protection of the consumer.

I would suggest that it is not enough to provide, as does the present bill, that the Commission must issue a complaint within sixty days after it obtains a preliminary injunction from the court. I would go further and require the Commission, if it is to retain the benefit of the court restraint, to complete as well as commence its administrative proceedings within a limited period of time. I see no reason why a false advertising case cannot be tried and determined by the Commission within the space of three months after complaint is filed and an injunction sought. A time limitation of the kind I suggest would encourage the prompt dispatch of Commission business which is desirable both for the consumer and for those charged with wrongdoing, and would cut down on the backlog of cases which has been the subject of recent criticism and which the President referred to in his message.

We must not overlook that much can be achieved in law enforcement without instituting either administrative or court proceedings if the device of voluntary assurances is properly utilized. There is no reason to incur the expense and delays incident to litigation when there is no disposition on the part of the accused businessman to continue the challenged practice. An alert Commission staff, after processing a consumer complaint, can through informal conferences speedily obtain a voluntary assurance of discontinuance and thus achieve with a minimum of expense and without protracted formal proceedings immediate compliance. This was the procedure which we required in our New York legislation and, according to the Attorney General of that state, the procedure has worked well in practice. Of course, no voluntary agreement of discontinuance will advance the consumer interest if it is not properly policed. Indeed, paper enforcement may be worse than no enforcement if it serves only to obscure the necessity for providing a truly effective remedy. But the solution, I submit, is not to write off the voluntary compliance device as a vehicle of enforcement; what is needed is continued surveillance coupled with prompt measures to compel observance when there is non-compliance.

The administrative process, in my view, is especially adapted to dealing with deceptive business practices. It is more important to strengthen the Federal

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[12] 15 U.S.C. sec. 53.

[13] Testimony before House Committee on Interstate and Foreign Commerce, May 22, 1962.

Trade Commission than to shift some of its duties to other agencies of government. For this reason I question the wisdom of Section 203, which endows the Attorney General with responsibility for bringing court suits to prevent the very acts which it is now the duty of the Commission to forbid. Experience teaches that when responsibility is divided between two governmental bodies, the two together do not do as good a job as either acting alone. Dual enforcement of the antitrust laws by the Department of Justice and the Federal Trade Commission has led to conflict, confusion, uncertainty and inefficiency. I have never been able to perceive the benefits from such dual administration in antitrust and I cannot see what will be gained here. If the Commission is given the right to seek preliminary relief in the courts, why is it necessary to endow the Attorney General with the same power? The Department of Justice will have to assemble a huge staff of technicians, testers, investigators, and the like—the same kind of staff the Commission already has. What is the purpose of this profoundly unnecessary duplication? If the Congress lacks confidence in the Commission, it should abolish it. It should not sap it of vitality or render it impotent by assigning its duties to other governmental bodies and by allowing such other bodies to compete for the skilled and dedicated manpower which the Commission so vitally needs. Section 203 is unnecessary and I therefore suggest that it be stricken.

I stated at the outset of my testimony that one of two major legislative problems in preventing consumer frauds lies in the proper definition of the conduct to be prohibited. A generic prohibition of unfair or deceptive acts and practices will cover the waterfront. The more general the prohibition the more effective it will prove in practice. The exact meaning of any such comprehensive interdiction will, of course, depend on judicial interpretation, but the courts will not be writing on a clean page. They have the fifty-five-year experience of the Federal Trade Commission as guidance. In my opinion, present substantive federal law is quite adequate to the task of coping with the ingenuity of the most unscrupulous mind in devising novel methods of defrauding the consumer.[14] Section 202 of S. 3201, unlike the Wheeler-Lea amendments of the Federal Trade Commission Act, does not generically forbid unfair or deceptive acts. Instead it proscribes only the 11 practices which are listed in Section 201 and which may be restrained at the suit of the Attorney General or challenged in private consumer actions. Although it may be argued that this list covers most of the major misrepresentations against which the Commission has heretofore proceeded, the question nevertheless arises why there should be any limitation in the forms of deception which may be attacked under the new legislation. I think that experience teaches that any enumeration, however carefully made, can result in unhappy omissions or may prove to be too restrictive as the years roll by. I also think that the terms "knowing" and "knowingly" as used in the various paragraphs of Section 201 could prove to be mischievous. I can discern no reason why (if suits by the Attorney General and consumers are to be allowed) Sections 203 and 204 should be less extensive in their coverage than the Federal Trade Commission Act.

Turning now from the question of defining the conduct to be proscribed to the second major problem dealt with by the various pending bills—that of devising appropriate enforcement measures—I wish to register my basic disagreement with the reliance placed on private consumer actions in the federal courts and, in particular, with the consumer class action procedure for remedying infractions of bothy state and federal law which is provided by S. 3092. As I hope to demonstrate later in my testimony, there are far better ways of safeguarding the consumer interest.

My difficulties with S. 3092 are threefold. First, unlike S. 3338, which applies the provisions of Rule 23 of the Federal Rules of Civil Procedure to consumer suits, S. 3092 sets forth no guidelines whatsoever as to the circumstances in which a consumer class action should be allowed. Second, the bill would permit class actions to be brought in federal courts to vindicate any rights which individuals may have under any state law deemed to be "for the benefit of consumers"—regardless of how small the amount in controversy may be. And third, unlike S. 3201, there is no requirement that such a consumer suit be

[14] Millstein, "The Federal Trade Commission and False Advertising," 64 Col. L. Rev. 439 (1964); "Developments in the Law—Deceptive Advertising," 80 Harv. L. Rev. 1005 (1967).

preceded by and adjudication or illegallity or a consent order in a suit or proceeding brought by the federal government. The net effect of these provisions, I submit, would be to impose an intolerable burden on the federal courts and subject accused wrongdoers to unjust harassment without resulting in any commensurate benefit to consumers.

The purpose of class suits has traditionally been to allow the courts to deal with a multiplicity of claims in an economical manner by permitting the actual parties to a litigation also to represent the interests of persons who are not before the court but who occupy substantially the same legal positions with respect to the controversy in question. The reasons for caution in the utilization of such a device are readily apparent. On the one hand, there is a danger to potential defendants, since a plaintiff with even a miniscule claim may increase the *in terrorem* effect of his action by invoking the claims of untold numbers of other persons; on the other hand, since absent claimants are, in effect, made to stand or fall with their purported representatives, it is essential that there be every assurance that their interests are in fact being adequately represented. In addition—as the courts have shown themselves to be acutely aware—the class action procedure can have the effect of instantly transforming a litigation into a gigantic burden on the court's resources beyond its capacity to manage or effectively control.

For these reasons, the draftsmen of Rule 23 took great pains to insure that class actions would be permitted only under carefully prescribed conditions. Before class suits can be maintained under that rule the court must determine, *inter alia*, that there are questions of law and fact common to the class, that the claims of the representative parties are typical of the claims of the class, that the representative parties will fairly and adequately protect the interests of the class, that the questions of law and fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available remedies for the fair and efficient adjudication of the controversy. Most important of all for present purposes, the court in making these findings must decide that a class action is capable of judicial management.

The necessity of applying the safeguards provided by Rule 23 is particularly acute in the case of consumer claims. Here, the homogeneity which justifies such wholesale adjudication will often be lacking. Purchases are made by consumers at different times and places and from different sellers. Normally the ultimate consumer does not buy directly from the manufacturer. If the producer is being sued in a consumer class action, it will be on the basis of multiple purchases from multiple sellers under varying conditions and frequently varying prices. Furthermore, there is every likelihood that a consumer-plaintiff's claim may be very small—under S. 3092 the defrauded purchaser of a $1 item could presumably bring suit on behalf of all other purchasers of that product in the United States. Without guidelines of any sort, one can well imagine consumer-plaintiffs in each case asserting representation of the largest class imaginable. Such gigantic suits to vindicate consumer claims will impose a strain on the federal courts which may prove infinitely greater than anything foreseen by the bill's draftsmen. Where there are thousands, millions, tens of millions or even hundreds of millions of claimants, how are these claims to be processed by the courts? And what happens if the defendant insists upon its constitutional right of a jury trial on the issue of the amount of damages suffered by each individual claimant?

The burden S. 3092 would impose on the federal judiciary is further aggravated by the provision in the bill permitting class actions to be brought for claims based on any state statute or decisional law which may be found to be "for the benefit of consumers." Since the word "consumer" is defined to include anyone offered or supplied "interests in land" as well as goods, services and intangibles, the effect of the bill is to extend federal jurisdiction to all landlord and tenant disputes as well as to all contract and fraud cases affecting consumers. In addition to pointing out that such wholesale transfer of essentially local disputes to the federal courts violates the most basic precepts of our federalism, I would ask this Committee to consider how, as a practical matter, the limited resources of the federal judiciary can be expected to cope with this flood of litigation. The number of federal judges as contrasted with the number of state court judges is infinitesimal. The federal courts have very heavy responsibilities in the administration of federal criminal justice, in the trial of complex

cases arising out of federal statutes, such as antitrust, patents, trademarks, copyrights and the like, in the interpretation of the host of new laws that go on the books each year, and in defending the constitutional rights of all of our citizens. A large consumer class action could put a federal court out of action for years and disqualify it from performing its other important duties. Consider, for example, a case now pending where the action has been brought on behalf of every inhabitant of the United States. However vital the protection of the consumer may be, it is no less important that the federal courts be available to enforce the wide range of other laws which they are called upon to administer.

The class action procedure prosed in S. 3092 may also result in great inequity for the potential defendants in such suits. In considering the interests of such persons—which would include all of the businesses in America, both large and small, which produce for or sell to consumers—we should remember that we are talking about persons who, in the main, are not unscrupulous defrauders of the public. Many of the deceptive acts and practices which the Federal Trade Commission has dealt with in the past do not concern hard-core frauds. Whether or not the law has been violated is not always clear. To put a businessman to the expense of defending himself against a class suit may place him in a position where the costs of litigation by themselves can impose upon him a penalty completely disproportionate to the offense. Moreover, these heavy expenses are incurred even if the defendant establishes his innocence. Ultimately these costs, like all costs of doing business, will be borne by the consumer. Hence one may well question the wisdom of encouraging class actions as is done by S. 3092 in contrast to Rule 23, which by its stringent controls discourages their institution save in those special situations where they would be appropriate. The danger of inequity to businessmen who deal in consumer goods and services is substantially increased by the absence of any requirement in S. 3092 that such private suits not be brought until after the commencement of a government action. There is thus no bridle whatsoever to restrain petty, crank or nuisance litigation, and businessmen would no doubt be faced with numerous suits of this character, many of which could be of enormous scope.

Having pointed out the dangers inherent in the class suit procedure which S. 3092 provides, I ask this Committee to consider whether class suits in fact afford advantages to the consumer which could conceivably offset the drawbacks which I have described. I suggest that in most cases the pecuniary benefit to individual consumers resulting from the proposed class action procedure would be either non-existent or manifestly inconsequential by any standard. It is for this reason, as well as because of the clear disadvantages of the device for the judicial system generally, that I feel that the cause of consumer protection can best be served by other, less onerous means.

Let us consider the measure of damages which might be appropriate in the most common cases of consumer fraud. What, for example, would be the amount of damages which would be awarded to the victim of bait and switch advertising who was induced to purchase a product other than that advertised? How much should be awarded to the purchaser at a "going out of business sale" which in fact had been going on for ten years? It is clear that in such instances—as in many other areas of consumer deception—a monetary recovery is unrealizable. Thus, for such conduct the effect of the proposed consumer class action would be nil. Zero multiplied by 100 million is still zero.

Turning to those cases in which some definite amount of individual damages can be shown, it is reasonable to expect that most such monetary claims will be relatively small—so small, in fact, that any recovery due to the consumer is likely to be largely eroded by the costs of litigation. In *Gas Service Company* v. *Coburn*, a companion case with *Snyder* v. *Harris*, the plaintiff s claim amounted to $7.81. The amount of the overcharge of the 18,000 other class members was unknown. While new legislation such as S. 3092 may override the decision in *Snyder* v. *Harris*, which did not permit the aggregation of claims to satisfy the jurisdictional amount in controversy, it does not and cannot constitutionally obviate the need for processing each claim in accordance with established judicial procedures. This can be very costly. There is first the cost of proving each claim. There is the cost of publishing or serving notice upon the class members. There is the cost of administration in the federal courts. There are the fees of counsel. Is it not likely that the administrative costs may well exceed the amount of the claim itself? In any event, how much of the $7.81 overcharge would remain for each consumer plaintiff?

If it is the theory of S. 3092 that many persons, each having a small claim, cannot obtain effective redress under state law and that it is therefore in the public interest to create a federal right in behalf of such consumer claimants, I ask whether, in view of the dangers inherent in the class action device and the miniscule benefit individual consumers can expect, it would not be more in the public interest if the resources to be expended in conducting such litigation were allocated to some other consumer purpose.

The important thing, it seems to me, is to keep the stable locked before the horse is stolen. With proper enforcement most fraudulent schemes could be thwarted by the prompt issuance of preliminary injunctions. Prevention will advance the public interest to a much greater extent than compensation. Under the new legislation the Commission will have the power to seek such preliminary relief. So do some of the states under state law and those that have no such legislation should follow the lead of the federal government and the states that provide such relief.

The enforcement agencies, whether they be the Commission or the Attorney General, need adequate appropriations for purposes of detection, investigation and litigation. Given the tools, the enforcement agencies should be able to stem the tide of misrepresentation by prompt and effective action.

An additional and especially effective means of preventing consumer frauds is one which the President stressed in his message on consumer protection. I am referring to consumer education and the distribution of information which can aid consumers in making intelligent purchasing decisions. The President indicated that the nationwide network of community action agencies might be one instrument for extending such education to the poor—who are the group most seriously victimized by consumer deception. He further stated that he had requested that a new consumer bulletin be published on a regular basis. I feel that this is one area in which every dollar spent can only mean saving untold dollars which would otherwise have to be expended in the infinitely more expensive task of attempting to remedy harm which has already occurred.

For deterrents we normally have relied on the criminal sanction. There have on the books for decades state statutes making hard-core fraudulent misrepresentations a criminal offense. My committee in New York strengthened the New York criminal statute. The reason these laws have not been effective is not so much because of any deficiencies in their draftsmanship as in the lack of interest in the enforcement officials, as well as the lack of money needed for effective enforcement. There is a criminal sanction in the Wheeler-Lea Act in respect of fraudulent advertising of food, drugs and cosmetics. The mail fraud statute hits many fraudulent schemes. The Wheeler-Lea Act can be broadened to cover the fraudulent advertising of all products and the mail fraud statute can be tightened to make it a more useful instrument. But if these enactments are to serve any useful purpose, there must be appropriated adequate sums for their enforcement.

Having regard for the inherent limitations in the criminal remedy, I would recommend that the committee consider imposing a civil penalty for the violation of the new statute. The Federal Trade Commission could be authorized when it requires the respondent to cease and desist to impose a reparation order to be prescribed by the Congress. The Commission would determine the amount of the reparation within the minimum or maximum specified by law in terms of the gravity of the challenged act or practice. The sums so collected could be used to subsidize not only the Commission's efforts in behalf of consumers but also the other elements of the broad consumer program outlined by President Nixon in his message. Such a sanction, I believe, would be a greater deterrent than criminal punishment and, further, would be more effective as a deterrent than the consumer class action.

I turn finally to the matter of compensation. A consumer who is injured can maintain his own action under state law in tort or in contract, and it is on the state courts that the burden of handling this litigation should primarily rest. It is up to the states to inaugurate whatever judicial reforms may be required. It may be that special consumer claims courts should be established at the state level to handle consumer suits. As with the Family Court in New York and its equivalents elsewhere, this might have the salutary effect of producing a specialized judiciary uniquely informed and prepared to handle the special problems of consumers in each particular area on an informal basis. After all, the primary responsibility for protecting consumers against local frauds rests with

the states, both in respect of consumer suits and in the enforcement and administration of local laws and ordinances. While direct federal action would not be appropriate here, it is not necessary that each state approach such problems with complete independence. The Uniform Consumer Credit Code affords one example of the fruits of interstate cooperation, and similar uniform laws might be useful in defining the scope of proscribed conduct as well as in providing the appropriate judicial machinery for enforcing consumer rights. Such state efforts might also be aided by funds appropriated by Congress in a spirit of cooperative federalism. Any monies spent in making the states more able to administer consumer litigation are likely to be far less than what would be required to enlarge the federal judiciary to handle such suits.

The enactment of S. 3201, as revised in accordance with the suggestions I have ventured to make to this Committee, coupled with the administrative measures proposed by the President in his message, when combined with the effective discharge by the states of their own responsibilities in this area, should go a long way in putting our consumer house in order.

It borders on the platitudinous for me to assert as I conclude that a reform to be meaningful needs more than new legislation or attractive executive programs. To accomplish the objectives of adequate consumer protection, on which there is singular unanimity, we will require dedicated personnel and generous appropriations to nourish their efforts.

Mr. CARY. Mr. Norris, representing the Chamber of Commerce, Antitrust and Trade Regulation Committee. Would you come forward? I think we may as well begin in Senator Moss' absence. He is expected to return.

STATEMENT OF WILLIAM B. NORRIS, VICE PRESIDENT-LEGAL AND SECRETARY OF CARLING BREWING CO. OF CLEVELAND, OHIO; CHAMBER OF COMMERCE ANTITRUST AND TRADE REGULATION COMMITTEE

Mr. NORRIS. Thank you, Mr. Cary.

My name is William B. Norris. I am vice president-legal and secretary of the Carling Brewing Co., of Cleveland, Ohio. I am here today in behalf of the national chamber of commerce as a member of its Antitrust and Trade Regulation Committee.

Before making reference to the prepared remarks and any other editorial comment, I wonder if I might express not only my appreciation for being here and the chamber's appreciation, but there is kind of a side bonus for me. I sat in Professor Handler's trade regulation course 20 years ago at Columbia Law School and it is a great privilege to be following such a great teacher.

I will try to summarize the portions of the written statement. However, it will be I think promoting clarity if portions of it are read.

The national chamber, as you know, is the world's largest association of business enterprises and organizations, and our interest is in the welfare not only of the millions of American businessmen and women but also of the 203 million consumers whose protection and economic well-being are critical to the interests of our members.

It is our firm belief that the consumer has a right to honesty and integrity in the marketplace—in the major transactions as well as in the smallest day-to-day purchases. Those who defile the integrity of the marketplace with fraudulent or deceptive acts or practices do injury not only to consumers but also to those ethical and legitimate businessmen who constitute the overwhelming majority of all business.

It is because the chamber believes so strongly in what President Nixon has termed the natural alliance between business and consumers, that the national chamber last month adopted a 10-point business-consumer relations code, which I am not taking time to read, but is appended to my statement, as well as a letter from President Nixon to Mr. Booth at the chamber, acknowledging receipt of this code. I would, however, draw particular attention to section 6 of this code.

Let me read section 6:

The board of directors of the chamber has voted to pledge the resources of the chamber's nationwide federation toward achieving the widest recognition of voluntary implementation of the code of business-consumer relations. We affirm the responsibility of American business to eliminate frauds and deceptions from the marketplace, setting as our goal not strict legality but honesty in all transactions.

Much of what I will say is based upon the very fundamental belief that honesty is the yardstick that must be applied in the areas that the committee is presently dealing with.

As we consider proposed legislation we note that there is no possibility that by law alone can we make our system for the production and distribution of goods and services 100 percent perfect. Our system is administered by human beings who are all subject to human frailties.

Any laws enacted will therefore be subject to imperfections in application. We favor balanced judgment in determining the extent to which further legislation should be enacted.

I would like to say for the benefit of the committee that in viewing the three bills that are here pending today, it is terribly important, as Professor Handler has pointed out, to look at the liability to society contained in the proposal for class actions as a means of redressing hard-core fraud. There can be no objection to the basic desire to eliminate hard-core frauds. We are all aware of the many kinds of deceptions that are practiced.

The Kerner report made reference to the practice, to the many practices. We are aware that there can be no objection to the desire to eliminate those practices. But we believe the committee must consider the benefits to society that will accrue from this means of trying to redress hard-core fraud.

We urge this Congress to enact legislation which will assure that potential consumer injuries arising out of frauds and deceptions are stopped before they can occur. This, we believe, is the single overriding need in the whole field of consumer remedies. We urge, too, that Congress not be distracted from this need by proposals which promise more than they can deliver and which at best only lock the barn door after the horse has disappeared into the night.

If consumer injury is to be prevented before it takes place, the agency most likely to be successful in that effort is the Federal Trade Commission. No other Federal agency contains the FTC's experience and expertise in dealing with fraud and deception.

Of course, the Commission in recent years has come under attack for ineffectual operation, mismanagement, putting its efforts and energies against more trivial and less substantive problems. We are aware of

the American Bar Association's report on the Federal Trade Commission. We are aware of the criticisms made by the group of faculty members and students referred to as Nader's raiders. Other critics have raised their voices in the cry for Federal Trade Commission reform. But we do believe it is important to try to make the Federal Trade Commission the principal focus of consumer fraud and deception activities in the Federal Government.

We disagree with those who believe that the FTC has outlived its usefulness as an instrument of consumer protection. Despite its many defects, the Federal Trade Commission is still the logical focus of Federal consumer protection activities. But extensive steps must be taken to make the Commission the effective force Congress intended it to be.

Two of these steps are contained in measures now before this subcommittee which we believe should be enacted. One of these is the administration's proposal to extend the FTC's authority to matters which "affect" interstate commerce. We strongly support that necessary reform to enable the Commission to reach those who would defraud the public no matter where they are.

The second necessary step, if the Commission is to be enabled to prevent consumer injury, is to give it authority to seek preliminary injunctions against alleged violations, injurious to consumers, of section 5 of the FTC Act—also a proposal of the administration. Deceptive sales legislation, which we have supported in past Congresses and which we support today, provides the means to stop frauds and deceptions before—not merely after—the fact.

We do believe, Mr. Cary, and members of the committee, that the temporary restraining order is a particularly harsh means, and we believe that the preliminary injunction, which gives notice to the alleged wrongdoer, is on balance the better device to be encouraged.

The very sharpness of the preliminary injunction as a consumer protection weapon requires, however, a suitable scabbard to prevent its injuring the honest, legitimate businessman.

With the authority to seek injunctive protection, the hard-core frauds can be moved against rapidly. Consumers would not have to wait the long periods of time for redress that are presently involved in cease-and-desist order hearings.

If the Federal Trade Commission had the power to go into court with the court using its normal equity jurisdiction and enjoin a practice during the pendency of the administrative hearing, we believe that this combination of factors is going to go a long way toward relieving our society of most hard-core fraud practices.

The three specific protections that we would urge, I have already made reference to one or two of them, that temporary restraining orders should not be authorized because they can be issued without notice and hence without providing a full and fair opportunity for defense. This is an exceptionally severe and drastic remedy and is typically granted in civil cases only when serious and irreparable injury would occur without the restraining order and only when there is a high probability that the party seeking the order will prove successful in his pursuit of the case.

The second safeguard is that the preliminary injunction should not be granted automatically. I have made reference to this. We be-

lieve that the traditional equity discretion in passing on Federal Trade Commission requests should apply.

Third, the Commission should be required to issue administrative complaints against the alleged violator contemporaneously with or prior to the filing of a petition for injunction. This would assure that the FTC actually investigated an alleged violation of the law it administers before an injunction can be issued.

This would not require an investigation of extended duration and in cases of patent fraud a complaint could be speedily issued. It would, however, afford the basic protection of requiring the Commission to show the court some documented reason for requesting an injunction.

These protections are similar to those contained in the deceptive sales legislation passed by the Senate in the 90th Congress.

My prepared statement recommends that the professional management study called for by the President would be a good idea. We think that some of the ways in which the Federal Trade Commission might be reorganized and revitalized to better serve society should await such management survey, perhaps by the Bureau of the Budget, and I will not make further reference to the material contained therein.

I refer you, sir, to those pages. With regard to the subject of class actions, we approach this subject thinking of the evil sought to be dealt with, on the one hand, and the necessary conditions of the tools applied on the other.

The chamber of commerce represents not just the huge corporate giants in this country. It also represents thousands of small businessmen and women. We have a responsibility to those thousands of small businessmen and women to respectfully request that the committee consider the crushing impact on legitimate business that the class-action legislation represents.

We strongly reject any proposal authorizing consumer class actions since the class-action concept is misdirected and does not meet the overriding need of establishing a workable method to prevent frauds and deceptions.

At best, class actions are only remedial to the consumer. At worst, they are a deceptive promise of prevention which the consumer is unlikely to see fulfilled. This is especially true of the low-income consumer who is the typical prey of unscrupulous operators, particularly in inner city areas.

We think it would be a mistake for the Congress to, in effect, arouse expectations that have very little promise of being fulfilled. The Congress would not want to hold out what, in effect, might be considered a false promise of security.

Many of these fly-by-night operators, if I may refer to them as such, and I here speak of those men and women who do exist in society that perpetrate what we have come to call hard-core fraud—many of these operators conduct their activities from no fixed address.

It is difficult enough to locate them for purposes of prosecution of any kind. To get them to hold still long enough to be sued, whether individually or by class, is a wholly unrealistic wish.

Even those who operate fraudulently from a store or other fixed address are unlikely to have sufficient resources to make them attractive targets for consumer litigation—or, if they do have such resources, to show them on their books.

Thus, there is no real likelihood that class actions would ever be an effective weapon against those who freely and typically utilize fraudulent and deceptive practices to mulct the ignorant, the poor, and the unwary. To pretend otherwise is to add still another cruelly deceptive promise to those which the Kerner Commission found fan the flames of frustration and ferment in the urban ghetto.

Furthermore, the class action mechanism will not provide consumers of any income level with as easy and expeditious a means of redress as proponents of the legislation suggest. On the contrary, the steps involved in such litigation are likely to be extensive and protracted. In typical class actions, a great deal of time is expended assembling the class * * * assuring that the class is acceptable to the courts * * * notifying all class members * * * going through extensive pretrial hearings and conferences * * * conducting the actual trial * * * and then—and only then—beginning a process of assessing actual damages which may well consume as much time as the factfinding process itself.

Complications arising at any stage in these proceedings can easily drag them out still further. In a Illinois case—and I have citations—4 years passed before a question was resolved involving the size of the class qualified to sue.

In another class action case, assessment of the amount of damages consumed 3 years following the trial on the merits of the case.

If these problems are found in class actions where the membership of the class is reasonably clear (as in stockholder suits) and the extent of damage can be fairly easily shown, how much more complicated would consumer class actions be where the membership of the class and the amount of damages will often at best be speculative?

Moreover, existing court backlogs in many districts and circuits are sufficiently heavy now that the large volume of litigation which this legislation would tempt into court could well seriously hamper the judicial process. According to Justice Department data, the average civil case must now wait a year and a half before even coming to trial—and in at least one district the wait is over 6 years.

I refer to the southern district of California. How much worse will the situation be if the Federal courts are saddled as well with consumer class litigation? And to these lengths of time must be added the years required to try the case on its merits and then determine the amount of damages.

The legal maxim that justice delayed is justice denied is likely to bear particularly bitter fruit for the consumer who has been lured into believing that class actions will protect him from fradulent and deceptive acts or practices.

The Supreme Court itself has cited Federal court congestion as a reason for barring a class action. I refer to this more in my prepared remarks. I would also cite the committee to the activities of the Federal Bench—and I mean the judges.

In a recent bulletin by the board of editors for the Manual for Complex and Multidistrict Litigation, which is of course an arm of the Federal Judicial Center, abuses, potential abuses, of the class action have occupied considerable attention of our Federal judges, and this is not something that can lightly be put aside.

Additionally, we must not discount the possibility that class action legislation might result in stirring up major litigation which would not necessarily be effective in eliminating frauds and deceptions. There is some analogy to what has happened under the Truth-in-Lending Act.

There are at least 10 cases pending in the Federal courts today that I am aware of, and one, I think, with all candor, must carefully examine the kinds of claims being brought and compare the social benefit that this vehicle might provide in the elimination of the hard-core frauds.

I am suggesting that the net gain to society would be so small as not to justify the burdens that it would entail. I would like to address a few more remarks, with the committtee's indulgence, to the effect of class actions on small business.

Class actions constitute a grave economic hazard to business—and the magnitude of the threat is likely to be in inverse relationship to the size of the business involved. Indeed, the effects on small businesses would be particularly catastrophic if not actually fatal.

For one thing, legal costs alone of defending against class actions will impact disproportionately on small enterprises which rarely have the resources to employ the staff counsel uniformly found among larger companies.

Candor again requires that we consider that the temptation of vast damages and hence huge fees is likely to make suits against the larger corporations highly attractive. However, the small businessman is especially susceptible to potentially severe sales losses resulting from bad local publicity attendant on the mere filing of a consumer class action. This knowledge may make legitimate small enterprises alluring targets as well for plaintiffs really seeking fast out-of-court settlements.

Moreover, small businesses frequently lack sufficient current assets to cover the amounts likely to be claimed in class actions and local competitive situations may preclude recovery through price increases of the costs of legal defense and damage payments. Bankruptcy is the only alternative available to the small merchant caught in this vise.

If it is indelicate on my part to make reference to such emonomic facts of life, I apologize. Ironically, the fly-by-night operators at whom class action legislation is ostensibly aimed are virtually immune from the threats posed to legitimate businesses. Having no resources to guard—or at least none that are allowed to be visible—and no especial reputation or good will to protect, the fringe operator has so little to lose from a consumer class suit that there is no particular incentive to sue him.

I respectfully suggest, as Professor Handler has indicated, the deterrent effect of the criminal law, and how effective is that deterrent effect, is also something to be analogized to what would the actual deterrent effect of the consumer class action legislation be against those perpetrators of hard-core fraud.

The truly attractive targets would be the overwhelming majority of businesses which are honest, ethical, and legitimate—large companies because of their assets, and small merchants because of their vulnerability.

Furthermore, class action claims can be so vast that accounting firms are already experiencing serious uncertainties in evaluating the potential liabilities of defendant companies, which, of course, throws into question business credit and values of securities on which business credit is based.

Before concluding the chamber's presentation, I would like to depart from my prepared remarks very briefly to again highlight our position that honesty in business dealings is the major rubric of our position. Honesty as distinct from strict legality in all transactions.

Businessmen and consumers have an obligation to behave ethically and honestly in the marketplace, and the chamber would support appropriate Federal, State, and local measures and activities to protect both consumers and ethical business from fraudulent practices. Other witnesses before this committee have urged attention to be directed to other types of redress.

Many of these hardcore fraud practices are localized in nature. Small claims courts in municipal and State forums are something that must be looked at. Indeed, although the chamber has no position on this particular device, I am sure the committee is aware of the statutes that exist in the State of New York with regard to the whole subject of custodial relief, and this concept is not present today in the bills that we have asked to express an opinion about.

The chamber believes that in all candor this kind of thing must receive further attention and study, and it would be delighted to engage in such attention and study.

Essentially, it is our belief that consumer class actions provide a deceptively, ineffective remedy for consumers, especially low income urban consumers, threaten the caseloads of the Federal courts, and present an excessive economic threat to business, especially small business.

Worst of all, class actions would not even achieve the aim of ridding the marketplace of frauds and deceptions. That is the real need, and we respectfully suggest that is where Congress should direct the focus of its attention. The optimum answer to the problem of preventing frauds and deceptions before they take place is not class actions.

Rather it is the revitalization and reorganization of the Federal Trade Commission to make it the efficient and effective instrument of consumer protection it should be, arming it with extension of its jurisdiction to matters "affecting" commerce, with safeguarded power to seek preliminary injunctions, and with adequate funding.

The National Chamber of Commerce thanks the subcommittee and its chairman and counsel for the opportunity to appear.

(The prepared statement follows:)

STATEMENT BY WILLIAM B. NORRIS

The National Chamber is grateful for this opportunity to present its views on the several bills on consumer remedies being considered by this subcommittee.

As the world's largest association of business enterprises and organizations, our interest is the welfare not only of the millions of American businessmen and women but also of 203 million consumers whose protection and economic well-being are critical to the interests of our members.

It is our firm belief that the consumer has a right to honesty and integrity in the marketplace—in the major transactions as well as in the smallest day-to-day purchase. Those who defile the integrity of the marketplace with fraudulent or deceptive acts or practices do injury not only to consumers but also to those ethical and legitimate businessmen who constitute the overwhelming majority of all business.

It is because we believe so strongly in what President Nixon has termed the natural alliance between business and consumers, that the National Chamber last month adopted a ten-point Business-Consumer Relations Code. In addition to the four traditionally stated consumer rights to safety, to be heard, to choose, and to be informed, the Chamber statement suggests that consumers have a fifth right: the right to quality and integrity in the marketplace.

To advance further those five rights, the Chamber code sets forth ten points which all business enterprises are urged to put into effect in their day-to-day dealings with the consuming public. The text of the Business-Consumer Relations Code, along with the President's response to it, is appended to this statement.

We would draw your particular attention to point six which not only calls for the elimination of frauds and deceptions but also set forth the goal of honesty, rather than strict legality, in all marketplace transactions. We believe in that goal. We are urging our members to put it into effect. And we are pleased today to support desirable governmental measures to bring the attainment of that goal closer to reality.

As we consider proposed legislation we note that there is no possibility that by law alone we can make our system for the production and distfibution of goods and services 100 percent perfect. Our system is administered by human beings and is subject to human frailties. Any laws enacted will therefore be subject to imperfections in application. We favor balanced judgment in determining the extent to which further legislation should be enacted.

We urge this Congress to enact legislation which will assure that potential consumer injuries arising out of frauds and deceptions are stopped before they can occur. This, we believe, is the single overriding need in the whole field of consumer remedy. We urge, too, that Congress not be distracted from this need by proposals which promise more than they can deliver and which at best only lock the barn door after the horse has disappeared into the night.

If consumer injury is to be prevented before it takes place, the agency most likely to be successful in that effort is the Federal Trade Commission. No other Federal agency contains the FTC's experience and expertise in dealing with fraud and deception. In recent years, it is true, the commission has come in for heavy criticism from such disparate groups as the American Bar Association and the so-called "Nader's Raiders." Other critics have added their voices to the cry for extensive FTC reform.

But we disagree with those who believe that the FTC has outlived its usefulness as an instrument of consumer protection. Despite its many defects, the Federal Trade Commission is still the logical focus of Federal consumer protection activities. But extensive steps must be taken to make the commission the effective force Congress intended it to be when it passed the Wheeler-Lea Act in 1938.

FTC AUTHORITY

Two of these steps are contained in measures now before this subcommittee. One of these is the Administration's proposal to extend the FTC's authority to matters which "affect" interstate commerce. We strongly support that necessary reform to enable the commission to reach those who would defraud the public no matter where they are.

The second necessary step, if the commission is to be enabled to prevent consumer injury, is to give it authority to seek preliminary injunctions against alleged violations, injurious to consumers, of Section 5 of the FTC Act—also a proposal of the Administration. Deceptive Sales legislation, which we have supported in past Congresses and which we support today, provides the means to stop frauds and deceptions *before*—not merely after—the fact.

Because the extension of FTC authority has wide support today there is some

inclination on the part of a few to derogate its importance. The significance of this power should not be minimized, however. With authority to seek injunctive protection, hard-core frauds can be stopped in their tracks, especially in light of the potentially severe penalties which exist for violation of court injunctions. Consumers would no longer have to wait the long periods of time required before cease-and-desist orders can be issued to receive necessary protection from the unscrupulous.

The very sharpness of the preliminary injunction as a consumer protection weapon requires, however, a suitable scabbard to prevent its injuring the honest, legitimate businessman. We propose three specific protections:

First, *temporary restraining orders should not be authorized* because they can be issued without notice and hence without providing a full and fair opportunity for defense. This is an exceptionally severe and drastic remedy and is typically granted in civil cases only when serious and irreparable injury would occur without the restraining order and only when there is a high probability that the party seeking the order will prove successful in his pursuit of the case.

Second, *the preliminary injunction should not be granted automatically.* The courts should be specifically authorized to use traditional equity discretion in passing on FTC requests for preliminary injunctions. This is a necessity to assure fairness to the accused businessman as well as to the consumers for whose protection the injunction is sought.

Third, *the commission should be required to issue administrative complaints against the alleged violator contemporaneously with or prior to the filing of a petition for injunction.* This would assure that the FTC actually investigates an alleged violation of the laws it administers *before* an injunction can be issued. This would not require an investigation of extended duration and in cases of patent fraud a complaint could be speedily issued. It would, however, afford the basic protection of requiring the commission to show the court some documented reason for requesting an injunction.

These protections are similar to those contained in the Deceptive Sales legislation passed by the Senate in the 90th Congress.

FTC REVITALIZATION

Clearly, for these two measures—extension of FTC jurisdiction to matters which affect interstate commerce and authority for the commission to seek preliminary injunctions—to be effective, still a third reform will be required: the reform of the Federal Trade Commission itself. There is a clear need for a fundamental reorganization of the commission to enable it to function with maximum efficiency, effectiveness, and attention to the legitimate needs of consumers and ethical businessmen.

Probably a comprehensive professional management study of the commission's structure and procedures is required before it is possible to speak definitely and with precision about the ways in which the commission should be reorganized and revitalized. The study which the President has requested the Bureau of the Budget to make of the commission may provide the necessary analysis.

Undoubtedly, some of the needed reforms can be made internally and administratively, and in this respect some of the recent statements of Chairman Weinberger are most reassuring.

Still others are likely to require legislation and this may well include the most basic types of reforms. Certainly, no business enterprise could begin to function effectively with five heads, and we suggest that serious consideration be given to such alternatives as legislatively vesting the commission chairman with executive authority to direct the affairs and staff of the commission while reserving to the five commissioners policy-making rather than administrative authority. We do not submit this as a formal recommendation since that would be premature pending completion of a management study, but we do believe it should be seriously considered among other available options.

Still other badly needed changes will be of a subtler, though no less critical, nature. For instance, Chairman Weinberger has spoken of a morale and personnel problem and this can be resolved only with delicacy and tact. Most assuredly, however, the knowledge that Congress is dedicated to strengthening the commission, to giving it the tools to do the job, and not to subtly undermining its very existence by establishing new units to perform its traditional functions will go a long way toward revitalizing the morale and sense of purpose of the commission staff.

One of the tools which the commission patently requires is funding necessary for the full enforcement of the many laws which Congress has entrusted to the FTC over the years. During the fiscal year which ended last June 30, appropriations for the FTC amounted to less than $17 million. Appropriations for the current fiscal year total $19.5 million. The President's Budget requests $21 million for fiscal year 1971. These sums finance antimonopoly regulatory activities only a portion of which relate to consumer protection, as well as the more directly relevant functions of regulation of deceptive practices and enforcement of the truth-in-lending statute.

We appreciate that this subcommittee is not the proper body before which to discuss appropriations for the Federal Trade Commission and in any event a precise determination of what the commission actually requires to carry out all its responsibilities efficiently and effectively should await the aforementioned management survey. Nonetheless, the National Chamber wishes to go on record in support of the principle of adequate funding for the commission's consumer protection activities.

We believe the program we have outlined will go a long way toward effective consumer protection. A revitalized and reorganized Federal Trade Commission, appropriately empowered and funded, will be enabled to enforce more effectively the laws now on the books and thus to prevent the consumer frauds and deceptions sought to be remedied by consumer class action legislation.

CLASS ACTIONS

We must strongly reject any proposal authorizing consumer class actions. The class action concept is misdirected and does not meet the overriding need of establishing a workable method to *prevent* frauds and deceptions. At best, class actions are only remedial to the consumer. At worst, they are a deceptive promise of prevention which the consumer is unlikely to see fulfilled. This is especially true of the low-income consumer who is the typical prey of unscrupulous operators, particularly in inner-city areas.

Many of these operators conduct their activities from no fixed address. It is difficult enough to locate them for purposes of prosecution. To get them to hold still long enough to be sued, whether individually or by class, is a wholly unrealistic wish. Even those who operate fraudulently from a store or other fixed address are unlikely to have sufficient resources to make them attractive targets for consumer litigation—or, if they do have such resources, to show them on their books.

Thus, there is no real likelihood that class actions would ever be an effective weapon against those who freely and typically utilize fraudulent and deceptive practices to mulct the ignorant, the poor, and the unwary. To pretend otherwise is to add still another cruelly deceptive promise to those which the Kerner Commission found fan the flames of frustration and ferment in the urban ghetto.

Furthermore, the class action mechanism will not provide consumers of *any* income level with as easy and expeditious a means of redress as proponents of the legislation suggest. On the contrary, the steps involved in such litigation are likely to be extensive and protracted. In typical class actions, a great deal of time is expended assembling the class . . . assuring that the class is acceptable to the courts . . . notifying all class members . . . going through extensive pretrial hearings and conferences . . . conducting the actual trial . . . and then—and only then—beginning a process of assessing actual damages which may well consume as much time as the fact-finding process itself.

Complications arising at any stage in these proceedings can easily drag them out still further. In an Illinois case, four years passed before a question was resolved involving the size of the class qualified to sue. In another class action case, assessment of the amount of damages consumed three years following the trial of the merits of the case.

If these problems are found in class actions where the membership of the class is reasonably clear (as in stockholder suits) and the extent of damage can be fairly easily shown, how much more complicated would consumer class actions be where the membership of a class and the amount of damages will often at best be speculative?

Moreover, existing court backlogs in many districts and circuits are sufficiently heavy now that the large volume of litigation which this legislation would tempt into court could well seriously hamper the judicial process. According

to Justice Department data, the average civil case must now wait a year and a half before even coming to trial—and in at least one district the wait is over six years! How much worse will the situation be if the Federal courts are saddled as well with consumer class litigation? And to these lengths of time must be added the years required to try the case on its merits and then determine the amount of damages.

The legal maxim that justice delayed is justice denied is likely to bear particularly bitter fruit for the consumer who has been lured into believing that class actions will protect him from fraudulent and deceptive acts or practices.

The Supreme Court itself has cited Federal court congestion as a reason for barring a class action—and what body is in a better position to assess the impact of class actions on existing case loads? No one would responsibly suggest that the Federal judiciary be converted into a small claims court system, yet that is likely to be a principal consequence of class action legislation.

Additionally, we must not discount the possibility that class action legislation might result in stirring up major litigation which would not necessarily be effective in eliminating frauds and deceptions.

Under the recently passed Truth-in-Lending Act this "stirring up" process has already begun. Already a number of law suits have been filed by individual credit card holders claiming little in damages for themselves, but claiming massive damages on behalf of all other credit card holders.

In a single Federal district, eight class actions have already been filed under Truth-in-Lending, and members of the law firms involved are themselves among the plaintiffs in several of these cases.

EFFECT ON SMALL BUSINESS

Class actions constiute a grave economic hazard to business—and the magnitude of the threat is likely to be in inverse relationship to the size of the business. Indeed, the effects on small businesses would be particularly catastrophic if not actually fatal.

For one thing, legal costs alone of defending against class actions will impact disproportionately on small enterprises which rarely have the resources to employ the staff counsel uniformly found among larger companies.

The temptation of vast damages and hence huge fees is likely to make suits against the large corporations highly attractive. However, the small businessman is especially susceptible to potentially severe sales losses resulting from bad local publicity attendant on the mere filing of a consumer class action. This knowledge may make legitimate small enterprises alluring targets for plaintiffs really seeking fast out-of-court settlements.

Moreover, small businesses frequently lack sufficient current assets to cover the amounts likely to be claimed in class actions and local competitive situations may preclude recovery through price increases of the costs of legal defense and damage payments. Bankruptcy is the only alternative available to the small merchant caught in this vise.

Ironically, the fly-by-night operators at whom class action legislation is ostensibly aimed are virtually immune from the threats posed to legitimate businesses. Having no resources to guard—or at least none that are allowed to be visible—are no especial reputation or good will to protect, the fringe operator has so little to lose from a consumer class suit that there is no particular incentive to sue him.

The truly attractive targets would be the overwhelming majority of businesses which are honest, ethical, and legitimate—large companies because of their assets and small merchants because of their vulnerability.

Furthermore, class action claims can be so vast that accounting firms are already experiencing serious uncertainties in evaluating the potential liabilities of defendent companies. It is on these accounting statements that business credit and the value of securities are based.

CONCLUSION

In sum, it is our belief that consumer class actions provide a deceptively ineffective remedy for consumers, especially low-income urban consumers . . . threaten the caseloads of Federal courts . . . and present an excessive economic threat to business, especially small business.

Worst of all, class actions would not even achieve the aim of ridding the marketplace of frauds and deceptions. That is the real need, and we respectfully suggest that is where Congress should direct the focus of its attention. The optimum answer to the problem of preventing frauds and deceptions before they take place is *not* class actions. Rather it is the revitalization and reorganization of the Federal Trade Commission to make it the efficient and effective instrument of consumer protection it should be, arming it with extension of its jurisdiction to matters "affecting" commerce, with safeguarded power to seek preliminary injunctions, and with adequate funding.

CHAMBER OF COMMERCE OF THE
UNITED STATES OF AMERICA,
Washington, D.C., February 27, 1970.

The PRESIDENT of the United States,
The White House,
Washington, D.C.

DEAR MR. PRESIDENT: In response to your letter of January 6 in which you commented on the Business-Consumer Relations Program of the Chamber of Commerce of the United States, we take pleasure in announcing a new initiative in behalf of consumers—an initiative which will contribute to enhancing the quality of American life which we know you are dedicated to achieving.

The Chamber has been stimulated by your letter and by your Consumer Message to Congress. We agree wholeheartedly that businessmen and consumers are natural allies, each vitally dependent on the other. Like you, we are committed to advancing the four basic rights of consumers: The Right to Safety . . . to be Heard . . . to Choose . . . and to be Informed.

We reaffirm our commitment to expand business' positive response to the consumer movement and to the problems to which it has given voice. Historically, the greatest business rewards have gone to those who have been unsparing in their efforts to please the customer. Likewise, the National Chamber intends to spread this message throughout the business community.

We especially share your desire to enhance the quality of life and the environment, including the maintenance of a marketplace that is fair and just to the consuming public as well as to business. In this spirit, we propose to add a fifth consumer right: The Right to Quality and Integrity in the Marketplace.

In furtherance of these five rights, the Board of Directors of the Chamber has voted to pledge the resources of the Chamber's nationwide Federation toward achieving the widest recognition and voluntary implementation of the following code of business-consumer relations. We reaffirm the responsibility of American business to:

1. Protect the health and safety of consumers in the design and manufacture of products and the provision of consumer services. This includes action against harmful side effects on the quality of life and the environment arising from technological progress.
2. Utilize advancing technology to produce goods that meet high standards of quality at the lowest reasonable price.
3. Seek out the informed views of consumers and other groups to help assure customer satisfaction from the earliest stages of product planning.
4. Simplify, clarify, and honor product warranties and guarantees.
5. Maximize the quality of product servicing and repairs and encourage their pricing.
6. Eliminate fraud and deceptions from the marketplace, setting as our goal not strict legality but honesty in all transactions.
7. Ensure that sales personnel are familiar with product capabilities and limitations and that they fully respond to consumer needs for such information.
8. Provide consumers with objective information about products, services, and the workings of the marketplace by utilizing appropriate channels of communication, including programs of consumer education.
9. Facilitate sound value comparisons across the widest possible range and choice of products.
10. Provide effective channels for receiving and acting on consumer complaints and suggestions, utilizing the resources of associations, chambers of commerce, better business bureaus, recognized consumer groups, individual companies, and other appropriate bodies.

This 10-point code has been drawn up in full recognition that in a free society, there is no right without a corollary responsibility. All parties involved in the design, manufacture, distribution, servicing and use of consumer goods and services have both rights and responsibilities—and all must work together toward common goals if we are to share in an improving economic system's expanding benefits. As one of the participants in this partnership of progress—along with consumers and government—business pledges its best efforts toward this end.

We pledge that we will urge the nationwide membership of the National Chamber to adopt and adhere to these principles by:

Stimulating the widest possible development of Business-Consumer Relations Program among 2,700 local chambers of commerce and 1,100 trade and professional associations to adapt this code to their own industries.

Motivating our 37,000 business members to put these principles into effect in the day-to-day operations of their own enterprises.

In concert, these organizations can mobilize the vast energies of 5,000,000 businessmen and women in a comprehensive voluntary program to advance the rights of America's consumers and to achieve customer satisfaction in the fullest sense and the fullest measure.

Cordially,

ARCH N. BOOTH,
Executive Vice President.

THE WHITE HOUSE,
Washington, D.C., March 5, 1970.

Mr. ARCH N. BOOTH,
Executive Vice President,
U.S. Chamber of Commerce,
Washington, D.C.

DEAR ARCH: The ten-point program of the Chamber of Commerce of the United States represents an exceptionally forthright recognition of the business community's responsibility toward the legitimate needs of the buying public. Quality and integrity in the marketplace, like the air we breathe and the many freedoms our country has for so long enjoyed, are goals we now recognize as distinct aspects of the American heritage. There preservation is vitally important to every one of our fellow countrymen.

The initiative of the American business community in establishing this program for its members is deeply heartening. Now and in the years to come, the interests of the consumer will be vastly better served if manufacturers and retailers are prepared to discharge the full measure of their obligation freely and willingly than if they hesitate until they are compelled to act. Even the Federal Government's efforts to ensure fairness between buyer and seller can only be effective with the cooperation and ready support of individual businessmen.

It is a particular pleasure to send my congratulations to the Chamber on its farsighted understanding and its encouragement for the high ethical standards which benefit all members of our society alike and well.

With best wishes,

Sincerely,

RICHARD NIXON.

Senator MOSS. Thank you, Mr. Norris. I must apologize for being absent during a good part of your testimony. Senators like government correspondents, ought to come in duplicate or triplicate copies so that a person could be in all the places he is expected to be all the time.

I do appreciate your fine presentation. From what I heard, I am sure it was excellent. I haven't had time to read it in full, but I will do so. I might suggest that because I didn't hear it orally that I may ask you if you would respond to some written questions if I sent them down as I read the testimony and questions occur to me.

Mr. NORRIS. I am sure the chamber would have no objection and indeed would be delighted to do so, Mr. Chairman.

Senator Moss. I appreciate that very much. It is my fault that I was away and that I got myself involved in more than I could cover this morning, but I would like to do that. I would like to thank you and thank the chamber for its contribution to this record. I know that our concerns are the same. We are trying to find the maximum degree of protection for the consumer from frauds and deceptions and practices that exist in some places in the market, and in endeavoring to do that, we certainly want to take the right path. We don't want to do anything that is futile or that brings on additional problems that are not manageable.

So, this is the reason we are hearing rather extensive testimony on this class action matter which is a new field and is giving us quite a bit of concern.

Thank you very much, Mr. Norris.

Mr. NORRIS. Thank you.

Senator Moss. Our next witness is Mr. Harold Kohn, Attorney from Philadelphia.

We appreciate your appearance here, Mr. Kohn, and look forward to hearing your testimony.

STATEMENT OF HAROLD E. KOHN, ATTORNEY, PHILADELPHIA, PA.

Mr. KOHN. It is a pleasure to be here, Senator.

I am here, as you know, on rather short notice. I have no prepared statement. I will furnish one if it is deemed appropriate after I do say what I have to say today.

I understand that you are not concerned primarily with my observations on whether or not the consumers need protection or whether there are evils which need to be redressed, that I am here largely to testify to the class action procedural techniques. With that in mind, I will.

As you know, there are now provisions in the Federal Rules of Civil Procedure, rule 23, a rule which has been in effect for about 3 or 4 years now, whereby class suits can be brought in the Federal courts. I suppose I have been in as many of these as any lawyer in the country. Most of those in which I have participated have been in the antitrust field, representing primarily plaintiffs.

I have also been in a number in which we represented stockholders in connection with cases under the Securities Act and otherwise.

We have also been in a number in the civil liberties problems which have arisen under the Constitution and otherwise. So, I think we do have broad experience.

I am a practicing lawyer, as I indicated. I am happy to say we have a rather successful corporate practice as well, so I think I can approach the problem with a certain degree of objectivity and balance, and balanced experience.

I don't think that there are any untoward or insurmountable problems in connection with using the class suit procedure in consumers' cases any more than there are in any other cases. I think a large part of the concern is without any foundation in probable fact.

I always hesitate to take with little more than a smile the concern of people, who have certainly not been in the forefront of consumer pro-

tection, and statements by them in which they are concerned about the fact that a certain procedure may be ineffective in helping the consumer.

I think you ought to let the consumer's representatives be more the judge as to whether what we are going to do is going to be effective.

The class suit procedure is a very, very flexible procedure, and I think the U.S. district courts have shown a great deal of ability to exercise appropriate discretion depending upon the particular case before them. Sometimes the class is very broad, sometimes the class is narrow.

In the antibiotics case, in which I represented a number of claimants, both private and public, there were a number of classes, including one which really consists of all the purchasers and consumers of antibiotic drugs in the United States divided in sub-State classes. Notice went out there. There was no particular difficulty of administration whatsoever, and I can't conceive of a broader class than everybody in the United States.

I am presently involved in a gasoline price-fixing case involving price fixing in the three States of New Jersey, Pennsylvania, and Delaware. The class has not yet been shaped up by the court, but able defense counsel feel that they are sufficiently familiar with what is likely to happen and with the workability of the class suit procedures that one of them—they are represented by very distinguished counsel as I have said in New York, Chicago, and New Jersey—has already entered into a settlement agreement which assumes that a class will be formed of the purchasers of gasoline in those three States. There you have certainly 15 or 20 million people, at least a population of 15 to 20 million, of whom several million—too many when you ride the roads I guess—are buying gasoline.

As I say, the class suit device is used there where you have as broad a class as you can.

You are probably familiar with the recent class suit case brought by convicts, prisoners in the State of Arkansas and I think in another more Southern State. In Arkansas I think the convicts brought successfully a case to stop—there apparently was rather savage brutality going on in the prison camps. In the South the prisoners successfully brought a case to integrate prisons. You have the two extremes.

Recently, we brought a case which probably is of less importance than any of the others but shows what can be done, and I want to comment on this a little more fully in just a moment, a case on behalf of all the purchasers of season tickets for the Philadelphia Eagles professional football team who were required if they wanted a season ticket during the regular season to buy tickets to two exhibition games. I am reasonably confident that the outcome of that case will be quick and the result will be remedial.

I came in a little late. I did happen to catch the last witness' reference to the fact that you can't use the class suit as a preventive device; it is only remedial after the fact. I would say that is not entirely correct. As a matter of fact, rule 23 specifically contemplates, and one of the grounds of jurisdiction, is that the parties are all being subjected to the same sort of condition which can be remedied by injunctive procedures.

So, I would not be overly concerned about that.

I think, as you, yourself, have indicated, that in this type of matter you have to move ahead on all fronts. I think you have to activate and encourage the Federal administrative agencies. Goodness knows, somebody ought to arouse the State regulatory agencies from the lethargy into which they seem to have fallen. When I was a boy it was contemplated the public utility commissions in the various States and instrumentalities of that kind would look out for the consumers in transportation, in the utilities and other fields, and I think the job has been lamentable.

I think that by and large the class suit procedure, offering as it does the right to get into court immediately, the right to require that there be a focus upon the case immediately by somebody who has the power to make a decision and must make a decision, by holding out to the parties and counsel and by holding against the defendant what is certainly a very significant motivating factor in the United States, namely, money, which we either get or have to pay, will go very far toward remedying a good many of the abuses which either can't wait for legislative treatment or if given legislative treatment still require implementation of that legislative treatment.

I think I ought to give you a few caveats with regard to some of this. I think you have to be sure that when your legislation is passed it is in such form that if you want the Federal courts to exercise jurisdiction it is within the jurisdictional powers of the Federal courts.

Chapter 28 of the United States Code beginning as section 1331 and continuing thereafter for a number of sections outlines the jurisdiction of the Federal courts. In some instances you have to have a controversy in which there is involved $10,000 or more. In others you don't need the $10,000 jurisdictional requirement.

There is an intermediate provision which permits jurisdiction when the amount in controversy is $500.

I suppose this is not your problem. Some day somebody ought to sit down and bring those jurisdictional requirements into the 20th century by an appropriate code or an appropriate set of rules which covers all of them.

What I would stress is that you ought to be sure—I assume perhaps you will—that if you give Federal jurisdiction that you have done it properly, either by including in your bill a jurisdictional provision or by tailoring your bill to fit into one of the existing jurisdictional provisions.

I think also it would be appropriate to give or at least consider giving, and I would recommend giving, concurrent jurisdiction to the Federal and local courts. There are many situations where you are better off and it is more convenient to litigate in the local courts, and many of the State procedural codes do contain class provisions, perhaps not as broad as the Federal Rules of Civil Procedure, but generally workable. You mustn't forget there are many people who are far removed from Federal courts, which don't sit everywhere as conveniently as they do for us along the eastern seaboard where they are within ready reach of most practicing attorneys.

I think also that some consideration might be given to some kinds of limited jurisdiction, either by something comparable to Federal referees in bankruptcy or Federal commissioners or magistrates, be-

cause it is true that the Federal courts do have a tremendous burden of work. They are handling now a lot of accident and other cases that they shouldn't be handling because of the accident of diversity of citizenship which is probably outmoded in many situations today.

I think those judges do need a certain amount of consideration, because they do hear many cases which involve grave matters of public principle which you just cannot process along in rote the way you do automobile cases or the way you do other kinds of similar cases.

I think you should be sure you do not swamp them, and I don't think you want to create a climate of opinion in the Federal courts that is adverse to this kind of legislation because of the very real problem the judges can only do so much work, and there are only so many Federal judges and we are not likely to get a substantial increase in their numbers in the future.

I do not think you need specialized courts for consumer cases. I think the courts have shown great aptitude and ability in handling matters of all kinds.

One thing you have to be careful of, the Federal courts have held in class suits you cannot aggregate or add up all the amounts that the individual claimants have in order to satisfy the $10,000 jurisdictional requirement where there is such a requirement. In the antitrust cases you never have that problem since there is jurisdiction to handle all antitrust cases, regardless of the amount in controvery. Of course, most do involve more than that amount of money. But if you had a case which was not under a Federal statute which granted independent jurisdiction, then, if you would have a thousand $100 claims, even though the total amount is $100,000, you couldn't get into the Federal courts.

So, I think some legislation ought to cover that particular problem.

You will be told or perhaps you have been told the problems of notice are difficult and that sort of thing. They are not that difficult. A variety of procedures have been worked out in cases which I know from personal experience since I have participated in them. In some instances notice is taken care of by advertising. In other instances, notice is taken care of by getting customer lists and similar lists of people involved from the defendants themselves.

We contemplate, for example, in the gasoline case, ultimately notice may be sent out with the then current bill by the defendants themselves.

Some courts have used the government franking privilege to send out notices so that the costs on the particular litigants is kept at a minimum.

I don't know of any other comments that I would be inclined to make. As I said, since I did come on relatively short notice, I don't know fully exactly what it is that the committee would have in mind beyond what I have referred to.

I would be very happy to answer any questions that you have in mind now and give you whatever light I can shed on it.

Senator Moss. Thank you, Mr. Kohn, for your comments. Because of your experience and background with the class suits, which you point out are largely in the antitrust field, but are under rule 23 of

the Federal Code, which is what would be utilized here, we were glad to have your comments.

Fears have been expressed with respect to harrassing or strike suits that might be generated if this sort of right were given to go in on class actions. A lawyer who would simply like to get a lot of clients in a big suit could be stirring around always trying to find some class actions that he might bring.

Mr. KOHN. Do you want me to comment on these as you go along, or do you want me to list them and then comment later?

Senator MOSS. No, I would like for you to comment on them as we go along.

Mr. KOHN. First of all, the class suit, unlike any other litigation, is much more under the control and subject to the courts' discretion and guidance. It won't take long before any lawyer who tries to bring strike suits is hauled up pretty short by the court in this area, whereas he can bring all the other suits that he wants. He could very easily join, if he wants to, 10 ar 20 or 100 people who bring this kind of litigation on their own, or as intervenors. The court doesn't have to, if it feels the matter is not meritorious, does not have to permit him to continue as a class suit representative. The court must determine that he is an appropriate representative. The court has to determine that there are common issues of law and fact. Some courts have indicated although this matter is not one which has been finally determined by appellate courts, that he must make a prima facie showing that he has a good cause of action before they will permit a class to be shaped up, which, of course, you don't have to do in connection with any other litigation.

So, I think actually the class suit procedure is much more subject to court control so far as strike suits and unmeritorious suits are concerned than most other litigation.

And lawyers have other things to do with their time, too. Lawyers don't like to embark on vain and useless litigation if they have any sense and ability. Those who have some ability have a good many other more profitable things to do. Those who don't have ability don't have to scare anybody particularly; and I say now, from 4 years of experience, that there has been no plethora of strike suits, that they have not been abused, and that far from being abused, the class suit device has enabled nationwide settlements which have cut down and saved everybody litigation costs.

For example, in the antibiotic case, can you imagine the chaotic situation we would have if each of those claims had to be litigated separately, or in the copper tubing case where we represented over a thousand—ultimately a thousand plaintiffs who were covered? Or in the plumbing case, which we are covering now? Or in cases like the Eisen case, which is pending in the Second Circuit, where all the small purchasers of securities are endeavoring to have their rights vindicated in one suit?

I say there is nothing to fear in this respect. This may be amusing, and it is wholly coincidental, but it has been our experience in the past several years that every time we file one of these major antitrust suits against a particular industry, the stock goes up. It happened in

the electrical equipment case; it happened in the aluminum cases; it happened in the copper cases; it happened in the drug cases.

Somehow or other, it makes people in the marketplace think this must be good, if they can get away with it for all these years.

Senator Moss. The way the market has been performing, you should be retained to file strike suits across the whole board.

Mr. KOHN. Ours are not strike suits. Ours are class suits.

Senator Moss. It was suggested by one of our witnesses that, maybe, there ought to be sort of a *de minimus* rule on amount. Could this be handled by the courts? It was suggested, perhaps if you had a sale of a can of something on which each person was overcharged 3 cents, or something of that sort, that it might fall under the *de minimus* rule.

Mr. KOHN. We have had something like that experience for a different reason in the antibiotics cases. The amounts there were not de minimis. They were quite large, but the amount that any particular claimant would receive was relatively small.

In other words, you buy this stuff once very 6 months or a year, unless you have a chronic ailment. We worked out a device whereby it was assumed that everyone who did not opt out of the class, and who did not file a claim, assigned his claim to the State or city of which he was an inhabitant, or a resident. And most of the money in that settlement will actually be paid to the States or to the cities, who can then use the money for health or other purposes.

I just don't think because you cheat everybody just a little bit, but cheat millions or tens of millions of people, that you should get away with it. I think the class suit, with the flexibility that the judges have worked out in this device to give the money to the State, eliminates that problem.

In other words, suppose everybody is cheated out of 3 cents, but there are 10 million people cheated. That is a relatively large sum of money and shouldn't be ignored.

On the other hand, if you cheated out of 3 cents perhaps a thousand people, the thing will take care of itself. No lawyer is going to bring a suit of that kind.

So I tend to shy away from that sort of thing. I would let the test of the marketplace, so to speak, determine what is going to happen. That is an amendment which you can put in later on if there appears to be abuse.

I really don't think there is going to be abuse, because people don't like to waste their time.

Senator Moss. At what point does the judge make the ruling on whether a class suit may be brought? Does he make a preliminary order of some kind?

Mr. KOHN. The rule requires the judge to do it as soon as practicable. Some judges in some cases, depending on all the circumstances, do it very early. Others let the matter drift along, because it has been found, for example, that by not shaping up the class too quickly, you allow flexibility for settlement and you can shape the classes then in the light of where the parties, after a year or two of the litigation, feel that settlement ought to go.

The class representative ordinarily conducts the litigation anyway,

whether the notice has gone out or not, and it imposes no real burden. It is just as if the case were being litigated on behalf of one party against another party, or against a group of parties.

I tell you that rule requires no amendment, because the courts with large experience in working with competent counsel have been able to gear the consideration of that problem to the particular matter.

If the case looks really way out in left field, and defendants ask for an early decision, the courts do give real consideration to an early decision. As I indicated before, they may require the plaintiff not only to show that he has an appropriate class, but that he has a prima facie cause of action. And if he can't give him something that looks like it is for real, they will deny them as a class, even if they don't throw the action out completely.

Senator Moss. That was going to be the second part, whether this order includes a finding of a prima facie or probable cause of action.

Mr. KOHN. It doesn't so state in so many words, but, as I have said, some courts have applied that rule, generally where there is some doubt about whether there is such a cause of action—either factually or legally.

The court isn't obliged to do it. If, for example, you get a case in which the Government has obtained nolo pleas in an antitrust case, years ago the defendants used to say you still have to show you've got a prima facie case. They have now stopped using up their time, and the court's time.

On the other hand, if you get a case which looks rather peculiar or dubious, and the parties seem irresponsible, the judge can require a prima facie showing, and in some cases they have.

Senator Moss. Would you leave it flexible?

Mr. KOHN. I would leave it flexible. That rule was drafted after a long series of investigations and conferences with plaintiffs' lawyers, and defendants' lawyers, and judges with experience looking into the matter; and I don't think there is any need for change. And there is a continuing supervision of it by committees of judges. And I would hesitate to suggest any tampering with that rule.

Where I think you have to be careful is to be sure you've got jurisdiction, wherever it is you want jurisdiction. The procedural rule will then follow automatically.

Senator Moss. The courts will work out the procedural rule based on the experience they build up with cases of this sort, once they have jurisdiction?

Mr. KOHN. That's right.

Senator Moss. Some of the opponents of the class action suits raise the question that the suits will be brought for all consumers, and $1 billion damages and large numbers like that, will make it unmanageable. Do you see that as a real problem?

Mr. KOHN. No, it is not unmanageable. Experienced counsel, first of all, shy away from naming any billion dollars amount. You don't have to mention it is a billion dollars before somebody knows it is serious.

On the other hand, many people, actually I think there haven't been many—there have been two or three sort of half-baked cases that

people have brought. I think there was one at the time of the electrical antitrust cases where somebody in Chicago or Detroit brought a case for electrical toasters, or something like that. It died a natural death at an early age.

In the drug cases, which I did allude to, you had every consumer in the United States. That case is not by any means unmanageable. Actually it has been settled for all except a marginal group of people —I suppose marginal is the wrong word—a group of west coast States thought they should get a little more for their people and they haven't joined the settlement. Most of the 50 States and all the hospitals in the country have joined in. You couldn't have a broader group than that.

We have seen classes of varying size. We have had relatively small classes, we have had classes including all the consumers of gasoline in three States. I know from practical experience; this is not Pollyanna; this is not somebody who is sitting in a university someplace figuring out what is going to happen. I'm doing it every day, and I know it is workable.

We don't have a tremendously large number working on this—just 10. Our office has about 40, but 30 are doing something else.

You can make anything unmanageable if you want to, I suppose, but I know from experience that it is easy.

I have told you the various methods whereby notice can be given, and it is no more unmanageable—for example, I have done work, or I represent public utilities. I have also done work representing our city, whereby we represented all of the users of public transit—that sort of thing—millions of people. And there has been no difficulty in the management of that. It is no more difficult in the final analysis when you distribute the money than sending out millions of checks every quarter to the millions of people who own stock in the corporations throughout the United States.

We have gotten way beyond the problem of any difficulty in dealwith large numbers of people.

Senator Moss. I certainly appreciate your coming to testify before us this morning, Mr. Kohn. You, who are right on the firing line in dealing with class actions every day, can certainly give us a background and insight that we need to have.

There are a great many people who are apprehensive about this, and they have raised a lot of questions. This committee needs to examine both sides of the coin to make sure we are not pressing into a field which will bring on difficulties that are not manageable.

Your reassurance that they would be readily manageable under the basic terms of rule 23, with a simple addition of jurisdiction to take consumer-type suits, is reassuring.

Mr. KOHN. I would like to add one more comment before I go.

The pollution case is another one which I ought to mention in which we are involved, where the judges seem to have no concern whatsoever about that. Once again, it is brought on behalf, really, of everybody.

We, yesterday, went into the district court in Philadelphia and obtained an order for the turning over of certain papers which bene-

fits every consumer in the United States, or every person. Isn't it better that you do that in a class suit, rather than have 100 lawyers floundering around all over the country trying to do the same thing? Because many people feel aggrieved, and it is better to have it shaped up in a class.

Actually, there is a Multiple Litigation Panel of judges. If you file 10 class suits, they put them all together and the panel of judges requires that they be litigated in one place, under section 1407 of the Legal Code. There you have the judges themselves feeling there is no problem about merging many class suits involving the same issue.

I think, and as I say, I'm not commenting on the general need for consumer protection, perhaps there are times—there was an editorial in the Wall Street Journal this morning—that the problem can be overmagnified. It is just like violence in the street. Most of us seldom see it. When you get hit by it, it is certainly important.

But I do think there is in the United States today, among the middle-income group—Vice President Agnew's constituency, the silent majority—a feeling that somehow or other their interests are not being protected. The people at the top and the people at the bottom have all kinds of people looking out for them, but the fellow who does pay 3 cents more for the can, the fellow who does get charged a cent more for his gasoline, the fellow who does pay $12 for the prescription that ought to be $2, he has no protection.

The class suit device has turned out to be an admirable device for protecting that kind of person. He's stable, you know where he is. There are records with regard to his purchases. It is relatively easy to send out notices to him. He pays taxes, so that if he doesn't get the money himself but it goes to the Government of which he is a part, his tax burden or the hospital or what have you, in which he is interested, is protected.

I think this would be a tremendous step forward to bring, with the use of this kind of device, the kind of protection to these people that they need, before they really go off their rockers with frustration, when they are met every day with everything that they have to do with some kind of block for which they see no remedy.

Let's keep them peaceful and docile and using the law, rather than using the methods of self-help which I think is so dangerous and which we all deplore.

Senator Moss. Thank you, Mr. Kohn. You have been very helpful.

It won't be necessary for you to prepare a written transcript of your testimony. We have it on the transcript; although I would like to say if questions occur to me in reviewing that, I would hope that I could write to you, and you would respond with anything that I want to have clarified.

Mr. Kohn. If the people drafting the legislation want to give us a buzz on the telephone, or write to us, we would be glad to give you help on that.

Senator Moss. Thank you very much.

(The following letter was subsequently received for inclusion in the record:)

DILWORTH, PAXSON, KALISH, KOHN & LEVY,
Phiadelphia, Pa., April 2, 1970.

Hon. FRANK E. MOSS,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MOSS: When I testified before your committee, Wednesday, March 18, I had not seen your letter, dated January 28, 1970, which I have since read.

I should like to supplement my testimony with the following comments:

I am heartily in accord with your suggestion that court decisions in consumer actions brought by The Department of Justice and Orders of the Federal Trade Commission should be accorded prima facie weight in private consumer class actions against the same defendants. Indeed, I would go even further and apply the now well established decisional principles of collateral estoppel in such cases. This would mean that issues decided in prior government cases, where the defendent had been given an opportunity to defend, would be regarded as conclusively determined in the subsequent private litigation. This rule has been applied with increasing frequency, and I do not see why it should not be applied in this type of litigation. See the following cases:

Hurt v. Stirone, 416 Pa. 493 (1965)

Pennsylvania Turnpike Commission v. U.S. Fidelity and Guaranty Co., 412 Pa. 222 (1963)

United States v. United Air Lines, Inc., 216 F. Supp 709 (E.D. Wash and D. Nev. 1962) aff'd on the issue of collateral estoppel, Sub nom United Airlines, Inc. v. Wiener, 335 F.2d 379,404 (9th Cir.) cert. dismissed, 379 U.S. 951 (1964)

Provident Tradesmens Bank & Trust Co. v. Lumbermens Mutual Cas. Co., 411 F.2d 88 (3rd Cir. 1969)

Graves v. Associated Transport, 344 F.2d 894 (4th Cir. 1965)

When the prima facie rule was first enacted by legislation in the antitrust field, it was regarded as a step forward. But the decisional law in many other fields has now passed it, and the prima facie rule in antitrust cases is actually anachronistic, since it gives lesser affect to prior rulings than does the law generally. If any legislation is to be enacted, it should go at least as far in the efficient administration of justice and the protection of consumers.

Second, I strongly support the proposition that there should be no requirement of prior government action before consumers can go into court. Such a restriction would defeat the very purpose of consumer litigation, by confining the efforts of thousands of lawyers to the few cases which a small division, the Department of Justice can administer. We want, and need, the benefits of this additional manpower unhampered by confining it to the few cases. This does not mean that private counsel should not also file litigation in situations where the government has pioneered. But, they should not be confined to such areas, just as they are not confined by government cases in the private sector of the antitrust field. This is very important, because otherwise the suggested extension of consumer protection will prove to be illusory.

I think you might also be interested in address on class suits, delivered by an associate of mine, Aaron M. Fine, Esquire, at the last meeting of the American Bar Association this past summer. You are at liberty to include with my testimony, this letter and Mr. Fine's class action remarks.

Again, let me express my pleasure at being afforded the opportunity of testifying in support of this necessary and timely legislation.

Very truly yours,

HAROLD E. KOHN.

Senator Moss. Our next witness is Herbert S. Denenberg, who is a professor at the Whorton School of Finance at the University of Pennsylvania.

We are pleased to have you, Professor Denenberg.

STATEMENT OF HERBERT S. DENENBERG, PROFESSOR AT THE WHARTON SCHOOL OF FINANCE AND COMMERCE, UNIVERSITY OF PENNSYLVANIA

Mr. DENENBERG. Mr. Chairman, first of all I would like to congratulate you and your committee on the work on behalf of these three consumer protection bills. I think your work has already made an important contribution to the cause of consumer protection.

Then, I would like to file my statement which relates to the problems of the insurance consumer with the committee and present at this time a summary statement instead.

Senator MOSS. That will be done after your oral testimony.

Mr. DENENBERG. Anyone who tells this committee that the insurance consumer doesn't need a lot more help than he's getting, has got to be kidding.

Anyone who tells you that the problems of the insurance consumer are likely to get better before they get worse has got to be kidding.

Anyone who tells you that problems and abuses are not widespread in the insurance marketplace has got to be kidding.

Anyone who tells you that we can rely on insurance regulation alone to adequately protect the consumer has got to be kidding.

Anyone who tells you that the regulator does not need a lot more help in protecting the consumer, however component, well-meaning and well-financed the regulator happens to be, has got to be kidding.

I think the plight of the consumer is clear, and the insurance consumer, in many ways, is perhaps the most uninformed, confused, vulnerable and put-upon of all consumers. And the consumer class action would be an important contribution to providing the protection the insurance consumer needs, and the help which the regulatory system itself needs.

These views are not necessarily intended to be critical of State insurance regulation, or even of industry performance. They simply attempt to recognize the inherent limitations of regulations and the inevitable abuses that accompany any human activity, including the near universal marketing of a product such as insurance.

Even if I thought that insurance was the most noble of industries and that the insurance regulator was the most noble of all regulators, I would still say what I am saying today.

Let me explain these conclusions in more detail.

First, why are the problems of the insurance consumer especially serious? The answer to this question is almost self-explanatory. Insurance is complex merchandise which the consumer rarely understands. At best, the insurance policy is technical, legalistic, and intangible. More often, it is confounding to the point of being incomprehensible. Even appellate judges are often heard to complain about the "bewildering array of exclusions, definitions and conditions" that they must judicially interpret.

No one seems to be capable of coping with the complexities of the insurance transaction. Blue collar workers, white collar workers, and even the professional elite seem to be equally confused. Investigations of the insurance marketplace, often find sophisticated professional insurance buyers being victimized as well as the man in the

street. The flavor of all this might be summarized by the remark of Senator Dodd to the full-time, professional insurance buyer of the Food Fair chain of grocery stores: "It bothers me that you got stuck three times. It must have bothered you." Replied the professional insurance buyer for all of us: "Oh, yes."

Neither training or position seem to make any difference. During the hearings on insurance before the City Council of the District of Columbia, it was pointed out that even the Mayor of Washington, D.C. had difficulty in maintaining insurance on his building. And some insurance commissioners can relate how the automobile insurance policies of State legislators have been unwittingly canceled, much to the immediate dismay of the legislator, and the ultimate dismay of the insurance company.

I was even told from a reliable source that a U.S. Senator on this subcommittee recently had his insurance policy canceled, so that proves conclusively that even the wisest and most powerful men in the country have trouble with their insurance.

Because of the nature of insurance, there is not only a lack of consumer understanding, but also a failure of other protective forces to emerge. For example, the press—with its newfound propensity for investigative reporting—provides important protection for the consumer against certain kinds of abuses. But the same forbidding technicalities that frighten off the consumer, also seem to have a dampening effect on press coverage.

Other expected sources of countervailing power on behalf of the consumer do not operate with full efficiency in the insurance arena. Unions, for example, have made little contribution to the solution of our serious property and liability insurance problems.

This brings us to the next question: Can the regulator protect the consumer?

Anyone who says State regulation is adequate to protect the public is deliciously naive and possessed of fairy-tale faith. Regulators—State, Federal, or any other kind—simply do not have the time and resources, even if they had the inclination to protect the individual consumer. Those who say stop all abuses before they occur express a grand but unrealistic sentiment.

The insurance regulator is now overwhelmed with a menagerie of basic problems that are almost too much for him. He can have little time for helping individual consumers, when he is attempting frantically to save a whole line of insurance. He may be too busy putting out fires to even handle all widespread abuses. The crises of the insurance industry have become headline stories of late: (1) Ever ascending automobile premiums that threaten the collapse of our personal injury reparation system; (2) A continuing shortage of property insurance in center-city areas; (3) Blue-Cross and health insurance systems caught up in a system of delivering medical care that no longer seems to work. These specific problems all come together with the rise of the conglomerate and holding company in the insurance industry; a flight of capital from the business; a growing shortage of insurance of all kinds; and the entry of the insurance business into the equity business, including mutual funds and variable annuities, as well as many other new businesses.

The regulator finds personnel and resources in short supply. An exhaustive survey of the complaint sections of State insurance departments found that 21 States "feel that they are prevented from handling complaints effectively because they do not have an adequate staff."

That study was made in 1965 and 1966 and I called the professor who made it last night and he told me that he has maintained a continuing interest in this problem, and on the basis of his further studies there has been no improvement in this situation.

So, this 1965–66 study still stands.

A distinguished insurance commissioner has pointed out that some insurance departments are even afraid to hold hearings: "In such a hearing, the highly competent legal and actuarial talent available to the insurer may be able to present a much stronger case than can the insurance department relying, as it must, in low-salaried personnel, and a part-time attorney to present its side of the argument."

Every major study of State regulation to date has produced essentially the same list of major defects that were first cataloged in a classic study almost 50 years ago. This list includes a lack of trained personnel and resources.

Even if the insurance commissioner had the resources and personnel to fully protect the consumer, he may not have the inclination to do so. Like all regulators, he may be industry-oriented rather than consumer oriented. He deals with the industry daily and may soon become more conversant with its problems than with those of the consumer. The insurance commissioner often comes from the ranks of the insurance industry and often intends and does in fact return to insurance employment after completing his service.

In preparing for this testimony, I looked through the 1968 Directory of Insurance Commissioners prepared by the National Association of Independent Insurers.

Alphabetically considered, this directory indicated the commissioner of Alabama was in the insurance business 13 years before his appointment. The commissioner of Alaska was in the insurance business for 15 years prior to his appointment. The insurance commissioner of Arizona was in the business 24 years prior to his appointment. This was an auspicious start and I found about 16 commissioners with insurance industry experience totaling over 132 years. This does not include commissioners with other obvious connections with the industry that were not indicated in the directory, such as legal counsel of insurance interests.

I think you can also see the problem with insurance regulation when you review the state of the regulatory law in this country today.

For example, it is well known that the public has had the advantage of health and life insurance for over 50 years, and yet they have been denied the advantages of group property and liability insurance. We are just getting around to this.

I do cite many similar illustrations which indicate that the State insurance regulator cannot adequately protect the public.

I am not necessarily advocating Federal regulation. My own view is that State regulation may be lousy but Federal regulation might be lousier.

Sometimes the insurance commissioner has the time, resources and inclination to protect the consumer, but often one or more of these essential ingredients are lacking.

This brings us to the next question: Are there serious abuses in the marketplace calling for new and more effective remedies?

Like insurance commissioners, investigators, and students of the business have been so busy studying the passing parade of insurance crises, that they have had little time for many problem areas. But, it is easy to tick off problems to demonstrate the need for greater protection for the consumer.

Phoney mail order insurers are now selling to corporate insurance buyers all over the world. These companies efficiently collect premiums, but don't believe in paying claims. This is a current problem, but with a history that was documented by hearings of the Senate Anti-Trust and Monopoly Subcommittee. It is an interesting example, as it shows that even sophisticated professional insurance buyers can be taken. It is also a perennial problem. In addition, it is a problem posing special difficulty for State regulation due to the national and international scope of the problem.

Another closely related and perennial problem is the mail-order insurer that preys on the health insurance needs of the aged and other consumer groups. Various kinds of deceptions are practiced which are difficult to eliminate, and even when the regulator asserts his jurisdiction, the damages to the consumer, already inflicted, may not be made good. One commissioner told me on March 14, 1970: "I have no firsthand knowledge of how serious the mail-order insurance problem was 5 years ago, but I do know it is still serious today."

Just as the mail-order insurers have preyed on the aged, so marginal insurers have preyed on substandard auto risks. In 1965, the Senate Anti-Trust and Monopoly Subcommittee initiated an investigation of high-risk automobile insurance. The hearing volume of that investigation compiled a great deal of evidence on fradulent insurance company operations and consequent damage to the public. The insolvencies were attributed to "dishonesty practiced by company management, or management failure to act in the best interests of the company and its policyholders."

These insolvencies are still inflicting losses of about $25 million a year on consumers and untold psychological damage on the public that needs and expects certainty and reliability in all of its insurance transactions.

Cash value life insurance rperesents another difficult problem in which the consumer has no idea of the real costs of different kinds of policies.

Credit insurance involves still another grand example of consumer abuse on a grand scale. Here the complications of insurance are stacked on top of the complex calculations and complicated forms that characterize the credit industry.

The credit insurance industry came of age in about 1950. Both its growth and that of accompanying consumer abuses have since been spectacular. An extended investigation of abuses in this industry also by the Senate Anti-Trust and Monopoly Subcommittee in 1967 found every kind of abuse, overcharging, and claims resistance imaginable.

Other kinds of complaints most often submitted to the insurance department are postclaim underwriting; that is, canceling or voiding an insurance policy after a claim instead of initially investigating the applicant; failure to settle small claims; inadequate settlements; unlicensed insurers, delays in settlements, and misrepresentations.

This brings us to the next question: How could the consumer class action help the consumer policyholder?

The marketplace inflicts mass fraud, mass misrepresentation, and mass abuse on the consumer. Fair play requires that the consumer should be able to defend himself by a mass counterattack together with all similarly affected consumers. The class action permits the consumer to do so. For it permits the claims of all consumers victimized by the same company in the same fashion to be asserted together.

This has many noteworthy effects. It makes possible the assertion of individual claims together that would not be practicable to assert alone. Many of the most common insurance abuses involve amounts too small to make individual litigation possible. For example, a high percentage of complaints to insurance departments involve accident and health policies or automobile collision and comprehensive policies in which the amount in dispute is far too small to make litigation worthwhile. In fact, one of the most common sources of complaint is unjustified failure to settle small claims.

The administrative remedy, by assertion of a complaint to the insurance commissioner, is often an inadequate and unreliable remedy for the reasons suggested earlier, in connection with the discussion of the problems of insurance regulators.

Still another happy effect of the class action would be the establishment of a strong consumer bar to effectively represent the consumer interest. General Motors gets good attorneys by paying them. Lawyers, like most other people, noble and ignoble, are where the money is. The consumer is going to have to find ways to pay his legal advisers. One way to do so is through the class action. For the attorneys are paid thereunder, for their "service to the class." It has been said that no one should underestimate the individual attorney representing his client when the "blue chips" are down. The "blue chips" have been down for the consumer for a long time. It is time to see that he gets the representation and remedy he is entitled to.

The class action represents the application of the concepts of free enterprise to further the consumer interest. For it takes some of the current burden off the shoulders of the regulators and turns it over to one of the last great bastions of free enterprise—our attorneys in private practice.

The class action also applies sound notions of competition to the protection of the consumer interest. For it sets up alternative remedies—the class action or the regulatory remedy—in competition to best serve the public interest.

The class action can be viewed as a supplement to the regulatory process as well. The regulator has limited resources and should strive to make his system self-policing. The class action helps him to do so, and enables him to concentrate on resolving basic regulatory issues.

The class action may be slow but no remedy at all is even slower.

The consumer needs help. He wants to be able to help himself. And

he wants an effective source of self-help. The consumer class action is a reasonable answer to a legitimate need of the consumer.

This conclusion can be reached whatever your views are of the performance of the insurance industry or State regulation. Abuses are inevitable, especially in an industry such as insurance, and regulation has inherent limitations which prevent it from adequately protecting the consumer. Realism requires that we provide an effective remedy for the consumer and a realistic supplement to the regulatory process. The consumer class action can provide both of those urgent necessities.

Thank you.

Senator Moss. Thank you very much. That was a most lucid and excellent statement, bringing our attention to problems faced by consumers in this particular area of insurance. We too often concentrate our attention on the practices of the ghetto schemes and fly-by-night operators that sell tangible merchandise, overlooking the importance of a sphere of consumer abuse that is much wider and does include the insurance field. We are glad to have you bring this to our attention.

I wonder if you could give us a couple of examples of specific cases of fraud or deception that will help to focus on the nature of the cases you refer to in your summary?

Mr. Denenberg. One which I mention in my full statement is the phony mail order insurance companies which are now operating in some of our States and even abroad and are selling commercial insurance. These are insurance companies which simply do not have adequate capital resources or they do not want to pay their claims.

In appendix 4 of my statement I have included articles from "Business Insurance" which is one of the publications that has exposed these abuses over the last 15 months. And before making this statement I called the editor of "Business Insurance," incidentally, and he told me that no one has corrected or contradicted anything that he has published in regard to this mail order situation.

I could cite another example. I think another serious problem is the life insurance policyholder who simply cannot figure out how much his life insurance costs because of the complex nature of the transaction. Even the experts are having difficulty figuring out—given a series of policies, given different premiums, given different cash values and dividends—which policy represents the lowest premium.

Many agents do not understand that, and even their experts cannot grapple with the problem. Because of this, I think the consumer is being misled in many ways.

For example, the typical agent says all cash value insurance on the same plan costs the same. This is not true.

Another fundamental example of that is the notion you save money by buying insurance when you are younger. This really is not true. You start out with a lower premium, but the mortality costs are going to be the same, and you are going to have to pay the actual mortality costs each year, simply in a different fashion.

The abuses in credit life and credit health, which I mentioned, are also carefully documented in that four-volume reports of the Senate Antitrust and Monopoly Subcommittee, and there are still, of course,

problems in the automobile insurance area. Congress is now considering some sort of remedy for the automobile insurance problem.

Policyholders are said to be losing $25 million a year, and as the Senate Antitrust and Monopoly Subcommittee found, much of this is due to unsound companies and even fradulent companies.

Finally, I mentioned mail order health insurance which people buy insurance through the mail. The company may not pay the claims. There may be misrepresentation as to the nature of the company.

This has been a problem for many years, and it is still a continuing problem. As I indicated, I talked with the Insurance Commissioner of West Virginia 2 days ago to verify that there has been no change, and he said it is still quite a serious problem.

Senator Moss. We have before us a bill that would pose an insurance fund, that is, like a deposit insurance fund on bank deposits, to indemnify policyholders of insurance companies, casuality companies that became insolvent. What is your opinion about legislation of that sort?

Mr. DENENBERG. Actually, I expressed my views on this in connection with the advisory committee that I am on with the Department of Transportation's automobile study.

Six or seven of us, including several State insurance commissioners, presented the view that the consumer needed protection against insolvency, but it should be given on the State level rather than with the Federal Government moving in. There should be legislation to indirectly require the States to provide this insolvency protection.

For example, the model of the unemployment insurance laws might be a good one where this would be a tax imposed on all premiums unless the States provided such protection.

I might add the States are doing this. I worked on one for the State of Wisconsin which recently became law—Iowa, California and Michigan and several other States which have recently set up solvency funds. I think there is a trend underway.

As I said before, I think State insurance regulation should be preserved. I feel it has its problems, but Federal regulation would probably be worse. So I would advocate indirect methods of forcing the States to provide these urgently needed insolvency funds.

Senator Moss. If half the States did it and half did not, where would we sit?

Mr. DENENBERG. I think if the legislation is drafted correctly, all the States will do it. In other words, the States would not necessarily have to set up their own solvency funds, but if you impose a tax on the State and you say you are going to have to pay this tax unless you create an insolvency fund, I do not think the State legislature is going to sit there.

I think that is the kind of thing that would impel them to take action, and I am confident that no State would want to see other tax moneys diverted if simply by enacting a law it could save these resources for its own purposes.

Senator Moss. Do you think that sort of tax would run into any constitutional problem of a tax contingent on a State failing to take some legislative action?

Mr. DENENBERG. I am sure the statute would have to be artistically drafted but I am confident it could be drafted, perhaps not in the precise language which I indicated to achieve the purposes which I have expressed.

Senator Moss. I wonder, since we are talking about State insurance law and State regulation, if the consumer's point of view is represented in the forms of the State insurance laws?

Mr. DENENBERG. Well, I had a recent experience in the State of Nevada where I received a call from three legislators who said we have just completed hearings on our law and we have not really heard the consumer interest at all. We have heard one insurance company representative after another, one lobbyist after another, but we have not heard from the consumer.

As a result of this, they actually created a special arrangement whereby I am supposed to look at that law from the consumer's point of view and give them some ideas on amendments. This was actually approved by the Legislative Council of Nevada.

I think very often the consumer is not adequately represented in the legislative process. I think the press always does a miserable job in covering insurance laws. Unless it involves a 40 percent rate increase the press can never get excited about reporting on insurance laws.

For all these reasons, I think very often the consumer is not adequately represented.

I have been on an insurance revision in the State of Wisconsin now for about 4 years, which represents the most comprehensive revision of insurance laws for a long time, and hopefully there I think the consumer is getting some representation, but I think all too often he does not get the representation he is entitled to. That may be true of all legislation, but it is probably more true of insurance than most.

Senator Moss. Do all of the States or a majority of the States have laws on their books that outlaw fraud and deception in insurance?

Mr. DENENBERG. Yes, they do, but it is the problem of enforcement. The easiest thing in the world is to pass a law, but you need personnel and resources to enforce these laws. Very often the commissioner is simply too busy.

As I indicated, in the survey I mentioned, there are over 20 States that admit they cannot even process the insurance complaints that are presented to them. So they can hardly go out and look for problems that exist and yet are not brought to their attention. Most people do not know about the insurance complaint department in their State.

Senator Moss. Would the funding or the prospects of adequate funding and personnel be better if it were a Federal regulation rather than a State broken down into the 50 States?

Mr. DENENBERG. I do not see where it would. We have seen the Federal regulatory agencies, and their performance is probably as bad or worse than the State agencies. Apparently the Federal Government cannot produce all the money it needs for its regulatory agencies. I think all regulatory agencies need more money, but a point which I think is important to make is that even if they had all the money in the world, I think you are still going to have a lot of problems and you still need some alternative remedies.

Furthermore, the regulator may not often be the best and most efficient way to regulate. You may be better off by bringing in a skilled attorney, like Mr. Kohn who appeared before, who might do a better job of presenting the consumer interest than the underpaid consumer commissioner.

Incidentally, in many States insurance regulation is excellent and in many States it is very bad, but regardless of what it is I think the consumer needs more protection.

Senator Moss. Really, the main thrust of your presentation is that if a class suit were made available for insurance consumers, that this would release a lot of expert manpower in the form of competent lawyers to assemble the data and present the matter to a court for relief for the consumers; is that right?

Mr. DENENBERG. Yes. I think every study of regulation that I have ever seen says one of the big problems is that the insurance regulator is so busy with a lot of little things; he never has the fix on the big picture. This is especially true at the moment, because insurance is really going through a revolution.

I think it would be more efficient to take some of the problems that the commissioners face and turn them over to able private attorneys. This would also develop this consumer bar.

Now it does not pay an attorney to get involved very often in insurance matters. But if you could get experienced attorneys who are now doing other things to represent the consumer, I think that would have a good effect, not only in reducing frauds, but it would also produce the kind of attorney that could go in and represent the consumer on regulatory matters before legislative bodies.

Senator Moss. Thank you for your very eloquent and excellent statement.

The full statement you have prepared including the four appendices will be in the record in full as well as the summary which you utilized in presenting your testimony orally before the subcommittee, which proved most helpful.

(The statement and appendixes follow.)

STATEMENT OF HERBERT S. DENENBERG*

THE INSURANCE POLICYHOLDER, CONSUMER POWER, AND INSURANCE REGULATION:

THE CONSUMER CLASS ACTION: THE APPLICATION OF "COMPETITION" AND "FREE ENTERPRISE" IN PROVIDING REALISTIC REMEDIES

The consumer encounters incompetence, indifference, bad advice, misrepresentation, and fraud in many places. Nowhere are his problems more difficult than in the area of insurance. Nowhere are new and more effective remedies more urgently needed than in the area of insurance. Nowhere are problems likely to get worse before they get better than in the area of insurance.

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Nature of Product

Insurance is a complex, technical, legalistic and intangible product which the consumer rarely understands. As a result, insurance become a logical target for consumer abuses because of its very nature.

The uneducated and the disadvantaged are not alone in meeting confusion and difficulties in their encounters with insurance. White collar workers and professionals are quick to admit lack of understanding of their insurance protection. Even appellate judges have become noted for the frequency of their complaints about the incomprehensibility of insurance contracts. One learned judge, in a comment described as not atypical of the judicial view of the general liability policy used until 1966, said: "The policy contains such a bewildering array of exclusions, definitions and conditions that the result is confounding to the point of being unintelligible." [1] Other policies continue to pose the same kind of difficulties.

Along with appellate judges, even the insurance buyers of large corporations have found insurance to pose forbidding and dangerous territory. Both past and current insurance frauds have caused damage to corporations whose insurance programs were managed by sophisticated professionals.

In the 1963 Congressional hearings, for example, the insurance manager of Food Fair described his troubles in the insurance market place, and Senator Dodd then commented to him: "It bothers me that you got stuck three times. It must have bothered you." Replied the insurance manager: "Oh, yes." [2]

No one now seems to be capable of coping with the complexities and difficulties of the insurance transaction. At the hearings before the District of Columbia City Council, it was pointed out that even the Mayor had difficulty in maintaining insurance on his building.[3] Insurance commissioners sometimes enjoy relating tales concerning the unwitting cancellation of automobile insurance policies of state legislators. This sort of cancellation usually produces immediate dismay for the state legislator—and ultimate dismay for the "offending" company.

Public understanding of the insurance process is so slight that the consumer is sometimes even unable to comprehend whether he is being victimized by the insurance industry or merely being subjected to legitimate market forces. An example: Only last week I was asked to help a 69 year old Philadelphia woman faced with a problem in obtaining insurance on her home. The house, in an old neighborhood in Philadelphia, was worth less than $17,000 on the market and was insured for $45,000 under a Homeowner's Policy, which indemnifies for replacement cost. The insurance company then asked her to raise the amount of insurance to $82,000, which it claimed to be the replacement cost. A short time later the company said it was going to cancel the Homeowner's coverage, and replace it with the more limited coverage of a straight fire policy. The woman was convinced that after being insured with this company for many years she was entitled to better treatment, but had no idea whether the company's action was improper, illegal, or completely reasonable.

The proverbial can of spoiled fish is sometimes easier to detect than the analogous insurance transaction.

Even agents and brokers, the full-time professionals in their fields, sometimes do not understand their own product. There can be no better illustration than the life insurance agents who frequently tell customers that all ordinary life insurance costs the same. Nothing could be further from the truth, as every study of the subject has indicated. There are not only misconceptions about cost differentials, but sometimes even data to determine appropriate cost differentials are lacking.

Veteran agents and brokers find some aspects of the insurance transaction too deep for full understanding. But it should be recognized that licensing requirements for agents and brokers in most states are far from rigorous. In many states an agent can be licensed on a temporary basis, if he is enrolled in an approved course of instruction. As a result, there are agents with "learners' permits" who are out selling insurance. Some states have no educational requirements for licensing agents and brokers, and the examinations may be of minimal

[1] Maretti V. Midland National Insurance Co., 190 N.E. 2d 597 (Ill. 1963).

[2] Hearings Before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, Part II, Surplus Lines Insurance, April 2, 4 and May 15, 1968, p. 6437.

[3] Testimony of Joseph Pierce, C.P.C.U., an insurance agent, on July 22, 1969.

difficulty and may even change from year to year. One prominent former commissioner has pointed out that in some states "the agent's license is merely a revenue raising service for the state." [4] Another commissioner, Samuel H. Weese of West Virginia, told me on March 14, 1970: "Although it's not par for the course, I know of companies who have 75 percent turnover on their agents." This all adds up to having many agents, with little or no training, being turned loose on the public to sell insurance. More important, the lack of understanding even among agency forces, does not bode well for the level of consumer understanding.

Insurance, therefore, is different from most other products, because of its ability to generate public misunderstanding at all levels. Such a typically uninformed public is especially susceptible to all the typical abuses that the market place is heir to.

Lack of Countervailing Power

The consumer faces the complexities of the insurance market without the kinds of protective cover that might be expected from forces that should be operating. The press has become an important source of consumer protection by its new found propensities for investigative reporting. Yet, it has done relatively little to bring public understanding to the insurance process or to expose and alleviate consumer insurance problems. The same forbidding technicalities that frighten the consumer also seem to have an adverse effect on press coverage of insurance problems. (A more complete discussion of this problem is represented in a document, included as Appendix 1 to this statement.)

Other usual sources of countervailing power are also not fully operating in the insurance arena. Unions have made elegant noises about increasing automobile insurance rates, but have rarely mustered much expertise, especially in the property liability insurance area. Recently unions have become interested in group property and liability insurance, but their main impact has been on life, retirement, and health insurance, which up to now has been their main area of concern in collective bargaining. In the great struggle over providing an adequate center city insurance market, unions have often been notable for their silence. For example, the District of Columbia's problem was among the most serious in the nation. Yet, when the District of Columbia held extended hearings on the subject, no union witness appeared. There was little visible union effort to shape the study of the President's National Commission on Insurance in Riot-Affected Areas. Many other examples could be cited to support the conclusion that unions, contrary to what might be expected, have not had a significant effect on protecting the consumer interest in insurance.

The legal profession, with its special expertise, might be expected to be in the forefront of the battle to protect the consumer interest in insurance. Its talent, however, is simply too expensive to become involved in the great bulk of run-of-the-mill problem cases. There is minimal access to services like group legal practices and the class action which would make it possible to effectively utilize legal talent to solve consumer insurance problems.

The lawyer generally finds no important source of income in insurance litigation unless he represents an insurance company or a plaintiff with a substantial policy claim. As a result, most lawyers are not knowledgeable in matters of insurance law relating to the typical coverage or other consumer problems. There are not enough economic opportunities to develop this kind of expertise.

This lack of countervailing power is nowhere more evident than in the legislative process. When insurance laws are being revised, there is at least one insurance lobbyist for every jot, tittle, and title in the statute. But consumer, union, or other lobbyists are often not there, and the daily press can rarely seem to find a bombshell in the labyinthine technicalities of an insurance code. Even the state legislators cannot ordinarily be effective in this process, as they are usually operating without trained staff and may view themselves as lucky to even have secretarial assistance. I recently discussed this matter with some Nevada legislators who noted that their legislative process produced many hearings when a new insurance code was considered, but that the hearings produced only an endless and almost uninterrupted list of insurance witnesses. The legislators felt the public viewpoint was not represented and finally called for a special study of the law from a consumer point of view.

A preliminary report on the study of the Nevada law is enclosed as Appendix

[4] Allen L. Mayerson, "An Inside Look at Insurance Regulation," *Journal of Risk and Insurance*, March 1965, p. 70.

2 of this statement to indicate the kinds of consumer oriented questions that may not be raised in most insurance code revisions.

Other potential sources of countervailing power such as the organizations of insurance manager and the academic community, have also not produced the countervailing power that might otherwise be expected. (For a more detailed discussion of countervailing power and insurance regulation, see Appendix 3 of this statement).

Does State Insurance Regulation Protect the Consumer?

Anyone who says state regulation is adequate to protect the consumer is deliciously naive and possessed of fairy-tale faith.

Regulators—state, federal or any other—simply do not have the time and resources even if they have the inclination and capability to protect the individual consumer.

Federal agencies have often shown the same ineptitude of state agencies. As a special report in *Business Week* [5] summarized the status of federal regulation: ". . . something has gone wrong at all the great agencies with the delicate feedback from the economic organism under regulation. The thermostat is stuck, the businessmen alike will soon feel the heat."

The ability to protect the consumer

The opportunities and avenues for abuse are so many and varied that the regulator cannot be expected to detect and correct them all on a case-by-case basis.

Even if he had adequate resources, the insurance commissioner would be more than swamped with resolving general problems rather than resolving individual complaints. The insurance regulator is now overwhelmed with a whole menagerie of crises that will keep him committed for years to come. The problem of providing an adequate market for property insurance in center city areas has only begun to be resolved, and the solution to the shortage of crime insurance has not even been adequately discussed. Automobile insurance poses an ever-widening problem facing ever more inadequate solutions. Medical malpractice insurance is in such short supply at such high rates that it may drive physicans from the practice of medicine. Other malpractice lines have already developed similar problems or are rapidly on their way to doing so.

The jumbo jets have spotlighted a growing shortage of liability insurance, which is also evident in the area of products liability insurance. The inadequate property insurance market is even receiving attention from a White House Task Force. Life insurance has not resolved its problems of adequate disclosure of price information and the very existence of health insurance is threatened. Added to these and other problems are some dramatic shifts in company organization with the rise of the holding company and the encroachment of the conglomerate. Upstream dividends to holding companies amounted to almost a billion dollars last year. States are still operating with antiquated insurance laws, in need of reconsideration by the regulator, and modernization.

Insurance regulators are willing to admit the basic problem facing them. A trade publication reported that the insurance commissioner of Illinois said that he had to find

> . . . answers to many of the shortcomings and abuses within the industry. He particularly referred to hard core areas and the fact that the manner in which some companies handled their obligations entitled them to nothing less than a "failing grade."
>
> "It will take a long time to restore public confidence and heal the bad public relations created by these incidents."
>
> He concluded that "changing times have caught up with insurance marketing and methods." [6]

Commissioners have to apply their limited resources on these major problems and cannot be expected to give individual consumer complaints individualized attention. Even some of the smaller states, like Nevada, which have not been overwhelmed by urban insurance problems, have noted problems in handling complaints. The 1967 Annual Report of the Commissioner of Insurance of Nevada states:

> The handling of policyholder's service requests is still an ever increasing burden on our limited number of personnel in this section. In order to continue providing this service to the insurance buying public, it will be

[5] February 28, 1970, p. 61.
[6] *Insurance Exchange Magazine,* February 1970, p. 4.

necessary to increase the number of personnel handling these matters and to upgrade the personnel classifications thereof.

An extensive survey conducted by Professor Stone, of complaint departments of state insurance commissions, found that 21 departments "feel that they are prevented from handling complaints effectively because they do not have an adequate staff." [7] Stone found that only a few departments feel that they are adequately staffed. He summarized the results of his survey as follows:

> Nearly all of the departments are short of help and are unable to handle adequately the volume of complaints that they receive daily. To complicate the problem further, the number of complaints that the departments receive is increasing each year.[8]

His study as well as others have confirmed that insurance department staffs, not only the complaint division, are often understaffed, underpaid, and underqualified.

Other personnel problems also impair the adequate handling of consumer complaints. Former Commissioner Mayerson of Michigan has pointed out that many states:

> . . . must rely on the attorney general's office for legal advice . . . . However it is rare that the attorney general is sufficiently well-versed in insurance law, or has the time to provide the legal counsel required by the insurance commission who is not himself a lawyer.[9]

Professor Stone also concluded that the shortage of legal personnel prevented state insurance commissioners from protecting the consumer. He noted that the "shortage of legal aid is so critical that the departments hesitate to hold hearings." [10] Professor Mayerson has pointed out that insurance departments may be reluctant to use their power. He stated:

> In such a hearing, the highly competent legal and actuarial talent available to the insurer may be able to present a much stronger case than can the insurance department relying, as it often must, on low-salaried personnel and a part-time attorney to present its side of the argument.[11]

There is not only lack of resources for adequately protecting the insurance consumer, but also sometimes the lack of inclination to do so. Regulators—state, federal and local; honest and dishonest; able and incompetent—tend to be captured by the industry they regulate. The process has been described by a former chairman of the Securities and Exchange Commission:

> Part of the process of becoming a "captive" may stem from the fact that the parties are dealing with the industry day to day and begin to appreciate their problems without taking due account of the public interest.

This same problem was explained in another way by the Landis Report on Administrative Agencies:

> Irrespective of the absence of social contacts and the absence of undue hospitality, it is the daily machine-gun-like impact on both agency and its staff of industry representation that makes for industry orientation on the part of many honest and capable agency members as well as agency staffs.

The insurance commissioner, who heads the state insurance department, often comes from the ranks of the industry and intends to return to the ranks of the industry upon conclusion of his term. In preparing for this testimony, I looked through the 1968 Directory of Insurance Commissioners prepared by the National Association of Insurance Commissioners.

Alphabetically considered, this directory indicated the Commissioner of Alabama was in the insurance business 13 years before his appointment. The Commissioner of Alaska was in the insurance business for 15 years prior to his appointment. The insurance commissioner of Arizona was in the business 24 years prior to his appointment. This was an auspicious start and I found about 17 commissioners with insurance industry experience totalling over 132 years. This does not include Commissioners with other obvious connections with the industry that were not indicated in the directory, such as legal counsel of insurance interests.

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[7] Gary K. Stone, "An Analysis of the Complaint Handling Procedures of the State Insurance Departments." A Ph. D. Dissertation in Business and Applied Economics at the University of Pennsylvania (1966), p. 27.

[8] Stone, "A Trend in Complaints Processed by State Insurance Departments," *Journal of Risk and Insurance*, June 1967, p. 231.

[9] Allen L. Mayerson, "An Inside Look at Insurance Regulation," *Journal of Risk and Insurance*, March 1965, pp. 58–59.

[10] Stone, Ph. D. Dissertation, p. 193.

[11] Mayerson, p. 59.

The Basic Deficiencies of Regulation

State insurance regulation often gets a bad report-card. But other kinds of economic regulation are winning no prizes. This may be a deficiency of regulation, as well as perhaps a simple affirmation of the fact that we cannot expect too much of regulation.

The statement of the 1960 Senate Report on state regulation is still painfully true:

> The basic defects of state regulation discussed in the Patterson Study in 1923 are still apparent in current activities and operations of state insurance departments. Many of the defects of state regulation catalogued in the *Final Report* of the TNEC parallel, and, in various respects, duplicate the conclusions of this subcommittee report.

Subsequent investigations of the Senate Anti-Trust and Monopoly Subcommittee have also continued to highlight many of the same chronic deficiencies catalogued almost half a century ago.

These deficiencies have not miraculously disappeared. State regulation has undoubtedly improved, but the problems it faces have become much more severe in recent years.

Just as many of the substantive problems of insurance regulation have hung on with grim tenacity, so have the shortcomings of the commissioner's office.

Regulation will be imperfect for a long time to come. We salute the states for the real improvements in state regulation recently accomplished. But the consumer is interested in having his problems solved here and now, not in admiring the grand evolution of our system of economic regulation. We should be looking for new methods of helping the insurance consumer with some sense of urgency.

ARE THERE SERIOUS ABUSES IN THE INSURANCE MARKETPLACE CALLING FOR NEW AND MORE EFFECTIVE REMEDIES?

One need not be critical of state regulation in asserting that there are many abuses in the insurance marketplace that indicate the need of new initiatives to protect the consumer. This is so despite the fact that all of the states have adopted unfair trade practices acts, most of which closely follow or coincide with the Model Unfair Practices Act approved by the National Association of Insurance Commissioners in 1947, and despite the existence of insurance regulation in every state and U.S. jurisdiction.

Some Particular Problems

One of the most recent abuses is the development of phony mail order insurers that are selling to corporate buyers. A trade publication, *Business Insurance*, was influential in exposing some of these companies operating out of Missouri. Its exposé led to action against so-called minimutals operating beyond their authority. In the meantime, buyers all over the world, from as far away as Ethiopia, suffered damage as a result of the operations of these phony companies, which wrote insurance but did not pay their claims.

In its most recent issue (of March 16, 1970), *Business Insurance* has a further report on questionable business activities.[12] The report indicates that only last month the Missouri Secretary of State ordered the forfeiture of the charter of a "minimutual" based there. It was exposed by *Business Insurance* about 15 months ago. Appendix 4 contains excerpts from *Business Insurance* on this and related matters. The managing editor of *Business Insurance* advised me that its reports on this matter have not yet been contradicted by anyone.

Similar problems were disclosed in the 1963 hearings on surplus lines insurance before the Senate Anti-Trust and Monopoly Committee of the Judiciary of the United States Senate in 1963.[13]

This particular problem is noted for several reasons. First, it shows again that even the most sophisticated corporate insurance buyers run into trouble in the insurance marketplace, ranging from phony companies on down. Second, it shows that many serious problems of the insurance marketplace are perennials. There is a tendency to think that after a certain amount of talk and investigation a problem is solved, but in fact it turns up in some new form, or even in its original form. Third, it illustrates a problem that state regulation has always had a difficult time in controlling due to the interstate and international scope of some of these operations.

[12] March 16, 1970, p. 1. (Advance galley proof is included in Appendix 4.)
[13] The Insurance Industry: Surplus Lines Insurance, Part 11.

A closely related and perennial problem is that of mail-order insurance in the mass markets. Just as the corporate insurance market has been prey for phony companies and improper claims practices so has the mass market.

The Subcommittee on Frauds and Misrepresentations Affecting the Elderly to the Special Committee on Aging of the United States Senate reported on January 31, 1965 that

> Economic pressures on older Americans are causing many to turn to mail-order health insurance offered by marginal companies which distort or omit facts in order to suggest that the policy gives more protection than it really does . . . Wide opportunities for deception or confussion exist in sales of health insurance policies, and buyers are usually dependent upon the good faith of the seller for accurate interpretation of provisions.[14]

There have been many studies, investigation, and administrative actions since that time. The problem has been worked on but not solved. There is still a serious problem of abuse from mail order insurance, despite favorable rulings from the the United States Supreme Court affirming the power of the commissioner to reach unauthorized insurers. As Samuel H. Weese of West Virginia, one of the new breed of able, young commissioners, told me on March 14, 1970: "I have no first-hand knowledge of how serious the mail-order insurance problem was five years ago, but I do know it is still serious today." This is another unsolved problem of insurance regulation.

As marginal companies have preyed on the aged for health insurance, so they have preyed on those who are considered bad risks by automobile insurance underwriters. In 1965, the Senate Anti-Trust and Monopoly Subcommittee initiated an investigation of high risk automobile insurance. The hearing volume of that investigation compiled a great deal of evidence on fraudulent insurance company operations and consequent damage to thhe public.[15]

Senator Dodd summarized the findings of that investigation as follows:

> The hearings and our investigations show that during the last 6 years, 73 companies writing motor vehicle insurance have been placed in liquidation or receivership.
>
> We found during our investigations that nearly all of the insolvencies were caused by specific acts of dishonesty practiced by company management, or management's failure to act in the best interests of the company and its policyholders.[16]

Senator Magnuson, in May of 1969, stated that since 1958, no less than 109 automobile insurance companies and 18 fire insurance companies have become insolvent.[17]

Finally the testimony of the Nixon Administration on S. 2236 indicates that the consumer is losing $25 million a year due to property and liability insolvencies, mainly involving automobile insurers.[18]

Another insurance consumer problem of equal tenacity with the rest is that caused by credit life and health insurance. This area of abuse involves the complications of insurance stacked on top of the "complex calculations and complicated forms" that characterize the credit industry.

This problem has a history running back almost to the beginning of the period of real growth of the credit life and health insurance in the United States. Until 1950, the business was characterized as of "modest" proportions. Since then both the industry and consumer abuses therein have experienced rapid growth.

As early as 1954 abuses in the credit life and health insurance were being investigated by the Senate Anti-Monopoly Subcommittee (under the late Senator William Langer). Abuses are still rampant, and in 1967 the Senate Anti-Trust and Monopoly Subcommittee engaged in an extensive investigation of credit insurance.[19] It found a whole series of abuses, which were partially summarized by the then insurance commissioner of Vermont:[20]

> (1) Fantastic profits are being made from the incidental sale of insurance in connection with loans and other credit transactions.

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[14] Frauds and Deceptions Affecting the Elderly: Investigations, Findings and Recommendations, p. 47.

[15] The Insurance Industry, Part 12, High-Risk Automobile Insurance.

[16] *Congressional Record*, January 26, 1967, Vol. 113, No. 11.

[17] *Congressional Record*, May 23, 1969, Vol. 115, No. 85.

[18] Statement on Behalf of the Department of Commerce and Transportation Before the Senate Commerce Committee, February 10, 1970.

[19] See four volumes of testimony and documents on Hearings on the Consumer Credit-Credit Insurance.

[20] Hearings on Consumer Credit Industry, Part 1, p. 68.

(2) In large measure, these profits are being captured by the finance industry, directly and indirectly, not the insurance industry, although many insurers are doing right well.

(3) They are made possible because competition works against the debtor to raise his costs.

(4) Someone must protect the debtor, who is in an inferior position to the creditor.

(5) This protection must come from government but state governments have been slow to act. This is not necessarily the fault of the insurance commissioner because he may be unable to secure legislation due to pressure exerted by creditors. Maryland and Iowa were unable to pass the model credit life bill this year for this reason, I understand.

(6) The citizens of many of our states need help.

Other kinds of abuses included improper claims tactics and every variety of overcharge conceivable, whether legal or illegal.

Here is another perennial problem, another serious consumer problem, and perhaps one which cannot even be solved by state insurance regulation.

Other consumer problems could be catalogued at great length. One way to do so is to summarize the kinds of problems that are presented most frequently to the complaints section of insurance departments. Professor Stone found that 26 states reported complaints for post-claim underwriting (cancelling or voiding a policy after a claim instead of initially investigating the applicant); 23 states reported failure to settle small claims; 15 states reported inadequate settlements; 11 reported unlicensed insurers; 10 reported delays in settlement; 7 reported misrepresentations.[21] The 200,000 or so complaints presented to insurance departments represent only a small fraction of consumer problems. And as one regulator has noted, even the non-meritorious complaints often indicate that the insurance company has not adequately explained its product.

Some More General Symptoms

There are other more fundamental symptoms of the regulatory system's failure to protect the consumer.

The growth of group property and liability insurance, a sound and obvious development, has been frustrated by state regulation. We are all familiar with the benefits of group life and health insurance, which has become the protector of almost every American family. Yet these same families have been denied the benefit of its counterpart for the purchase of their automobile insurance and homeowners insurance. They have been denied the economies and conveniences of group insurance marketing. Because of the failure of regulation to permit the development of group property and liability insurance, the American consumer, in a very real sense, has been overcharged in the neighborhood of $3.5 billion dollars during the last ten years, the amount of potential savings under group plans.

Even group life insurance has not been permitted to develop its full potential. It must face various artificial limitations on the kind of group that can be covered by a policy and the amount of insurance that an individual may obtain under such a policy. These and other limitations have been imposed to protect various segments of the insurance business, at a continuing and exorbitant cost to the insurance consumer. In other words, over the years, the insurance consumer has been paying a heavy tariff to maintain the competitive advantage of various segments of the industry. Many other examples could be cited, such as the limitations on credit cards to market insurance, and the prohibitions on the "wrap-up," a device to more economically provide insurance on construction projects.

Insurance regulation cannot always be relied on to protect the consumer on matters of overriding importance. This should at least give us pause before we assume that it can protect the consumer against individual abuses in the marketplace.

SHOULD REMEDIES BE AVAILABLE IF AND WHEN THEY ARE NEEDED?

Even if we assume that there are no consumer wrongs to be remedied at this moment, we should still insist on the availability of adequate remedies.

Major consumer problems in insurance have sometimes swelled to dramatic proportions almost overnight. The civil disorders of the 1960's created one of

[21] Stone, Ph. D. Dissertation, p. 150.

the most serious shortages of property insurance in modern times, and brought along a whole train of abuses including mass cancellations and overcharging. Present tight insurance markets may also escalate to crisis proportions at any time.

Many have pointed out that organized criminal elements have stepped up their drive to take over reputable insurers. For example, Joseph A. Humphreys, executive director of the National Association of Insurance Commissioners nonadmitted insurance office, is reported to have described swindlers' efforts to—

(1) whip together insurance-mutual fund securities complexes;
(2) bilk sophisticated builders who need mortgage money;
(3) acquire fairly large alien insurers; and
(4) take over domestic insurers and use them to ferry money out of the country.[22]

A NEW AND NEEDED REMEDY: THE CONSUMER CLASS ACTION

We have regulation because competition does not work. Now that regulation does not work, many are suggesting that we try again to make competition work so that we will not need regulation. This may involve an interesting circular excursion, but I think most would agree to give competition the first chance to regulate.

Introducing "Free Enterprise" to the Field of Consumer Remedies

If we believe in competition, we should perhaps give competition a try in the field of remedies for the consumer. One way to do so is through the adoption of authorizing legislation for consumer class actions. For the consumer class action would create a realistic remedy for the victimized consumer, no matter how small his claim happens to be. For the claims of all consumers victimized by the same company in the same fashion can be asserted together in a class action.

By asserting a mass of claims together, there is enough at stake to obtain adequate legal representation and make real protection of the consumer feasible. Thus, there would be realistic alternatives and competition to the remedy asserted by the regulator. If we believe in free enterprise, perhaps we can start by turning over much of the work of government civil servants in the insurance department to the practicing attorneys, one of the last great bastions of free enterprise.

The consumer class action need not be looked upon as "competition" for the regulatory agency. It can be looked upon as a logical supplement to regulation as well. The regulator hardly has legal personnel for his most central tasks, let alone for the resolution of individual complaints. As already indicated, some regulators are so short of legal help that they are afraid to call hearings. The regulator will be able to use outside attorneys "free of charge" if he can "delegate" part of his responsibility to them. This is essentially what would happen if the consumer class action were available.

The regulatory supplement of the class action is in keeping with sound regulatory theory. A system of regulation should be self-policing whenever possible. This makes performance more reliable and also keeps the regulator free to resolve broad issues of general application.

One of the most important incidental results of class actions will be the development of a strong consumer bar. General Motors gets good lawyers because it pays them. The consumer will get good representation when he starts paying his attorneys well (as he can with a class action). Lawyers, like other people, noble and ignoble, are typically where the money is.

There are other important reasons for giving the insurance consumer access to the class action.

Litigation Now Impractical

The classic circumstances of abuse of the insured often involve amounts too small to make litigation practical. A high percentage of all complaints submitted to state insurance departments involve accident and health policies or automobile collision and comprehensive policies in which the amount in dispute may be far too small to make litigation worthwhile, however important it might be to the individual insured. In fact, one of the most common sources of complaint against insurers is unjustified failure to settle small claims. Other sources of complaints may also not generate substantial damages for a single insured—for

[22] *National Underwriter* (Fire and Casualty Edition), December 19, 1969, p. 1.

example, unjustified delay in settling claims, and misrepresentation of the terms of policies. The hardship visited on the victim of these practices may be great even though actual legal damages may not justify resort to the courts. Litigation, or even legal advice, is likely to be prohibitively expensive for small claims.

Administrative Remedy Inadequate

The defrauded insured now cannot realistically rely on litigation for his remedy. Nor can he always rely on the insurance department of his state. The insurance regulator, as already indicated, is overworked and understaffed. He may be industry rather than consumer oriented. And, he may be unknown to the consumer, especially to the consumer most in need of help. It does not ordinarily pay attorneys to become involved in the assertion of small claims before administrative agencies such as insurance departments, and they may not be highly motivated to educate the public on the availability of administrative remedies.

The administrative remedy has a further disadvantage: It may not provide a sufficiently strong deterrent to potential wrong-doers. The individual complaint may be separately handled and adjusted without penalty or with only a resulting restraining order for the future. Some insurance departments do not even maintain records that would be adequate to establish a pattern of conduct and thus justify more severe penalties.[23]

IMPACT OF THE CONSUMER CLASS ACTION

The consumer class action is designed to help the defrauded consumer by providing him with a new form of legal remedy and more effective legal representation. Under this act, the claims of all defrauded insureds, victimized by the same company in the same fashion, could be asserted by one or more consumers on behalf of the entire group, thus providing the class of insureds with a realistic remedy, and with an effective representative. One insured could sue on behalf of all those affected by an insurer's policy of delaying payment of claims or refusing to pay small claims, or on behalf of all those adversely affected by a deceptive policy provision.

These insureds would no longer have to rely on understaffed insurance departments which may be industry, rather than consumer-oriented. They would no longer have to rely on individual litigation, which in most cases would be prohibitively expensise. They would have a new and effective advocate, the individual attorney, who would be properly motivated and rewarded by the method of compensating the attorney under S. 3092: "Whenever a class of consumers prevails in a class action under this Act . . . the court shall award to the attorneys representing the class a reasonable fee based on the value of their services to the class."

It has been said that no one should underestimate the resources and ability of the individual attorney representing his client when the "blue chips" are down. The "blue chips" have been down for the consumer for a long time. It is time to see that the consumer gets the representation and the remedy that he is entitled to.

The class action would benefit all legitimate interests involved in the insurance process. It would help protect the consumer against improper practices by providing him with a new and effective remedy when he is one of a class adversely affected by improper practices. It would make legal advice more readily accessible to the consumer, and provide greater incentive for work by both consumer groups and attorneys on the problems of educating and advising the public in regard to insurance and other problems. It would relieve the understaffed and underfinanced insurance regulator of part of his heavy burden, and make the regulatory system more fully self-policing. It would help protect the great majority of insurers and agents against the adverse public relations impact of the small group of persons who indulge in practices that would become subject to the new remedy; it would provide a new and strong deterrent to potential wrong-doers. The class action would help mobilize the consumers in obtaining long-needed countervailing power in the insurance regulatory process.

[23] President's National Advisory Panel on Insurance in Riot-Affected Areas, *Meeting the Insurance Crisis of Our Cities*. (Washington, D.C., U.S. Government Printing Office, 1968), p. 50.

APPENDIX 1

The Business Page and Insurance Reporting: Even Vice Presidents Can Be Right

By Herbert S. Denenberg

Presented at the Wharton Seminar for Business Writers during an open Panel Discussion with Edwin J. Dale, Jr., of the *New York Times*, J. A. Livingston, syndicated columnist of the *Philadelphia Evening Bulletin*, William Rappleye, editor of *The American Banker*, Professors Irwin Friend, Lawrence R. Klein and Herbert S. Denenberg of the Wharton School, and Robert Nichols, Special Assistant to the Board of Governors of the Federal Reserve System, moderator on the subject "Economic Communication: Clear and Present Public Issue."

If we are going to be critical of the news media, business reporting is as good a place as any to start; and in the area of business reporting, there is no better focus than insurance. Insurance seems to be one of the many step-children of the business page. There is a wide variety of reasons for this status. The business page is spread all too thin. It may be able to muster expertise and space for the stock market, monetary and fiscal policy, and general economic trends, but it cannot and has not adequately reported on the insurance industry. Insurance may also seem to be among the less dramatic subjects to be reported on. Art Buchwald once described something as dull by saying that it was about as exciting as covering the Prudential Insurance Company. The business is also camouflaged by forbidding technical aspects and jargon that even practitioners can't understand and judges can't interpret. One Sunday supplement editor of one of the nation's leading newspapers told me that for similar reasons his people virtually ignored insurance until a few of his colleagues had their automobile insurance cancelled.

Although insurance may seem dull, in fact the insurance industry presents a picture at this moment that is anything but dull. It is undergoing what can easily be described as an endless crisis and a continuous revolution. This applies to virtually every line of insurance. The industry is caught in the cross fire of a complex set of social revolutions and will have a difficult time merely to survive and especially to prosper.

Some examples of industry problems: Many doctors are now being asked to pay $15,000 yearly for malpractice insurance and large hospitals may be paying half a million dollar premiums or more. Our center cities are still struggling with a chronic shortage of property insurance and a solution to the crime insurance problem hasn't even been adequately discussed. The $100 million liability policy on the new jumbo jets is considered inadequate. Health insurance and automobile insurance have become national political issues. Life insurance is facing sever criticism for its unwillingness and even inability to make adequate and meaningful price disclosure. Workmen's compensation is under pressure for federal standards, and Pennsylvania, for example, can boast one of the worst and most inadequate compensation laws in the United States.

To add to the industry's already mounting problems, on last Sunday's (February 15, 1970) "Face the Nation" TV broadcast, Ralph Nader singled out two industries which he considers to be in need of special attention—banking and *insurance.*

This bleak picture may not all be the responssibility of the insurance industry, but it surely is its problem. Despite this picture, the industry has merited little in depth and enlightening business reporting from the daily press.[1]

Let me present a few representative examples from my own experience.

(1) On June 26, 1968 the Commonwealth of Puerto Rico became the first United States jurisdiction to adopt an automobile compensation plan to indemnify all victims of automobile accidents regardless of fault from a government insurance fund. This represented a revolutionary approach to the automobile insurance and reparation problem. Sometime after its passage, *Consumer's Union* said that this legislation was one of the most important factors in stimulating automobile insurance and reparation reform in the United States. Although the debate over this new approach to automobile compensation was headline news in Puerto Rico for many months, the press did not even report on the legislation until sometime after it had been passed. The *New York Times*, for example, did

[1] The term daily press here excludes the two leading specialized business papers, the *Journal of Commerce* and the *Wall Street Journal.*

not report on this legislation until 1970, about a year and a half after it had been passed.

(2) Another example: The Small Business Administration in 1969 released the first comprehensive study of the impact of crime on business. The study was based on a cross-sectional sample, representative of all American business, the first of its kind except for that found in the tax statistics of the Internal Revenue Service. The study contained massive documentation of many facets of the economics of crime—the amount of losses, preventive measures taken by business, insurance carried and cancelled, and proposed solutions.

The study was released when interest in crime was at a fever pitch. Yet, the director of this study tells me that there wasn't a single story in any daily newspaper on this report and only two reporters even called him, and on matters incidental to the report.

Although the *New York Times* did not even mention the report when it came out, I noticed that seven months later, this newspaper gave a front page position to a story that proved that "One out of 10 customers secretly followed into a large Manhattan department store in a recent study stole something before leaving" (November 8, 1969). The study was conducted by the president of a company that "specializes in helping factories and stores to reduce thefts by employees."

The story went on to indicate that most retailers felt that employee theft is much more important than shoplifting. Actually, the SBA study contained statistics that would have made all this speculation unnecessary. (It indicated American business lost $504 million from shoplifting and $381 million from employee theft annually.)

The moral of this story may be that comprehensive, national studies on vital matters are often ignored by the press; but if someone can prove, based on a sample, however small, that 10 percent of New Yorkers are shoplifters, mental cases, or merely chronically ill, he is destined for front page billing.

(3) The riots and civil disorders of 1967 and 1968 created one of the most serious property insurance crises ever to face the country. The shortage of insurance threatened the collapse of credit in center cities and the end of rebuilding after the riots. This development led to passage of the National Insurance Development Act of August 1, 1969, by which the federal government moved into the reinsurance business in order to guarantee an adequate market. I am happy to report that this story was widely carried. However, I was able to observe the reporting on this story first hand and was surprised to find that each paper seemed to use a different reporter at each stage of the legislative development. When the bill was finally passed, some of our leading newspapers used reporters that knew nothing of the previous legislative development and yet had to come up with a story in a matter of a few hours on this landmark legislation.

No story was more important to riot-torn communities like Detroit, Newark and Boston than the release of the President's Report on Insurance in Riot-Affected Areas (entitled *Meeting the Insurance Crisis of Our Cities*) which proposed the solution to the collapse of the insurance market in center cities. This solution was eventually enacted into law as already indicated. Yet as far as I know, based on a purportedly complete file of stories on the Report, papers in such cities as Detroit, Newark and Boston faithfully reprinted the Commission's press release. But they all failed to comment or report on an appendix to the Report which contained detailed statistics on the lack of insurance in the urban core of their riot-torn cities. The Newark papers even missed what I considered to be the prize quotation of the Report. A Newark butcher was asked whether he had any insurance and answered: "No sir, nobody wants to insure us. I would give my right hand for insurance" (p. 2).

(4) In 1968, an insurance commissioner of a leading regulatory state delivered a speech in which he advocated far-reaching proposals involving an anti-cancellation law, a solvency fund, an expanded assigned risk plan, and a new rating law. The leading paper in the state (considered one of the best in the country) received the speech in advance and an explanatory press release, yet the paper did not report on the story until sometime later, when the speech appeared on the front page of a leading insurance trade publication.

This newspaper apparently did not even appreciate the importance of the story until it showed up on page one of the trade press.

(5) One final example: The disputes over automobile rate increases have been endless and noisy. Yet the daily press has done virtually nothing to clarify the issues involved. They quote both sides of the controversy, but leave the public

in the same confused state that a jury is in, when it receives conflicting and unintelligible opinions from two expert witnesses on different sides of the case.

Editorial writers have long agitated for insurance rate regulatory laws that make rate filings public information immediately (rather than on their effective date). But despite all of this journalistic noise, once rate regulatory laws have been amended to make filings available to the public, reporters and editorial writers are rarely, if ever, seen asking for and analyzing their new public information.

It is, of course, easier to criticize than cure, but I would like to make a few basic suggestions that might help improve insurance reporting.

(1) First, I would suggest that ready-made stories in the form of government and academic studies and congressional or legislative hearings on insurance are often ignored or neglected. A reporter can spend a whole day gathering information on a given subject and then perhaps end up with only a narrow and sometimes erroneous view. A ready-made study may be converted into a more comprehensive and reliable story in a matter of hours.

There is also a growing and important body of material in academic insurance journals that might easily be the basis of an endless stream of important stories. An enterprising reporter need only translate the efforts of the academic community into plain English to distinguish himself for insurance reporting.

Another rich source of material are the files of the insurance commissioner. In some states these are completely open. Yet reporters rarely utilize this gold mine of information.

I make it a point to always ask insurance commissioners, attorneys and others involved in major regulatory battles how many phone calls they have received from reporters on these matters. The answer is invariably few or none at all.

Perhaps it boils down to what Miles Cunningham of the *Philadelphia Bulletin* told me: Reporters spend too much time just waiting for the phone to ring. The least they can do is read while they wait and perhaps make a few calls on their own.

(2) I think it is also clear that reporters on the daily press do not fully utilize the other literature of insurance. The insurance trade press has its problems but it is an invaluable source of leads and ideas that are often neglected. The trade press has specialists who can bring the expertise to an insurance story which the daily press can rarely muster. And by the insurance trade press I mean not only the two or three most widely read publications but all of the national and regional publications which have their own particular interests and competence. Some of these publications now do some excellent reporting that might be of general interest.

(3) I think there is also a fundamental need for more specialists to report on insurance in the daily press. I am surprised that the daily press does not make a greater effort to utilize the expertise of the trade press through some sort of tie-in arrangement. And I think the daily press can better utilize the academic community. The reporter should discover the specialists who can provide a certain measure of objectivity and a broader perspective not always found within industry ranks. One editor of the insurance trade press put it this way: "The acceleration of events and the wider field that must be covered are imposing such crucial demands on the press it may eventually break down into specialties with pretty much an absence of good overall coverage. . . . One great hope for relief is the academic community with its more or less disinterested and broader-based outlook."

I would also suggest that the daily press attempt to attract academic specialists to do business reporting and writing on a part-time basis, and perhaps on a full-time basis during their sabbaticals. The insurance trade press has utilized the resources of the academic community much more effectively than the daily press.

(4) I also think the daily press should do more muckraking. I think the public would like to see more critical reporting. There is some response to this need but it is inadequate. Too many editors and reporters think that muckraking went out with the nineteenth century and now it's sufficient to wait for press releases from insurance industry sources. I heard a former insurance reporter of the *New York Times* say, during a panel discussion, it was easy to cover the insurance industry because the industry put out almost nothing worth reading or reporting on.

We need more of what has been described as the socially responsible reporter-reformer. The age of reform is upon us and we need some journalism to match.

(5) Finally, I think journalism will have to face reality along with insurance and other low-pay industries. As George Bernard Shaw has pointed out, there just aren't enough competent men to go around. And the shortage has gotten worse since Shaw's time. Never before has there been such vigorous competition for a limited supply of able people. And although there are many exceptions, you still get what you pay for.

APPENDIX 2

An Analysis of the Proposed Nevada Insurance Law From a Consumer Point of View:

A Preliminary Report Prepared by Herbert S. Denenberg, Loman Professor of Insurance, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, at the request of William D. Swackhamer, Thomas M. Kean, and Richard M. Bryan, Assemblymen, Assembly of the State of Nevada, State Capitol Building, Carson City, Nevada.

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Purpose of This Report

This preliminary report is designed to evaluate the proposed Nevada Insurance Code (Senate Bill No. 39) from the point of view of the insurance consumer and the public generally.

In accordance with the spirit of Assembly Concurrent Resolution No. 51, this is a study of the Nevada Insurance Code, "from the basic point of view of present and potential policyholders and all having any interest under insurance policies."

The study, in accordance with that resolution, also attempts to measure the proposed code against the purposes stated in sec. 15 of Senate Bill 39. These purposes are to:

(*a*) Protect policyholders and all having an interest under insurance policies;

(*b*) Implement the public interest in the business of insurance;

(*c*) Provide adequate standards of solvency of insurers, and of integrity and competence in conduct of their affairs in the home offices and in the field;

(*d*) Prevent misleading, unfair and monopolistic practices in insurance operations; and

(*e*) Continue to provide the State of Nevada with a comprehensive, modern and adequate body of law, in response to the McCarran Act (Public Law 15, 79th Cong., 15 U.S.C. secs. 1011 to 1015, inclusive), for the effective regulation and supervision of insurance transacted within, or affecting interests of the people of this State.

Scope of Report

The final version of the report is not due until the beginning of the regular legislative session in 1970. But in order to indicate the direction of this study, it was determined that a brief preliminary report would be desirable.

As this is a preliminary report, it includes only a sample of the kinds of recommendations to be included in the later version. The recommendations are not yet complete and not yet in final form. They will be subject to change and expansion in the final report, and the author of this report will welcome suggestions from all sources.

It also spells out general lines of revisions and suggests possible models from other jurisdictions. At this time, however, it does not include the precise language of proposed amendments.

The bulk of this report includes an item by item sampling of some areas of possible amendment to proposed Senate Bill No. 39.

Before making these recommendations, it should be noted that this report is in no way intended to reflect adversely on the quality of the legislative effort that went into S.B. 39. The proposed code is indeed a high quality and well-conceived statute. Nonetheless, it can be greatly improved by the recommendations made herein to protect the consumer interest and to assure sound regulation for all the citizens of Nevada. At the same time developments since the proposed code was drafted, point to new and sound directions in consumer protection which can now be recommended.

Sponsorship of Report

Three assemblymen of the State Legislature of Nevada—William D. Swackhamer, Thomas M. Kean, and Richard M. Bryan—asked the author of this report to prepare an analysis of the proposed insurance code from a consumer point of view. The author has here attempted to do so. He was given a free-hand to make this analysis with no instructions other than to "call it as he saw it."

The author wishes to thank the Assemblymen Swackhamer, Kean, and Bryan for this opportunity, but he assumes full responsibility for the contents of this report. He speaks only for himself, and this report is intended to represent only his views on the proposed code from a consumer point of view.

The request for this report came as a result of the legislative history of the proposed insuranace code. The written records of activity relating to the proposed code indicates that dozens of representatives of the insurance business have analyzed the code and given their views. There was virtually no representative of a consumer group to pass judgment on the other side.

The author has attempted to consider what the consumer interest requires in the insurance code. While attempting to be fair and reasonable as to all segments of the insurance business, he has attempted to formulate changes in the proposed insurance code which the insurance consumer is entitled to. It is submitted that in the long run what is good for the consumer interest is also good for the insurance industry; and that the amendments here proposed will mean an insurance law that serves all the citizens of the State of Nevada.

This is an age of "consumerism" and it is submitted that it is sound from a public policy point of view to bring the consumer point of view to legislative matters such as an insurance code. Whether the reader may agree or disagree with the views expressed, the report is offered in the hope that it will contribute to better understanding and more careful public debate of the issues raised by the proposed insurance code.

Specific Recommendations

1. Selection of the Insurance Commissioner

The regulation of insurance in the public interest depends in large measure on the insurance commissioner. Under both present and proposed law, he is given broad authority to enforce the insurance laws, organize and manage the insurance division, and to carry on a wide variety of activities designed to protect policyholders and implement the public interest in the insurance business.

He should be chosen on the basis of his administrative and technical qualifications as well as his ability to objectively and fairly enforce the insurance laws. Therefore, the statutory definition of the commissioner's qualifications should be carefully shaped to that end.

The proposed law defines the insurance commissioner's qualifications as follows:

> No person shall be appointed as, or hold the office of, commissioner unless he has had at least five years of responsible administrative experience in the insurance business or as a general administrative officer of a state insurance department (sec. 23).

This definition unduly limits the circle of those eligible for the position of insurance commissioner. Thus, the proposed code disqualifies many able persons who might make excellent commissioners.

Experience in other states has demonstrated that some of the most effective and able insurance commissioners had no previous experience in the insurance business or in state insurance departments. In many cases they were distinguished attorneys or public servants who had the administrative and technical acumen to enable them to become distinguished regulators.

The proposed qualifications would be unsound in any state, but are especially inappropriate in a small state like Nevada. For under the proposed qualification law, the commissioner must come from the handful of those in the insurance division, their predecessors, or from out-of-state insurance departments. Otherwise the commissioner would have to come from the ranks of the insurance industry. As a result, the structure of the law not only bars able persons but also almost guarantees a bias in favor of the insurance industry.

There is no reason to absolutely rule out the choice of a commissioner from the ranks of the insurance business. But there is also no reason to structure the law, so that the commissioner is most likely to come from the insurance business. Under the proposed law, of necessity most persons eligible for commissioner would have connections with the business.

Even if the commissioner does not come from the ranks of the insurance business, he is often insurance industry oriented. As the Committee on the Judiciary of the House of Representatives has pointed out:

> Regulation of an industry that has some of the characteristics of a public utility, as it has developed in the United States, takes place under circumstances where the governmental supervisory personnel and industry representatives perforce work closely, on a day-to-day basis in many cooperative areas. Generally, it is a situation where a small group of public officials must rely upon a much larger group of industry representatives for the basic information needed to discharge public responsibilities. In the course of time, these two groups of individuals become close associates. In addition, in the normal situation, there is a relatively constant flow of personnel between the industry and the regulatory body. In the course of time, cooperative arrangements, with the interests of the respective parties blurred, are substituted for arm's length dealings.

In other words, the commissioner is all too likely to be industry oriented; there is good reason, therefore, not to increase the likelihood of this bias by encouraging the appointment of a commissioner from the ranks of the insurance business.

Every attempt should be made to enhance the chances of obtaining a commissioner who is both able and objective in regard to the insurance business. This can best be done by broadening rather than restricting the circle of those eligible for appointment as commissioner.

2. INSURANCE MARKETING METHODS

In recent years, there has been great stress on the need to provide more economical insurance marketing methods. For example, the President's National Advisory Panel on Insurance in Riot-Affected Areas pointed out that "more economical methods of marketing insurance should be encouraged" (p. 107). A recent report by the Small Business Administration, prepared for the Congress, concluded: "There is a need for . . . a structuring of the methods of the insurance industry to bring about lower costs and more adequate insurance" (p. 17). An examination of recent statistical reports on the insurance industry indicates that on some lines and for some companies 45 or 50 percent of the premium dollar may go for expenses (see, for example, *Best's Aggregates and Averages* (1969) for statistics relating to the property-liability insurance business).

When the most economical methods of marketing insurance are not utilized, the public is forced to pay more than it should for insurance protection. Even more important, the high cost of insurance may limit its availability. For the public may not be able to afford it; and insurance companies may find it is un-

economical or impracticable to make it readily available if too few people are able to buy the coverage. An insurance executive testifying before the President's National Advisory Panel on Insurance in Riot-Affected Areas admitted that one reason crime insurance was not readily available was that the marketing expenses were excessive (Hearings of President's National Advisory Panel on Insurance in Riot-Affected Areas, p. 248).

There are several provisions in the proposed law which needlessly impair the ability of insurance companies to market insurance in the most economical manner.

A. *Improper Prohibition of Group Property and Liability Insurance.*

A section of the proposed law entitled "Fictitious Groups" (sec. 334) has a technical and innocuous ring when subjected to hurried reading. However, it has far reaching implications for it is designed to prohibit group property and liability insurance (such as group automobile and homeowner's insurance).

The advantages of group life and health insurance are well-known, and almost universally enjoyed. For example, over 31 million people are covered by group health insurance covering the disability risk while over 138 million persons have group health insurance covering basic hospital expenses.

The same advantages of group life and health insurance are applicable to group property and liability insurance. Yet the benefits of group approach have been needlessly withheld from the public by state insurance laws such as sec. 334 of the proposed Nevada insurance code. This so-called fictitious group provision proves that

> No insurer, whether an authorized insurer or an unauthorized insurer, shall make available through any rating plan or form, property, casualty or surety insurance to any firm, corporation or association of individuals any preferred rate or premium based upon any fictitious groupings of such firm, corporation or association (sec. 334(1)).

This kind of statute has been interpreted to mean that a group property and liability policy cannot be written which provides a discount or other special consideration to the group. Thus the discount and economies available to the group life and health insured are denied the property and liability insured. The general provisions of fictitious group law would even make group life and health insurance illegal, but for a special exception, which reads: "This section does not apply to life insurance, health insurance, annuity contracts or wet marine and transportation insurance" (sec. 334(3)).

Group insurance should be clearly legalized and made available to the public. The manifold advantages of group property and liability insurance should not be needlessly withheld from the public, especially in times of ever-rising and sometimes prohibitive insurance costs.

B. *Improper Restraints on Group Life Insurance*

Group life insurance is one of the most economical methods of providing insurance. It also has the advantage of insuring the "uninsurable" by covering the membership of entire groups including both those in good and bad health. For these and other reasons, group life insurance has demonstrated phenomenal growth and popularity. Today $343 billion of group life is in force in the United States.

Yet legislation has unreasonably restricted the growth of group life, including the proposed Nevada law. For example, section 454 authorizes the group insurance of members of an association but only one whose members "are in the same industry occupation or profession." Thus, associations of diverse occupational make-up are denied the benefit of group insurance. Section 455 permits the benefits of group insurance to dependents of group members. But this section limits the coverage to a maximum of $2000 on a spouse and $1000 on a child.

These restrictions are unnecessary and are designed for anticompetitive reasons. All such restrictions should be stricken from the group life insurance law which is Chapter 18 of the proposed code.

C. *Improper Prohibition of Wrap-up*

A method closely akin to group insurance is the so-called "wrap-up." This is a method by which a builder provides all of the insurance for all contractors and subcontractors on a construction project under a single contract. It is most commonly applied to liability and workmen's compensation coverage.

Although the wrap-up is a relatively recent development, it is now widely used on large construction projects. Among its advantages are the following:

(1) Because the owner buys the insurance, he can save money by the economies of mass merchandising;

(2) Because a single insurer is involved and because it obtains a substantial premium, it can execute a more comprehensive and effective loss control program and improve job safety and minimize death and injuries on the job;

(3) Because only a single insurer is involved, there is no need for excessive subrogation suits between the insurance companies of different contractors or subcontractors.

For these and other reasons, the wrap-up has found increasing favor as a method of saving not only dollars but life and limb.

Section 332 of the proposed code would make the wrap-up illegal for public construction contracts in Nevada. For it prohibits officers and employees of this state from negotiating, making application for, or obtaining or procuring contracts of insurance "which can be obtained or procured by the bidder, contractor or subcontractor" (sec. 332(2)). Therefore, the state would be prevented from buying the wrap-up contracts for state construction projects. This will mean higher costs and more work injuries on state construction projects, and a greater burden on the taxpayers and construction workers of Nevada.

The wrap-up should not be prohibited. It should be clearly legalized and encouraged.

D. *Improper Restraints on Vending Machine Marketing*

The use of the vending machines for insurance marketing can provide the consumer with convenience and economy. Virtually all air travelers are now familiar with vending machines in the airport used for selling travel accident insurance.

The proposed code authorizes the sale of insurance through vending machines (sec. 226). The authorization is limited, however, to the sale of "personal travel accident insurance policies." There is no reason to limit sales to this one kind of insurance. It may be convenient, economical, and practicable to market other lines of insurance through vending machines and the way should be open to do so. This section of the proposed code should be broadened to authorize the marketing of any line of insurance that can be properly marketed through vending machines.

3. METHODS OF PROVIDING INSURANCE FOR THOSE WHO CANNOT OBTAIN INSURANCE IN THE VOLUNTARY MARKET

Insurance has become an economic necessity. Homeowners and businessmen cannot obtain credit without insurance. New homes will not be built and new businesses will not be established without insurance. The public that requires automobile insurance also requires automobile transportation. Physicians are reluctant to practice medicine without the protection of malpractice insurance. Businesses of every kind require adequate insurance markets.

Because insurance is an economic necessity, provision must be made to make it available when the private insurance market refuses to provide it. The proposed code authorizes casualty insurers to make agreements to apportion insurance applicants among themselves when such applicants cannot obtain insurance by ordinary means (sec. 370). This kind of provision may work when insurers are willing to act and can obtain agreement. Insurers may be unwilling to act or may be unable to reach agreement.

The proposed law provides the commissioner with authority to set up insurance pools or assigned risk plans when they are needed and are not forthcoming on a voluntary basis. The proposed law also fails to cover the need for property insurance (such as fire and extended coverage) in any manner.

The new insurance code should provide the commissioner with authority to act on any essential property or casualty line when there is not an adequate market to provide coverage to those who meet reasonable underwriting standards.

A possible model for Nevada would be Chapter 619 of the recently enacted Wisconsin law.

4. PROVISION FOR PROTECTION AGAINST INSURER INSOLVENCY

Both Congress and state legislators have been paying increasing attention to the problem of insurance company insolvency. Many feel that the public should

be protected against insurance company failures. The consequences to the public and to policyholders of insurance company failure are too serious not to protect against this contingency.

In the case of failure of a life insurance company, the policyholder may lose all or part of his life savings (in the form of cash-value) as well as vital protection for his family. In the case of a failure of a property and casualty company, the burden may be equally crushing if the policyholder is left without protection for a serious loss.

Even states with few, if any, experiences with insurance insolvency have taken steps to protect policyholders. The contingency, however remote, should be provided for.

No one can guarantee that there will not be serious insurance company insolvencies in Nevada in the future. And like other states, there have been insolvencies in Nevada in the past. The 1967 Report of the Insurance Commissioner of Nevada (page g) indicates that a petition for receivership was filed against the Great Basin Insurance Company of Nevada on September 1, 1967; that a petition for receivership was filed against the Mark Twain Life Insurance Company of Nevada in 1966; and that the liquidation of the Blue Cross Life Insurance Company of Nevada was completed in September of 1967.

There is a systematic method of protecting against insurer insolvency. If there are no insolvencies the method is costless. If there are insolvencies, the loss to policyholders may be provided for by an assessment, after the insolvency, against all insurers doing business in the state.

A good model for such an insolvency law is the recently enacted Chapter 646 of the Wisconsin law. It is financed on a post hoc assessment basis, that is, on assessments made against the insurance industry if and only if an insolvency occurs. It covers all lines of insurance.

There is ample precedent for such insolvency protection, not only in the Federal Deposit Insurance Corporation and other insurance funds for savings institutions, but also in the growing list of states with provisions for creating funds or assessments to protect policyholders against insolvencies of workmen's compensation insurers, automobile insurers, life insurers and including the comprehensive all-lines law of Wisconsin. Among the other states that have recently enacted comprehensive solvency funds are California, Michigan and New York. In addition, New Hampshire passed legislation creating a fund for protection against insolvency of automobile insurers. Other states that have solvency funds, for one or more lines of insurance, include Connecticut, Maryland, Minnesota, New Jersey, Pennsylvania, and North Carolina.

5. PROVISION LIMITING INSURANCE COMPANY CANCELLATIONS

Insurance that is not dependable does not afford the economic and psychological security it is designed to provide. Insurance that is subject to short-notice and arbitrary cancellation is not dependable and does not fully perform its function.

There has been a legislative trend underway for many years to more adequately protect policyholders against arbitrary short-term cancellations.

Nevada's present law has few limitations on the right of an insurer to cancel insurance. Few, if any, would recommend complete elimination of the insurer's right to cancel. There is no reason, however, for not regulating this right to cancellation more carefully.

Wisconsin has recently acted on this problem by limiting the insurer's grounds for cancellation to nonpayment of premium and such other grounds as the commissioner may approve for inclusion in the policy (see Chapter 631 of the Wisconsin law).

If the insurance company does not have grounds for cancellation, under the new Wisconsin law, he must let the policy continue to its termination date and then refuse to renew the policy. The insurance company must, however, give 30 days notice of its intention not to renew.

6. PROVISION FOR PROTECTION OF POLICYHOLDERS AGAINST EXCESSIVE RATES

A. *Improper Exemptions from Present Rating Law*

All states have rate regulatory laws in order to protect the public against rates that are excessive or discriminatory. The proposed code has a general rating law (Chapter 15). It fails to adequately control all lines of insurance in need of regulation.

The most obvious omission is credit life and health insurance which has been subject to widespread abuse. Extensive Congressional investigations, notably

in 1967, document widespread overcharges for credit life and health insurance.

Under the proposed general rating law, life and health insurance are exempted (secs. 342 and 343(2)). Other, but inadequate, regulation is provided elsewhere in the proposed law for some life and health lines. For example, section 529(2) prohibits credit life and health policies "if the table of premium rates charged or to be charged appears by reasonable assumptions to be excessive in relation to benefits," and 386(4) contains similar controls over life, health and annuity policies. As the experience of other jurisdictions demonstrates, this kind of cursory regulation provides inadequate protection to the public against overcharges. For this reason it is recommended that credit life and health insurance be subjected to the comprehensive and carefully drawn regulatory structure of the general rating laws. Like credit life and health insurance, the proposed code does not adequately regulate title insurance (which is covered by Chapter 25). There is no reason why the protection of the rating laws should not extend to virtually all lines of insurance. This approach was recently followed in Wisconsin's New Chapter 625 (secs. 625.03(4) and (6)).

B. *Economically Illogical Standards for Ratemaking*

Chapter 15 on "Rates and Rating Organizations" provides for certain standards and criteria to be used in rate making (sec. 344). It is provided that due consideration shall be given to "a reasonable margin for underwriting profit and contingencies" (sec. 344(1)(b)). The bill, therefore, proposes to ignore the investment income of insurers in establishing rates that are "not excessive, inadequate or unfairly discriminatory."

It is economically illogical to ignore investment return in the ratemaking process. Any businessman in setting prices is concerned with his total return on the product he is attempting to price. A banker, for example, in establishing the price of a checking account, would be foolhardy if he ignored the potential investment return on the money placed on deposit. For this reason, many banks offer checking accounts without any charge to the depositor; the expenses of the service are more than offset by the investment return on the funds.

If total return on premium writings, including investment income, were not taken into account, this would be evidence of a lack of a health competitive market.

The regulatory system should pay heed to elementary economic logic and consider total return on premium writings in setting rates. There is a definite national trend toward taking investment income into account in setting rates because of the obvious economic logic of so doing.

The Nevada law should require the commissioner to take full return into account by striking "underwriting" from the phrase "a reasonable margin for underwriting profit and contingencies."

C. *More Flexible Rating Laws*

There is a national trend to enact more flexible rating law to encourage open and vigorous competition in the insurance business. New York and Wisconsin, for example, are two leading regulatory states that have enacted such laws. Their laws permit great flexibility to lighten regulation when there is competition and to tighten regulation when there is no competition or when rates are unreasonably high.

Chapter 15 of the proposed code, entitled "Rates and Rating Organizations" is not an unduly inflexible law but it could be remodeled to make it even more flexible and effective from a regulatory point of view. For example, the commissioner should be able to ease or lighten regulatory burdens when they are unnecessary for a given line. By like token, he should be able to tighten regulation when necessary to protect the public. The proposed code makes rate filings effective when made (sec. 347). The commissioner should also have power to rule that filings are not effective until on file for a specified period or until formally approved. Likewise, he should have authority to eliminate filing requirements for any or all lines of insurance.

The rating law should be restructured to make competition effective to the fullest, but to be able to most fully regulate to eliminate abuses when necessary.

7. METHODS OF MORE EFFECTIVELY MOBILIZING THE CONSUMER INTEREST

The insurance regulatory process provides continual contacts between the insurance commissioner and the industry he regulates. There is also a need to assure that the consumer interest receives adequate recognition.

A. *Consumer Advisory Councils*

One method of mobilizing the consumer interest is through appointment of advisory councils (or committees) by the commissioner, in order to obtain a consumer viewpoint. Advisory councils might also be used to obtain viewpoints of agents, insurers, or others on specific regulatory problems.

There is ample precedent, both in the United States and abroad, for statutory authorization of advisory councils. Typically, they are used to obtain industry views. There is no reason why they cannot be used to obtain consumer and policyholder views as well.

A simple statutory provision can be inserted in the code to expressly authorize the commissioner to create advisory councils or committees for various purposes.

B. *Statutory Authority to Require the Insurance Companies to Review Complaints*

(Corporate Ombudsmen) Policyholders often have disagreements with insurers involving small sums that make litigation prohibitively expensive. There is a need for methods of informally settling such complaints, without litigation and with formal proceedings.

One method of disposing of policyholder complaints is through a special unit established in the insurance department. The Nevada Insurance Division now has a Policyholder Complaint Section. The 1967 Annual Report of the Commissioner of Insurance describes the activities of this section (pp. d–e). The Report notes:

> The handling of policyholder's service requests is still an ever increasing burden on our limited number of personnel in this section. In order to continue providing this service to the insurance buying public, it will be necessary to increase the number of personnel handling these matters and to upgrade the personnel classifications thereof.

The Policyholder Complaint Section should receive the support it needs. To supplement the work of this section, and in part to eliminate the need therefor, an attempt should be made to have insurance companies give policyholders a better channel of appeal within the corporate organization itself. Even the Armed Forces provide a channel of administrative appeal for aggrieved claimants under the claims statutes they administer.

Insurance companies should appoint "corporate ombudsmen" or establish similar machinery to permit aggrieved policyholders and claimants to "appeal" a decision of a claimsman or other insurer personnel. The companies should be encouraged to appoint "corporate ombudsmen" on a voluntary basis. The insurance commissioner, however, should be given statutory authority to make rules and regulation for the establishment and duties of corporate ombudsmen.

In addition to such corporate ombudsmen, or possibly in their stead, the insurance companies might set up special industry-wide agencies to process claims. There is precedent for such action. For example, in the State of Wisconsin, the industry has set up an "Insurance Information Center" to process and investigate complaints against insurers and to answer insurance inquiries. The Center has operated since September of 1967. The Center's literature states:

> As a public service, the Wisconsin Insurance Alliance companies have established a "Complaint and Inquiry Program." The purpose is to provide a "clearinghouse" through which the general public may direct complaints or inquiries. In turn, these are referred to the insurance companies involved for investigation and reply.

Whether set up by individual companies, or by the industry acting together, these complaint and inquiry units might be subject to similar regulatory supervision.

The industry has always advocated self-regulation. It should on this occasion be taken at its word.

8. METHODS OF UTILIZING INSURANCE INDUSTRY'S STOREHOUSE OF INFORMATION AND EXPERTISE ON LOSS PREVENTION

A recently passed Wisconsin insurance law states that one of the purposes of insurance regulation is the encouragement of "loss prevention as an aspect of the operation of the insurance enterprise." There is also precedent abroad for making loss prevention a purpose of insurance regulation.

The insurance law might bring pressure for loss prevention activity by requiring all insurers operating in Nevada, and all rating bureaus and statistical agencies to report annually on their loss prevention programs, and the loss implications of their statistics, underwriting, and claims files. In addition, these

reports could include facts and statistics relating to loss prevention that the insurers and other organizations have available for public scrutiny.

Many insurers and trade associations have contended that it is not practical for individual insurers or organizations to undertake loss prevention research. Safety research may produce inadequate benefit for one organization, but rich rewards for the industry and society. Consideration should be given to requiring a certain amount of loss prevention work by insurers and their organization.

In any event, the proposed insurance code of Nevada should include statutory authority to permit the commissioner to see to it that the information and expertise of the industry in loss prevention is more effectively utilized. We had the facts needed to launch an automobile safety program in the 1940's but we did nothing until recently while millions were slaughtered on our highways. We have the facts now to prevent many other kinds of accidents and the time has come to utilize this invaluable information to save lives and property. The Nevada insurance code should see to it that needed steps are taken in this direction now. Therefore, needed provisions to achieve this end should be included in the proposed Nevada insurance code.

The insurance industry is in a unique position to do effective work in loss prevention activity. It has both the expertise and the vast store of information and experience that should be utilized now to save lives and property.

The insurance industry has a storehouse of information in its claims files that if made public would be invaluable in formulating loss prevention and safety programs. Insurance companies have millions of files with detailed information about almost every kind of human disaster imaginable—automobile accidents, slips and falls on stairways, fires, medical malpractice, building collapse, and so on virtually without end.

At the same time the industry employs thousands of engineers, inspectors, claimsmen, underwriters and other experts who understand the conditions that breed disaster and that kill, cripple and destroy in a continuous and unending tragedy. Many of our individual and national catastrophes are preventable, but those in the best position to act have done too little and too late.

Available information is not exploited for the public good. It is often buried in the archives of insurance companies. It may remain unexamined and unanalyzed and not be used to warn others who may experience similar accidents in the future.

Steps are urgently needed to assure that information and expertise within the insurance industry goes to work now to prevent accidents.

The insurance law should see to it that the industry capitalizes on its opportunities to prevent accidents and minimize losses.

APPENDIX 3

Insurance Regulation: The Search for Countervailing Power and Consumer Protection

(By Herbert S. Denenberg)

The author emphasizes the need for a sound insurance code and calls for inclusion of the consumer's voice in the regulatory dialogue. Herbert S. Denenberg is the Harry J. Loman, Professor of Property and Liability Insurance at the Wharton School of Finance and Commerce at the University of Pennsylvania. He presented this paper at an "Insurance Clinic" on Insurance Industry Regulation sponsored by the District of Columbia Chapter of the Society of Property and Casualty Underwriters on March 27, 1969.

Discussions of insurance regulation tend to concentrate on overriding substantive issues like the automobile problem, the center city insurance problem, and the holding company problem. These problems surely deserve emphasis, but sometimes an even more fundamental issue is neglected.

THE FUNDAMENTAL ISSUE

That more fundamental issue is how to provide a field of forces that is capable of generating sound insurance regulation. How can we structure insurance regulation to protect the public interest? How can we structure regulation to guarantee that all interests are given consideration and to provide countervailing power to that of the industry? How can we provide a regulatory environment

that protects the legitimate interests of the consumer and those of insurance companies and producers alike?

I'll attempt some answers to these questions by asking how insurance regulation can be restructured and how a field of forces can be created to provide that all views will be represented in the regulatory process, including those of the consumer.

To get some answers, I propose to look at the need for insurance law revision as well as the contribution of different groups to the regulatory dialogue—the regulators, the companies, the producers, the press, the professors, and the consumers.

A SOUND INSURANCE CODE

Part of the answer lies in producing a sound insurance code. This involves both careful, technical analysis, economic and legal research, and sound statutory draftsmanship.

It calls for the kind of comprehensive revision that is now taking place in Wisconsin. In 1965, the Wisconsin legislature found that the public welfare and interest could only be protected by a "thorough, careful study and modernization, revision and codification of the insurance laws to reflect the expansion of the insurance field and its increased competitive nature under present conditions," and called for a "unified, comprehensive study of the state insurance laws."

DELINQUENCY PROCEEDINGS IN INSURANCE

As a result of that legislative mandate, Wisconsin has been in the forefront of insurance law revision. For example, Wisconsin has produced legislation dealing with insolvent and delinquent insurance companies that has been recommended for nationwide adoption by the NAIC. This legislation has little sex appeal compared to, say, the rating laws, but it illustrates the endless chain of problems that must be solved to provide sound insurance legislation. The new Wisconsin legislation gives the Commissioner the authority he needs to deal with companies that are veering toward financial trouble or that are failing to protect the rights of policyholders or that are otherwise violating the law.

Under the new legislation, the Commissioner can issue a summary order in an informal proceeding which need not be public, requiring the company to conform to the law. The company's rights are fully protected, and it has recourse to the courts at any time to challenge the Commissioner's action. Under the old law, the Commissioner had the option of doing nothing or throwing the company into receivership, a radical measure which could be disastrous to the company.

The legislation also provides for distribution of the assets of a company that is liquidated with a system of priorities that makes economic and social sense. Surprisingly enough, under the laws of some states virtually all creditors have the same priority in the event of liquidation. The new Wisconsin law is carefully worked out to give loss claimants the highest priority, followed by claimants for the unearned premium reserve, followed by other creditors whose claims are considered of lesser urgency and social importance.

WISCONSIN CONSUMER PROTECTION ACT OF 1969

Perhaps a more dramtic illustration of the work of the revision is the draft of the Wisconsin Consumer Protection Act of 1969. This legislation was worked out at about the same time as the more publicized New York legislative package, but the Wisconsin legislation goes far beyond it in providing new consumer protection. The draft of this proposal may change before it becomes legislation. In my opinion, it is perfectly sound as it now stands.

The Wisconsin proposal guarantees all Wisconsin policyholders against loss or delay in the event of an insurance company insolvency. It protects both life and nonlife policyholders and both small and large policyholders. The New York bill is designed to protect only a limited class in limited amounts.

The Wisconsin proposal protects all policyholders—large and small—in all lines—against unjustified mid-term cancellations. New York's bill, again, protects only a limited class of policyholders in a limited number of lines.

The Wisconsin proposal opens up the assigned risk plan to provide all automobile coverages now considered essential in adequate amounts, and hence closely follows the New York bill. But it does much more. It permits new coverages to be added if and when they become essential. It is clear that the automobile insurance business is undergoing profound change, and coverages not even on the market today may be considered essential tomorrow. But the Wisconsin pro-

posal goes beyond providing a mechanism for solving today's and tomorrow's automobile insurance problems. It authorizes the Commissioner to establish an assigned risk plan for any kind of coverage when the insurance market does not provide an adequate supply of insurance on a voluntary basis.

Finally, the Wisconsin proposal does away with prior-approval rate regulation and substitutes use-and-file legislation. But it also gives the Commissioner full authority to go to a file-and-use approach. The proposal, unlike that of New York, covers all lines of insurance without exception. The proposed legislation, unlike that of New York, expressly authorizes group property and liability insurance, a sound and inevitable merchandising method.

That is one slice of the Wisconsin revision, which has also produced comprehensive proposals relating to the corporation law of insurance and the investment law of insurance and will eventually produce the first comprehensive across-the-board, in-depth study and revision of the insurance law in modern times.

It is strange, indeed, that Wisconsin is the leader in insurance revision, while the great industrial states have failed to provide the resources or leadership to produce needed revision of the insurance laws. There is a gerat deal of talk about state's *rights*, but little action on state *responsibilities*. No wonder the states are in danger of becoming vestigial remnants in view of their sorry record of performance.

So much for the need of providing sound insurance laws, for that is only a fraction of the problem.

NEED FOR A CONSUMER VOICE

There is also an urgent need to provide a regulatory and perhaps an extra-regulatory structure to assure that the consumer has a voice in the determination of public policy relating to insurance.

For the fact of the matter is that the insurance industry has the most effective, if not the dominant, voice in the determination of the law and practice of insurance regulation. It is a sad and simple fact of life that the regulated provide a greater disciplinary force on the regulator than vice versa. Sometimes it can be asked who is the regulator and who is the regulated.

The law is sometimes almost drafted to achieve the wrong result. One state has the following statutory provision relating to the qualifications of the Commissioner:

"The commissioner shall have at least 5 years of responsible experience as an executive officer of an insurance company or as an administrative officer of a state insurance department, or at least 5 years of continuous active participation, immediately preceding his appointment, as a licensed agent in this state. . . ."[1]

Despite the law and despite good intentions, the regulator is likely to become a captive of the regulated. The process which captures the regulator—whether Insurance Commissioner, Securities Commissioners, or what-have-you—has been described by a former chairman of the Securities and Exchange Commission as follows:

"Part of the process of becoming a 'captive' may stem from the fact that the parties are dealing with the industry day to day and begin to appreciate their problems without taking due account of the public interest."

This same problem was explained in another way by the Landis Report on Administrative Agencies:

"Irrespective of the absence of social contacts and the absence of undue hospitality, it is the daily machine-gun-like impact on both agency and its staff of industry representation that makes for industry orientation on the part of many honest and capable agency members as well as agency staffs."

This problem has recently been analyzed specifically in the insurance context by a report of the Committee on the Judiciary of the House of Representatives:

"Regulation of an industry that has some of the characteristics of a public utility, as it has developed in the United States, takes place under circumstances where the governmental supervisory personnel and industry representatives perforce work closely, on a day-to-day basis in many cooperative areas. Generally, it is a situation where a small group of public officials must rely upon a much larger group of industry representatives for the basic information needed to discharge public responsibilities. In the course of time, these two groups of

[1] Nevada Insurance Law, sec. 680.040 (1).

individuals become close associates. In addition, in the normal situation, there is a relatively constant flow of personnel between the industry and the regulatory body. In the course of time, cooperative arrangements, with the interests of the respective parties blurred, are substituted for arm's length dealings."

The natural tendency of the regulator to be captured is facilitated by his lack of adequate staff, professional advice, and research capability. Commissioners often operate with inadequate personnel, the shortage of lawyers and actuaries being the most obvious and notorious. The Commissioner is often unable to develop the facts he needs to do a job. As a result, the Commissioner sometimes relies on facts and positions developed by the industry, often to the detriment of the consumer and the public.

This lack of resources has another deadly effect. The Commissioner is kept busy with brush-fires and day-to-day encounters. He lacks the time and resources to take the long look. His staff often lacks the imagination and initiative to come forward with new ideas and new programs. He is channelled into programs and dialogues the industry is interested in pursuing.

Fortunately insurance regulation in many states is beginning to improve, if not undergo a renaissance. Whatever the deficiencies of state insurance regulation, it is clear that it is vastly improved in the last decade and certainly in the last few years. There is every evidence that this much-needed trend will continue.

But it would not be enough simply to give the Commissioner greater resources and a larger staff. There must be mobilization and perhaps creation of countervailing power to match that of the industry. An effective and direct consumer voice would be an ideal but perhaps unattainable solution; but there are various sources of countervailing power that can provide the consumer important protection and help assure that all viewpoints are given full consideration in the determination of regulatory policy. There are several potential sources of this countervailing power, but they have not materialized in full or at least have not been fully effective.

Sources of Countervailing Power

THE INDUSTRY

One possible source of countervailing power is within the insurance industry itself. Various segments of the industry, with different points of view, can sometimes create a climate or a framework for a careful examination of the issues at stake. The divergence of interests between producers and companies or between different kinds of companies can sometimes redound to the benefit of the public.

The effectiveness of this kind of countervailing power has been weakened, in my opinion, by the inept political performance of the agents. They have not yet created the know-how and the staff to effectively present their case on many issues. They tend to rely too much on their naked economic interests as justification for their positions without fully developing a case that may exist and may be worth making. Their approach to group property and liability insurance is a horrible example. Agents could do themselves and the public a favor if they became a more effective, responsible and enlightening force in the political arena of regulation.

If producers were to be more effective in influencing legislation and regulation, it could well be to the benefit of consumers, for the agent and broker are closer to the buyer and often more consumer oriented. I recently suggested that the university professor and the large buyer—as represented in the American Society of Insurance Management—would form a natural alliance to bring a more consumer-oriented view to insurance regulation. Alexander Picone, writing in the *Journal of Commerce* (March 13, 1969), suggested that the agent and broker were also likely members of this alliance, and I think he is right.

THE PRESS

Still another possible source of countervailing power is the press. The trade press certainly has not done a job of providing countervailing power. The press is subject to pressure from advertisers, but the trade press is always especially vulnerable. The insurance trade press is the servant of the industry, not its critic. It is not even a good servant. It does so little digging and reporting that it fails to tell the industry what it should know.

A classic example of this failure to report the news concerns the Puerto Rico Social Protection Plan, the first automobile compensation plan ever passed in a United States jurisdiction. This plan was front page news in Puerto Rico for

two years, but it was not until the plan was passed virtually unanimously by the legislature of Puerto Rico that the trade press reported on this law.

One reason the industry may be slow in responding to public needs and political realities is that it may rely on a trade press that is an apologist rather than a critic, a compiler of company press releases rather than a gatherer of facts, a passive recipient rather than an active investigator. The trade press may avoid rather than face reality.

The trade press fails the industry just as surely as our daily newspapers fail the public. An insurance reporter of one of America's great newspapers said his job was easy. He described it as one of telling the public and the business community what is happening in the insurance industry. His job was made easy, he claimed, as little information is forthcoming from the industry. Like the trade press, our daily newspapers are too often content to digest whatever they are fed.

Our daily press does not distinguish itself either with careful and reliable reporting. Important insurance stories that have sometimes been incubating and developing for months or even years are often handled by reporters who were not among those assigned to covering previously related developments. There is a limit, of course, to how many specialists a newspaper can afford; but there is also a limit to how effectively a general practitioner reporter can correctly and adequately report under severe time limitations on a technical and complex subject like insurance.

A newspaper industry that can barely report the facts can hardly be expected to be critical or to be a crusader or to provide the kind of countervailing power that is needed. The insurance industry and the public will have to look elsewhere for critics.

There is one promising journalistic development and that is the emergence of a buyer-oriented segment of the trade press. The buyer provides a natural source of countervailing power that is more likely to be critical of the insurance industry, and that naturally tends toward the consumer interest.

THE BIG BUYER: ASIM

This new brand of journalism suggests another important source of countervailing power. That is the big buyer and the organization of big buyers— the American Society of Insurance Management (ASIM). Thus far ASIM has not been especially effective in the determination of public policy for insurance. But ASIM is coming of age, and there are signs it will be more effective in the future. It has recently appointed a legislative counsel to serve in Washington, D.C., and I suggest dramatic progress is in the offing.

ASIM represents only one segment of buyers, but it nevertheless holds promise of providing an authentic expert and effective consumer voice. For that reason, I have suggested that both the universities and ASIM have a special role to perform that is essential to the development of social practices and sound legislation relating to insurance. That role is to provide expertise, some measure of objectivity, and perhaps the most significant countervailing power available in the determination of insurance regulatory, legislative, and marketing practices.

UNIVERSITIES: THE INSURANCE PROFESSORS

So we have another source of countervailing power—the universities. According to Daniel Bell, "the university . . . is the place where theoretical knowledge is sought, tested and codified in a disinterested way. . . ." Has the university provided this disinterested voice, this much sought after ingredient of countervailing power?

Perhaps we can answer that question by observing the university professors of insurance, most of whom are members of the American Risk Insurance Association.

According to James Ridgeway, writing in *The Closed Corporation: American Universities in Crisis:*

"The insurance industry runs one of the cleverest public relations operations in the country. There are some 350 members of the American Risk and Insurance Association, Incorporated, a professional group of insurance and economics professors which maintains its headquarters at the State Farm Insurance building at Bloomington, Illinois. A questionnaire sent to the members of the association revealed that eighty of the 151 people who replied were either consultants or taught summer classes for insurance companies. Twenty professors said they were directors of insurance companies."

Like most muckraking, the facts quoted are not quite right and the quoted material is far from the whole truth and nothing but the truth. But the flavor of that statement is true. There is an uneasy but strong factual basis for Mr. Ridgeway's claims.

All too often the university professor is the paid tool of the industry, and whether he is paid, or a tool, or both, he all too infrequently voices a consumer point of view. But here, too, there is some recent and dramatic change. In the last few years there have been signs that those interested in insurance at the universities were beginning to become a new and important independent factor on the regulatory scene.

Professors, of insurance and otherwise, are seen in increasing abundance in Washington and state capitols in recent times. This new trend is likely to accelerate even more in the future.

So we see that many of the logical sources of countervailing power and of the consumer viewpoint have not always been fully available. The press and the professor are inert at best, and sold out at worst, but change is in the air.

THE CONSUMER

Change is needed, for the consumer himself, other than the ASIM variety, cannot be expected to fully protect his own interests. All too often the consumer speaks with a voice that is uninformed, irresponsible, and ineffective. He has some organizations to rely on, such as unions and community action groups, but often these organizations are not too far ahead of their members. As an example, the unions (with some exceptions, of course), have done little or nothing to solve the automobile problem or the center city insurance problem. But here, too, there are promises of change, and it may well be dramatic.

The elected representatives in the state capitol have not been overly effective either. The average state legislator is without his own staff assistance, is generally woefully uninformed on insurance matters, and has not represented his constituents effectively on insurance questions. Our state legislators are underpaid and understaffed—like our insurance commissioners—and in both cases the results have often been unpromising.

AN OVERVIEW

The picture painted is a bleak one for the consumer, but it is not without hope. I have concentrated on the dark side of the coin, but there is another side too. New and intriguing alliances of consumers are being proposed and are beginning to emerge.

Aware of the need for countervailing power, the regulator is beginning to institutionalize it. Maryland's Commissioner, for example, appointed a consumer group to help bring into focus the public's point of view. This is a sound development and one that should and is becoming more widespread. For example, in the District of Columbia, the Mayor's Committee on Economic Development brings an independent voice to insurance matters.

In recent years insurance regulation itself is undergoing a renaissance—a development that cannot be overemphasized—and the public can surely raise its expectations.

A variety of federal investigations now in progress will generate even stronger pressures for improvement in the system of insurance regulation and for protection of the consumer interest.

It would be too much to say that the consumer viewpoint—or as it is sometimes called, consumerism—is about to become overnight the dominant factor in the determination of public policy relating to insurance, but it is clearly becoming a more important factor daily.

The development may serve to better protect the public interest. It must certainly be understood and reckoned with by the insurance industry, and it may prove to be helpful rather than harmful to the industry. It is placing new obligations—sometimes seemingly onerous—on the companies, but it is helping to solve social problems that, if left unsolved, could lead to the death of the industry and the substitution of state insurance. Furthermore, it is helping to provide the industry with new opportunities and new freedom—including the promise of liberalized rating laws. Perhaps the new approach to rate regulation is the best example that consumerism is a new factor in the insurance equation, but one that may be helpful rather than harmful to an intelligent and responsive industry. [The End]

APPENDIX 4

[Excerpts from Business Insurance]

PHONY INSURANCE FIRMS FACE CRACKDOWN BY U.S. POST OFFICE AUTHORITIES

Chicago—A sweeping investigation by postal authorities is under way to expose the nationwide problem of mail-order type insurance companies that are selling phony insurance protection to corporate buyers under the guise of plugging the capacity gap.

Complaints to postal authorities and state insurance regulators indicate that the marginal insurance operations frequently use the names of respected companies as fronts or "reinsurers" to sell corporate insurance protection. Some of the companies involved are nonadmitted carriers that operate through licensed agents and brokers who unwittingly sell their worthless policies.

"They're going hog wild," a postal investigator told *Business Insurance*. "In fact, this is quite a keg of worms because the sharp operators move from company to company and sometimes operate four or more at a time."

He described the typical operation as one that writes policies in a nonexistent or nonadmitted company and advertises in solicitations and on the policy forms that the company is "100% reinsured" by some recognized company.

"Unfortunately, it turns out that the 'reinsuring' company knows nothing about the supposed primary insurer," the postal inspector said.

One scheme under scrutiny involves a nonadmitted insurer in Missouri taking advantage of a legal loophole that allows farm mutual companies to operate in the state without the jurisdiction of the Missouri insurance department.

The risk manager of a major firm that bought questionable coverage from the company brought its operations to the attention of *Business Insurance*. He suggested that other risk managers be wary of where their coverage comes from and warned that Bermuda-based insurance companies may be used to cover up the nonadmitted carrier's operations.

Officials of the Missouri insurance department said they are powerless to act against the nonadmitted insurer, but they said they had received complaints from as far away as Ethiopia about the company's practice of denying liability. One such claim involved a $2,000,000 oil rig loss that resulted in a $137,000 loss to the insured because the Missouri-based nonadmitted carrier refused to pay its 2% share of the loss while other companies settled their claims.

CLOSE THE LOOPHOLE

Complaints to the Missouri department of insurance indicate that at least two insurance companies are taking advantage of a wide loophole in the state's insurance regulatory laws to sell questionable coverage to businesses out of state.

Both firms are chartered as farm mutuals in Missouri and as such are totally exempt from the authority of the state insurance department. They file no annual statements and their investments are not subject to audit by responsible authorities. Farm mutuals in Missouri need only file a notice of incorporation with the secretary of state.

Theoretically such companies are allowed to write only property insurance coverages in their home counties and adjacent counties. But in practice some Missouri farm mutuals have solicited business in other states and complaints have come from as far away as Ethiopia.

Among the states only Missouri exempts farm mutuals from insurance department regulation. And, though we have heard arguments for nonregulation from farm mutual operators, we believe that it is in the best interests of both insurance buyers and insurance carriers that the Missouri loophole be closed promptly.

We suggest that the American Society of Insurance Management, in cooperation with the National Association of Insurance Commissioners and major insurance trade associations, move now to correct this problem. Insurance regulation nationwide is, after all, only as strong as its weakest link.

MISSOURI'S UNREGULATED FARM MUTUALS POSE PROBLEM FOR BUYERS

St. Louis—Irregularities in the operations of at least two unregulated farm mutual companies located here have drawn the attention of U.S. Post Office officials, the Missouri insurance department and insurance associations on state and national levels.

Complaints from insureds to the Missouri insurance department have centered recently around Farmers and Merchants Mutual Fire Insurance Co. and Bankers Security Mutual Insurance Co., both of which operate as unregulated farm mutual companies because of a loophole in Missouri's insurance laws. Missouri is the only state that does not require farm mutuals to come under insurance department regulation.

Buyers of corporate insurance programs have complained to the Missouri insurance department that the two companies have been involved in selling insurance in places as far away as California and Ethiopia, despite provision in their charters that limits their underwriting to their home county and adjacent counties.

The insurance department is able to do nothing about the complaints except to build extensive files of letters from insureds who have been disappointed in attempts to collect on claims and from those who question the underwriting capacities of the companies.

Questionable practices by certain farm mutuals in Missouri led to the enactment of reform legislation in 1953 that required that farm mutuals organized after passage of the law come under the jurisdiction of the insurance department. This law, however, did not affect more than 100 existing farm mutuals including Farmers and Merchants, organized in 1946, and Bankers Security, organized early in 1953.

Members of the legislative committee of the Missouri Assn. of Farm Mutuals are now considering the submission of additional "reform" legislation that would amend the 1953 statute by requiring farm mutuals:

To conform to standard requirements regarding surplus and other factors assuring company stability.

To submit regular annual statements to the department of insurance.

To list their officers and directors in corporate statements filed with the Missouri secretary of state.

Under existing regulations Missouri farm mutuals need only file corporate organization papers with the secretary of state. Only those companies organized after 1953 are under scrutiny of insurance regulators.

Officials of the Missouri insurance department express misgivings about accepting statements of any kind from farm mutuals.

"Right now," said one department official, "we won't accept statements from farm mutuals because we have no power to regulate them. Some who might get their hands on such companies would like us to accept statements because it would give them the color of authority."

The problem of Missouri's unregulated farm mutuals is viewed as serious by responsible executives of insurance trade associations, including Harold W. Walters, executive secretary of the National Assn. of Mutual Insurance Cos., Indianapolis.

"We'd like to see Missouri's farm mutuals under state insurance department jurisdiction," said Mr. Walters, whose association includes 1,120 mutual companies throughout the country. "There have been problems over the years because these companies are unregulated. Improvement is needed and we are sure that is will eventually come."

Mr. Walters' view, however, is not shared by John Staple, secretary of the Missouri Assn. of Farm Mutuals. Mr. Staple told *Business Insurance* that he and most farm mutual operators in Missouri are opposed to placing their companies under insurance department regulation.

"First of all," he contended, "there are more than 100 companies involved and the vast majority have operated successfully and without taint, some for more than a century. Furthermore, the insurance department is already overworked and it doesn't have the personnel to regulate scores of farm mutual companies."

Mr. Staple doubted that the Farmers and Merchants and Bankers Security were actually incorporated as farm mutuals. But a check by *Business Insurance* with the Missouri secretary of state revealed that both companies are "on file" as authorized farm mutuals. But the secretary of state's office has no authority to regulate the companies and, in fact, knows nothing more about them than their addresses and dates of incorporation.

Meanwhile, the Post Office department is turning its attention to mail-order insurance frauds. Postal inspectors in both Chicago and St. Louis are actively investigating illegitimate solicitation of insurance customers. Because of postal

regulations, they will not be specific about their investigations until indictments are returned.

Postmaster General W. Marvin Watson announced in September that the department is investigating a number of mail-order insurance schemes. Announcing the indictment of an Arkansas mail-order insurance operator, Mr. Watson said, "This is not, unfortunately, an isolated case. At the present time our inspectors have 63 questionable operations of this kind under investigation. A total of 37 promoters are now under indictment in these cases and awaiting trial."

Mr. Watson added that insurance "milking" schemes are "too prevalent, particularly in the high-risk auto insurance field."

Inspectors in the Chicago regional office told *Business Insurance* that questionable mail-order insurance sales operations have spilled over from personal lines and into the lucrative area of corporate insurance programs. Some companies under investigation sell through legitimate agents and brokers who, like their clients are unaware that the policies are illegally written and frequently worthless.

Postal authorities warned of these two common ploys:

The adoption of a company name that is similar to that of a respected insurer.

The unfounded claim that a questionable company is "reinsured 100%" by a responsible insurance company. In such cases the companies listed as "reinsurers" have no knowledge of the listing.

If You're Suspicious Call Postal Authorities

Washington—Post Office department officials advised *Business Insurance* readers who are suspicious of any insurance mail-order sales solicitation to call the postal inspector's office in the nearest major city.

"We don't go out looking for such schemes," a spokesman said. "We must depend upon the public to make complaints."

He added that postal inspectors often are able to crack down on insurance schemes because operators of such companies eventually use the mail in some way to further their operations.

NAIC Warns Buyers About 'Mini-Mutuals'

Jefferson City, Mo.—Files of the Missouri insurance department contain mounting evidence that charters of Missouri's unregulated farm mutuals are being illegally used nationwide to underwrite major business insurance risks unrelated to farm coverages.

Meanwhile, corporate insurance buyers and insurance brokers were warned by an official of the National Assn. of Insurance Commissioners to be wary of the use of "mini-mutuals" as "pseudo direct writers" of surplus lines insurance. The warning came from Joseph A. Humphreys, executive director of NAIC's Non-Admitted Insurers Information Office.

Because of a loophole in Missouri law, farm mutual companies organized before mid-1953 are exempt from regulation by the state insurance department. They are, however, limited to writing fire and lightning insurance in their home counties and adjoining counties.

Despite this limitation, a growing number of corporate insurance buyers in states ranging from Washington to Louisiana have unwittingly done business with Missouri's unregulated farm mutuals on risks ranging from oil rigs to trucks to high-limit excess property coverages. Some items:

A legitimate Texas broker reported to the Texas insurance department that it placed hull coverages involving "huge premiums" with Farmers & Merchants Mutual Fire Insurance Co., St. Louis, because it relied upon a 90% quota share reinsurance agreement between Farmers & Merchants and World Insurance Co. Ltd. of Bermuda. The broker, moving quickly to place the coverages elsewhere, vowed to do no further business with either insurer.

An inquiry to the Missouri insurance department from a Florida businessman revealed that Farmers & Merchants had written an auto liability policy in direct violation of statutory limitations on its underwriting scope. The department informed the corporate executive that "such companies (farmers' mutuals) are authorized under Missouri statutes to write only fire and lightning coverage and are specifically prohibited from writing automobile coverage."

Business Insurance was informed by an irate California risk manager that he had obtained excess property insurance coverage from Farmers & Merchants through his regular broker who obtained the excess coverage through a reputa-

ble and licensed excess broker in California. Said the risk manager: "We didn't go into the back alley to work something out and still we got enmeshed with an insurance scheme that results from lack of regulation in Missouri."

An insurance manager in Farmers & Merchants insured a truck in which his company had a financial interest. His inquiry to the Missouri department was met with the explanation that the company is not authorized to insure trucks nor can it do business in Washington.

The Michigan Department of Commerce discovered that Bankers Security Mutual Insurance Co., Kansas City, solicited insurance business by mail offers to Michigan businesses.

A recognized Chicago insurance agency found that one of its clients had purchased excess property insurance from Bankers Security. The Missouri insurance department informed the agency that the state "does not have any funds on deposit by this company for the benefit of all policyholders and we have no knowledge whatsoever of their financial condition:"

Bankers Security, which lists its address sometimes as Kansas City and at other times as St. Louis, underwrote fire and extended covereage protection on a concrete block commercial building in St. Louis, hundreds of miles from Jefferson County where it was incoporated in 1953.

George J. Eckmann, an attorney in the legal division of the Missouri insurance department, told *Business Insurance* that buyers and brokers who involve themselves in out-of-state contracts with Missouri farm mutuals are "negligent" in not checking the companies' authority to underwrite the risks they are taking.

Mr. Humphreys, in a report to the unauthorized insurance subcommittee of NAIC meeting in Los Angeles last month, offered this description of recent "mini-mutual" operations:

"Additional schemes have been recently uncovered, as surplus lines insurance black marketeers search for more 'pseudo direct writer' business names. We now note the misuse of that cornerstone of American insurance, the small farm or county mutual insurance company.

"In States where no regulation of such 'mini-mutuals' exists, they are already being misused and solicitation for the illicit use of them is on the increase. Charters of such mutuals thought dead, have been disinterred by hopeless legal action to establish them as alive, while using the expected time delay prior to cision, to load up the use of the name to the fullest black market advantage.

"All insurance commissioners are warned that either regulated or unregulated, no small or 'mini-mutual' insurance company can be held immune from the surplus lines black marketeer and his deceptive methods, if it falls within his scheming focus."

To Take Prompt Action

Business Insurance has uncovered an insurance promotion scheme in Missouri that a postal inspector has aptly described as "a can of worms." Only Missouri fails to regulate farm mutual insurance companies, a legal loophole that has allowed a few fast buck operators to use farm mutual charters to solicit insurance business far beyond the borders of the state.

Under Missouri law, farm mutuals are restricted to writing fire and lightning covereages on property in their home counties and in adjoining counties. This limitation is in keeping with the spirit of farm mutual organizations which played a vital part in assuring security for farmers as long as a century ago.

But today's economy is quite different from that of 1868. Missouri's loophole for farm mutuals has allowed alleged illegal underwriting by at least two companies—Bankers Security Mutual Fire Insurance Co., Kansas City, and Farmers & Merchants Mutual Fire Insurance Co., St. Louis. Both companies are named in numerous complaints on file at Missouri's insurance department. Queries about the companies have come from Washington state, Texas, Michigan, Oklahoma, California and even Ethiopia, none of which adjoins Jackson or St. Louis counties in Missouri.

One respected California risk manager reported, in fact, that he innocently got ensnarled with one of the farm mutuals and an overseas affiliate through a licensed and reputable broker dealing in excess coverages. "We didn't go into the back alley to work something out and still we got enmeshed with an insurance scheme that results from lack of regulation in Missouri," he said. His experience was awkward and costly. Worse, his unhappy experience could have happened—and probably has happened—to many other cautions risk managers.

Buyers of insurance must be especially wary in these times when insurance capacity is scarce to determine the financial stability and reputability of their carriers. This job is made more difficult when there are unregulated companies in operations that exceed legal limitations and territorial restrictions on their underwriting.

Remedial legislation is urgently needed in Missouri to bring farm mutuals under the jurisdiction of the insurance department. We have urged that this be accomplished with the support of the American Society of Insurance Management, the National Assn. of Insurance Commissioners and major insurance industry trade associations. But until reform legislation is adopted the problem of unregulated farm mutuals is one for Missouri's attorney general.

Norman Anderson, retiring attorney general of Missouri, conceded to *Business Insurance* that his office could take action to revoke charters of farm mutual companies for "repeated and continued" violation of charter limitations. Unfortunately, Mr. Anderson goes out of office at high noon on January 13, and anyway he didn't do much in four years of office to crack down on the abuses of these companies whose operations were well known to him and to members of his staff.

Mr. Anderson will be succeeded by John Danforth, whose compaign slogan was, "I dare you." Now we dare you, Mr. Danforth, to act promptly and firmly to shut down the illegal national and international operations of farm mutual companies in your state. You have the power to investigate and to pick up charters of those companies that write insurance beyond their charter limitations.

We dare you, Mr. Danforth, to take the steps necessary to clean up a situation that threatens public confidence in insurance nationwide. You have an opportunity to improve the image of insurers based in your state and at the same time clear up at least some of the doubts of corporate risk managers—some of whom have bought coverage from these farm mutuals and their overseas affiliates through legitimate insurance agencies and brokers. You see, Mr. Danforth, a small legal loophole created in pioneer days now affects our entire multibillion dollar insurance industry.

Missouri Attorney General Checks Statutes

Jefferson City, Mo.—Missouri Atty. Gen. John C. Danforth is "reviewing statutory law regulating farm mutual insurance companies" in response to charges by *Business Insurance* that some unregulated farm mutual companies have violated their charters by writing out-of-state business insurance coverages. Mr. Danforth's review began after news articles and editorials in this magazine pointed out that companies—supposedly limited to writing fire and lightning coverages in a restricted number of counties—were actually soliciting and writing complex coverages in places as far distant as Ethiopia. See related story on page 44.

Ex-operator of 'Mini-mutual' Receives Five-year Jail Sentence in Fraud

St. Louis—William M. Wider, 52-year-old former operator of an unregulated Missouri "mini-mutual" insurance company, was sentenced in U.S. district court here to serve four concurrent five-year terms for mail fraud in connection with his insurance agency operations.

Postal Inspector John Schicker, who conducted a four-year investigation of Mr. Wider's operations, said the fraud involved auto liability and fire insurance premiums that Mr. Wider converted to his own use.

Mr. Wider, who formerly operated Central Missouri Mutual Insurance Co., also wrote insurance through British Universal Assurance Ltd. and Buckingham Insurance Co., both domiciled in the Bahamas. He also owned Crest Insurance Co., formerly known as Old London Insurance Co., Jamacia, which specialized in writing substandard auto liability business in Texas, Tennessee, Oklahoma and Louisiana.

At one time Mr. Wider attempted to trade Central Missouri Mutual Insurance Co. for another company but the insurance executive who considered acquiring the company turned the deal down when he discovered that the unregulated farm mutual could write fire and lightning coverage only in its home county and adjacent counties in Missouri.

Business Insurance has exposed operations of unregulated Missouri farm mutuals that extend to major business risks written in Washington State, Louisiana, Texas and even in Ethiopia, far from Jackson and St. Louis counties where the companies are domiciled. In editorials this publication has called for revoca-

tion of the charter of companies that exceed their underwriting limitations and also for revision of Missouri insurance regulatory law to place the farm mutuals in that state under the jurisdiction of the state insurance department.

Missouri is the only state that does not require regulation of farm mutual companies.

Missouri Moves To Close Mini-Mutual Following Business Insurance Expose

Jefferson City, Mo.—Missouri Attorney General John C. Danforth's office has taken action to suspend the charter of a "mini-mutual" insurance company as a result of a *Business Insurance* disclosure that the company exceeded its charter limitations to write commercial insurance programs outside of this state.

Alfred C. Sikes, Mr. Danforth's assistant assigned to Missouri's insurance division, filed a *quo warranto* information in the circuit court of Jackson county against Farmers & Merchants Mutual Fire Insurance Co. saying that the company "is usurping corporate power beyond that granted by statute and in direct contradiction to (Missouri statutes)."

In a statement, Mr. Sikes added, "We have reason to believe that this company's adjustment procedures are not reasonable ones and that they are operating in excess of their corporate authority. If we are successful in this suit their charter will be forfeited and involuntary dissolution will occur."

Mr. Sikes noted that farm mutual companies in Missouri have not chosen to subject themselves to the jurisdiction of the division of insurance and are not regulated by that division. Missouri is the only state that does not require regulation of farm mutual companies.

Mr. Sikes credited articles and editorials in *Business Insurance* with bringing the "mini-mutual" problem to the attention of Mr. Danforth, who took office in January.

"*Business Insurance* articulated the problem and long-neglected files in our office indicated that suits that should have been filed had not been filed. The articles in *Business Insurance* were brought to our attention by several people," Mr. Sikes added, "and they indicated the need to move and to move swiftly."

Business Insurance first called attention to the "mini-mutual" problem in Missouri on Dec. 2, 1968, in an article reporting that some unregulated farm mutuals in Missouri were under investigation by postal authorities. That investigation is continuing and it is understood that an indictment of one company operator will be delivered soon.

On Dec. 16, 1968, *Business Insurance* detailed commercial insurance dealings by Missouri "mini-mutuals" that exceeded their charters by writing policies outside of the state lines other than fire and lightning insurance. Such policies were written in such far-flung places as California, Washington, Texas and Ethiopia, sometimes with the back-up of reinsurance contracts concluded with an insurance company domiciled in Bermuda.

On Jan. 6, *Business Insurance* carried an editorial titled "We dare you, Mr. Danforth, to take prompt action." The editorial called for the action represented by the *quo warranto* information now filed by Mr. Danforth's office in Jackson county circuit court. The title of the editorial was a play on Mr. Danforth's campaign slogan, "I dare you!"

In filing the suit, Mr. Sikes said, "The law very specifically sets out the jurisdictional limits of these companies which in most cases extend only to the county in which they are organized and adjoining counties. In addition, Missouri law restricts the type of insurance a farm mutual company may write. For example, there is no authority to write automobile casualty insurance, life insurance, or health or accident insurance.

"The attorney general's office recognizes that most farm mutual companies are reputable and operate wholly within the law, but," he added, "the attorney general will continue to file suits against those companies not operating within their statutory authority."

Mr. Sikes said that the suit filed in Jackson county was one of several that will be filed to reclaim the charter now being used by Phillip M. Wilson, who is president of Farmers & Merchants Mutual Insurance Co. doing business out of an office in St. Louis. Mr. Sikes said that there are three Farmers & Merchants Mutual companies in Missouri and that it is not clear just which charter Mr. Wilson employs. An article on Mr. Wilson's operations appears on page 36.

Ex-Agent Now Heads "Mini-Mutual" in Missouri

St. Louis, Mo.—An ex-insurance agent who surrendered his licenses under fire in 1965 now operates a "mini-mutual" insurance company that writes commercial risks outside of Missouri because of a loophole in this state's insurance laws.

Phillip Morell Wilson, 31, a diminutive (5'5") redhead, now heads Farmers & Merchants Mutual Fire Insurance Co., a farm mutual insurer domiciled here that is exempt from regulation by Missouri's division of insurance. The company is not required to file annual statements nor do its operations come under the scrutiny of Missouri's Insurance Superintendent Robert Scharz.

Though limited by its charter to writing fire and lightning coverage in St. Louis and adjoining counties, Farmers & Merchants Mutual, under Mr. Wilson's administration, has entered into complex quota reinsurance contracts with World Insurance Co. Ltd. of Bermuda. It has also written policies on a wide range of business risks including:

An excess property insurance policy through a legitimate West Coast broker on plants owned by a capacity-starved conglomerate in California.

An auto liability policy on a truck operated by a Washington state firm.

Auto liability coverage for a Florida business.

Hull coverages on a marine operation in Texas involving "huge premiums."

These commercial insurance writings by Mr. Wilson's company are documented in complaints filed with the state's insurance division. But because the company does not come under official jurisdiction of the division, the complaints are merely filed and the complainants informed that they have no recourse under state insurance laws.

Missouri's new Attorney General John C. Danforth began an investigation of the status of the charters of Farmers & Merchants Mutual and other "mini-mutuals" that are exempt from division of insurance jurisdiction after *Business Insurance* exposed commercial underwriting outside Missouri borders by Mr. Wilson's company and others, including Bankers Security Mutual Insurance Co. of Kansas City.

Postal inspectors are understood to be investigating Missouri "mini-mutual" operations in the wake of the conviction this year of William M. Wider, who was sentenced to four concurrent five-year terms as a result of his insurance operations that included Central Missouri Mutual Insurance Co., another unregulated farm mutual.

In 1965, Mr. Wilson, then an agent under the jurisdiction of the insurance division, turned in 10 agent's licenses and had seven others cancelled. In the course of the hearing, conducted by Deputy Insurance Superintendent John A. Sartorius, Mr. Wilson asked that the testimony be terminated and that he be allowed to surrender his licenses. That done, Mr. Sartorius told Mr. Wilson:

"For a young man I can only suggest to you this: You've got yourself in a pot of hot water in a very short period of time, because it's my understanding you're only 28 years of age. My advice is try to get on the right side of God and sort of travel the straight and narrow path.

"I don't know what line of endeavor you're to go into but I'm afraid that whatever field of endeavor you try you're going to find that eventually, unless you mend your ways, you're going to be in trouble again. I'm not here to give out a sermon, but that's just advice that I can see from the little things I've heard here this morning. And I can only say one other thing, that there were 35 people out there this morning to testify against you. You heard the testimony of only five."

Not long after Mr. Wilson was delicensed as an agent, he bought the charter of Farmers & Merchants from Bill Landwehr, an ex-convict. Yet Missouri state records are not required to show more than the date and county of incorporation of the farm mutual.

Mr. Wilson's company operates out of a building at 10060 Natural Bridge Road, St. Louis, whose list of occupants includes more than a score of businesses, including insurance companies whose names are unfamiliar to corporate insurance buyers and the public.

One St. Louis county official told *Business Insurance* that he and an associate visited the building and found one door marked with "a long, complicated name that ended in 'Limited.' We opened the door," he related, "and found that it was a broom closet."

Mr. Wilson, in addition to his insurance interests, has business associations with a string of barbecue pits and a company that produces paper dresses. Many of his business interests are conducted through a post office box in St. Louis that lists more than a score of companies and more than 10 individuals.

Boycott Bermuda, Bahamas Insurers, Regulator Tells Buyers

Olympia—Washington State Insurance Commissioner Karl V. Herrmann has warned insurance buyers against dealing with all insurance companies based in Bermuda and the Bahamas.

His warning came after the Washington insurance department discovered that World Insurance Co. Ltd. of Hamilton, Bermuda, assumed liability coverage on an 80-boat Seattle fishing fleet.

World Insurance, Mr. Herrmann said, "by our standards enjoys a totally unregulated status," and the insurance department has "no information as to the ability of World Insurance Co. to meet its financial obligations should substantial claims arise."

The operator of World Insurance, Allan J. Lefferdink, has been associated with a number of marginal insurance companies, some of which are now defunct, it is reported.

Among the dealings conducted in Hamilton, Bermuda, by World Insurance is a reinsurance agreement with Farmers and Merchants Mutual Fire Insurance Co., a Missouri "minimutual" that has written commercial coverage far beyond its authorized boundaries and charter limitations, as *Business Insurance* reported Jan. 6, 1969.

A spokesman for the Washington insurance department told *Business Insurance* after the commissioner's warning that World Insurance is operating in the state of Washington as a non-admitted surplus lines underwriter of marine insurance.

He said that the department of insurance cannot require World Insurance to file a financial statement under present laws, and the determination of the company's financial status has been left up to brokers.

The spokesman added that the warning was made simply because it is not possible for the department to guarantee the soundness of the companies that operate out of Bermuda and the Bahamas. He said that the statement by the commissioner does not suggest that all companies based at those two locations are unsound; rather it should mean that the department has no way of telling.

This attitude toward companies domiciled in the Bahamas and Bermuda was echoed to *Business Insurance* by Federal postal authorities active in the investigation of insurance frauds.

"We have been blocked from learning anything about Bermuda companies because these companies operate under legislative charters that protect them from scrutiny by law enforcement officials," an investigator said.

One observer suggested that corporate insurance buyers refuse to buy primary or reinsurance coverages offered by companies licensed on the island until the government agrees to make available the financial status of all companies, including World Insurance Co. Ltd.

"By hitting legitimate Bermuda companies in the pocketbook, we would get them on our side in efforts to clean up a situation that now pollutes the U.S. insurance and reinsurance markets," he said.

World Insurance Co. Ltd. entered the marine insurance field in Washington through a loophole that exists in regulatory statutes in a number of states. The loophole exempts marine and aviation coverages from regulation on the theory that such coverages cross state lines and should not be subject to the regulatory authority of one state.

Lloyd's of London, for legitimate purposes, has supported this exemption that has been turned into a loophole by World Insurance Co. Ltd. and other companies domiciled in the Bahamas and Bermuda. *Business Insurance* on Oct. 13 reported the indictment of seven persons, in Anchorage, Alaska, associated with British Frontier General Assurance Ltd., a Bahamian company that allegedly wrote worthless marine and aviation insurance coverages in 49 states.

Lefferdink Exits After Bermuda 'Agreement'

Hamilton, Bermuda—Allen J. Lefferdink, operator of World Insurance Co. Ltd. here, has pulled his insurance operations out of the colony "by agreement" and has headed for Europe on his ship the Sea Wolf.

Sir Henry Tucker, government leader (prime minister) of Bermuda, told *Business Insurance* that he had discussed with Mr. Lefferdink the "ceasing of his insurance operations in Bermuda."

The talk between Sir Henry and Mr. Lefferdink took place after Washington State Insurance Commissioner Karl V. Herrmann warned corporate insurance buyers against purchasing coverage from companies domiciled in Bermuda or the Bahamas. Mr. Herrmann said they enjoy totally unregulated status and that his department had no information on the ability of Mr. Lefferdink's World Insurance Co. to meet its financial obligations.

Commissioner Herrmann acted after Mr. Lefferdink's company assumed liability coverage on an 80-boat Seattle fishing fleet. *Business Insurance* had previously revealed the existence of a reinsurance treaty executed between Mr. Lefferdink and Philip M. Wilson, operator of Farmers and Merchants Mutual Fire Insurance Co., an unregulated minimutual in Missouri that has operated beyond its authorized boundaries and charter limitations.

"Beyond saying that Mr. Lefferdink left the colony by agreement, the government is not eager to comment on this matter," Sir Henry said. "Bermuda takes pride on the probity of companies operating here, and adverse publicity does nothing to enhance our ability to attract international companies of high standards.

"The majority of Bermudian insurance companies are owned by companies with unquestioned reputations," Sir Henry continued, "and the government of Bermuda is very much concerned about the character of insurance companies domiciled here."

Bermuda, he explained, has no insurance laws "because we regard insurance as a highly sophisticated business and the adoption of an insurance code in the Amrican sense would impose an obligation to properly police its provisions."

A report in the Royal Gazette published in Hamilton said that Mr. Lefferdink planned to shut down his operations over a period of two to six months. The newspaper said he invited his staff of 25 persons aboard the Sea Wolf to show them the ship and then, with his crew of seven, set off for Europe.

Recommendations to ASIM—Editor Suggests Six Ways To Stem Criminality in Insurance Industry

San Francisco.—A call for action by government and corporate risk managers to stem the rising tide of criminality in the insurance business was made by Richard Bjorklund, managing editor of *Business Insurance*, at meetings of the Southern California and Northern California chapters of the American Society of Insurance Management.

"Worthless coverage and unsatisfied judgments threaten all corporate buyers of insurance and their companies," Mr. Bjorklund asserted, "but it is possible to do something about the problem within the existing framework of state insurance regulation."

He recommended that ASIM promote among its members this six-point program for combatting frauds and criminality within the insurance industry:

Enact a Federal law making insurance companies subject, as other companies are, to the Federal Bankruptcy Act, with the provision that state insurance commissioners be the liquidators of insolvent companies. Such a move, he maintained, would enable the Federal government to prosecute those who deplete the assets of insurance companies that are in financial straits.

Adopt a uniform insurance regulatory act in all 50 states and the District of Columbia. Such an act, Mr. Bjorklund maintained, would prevent weak state insurance commissioners from leaning on weak provisions of their insurance regulatory statutes. "So often," he said, "a weak or corrupt insurance commissioner takes advantage of loopholes in the insurance statutes, just as do the criminals invading the industry."

Boycott insurance companies domiciled in the Bahama Islands, Bermuda and other places where local laws and officials do not require adequate balance sheet reports to enable U.S. insureds to measure financial adequacy of the companies. Mr. Bjorklund said that this publication has evidence that insurers operating out of Bermuda and other foreign jurisdictions complete reinsurance and other agreements with marginal U.S. insurance companies.

Require state insurance commissioners to delve into the balance sheets of companies domiciled in their states. He maintained that examination of financial statements is inadequate, particularly in the present business climate that pro-

motes holding companies and other corporate arrangements that might hide financial instability.

Creation of an American Society of Insurance Management clearinghouse for information about marginal insurance companies. Mr. Bjorklund said that there are some commercial reporting services that inform corporate buyers of the financial status and management characteristics of insurance companies. "But these services," he asserted, "are more passive than active, and sometimes they contribute to buyers' confusion when criminally operated companies adopt names similar to those approved by reporting services."

Willingness on the part of risk managers to report irregularities in coverage or claim adjustments. "Courage on the part of insurance buyers can do a great deal to shut down marginal insurers," Mr. Bjorklund asserted. "This was proved when a complaint to *Business Insurance* by a California risk manager resulted in the exposure of Missouri minimutual companies that operated for years outside of the jurisdiction of the state's insurance commissioner."

Mr. Bjorklund cited as fertile areas for criminals the Missouri minimutual situation, the essentially unregulated insurers on offshore islands, the failure of insurance commissioners to suspend operations of financially impaired insurers, and peculiar loopholes in state insurance statutes as well as loose licensing practices by some state insurance commissioners.

CAB Approves Airline Captive; Only Two Members Subscribe

Washington—The Civil Aeronautics Board's approval of the two airline captive insurance companies, which are intended to help ease the capacity crunch caused by the jumbo jets, was based in part on the belief that "there is a strong interest in the proposal and that necessary participation will be achieved."

Some observers, however, have expressed doubt in recent months that the airlines will support the new captive. Eastern and Trans World are the only present carrier parties to the agreement.

Skeptics say the airlines won't be willing to tie up the necessary large amounts of capital in a venture which probably won't make a return for years. There is an extremely heavy demand by airlines for capital, which has been intensified by the present tight money situation, they point out.

Just paying for the 747s will be a chore, they add, without having to put up part of the capital to insure them.

One of the arguments put forth by the Insurance Co. of North America, which formerly opposed the plan for the captives before the CAB, was that while it would spread the risks among participating carriers, in doing so their credit standing might be jeopardized.

The CAB rejected this argument, saying that "although the venture is novel and the carriers' commitment substantial, it does not now appear that the carriers' capital contributions relative to their present insurance premiums will be excessive."

The two new insurance companies will be based in Lausanne, Switzerland. They still need the approval of the Swiss government. Air Transport Insurance S. A. will underwrite primary risks; Air Transport Guaranty S. A. will handle excess risks.

[Late news]

Open Probe of UMW Pensions

Washington—Sen. Harrison William (D., N.J.) said his labor subcommittee will open hearings tomorrow (March 17) to probe the charge that UMA chief W. A. "Tony" Boyle engineered a 30% increase in monthly pension benefits in an effort to further his reelection campaign against Joseph Yablonski. "As much as I favor adequate, hard-earned benefits for the miners, we must nonetheless closely examine the charge that workers' pensions have been used as a campaign weapon by a candidate," Sen. Williams stated. Earlier story on page 40.

Expect Claims From Pro Cage Mishap

New York—Two professional basketball players who were injured when they ran into one of ABC-tv's roaming cameras on the apron of the court at Madison Square Garden here may be filing insurance claims with the television network. According to a source at ABC, the network is completely covered under its general liability policy which is written with Travelers. The two players—Nate Bowman of the N.Y. Knickerbockers and Archie Clark of the Philadelphia

76ers—were injured in separate run-ins with the camera. Neither was believed to have been seriously injured.

Link Wilson to 'Shadowy Financial Syndicate'

London—Insurance investigators are watching the growth of a network of companies which have begun operating in Europe in extensive business enterprises.

Lists of those concerned include several American businessmen who have figured in questionable insurance activities exposed by *Business Insurance*.

Among individuals linked directly or indirectly with current disclosures are Allen J. Lefferdink, of World Insurance Co., Ltd., who was revealed in *Business Insurance* on Dec. 8 to have left Bermuda for Europe on his yacht, the Sea Wolf. Mr. Lefferdink is reported to be working with the Nueva insurance brokerage firm in Brussels.

Also named are Philip Wilson, of St. Louis, Mo.; Wendell Thompson, of Burbank, Cal., and Richard Brandom, another American whose family is known among U.S. insurance interests.

In Jefferson City, Mo., the Missouri secretary of state's office last month ordered forfeited the charter of Farmer & Merchants Mutual Insurance Co., exposed 15 months ago by *Business Insurance* as a company that flagrantly violated its chartered authority by writing major business risks in places as far away as Ethiopia.

The secretary of state's action followed legislative action taken in response to an editorial in this publication that called for the protection of business and personal insurance buyers from minimutal insurance companies operating outside of their chartered authority.

Developments, which may have spread to Belgium and Germany from London, are being watched by Lloyd's officials with close curiosity, as well as by other people who supervise financial activities.

The disclosures were made by the well-informed business section of the Sunday Times, after almost six months research under its financial editor Charles Raw, who found a complex of companies engaged in international banking and insurance operations.

His report speaks of "the affairs of a mysterious and shadowy financial syndicate around the world."

It names Trans-Continental Insurance Casualty Co., of Nassau, Bahamas, as being closely involved.

Trans-Continental Casualty Insurance Co. is reported by U.S. sources to be writing significant amounts of hull insurance on expensive private yachts that ply the Atlantic, a class of business that has been shunned by conventional insurance companies.

Summarised, Mr. Raw's article recalls that about a year ago Trans-Continental Insurance offered to take huge lines of reinsurance business from Lloyd's and other British brokers on terms that were highly attractive.

The business was offered by several people, including Richard Barndom, who was reportedly working for St. Louis insurance broker Philip Wilson.

The total assets of Trans-Continental were put at $120 million, which led some London brokers to visit Missouri to meet its executives, including at that time Frank Blosser and James Owens.

Mr. Wilson, reported to be an associate of another St. Louis businessman named Axelrod, does underwriting business with Allen Lefferdink's World Insurance Co., and also for some Mid-West insurance companies.

Both Mr. Lefferdink, and Smith ("Jack") Brandom, a relative of Richard Brandom, are known in Britain for their projected interest in some of the cut-price insurance companies in London before these crashed three years ago. (The Sunday Times alleges that Jack Brandom has just been indicted in the U.S. on charges over the Gibraltar Insurance Co.)

Business Insurance confirmed that Jack Brandom was indicted on 11 counts of mail fraud in Federal district court in Kansas City on Jan. 29. The company involved—Midwest Mutual Casualty Co., Clayton, Mo.—wrote high-risk auto and fire insurance and, according to postal inspectors, some garage liability coverage.

The London newspaper article says that some London brokers later decided to do business with Trans-Cintinental, which in 1969 had Wendell Thompson as chairman and reputed assets of $300 million.

The report also names the Antwerp Assurance Co., of Belgium, as being in line for a take-over from American Equities Fund, which recently got Lloyd

Eisenhower, of Phoenix, Arizona, as president. He is said to have taken on the post from Harold Audsley, Jr., founder of the fund, and son of a Kansas man who was well-known in securities business.

Further business enterprises named in the report are First Liberty Fund, of Bahamas, and North Western Insurance Co., Toronto, Canada, as well as a finance house located in the Channel Islands, of Britain, named the Bank of Sark.

Mr. Raw comments: "Trans-Continental Insurance, and its complex board of financial cousins, continues to engage in ever larger and more ambitious operations around the world, proof apparently against all efforts to get the grips with its true size, ownership, policy or intent."

But mortgage deals in U.S., insurance in Belgium and Tel-Aviv, mutual fund sales in Germany, and reinsurance in Britain are clearly involved.

Senator Moss. This concludes our hearings for this morning.

(Whereupon, at 11:50 a.m., the subcommittee was adjourned, to reconvene in room 3302, at 9:30 a.m., on Thursday, March 19, 1970.)

CONSUMER PROTECTION

THURSDAY, MARCH 19, 1970

U.S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE FOR CONSUMERS,
Washington, D.C.

The subcommittee met at 4 p.m. in room 5110, New Senate Office Building, Hon. Frank E. Moss, chairman of the subcommittee presiding.

Present: Senator Moss.

Senator Moss. The subcommittee will come to order. I must apologize for postponing this hearing to this late in the day, but today happened to be one when all the hearings converged from various committees. The full Committee of Commerce and other committees on which I am assigned had meetings, so it was not possible to go ahead with the originally scheduled hour.

However, we will proceed now with two of the witnesses who would like to be heard today and at sometime next week we will hear the other witnesses who were not able to appear today, and who wish to appear before this subcommittee.

We are hearing testimony on three bills that are pending in this subcommittee: S. 2246, S. 3092 and S. 3201. Will Richards Barger of the National Association of Insurance Commissioners come forward and be seated at the table. We would be glad to hear your testimony, Mr. Barger.

You have a full prepared statement in this matter. The full text of your statement will be in the record. You may proceed as you wish. If you choose to highlight it and emphasize parts of it, you may do so knowing that the entire statement is in.

STATEMENT OF RICHARDS D. BARGER, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. BARGER. Thank you, Senator. My name is Richards Barger. I am the insurance commissioner of the State of California and am appearing on behalf of the National Association of Insurance Commissioners with regard to Senate Bill 3201 and its companion bills, if you want to refer to them as such.

First of all, I very much appreciate the opportunity to appear before this subcommittee and I very much appreciate the time that your staff has given to us to explain some of the presentation made in my statement.

I realize that my time is limited, and therefore I will try to capsulize my written statement and then if you have any questions, I will try to answer them.

It would appear to us that the purposes of S. 3201 and its companion bill in the House is to create in the Federal Trade Commission a right to regulate insurance now defined in the definition of services in section 210, subsection F.

We feel that this definition is completely unnecessary. Commensurate with the admonition in the charge given to us by Public Law 15, the McCurran Act, the States enacted a comprehensive fair trade bill on the State level which protects the consumer at the State level where it is most effective.

I might say that one of the questions that occurred to me is notwithstanding the fact that the model bills have been enacted in all 50 States, just how effective are these bills in protecting the consumer public. I would like to relate my experience as commissioner in California and the experience I have garnered from other commissioners for the express purpose of relating them at this hearing today. Let me tell you about my experience as the California Insurance Commissioner. We have a very comprehensive fair trade practices act which is almost verbatim the model bill. The bill was enacted in 1959.

Our department through its four offices located in Sacramento, San Francisco, San Diego, and Los Angeles services in total 18,000 complaints a year. Approximately 12,000 of these complaints directly come from dissatisfied members of the public who are usually policyholders in the State of California dealing with companies.

Our experience has been that approximately 35 percent of these claims are valid. Every person who enters the office of our department is interviewed by an insurance officer who discusses his case with him. We then correspond with the companies and ask for their complete files on the matter.

Last year we collected in the neighborhood of $3,500,000 on behalf of the consuming public in California as a result of complaints made to our department. I can tell you this, Senator: I myself answer a number of phone calls, and I by myself answer a number of letters that are sent to me, or directed as to the Governor.

Our experience has been in gross numbers the two largest types of complaints are complaints on disability insurance and automobile. Approximately 50 percent of those complaints received are disability and 25 percent are automobile complaints. The balance are spread over the whole spectrum of the insurance business.

My experience in the department also tells me that there is a second and very important part of consumer protection that this bill, 3201, does not even cover, for this bill covers the fraudulent and deceptive practices in the sales of products. It does not cover claims practices.

I might say this parenthetically: The bill as presently drafted does not fit the insurance business, whereas the model bills as enacted by the States specifically are couched in insurance terms and are relating to insurance practices that we know exist. The bill as presently drafted really relates to the commercial or the marketing aspects of the business.

The second item of equal importance is the matter of payment of claims by a company. If a company does not intend to pay its claims on the policy sold to the insured, it is as fraudulent as misrepresenting the product when the consumer buys it.

I think that this is an area where the Federal Trade Commission does not have any jurisdiction or doesn't have the tools in its arsenal to really remedy this ill. Because as any insurance commissioner, whether it is myself as commissioner in a large State such as California or a smaller State, has a number of tools available in the arsenal that can be utilized when a company either misrepresents their policies when sold or is not paying its claims which is another form of fraud on the consumer, if they didn't intend to pay them when they sold the policy.

I can examine the company at its own expense. I can file an accusation against the company. If the practices appear to be fraudulent and intentional, I can file an accusation to take away its license to do business in the State.

I can assure you any one of these are weapons in my arsenal and are most effective, particularly the latter. I have not hesitated to use them when the situation arose.

Let me relate several instances that I of my own personal knowledge know of in the department since I became commissioner.

We had one case where a company, through a series of agents who are now under criminal indictment, sold a policy to the public that was patently fradulent. We compelled the company to refund $850,000 to the people who bought the policy.

I have another situation where a company, a disability company, was shaving its claims by design. We found with a special examination that their practices in the claims department were designed to shave each claim as it came in. We told the company that either they went back under our supervision and audited all the claims over again and paid this money and corrected their claims practices or we were going to suspend their right to do business in the State of Califorina. Not suspend—revoke. It had a most salutary effect.

The company refunded about $350,000 under our direct supervision. Now, let's talk about some of the other States that I think are of comparable size.

New York is a State of a comparable size to California. Their policy is equally as agressive as ours. They have a policy service bureau that is aggressive in enforcing the rights of the consumer. Illinois and Pennsylvania also have aggressive policy services divisions.

Let's talk about the smaller States like Oregon which is adjacent to our State, and I think you have some knowledge of it at least geographically. The population in the State of Oregon is limited to Portland, Eugene, and Salem, which leaves the remaining part of the State really in limbo. Like Utah where you have Salt Lake City and St. George and Cedar City and the rest kind of exist on their own unless they are taken care of by some device.

The Oregon Insurance Department has a circuit rider program where 10 insurance officers travel throughout the State. They advertise in trade journals and in papers in the localities and spend 1 or 2 days a week in some of the remote communities like Ontario on the Snake River.

Every member of the public has the right to talk to an insurance officer about complaints against companies. This has a very salutory effect for two reasons. The consuming public feels somebody is worrying about them and somebody is giving them the right to voice grievances against the insurers whether ill founded or not.

All the complaints we find are not all meritorious, but at least the person knows he talked to somebody and got it off his chest. The people that have meritorious claims are able to discuss their claims with the department and they are adjusted.

In the State of Oregon last year the insurance department collected $400,000 on the basis of letters sent to companies and discussions with companies based upon claims made by claimants.

Another one of the things that concerns me, Senator, about 3201 and its companion bill is by the inclusion of insurance and services and the narrow definition of complaint of acts in the bill you are really limiting the protection to the consumer in this bill rather than expanding it.

Don't you see that the weapons available to a State insurance department are far more numerous than the right of injunction. And they are far more numerous than those 11 categories set forth in the bill itself.

I have already talked about claims. There are certain kinds of practices not covered in the act. As I said before, the bill itself is not tailored to insurance. I would also say that the bill is unnecessary, because I personally and philosophically don't feel that one overlapping layer of government on another is useful unless it is necessary.

Government per se is not beneficial to the taxpayers unless it is necessary as shown by the facts prior to its enactment. What I am trying to say to you is that the States are pursuing the rights of the consumers without cost to the consumer, without the right of hiring attorneys, without the right of going to court to do it.

When the consumer comes to us and voices a complaint, the cases are looked into and if they are meritorious we lean on the companies and we have what I call a continuing dialog until the matter is straightened out. One other thing that bothers me is that the matter of having the right to view claims from the consuming public has another function that really is not too readily apparent. When we have a number of claims relating to one single company, they serve as a barometer to my department that there is something wrong with this company. If over a period of 6 weeks or 6 months we find that we are getting a consistent volume of claims against one insurance company, we know one of two things is going on. Either the company is having financial problems which we then will step in to solve or the company is experiencing managerial changes that are affecting its adjustment practices adversely to the consuming public and we want to remedy those too.

Right now we are in the process of looking over our hit parade for one or two companies because we find a consistent volume of complaints building up in one particular area, and we feel that perhaps these are going to disclose that the company is doing some things in its adjusting that should bear discussion with the company if they want to do business in our State.

I guess that summarizes my testimony in a nutshell. I would rather answer your questions, and I assume you have some rather than going in more to the details of my prepared statement.

Senator Moss. Thank you. I am sure that your statement, which is very complete—I leafed through it and it is obviously well prepared and will be most helpful to our record.

I think I understand your summarization.

I am going to ask Mr. John Cary, professional member of the staff, if he would ask several questions that had occurrred to us when your statement came in.

I have to step out just briefly, and then I will be right back; but I will ask Mr. Cary to go ahead, and then I will come back and if I have additional questions, I will propound them at that time.

Mr. CARY. Is your experience in California in enforcing the laws against fraud and deception typical of the enforcement activities in all of the States?

Mr. BARGER. Yes, I think so. And I will tell you why. Our requirements, first of all, all States require that all health and accident policies—where the biggest area of concern is—must be approved as to form before they are allowed to be sold in the State. If they aren't approved as to form, they can't be sold.

Mr. CARY. All States do this?

Mr. BARGER. Yes. To my knowledge they do. All States don't require the life contracts to be approved, but my experience is life, vis-a-vis disability is not the real problem area. It is the disability area where the problems lie, particularly individual A. & H. That's where the problems are.

Mr. CARY. Is this with respect to payment of claims?

Mr. BARGER. I'm talking about the—before the policy is ever sold. In other words, they can't have a policy that says this policy only covers you at the corner of 34th and Madison Avenue on February 12, 1946. The policies have to meet our approval or they can't be sold.

So that is step one. We have strict policy approval in our state as to all A. & H. policies. That means that the terms of the contract can't be adverse to the consuming public, and can't be fraudulent and misleading and deceptive. That is step one.

Then if we find they are using an approved contract and selling it by fraudulent or deceptive literature, or by fraudulent oral presentations, we discipline the company; because we feel the company is responsible for its agents.

Mr. CARY. Do all States have the same amount of enforcemnet at this step—the second step—as your State?

Mr. BARGER. I think they do, commensurate with the problem they have. I would say the State of Wyoming has the same type of enforcement, but I would say for the number of problems they have in their State, yes, they do; but they only have a few hundred thousand people in the State.

Mr. CARY. But they take the same amount of actions to determine whether or not they have a problem.

Mr. BARGER. Yes.

Mr. CARY. Have you got to the second step?

Mr. BARGER. Yes. The third step is, after the contract is sold to the public, let's assume the contract is approved by the department of insurance. Let's assume that the contract is sold without misrepresentation. So we are by those two hurdles.

Let's assume that once the accident—event in question—occurs, the company, for reasons best known to itself, refused to pay or shaves its claims, or delays the claims intentionally, as a device to save money, our department has devices to remedy this. They are simply this: We

tell the company, "We will run a special examination on you; we are going to file a cease and desist order. If we find it's intentional, we will take away your license to do business in the State."

Mr. CARY. How do you find out about this practice to begin with?

Mr. BARGER. Complaints from the public. They pop up real quickly. We have a hit parade right now. We know the bad apples and examine them periodically. We had one company—disability company—that we had complaints on them. We go see if it was a procedure, a modus operandi. We sent three examiners in, and made them pull all the claims files.

Mr. CARY. Other States have this—as you phrased it—keep a "hit parade?"

Mr. BARGER. Yes. I received a phone call 2 weeks ago from the commissioner of a small Western State. He mentioned a company to me and said, "We are having trouble with this company." And he said, "If I remember it correctly, your department has devised what you call a scientific sampling system on claims files, and you used a number of bad apples: and we would like to use it."

I instructed our people in charge of this function to send up their worksheets on this, and they are using it now. I said, "The only requirement I ask of you is when you find out about these claim practices, I want to know, because it may be in our State too."

Mr. CARY. I take it your judgment would be there is not much variation between insurance departments in their enforcement against fraud and deception?

Mr. BARGER. Let me say this: There is always a variation as there are people and personalities. I would say that the variations probably are minimal from State to State.

Mr. CARY. Do you think that people in the State know that they have an insurance commissioner who will handle their complaints? I know Senator Moss received letters from people who have written to him before they have written to anybody else. It has also been brought to our attention that estimates of public awareness of the existence of an insurance commissioner are as low as 5 percent of the population.

Mr. BARGER. Let me tell you this: Based upon the phone calls I received, I don't believe it. We receive on the average of 18,000 complaints a year. Certainly I think since I have been insurance commissioner, and that is a year and a half, I have received no more than six letters from Members of Congress of complaints made to them. I received probably in the neighborhood of 50 letters from members of the legislature. The balance have been direct complaints to our insurance department.

I can only speak from my own experience in the State of California. I have figures from the Oregon Insurance Department. For the size State they have, and you must understand their figures have been increasing since they started the circuit rider program——

Mr. CARY. The thrust of some of my questions is as to whether there are fraudulent and deceptive practices you are not aware of, that don't come to your attention through the complaint mechanism?

Mr. BARGER. I'm sure there are, and I could say this: I'm sure there is evil in this world and wrongdoing wherever we go that we are not aware of, but we try to do the best we can.

Mr. CARY. The main point of your testimony is opposition to Federal Trade Commission or Justice Department authority to halt fraud in the insurance area. Do you think that we could structure concurrent authority for the Federal agencies so that it complements State efforts and helps you out?

Mr. BARGER. I tried to make that point in my brief opening statement. I philosophically am not one who believes if one governmental function is succeeding that another governmental function is necessary concurrently to help it out, particularly when the concurrent function is a function that is more physically removed from the consuming public than the one you are trying to help out.

Mr. CARY. How do you mean?

Mr. BARGER. I mean that there are, I think, approximately 13 offices of the Federal Trade Commission in the U.S.A. I am saying that by giving the concurrent jurisdiction to the Federal Trade Commission, to those people, they are perhaps required to go further away for remedy than they are if they could go to Annapolis, Md. or Richmond, Va. or to—I will stop there. Harrisburg and Philadelphia, Pa. Or Pittsburgh.

Mr. CARY. You have indicated that the States, in your opinion, are capable of coping with fraud and deception in the insurance area and that they are doing an adequate job.

Yesterday Professor Denenberg pointed out that the insurance industry is beset by so many crises of a fundamental nature that they really don't have time to give much attention, or adequate attention, to complaint settlement.

Mr. BARGER. With all due respect to him, who is a very learned gentleman, I would say Mr. Denenberg is erroneous in this allegation. I am a regulator and as such am not a part of the so-called "insurance industry." I have reviewed Mr. Deneberg's statement very briefly but I think I picked up the gist of what he is talking about. He talks about the crisis in capacity, the crisis in insurance in urban areas, so-called crisis in the credit insurance business. Those are the three things he talks about primarily if I remember correctly.

No. 1, the crisis, let's talk about the crisis in our urban areas. They relate to our urban areas. They have been solved by the industry and departments in urban areas through the so-called Fair Plans.

Let's talk about credit insurance. I have some knowledge because I sat in a hearing room in this building not more than 6 months ago and testified on bill S. 1754 and I am of the opinion that the credit insurance business is going through an evolutionary series of regulation that is protecting the public and will continue to protect the public even more than it is today.

Let's talk about the capacity crisis. How much time do you have? The capacity crisis is a matter that relates to a number of things that are completely out of our control: Advanced technology, the 747; inadequate rates because of monolithic and archaic, and sometimes political manifests of rate laws. You have to understand that insurance is a capital attracting business like any others. If it cannot attract capital it cannot increase its capacity. I would say that, particularly the insurance commissioners in larger States, I think we are doing a pretty good job in maintaining a risk capacity in our States.

I am confronted, as other commissioners are, with the malpractice capacity crisis in my own State—Professional liability. But I think we are in the process of getting that resolved through these "stimulation" of competitive bidding on some new group cases that came down for the doctors. All in all I would say Mr. Denenberg is erroneous.

I never had the pleasure of meeting him nor do I think he ever contacted our Department to determine what problems we had. Maybe he knows something I don't know. Perhaps he does. But I would say that Mr. Denenberg is erroneous if he tries to tell you that we are not able to solve our consumer problems because we are burdened down with urban insurance problems or malpractice problems or problems in the credit insurance business.

Mr. CARY. Where in your list of priorities, your order of priorities, does complaint settlement rank? By complaint settlement, I take it you mean dealing with fraud and deception.

Mr. BARGER. Let me tell you this: My first responsibility as an insurance commissioner is to protect the consumer public. That means whether it is complaints or whether it means, complaints or protecting their dollars. I would say it is, No. 1 priority, I would say that 35 to 40 percent of our revenue dollar, our budget dollars are spent directly and indirectly in our Policy Services Division.

Mr. CARY. That is the Division that would deal with complaints against fraud, deception, failure——

Mr. BARGER. Yes.

Another 40 percent is spent maintaining solvency of our companies.

Mr. CARY. I think that gives us a good indication.

Senator Moss. Since I missed some of the questioning and John says he thinks we have filled in the areas fairly well, I won't venture any more questions.

I simply want to say again how much I appreciate your coming here to testify for us as one of the commissioners of insurance representing the most populous State. You certainly bring experience and knowledge that is helpful to us.

I do thank you, Mr. Barger, for being here.

Mr. BARGER. Thank you, Senator.

Senator Moss. Just one minute.

Mr. Cary brought something to my attention, if you could respond to this before you leave.

All right, he suggested that maybe the best thing to do would be for us to put this down in a question and send it to you and have you respond in writing because it may take a little time in answering it and give you time to reflect and give the answer.

Mr. BARGER. All right. If you would address it to 107 South Broadway, Los Angeles, Calif. 90012, I would be glad to reply.

Thank you very much.

Senator Moss. Thank you, sir.

(The statement follows:)

STATEMENT OF RICHARDS D. BARGER

My name is Richards D. Barger. As the Insurance Commissioner of the State of California, I am appearing on behalf of the National Association of Insurance Commissioners. Having its inception in and regular meetings since 1871, the NAIC is the oldest voluntary association of state officials. It includes the principal regulatory authorities of the 50 states, the District of Columbia and territories of the United States.

The NAIC is vitally concerned with the impact of Title II of S. 3201, as it is currently drafted, on the existing system of state regulation of the insurance business. Section 201(a) of the bill defines eleven items as an "unfair or deceptive practice" including the offering or advertising of "goods and services". Under Section 201(f) the term " 'services' includes insurance services". Persons engaging in "unfair or deceptive practices", as defined in this Title, would be subject to injunction suits brought by the Attorney General and to cease and desist proceedings instituted by the FTC under Section 5. Whenever such a governmental action is successful, a consumer would have the right to bring a private action for recovery of actual damages.

The NAIC concurs with the general objective of S. 3201 since the protection of the consumer is the fundamental purpose upon which state regulation of insurance is based. Furthermore, the NAIC has taken no position favoring or opposing the concept of class actions. However, in implementing the class action concept with safeguards against "nuisance" suits, S. 3201 introduces a federal regulatory mechanism which impinges upon an area long and comprehensively occupied by state regulation of the insurance business. Thus the NAIC does object to the inclusion of "insurance services" in this bill since there already exists a detailed and comprehensive insurance regulatory mechanism paralleling that of the FTC at the state level.

I am also concerned about another important facet of consumer protection. The consumer services area in our Department, as in most Insurance Departments, is interwoven with other services rendered by our Department under the California Insurance Code. For example, in dealing with the problems for securing insurance for those living in minority urban areas (utilizing the State's so-called FAIR Plan), we found that we were able to provide information to people living in our urban areas as to availability of insurance based upon complaints made to our Department. But for the fact that our Department maintains a Policy Service Bureau, enabling it to analyze complaints, we could not have provided this service to the people of our state. Even if Section 201 of the bill were enacted to include insurance in its definition of "services", the FTC will not be in a position to render those other ancillary benefits in subsection (f) to the public that go hand-in-hand with eliminating unsavory practices by those few people in the insurance industry and their agents.

In 1944, the Supreme Court for the first time held that insurance was interstate commerce.[1] Thus the insurance business became subject to the Congressional power under the commerce clause of the United States Constitution. This, in turn, cast doubt on the validity of the existing structure of state insurance regulation. After many months of deliberation Congress enacted the McCarran-Ferguson Act in which Congress concluded that "continued regulation and taxation by the several states of the insurance business is in the public interest."[2] Sections 1 and 2(a) declared that the states (not the federal government) should have the regulatory responsibility in this area and served to remove the commerce clause as an obstacle to state regulation. However Congress did say that after 3 years the Sherman, Clayton and FTC Acts should apply to insurance "to the extent that such business is not regulated by State law".[3] The three year moratorium constituted an invitation by Congress to adopt regulation in the areas covered by these Acts to preclude federal intrusion.

In response the NAIC developed and adopted a model Unfair Trade Practices Act.[4] Every state has adopted legislation of this type. Although prior to 1945 many states had statutes or regulations on false and misleading advertising, the McCarran Act supplied the catalyst for a comprehensive nationwide effort resulting in the Model Act. The Supreme Court has held that these state unfair practices acts preclude FTC jurisdiction.[5]

Sections 1–3 of the State Model Unfair Trade Practices Act spell out the basic legislative purpose to regulate insurance. This is done by defining or providing for the determination of such practices, in accordance with the intent of Congress in the McCarran Act, which are unfair or deceptive and by prohibiting such practices. The general standard and prohibition of the Model Act is very similar to Section 5 of the FTC Act.[6]

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[1] *U.S.* v. *Southeastern Underwriters Ass'n.*, 322 U.S. 533 (1944).
[2] 59 Stat. 33 (1945). 15 U.S.C., sec. 1101–15.
[3] *Id.*
[4] Reprinted in 2 *Proceedings of the NAIC* 509 (1960).
[5] See *FTC* v. *National Casualty Co.*, 357 U.S. 560 (1958).
[6] NAIC Model Act Sec. 3 "No person shall engage in this state in any trade practice which is defined in this Act as, or determined pursuant to this Act to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance."
FTC Act Sec. 5 "(a) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful."

Sections 4–8 establish a procedure for enforcement of its prohibitions similar to that of the FTC Act. The drafters recognized that no statute of this character can delineate in precise terms every unfair act, method or practice. Thus, they sought to define and enumerate certain substantive offenses which were well recognized in the insurance business. Section 4 specifically prohibits unfair methods of competition or unfair or deceptive acts or practice in eight general areas:

(1) Misrepresentations and false advertising of policy contracts;
(2) False information and advertising generally;
(3) Defamation;
(4) Boycott, coercion and intimidation;
(5) False financial statements;
(6) Stock operations and advisory board contracts;
(7) Unfair discrimination; and
(8) Rebates.

The Act authorizes the insurance commissioner to examine and investigate persons engaged in the insurance business to determine whether such person has been or is engaged in an unfair or deceptive practice (Section 5). After a hearing, if the Commissioner finds that Section 4 has been violated, he shall issue a cease and desist order which of course is subject to judicial review (Sections 6–8).

While the definitive approach was used, the NAIC recognized that the enumeration of specific acts and practices would not completely occupy the field. Thus provision was made for an omnibus section. Section 9 provides that whenever the insurance commissioner has reason to believe that a person is engaging in a method of competition or act or practice not defined in Section 4 but that such is unfair or deceptive, after a hearing, e may find a violation of this Act. Thereafter the Commissioner, through his Attorney General, may seek an injunction. Section 10 permits an intervenor to appeal a commissioner finding of no violation. Section 11 imposes monetary penalties for violation of cease and desist orders. In addition, the Commissioner possesses other enforcement powers and sanctions (noted later) under other provisions of the insurance law.

In short, the Model Act provides a comprehensive and flexible regulatory mechanism which fully covers the field. This has been achieved at the specific invitation of Congress to do so and has been done in a manner paralleling that of the FTC Act. However, unlike the eleven items enumerated in S. 3201, the definitions in the Model Act are tailored specifically to the problems in the insurance business. Furthermore Section 4(1) and 4(a) dealing with misrepresentation, false advertising and deception, in general, cover the type of practices set out in S. 3201's eleven items And, even if they did not, if such practices were to occur in the insurance business, they would be subject to treatment under the omnibus provision.

In addition to the Model Act, individual states and the NAIC have gone further to delineate what is and is not permitted. For example, in 1955–6, the NAIC developed detailed "Rules Governing Advertisements of Accident and Sickness Insurance" to implement the more general statutory prohibitions against misleading and deceptive standards.[7] Most states have adopted these NAIC rules sometimes to supplement existing rules in a given state. Also prepared was the "Interpretive Guide for the NAIC Rules Governing Advertisement of Accident and Sickness Insurance" reflecting the views of the Subcommittee developing it. There are seemingly countless number of individual state insurance department regulations aimed at interpreting the statutes, providing a firmer basis for business activity, and implementing the ban on prohibited unfair practices.

Furthermore, state insurance regulation goes beyond what can be done under the FTC Act, which employs an "after the event" approach. For example, at the same time the Model Unfair Trade Practices Act was being drafted, the NAIC was also considering rate (or price) regulatory bills. The question of unfair practices in pricing could have been included in the FTC approach embodied in the Model Act. However, the states took a more stringent approach in adopting model rate regulatory bills giving the commissioner either approval or disapproval power over the pricing formula, its application and the change in rates in the property and liability area. In recent years, several states have placed increasing reliance on competition as a rate regulator. But, under both ap-

[7] Rules reprinted 1 *Proceedings of the NAIC* 83 (1962).

proaches rates must conform to three basic standards: i.e., they may not be excessive, inadequate or unreasonably discriminatory. This is checked either by an insurance department review prior to rate changes or by a subsequent rate examination of the insurer after the rates go into effect. Another example is the NAIC accident and health insurance regulatory law which enables the commissioner to disapprove policies whose benefits are unreasonable in relation to the premium charges.[8] Thus, in the critical area of pricing, the states have long exercised control which is not in the arsenal of the FTC.

In addition to controls over prices, insurance policy forms must be filed with the commissioner subject to his power of approval or disapproval. There are a multitude of statutory requirements relating to the content of an insurance policy.[9] Through the policy approval power and the statutory standards available, much of the source of misrepresentation, deception or other unfair practices is deterred in advance.

Every insurer, as a condition of doing business and continuing its license, is subject to periodic examination. Insurers are required to maintain files on complaints received by them. As a part of the examination, the insurer's handling of complaints is reviewed and improvements required where appropriate. In addition, insurance departments have established complaint procedures whereby departments intervene on behalf of an aggrieved party in a situation so warranting.

Within the last four years, among many actions taken, the California Department of Insurance has taken action against admitted insurers that resulted in refunds of premiums of $850,000.00 by an insurer to defrauding members of the public who had purchased policies of insurance by misrepresentation; the filing of an Accusation by the Department of Insurance against a life and disability carrier with the resulting refund of $300,000.00 to its policyholders and a complete revision of the company's claims practices; the filing of an action against a life and disability carrier with the result that the company's claims practices were completely changed and new auditing procedures installed and refund of $50,000.00 made to its policyholders; and the filing of an action against an insurer for alleged fraud and misrepresentation in the sale of its products with the result that $100,000.00 was made in restitution of moneys paid and also rescission made to every person who purchased the company's product. In addition, based upon an investigation carried on by the Los Angeles office of the Department, criminal indictments were brought in an adjoining County against 21 individuals and one general agency of an insurer. In addition, my predecessor, Richard S. L. Roddis, brought to a conclusion litigation that once and for all conferred jurisdiction upon the California Department of Insurance over those non-admitted insurers who were soliciting residents of California by mail from their domiciliary states.[10] The matter of mail solicitations by non-admitted insurers had been a constant source of aggravation to the various state insurance departments. This case spells out clearly the jurisdiction of the several states to assert control of these non-admitted insurers.

For the last four years, the California Department of Insurance has handled an average of 12,331 complaints annually through its four offices in San Diego, Los Angeles, San Francisco and Sacramento. Of this yearly average, 49.6% were claims arising out of disability contracts and 24.1% were claims arising out of automobile policies. This annual average of 12,331 cases does not include investigations handled by the Investigation Bureau in the California Department of Insurance. For the same four years the average investigation volume handled annually was 6,149 cases. Many of these cases related to licensees of the Department (agents and brokers), but many of these investigations dealt with the protection of the public in their dealings with the Department's licensees. If the average figures were taken into consideration of the Department's Investigation Bureau and its Policy Service Bureau, the average volume of cases handled by the California Department of Insurance was 18,400 cases per year. For the year 1968, the New York Department of Insurance processed 14,956 complaints and investigations through its New York City and Albany offices.

The New York Department has been very active in all aspects of consumer protection and the Order of the New York Department of Insurance on the

[8] 1947 *Proceedings of the NAIC* 391.

[9] E.g., Uniform Individual Accident and Sickness Policy Provisions Law, 1950 *Proceedings of the NAIC* 399.

[10] *People* v. *United National Life Ins. Co.*, (1967), 66 Cal. (2d) 577, 427 P (2d) 199; "Mail Order Insurers: A Case Study in the Ability of the States to Regulate the Insurance Business," 50 Marquette Law Review 175.

alleged cancellation of certain property risks in minority areas of Bedford-Stuyvesant, although subsequently annulled by Court Order, shows an alertness by them to remedy abuses against any segment of the public.

The Department of Insurance of the Commonwealth of Pennsylvania, through its Bureau of Policyholders' Services, for the last two years has processed annually an average of 12,500 complaints from members of the public and the Department of Insurance of the State of Illinois, for the year 1969, opened in excess of 11,000 cases of complaints from members of the public and closed 10,900 that year, with an indication that approximately 30% of those persons complaining to the Department of Insurance had meritorious claims.

One can logically ask, what are the activities of those smaller states? In answer to that question I would like to relate the Insurance Deaprtment of the State of Oregon's excellent consumer protection program. The Department of Insurance in Oregon has inaugurated a "circuit rider" program that travels throughout the state. In the year 1969 the Oregon Department handled 2,945 cases and recovered $320,000 for Oregon policyholders.

These facts show that the Departments of Insurance of the several States act as a local vehicle through which the members of the public can channel their complaints against the practices of insurers and their agents. To confer this duplicate jurisdiction on the FTC not only results in a waste of money and manpower, but has a tendency to deprive the members of the public in the several states of the right to redress of their grievances on the local level. "* * * The basic motivating policy behind the legislative movement that culminated in the enactment of the McCarran-Ferguson Act served to confirm the conclusion that when Congress provided that the Federal Trade Commission Act would be displaced to the extent that the insurance business was 'regulated' by State law, it referred only to regulations by the State where the business activities have their operative force. One of the major arguments advanced by proponents of leaving regulation to the States was that the States were in closer proximity to the people affected by the insurance business and, therefore, were in a better position to regulate that business than the Federal government." [11]

I subscribe to this language of Mr. Justice Stewart in the Travelers Health Association case, and the foregoing examples cited confirm that in matters of consumer relations the several states are effectively regulating the insurance business on a level closest to the people to be protected—the public.

Today we have summarized some aspects of state regulation on behalf of the insurance buying public with particular attention focused in the area of unfair and deceptive practices. States controls are pervasive. In the insurance field, they fully occupy the area covered by the FTC Act in non-insurance businesses. Furthermore such state controls are not only similiar to be also more extensive than those available under the FTC Act. In this light, what would be the impact of the proposed bill if it continues to include "insurance services."

S. 3201 would supersede part of the McCarran Act as to the inappropriateness of FTC and the Department of Justice regulatory jurisdiction of the insurance business. In turn, this would do one of two things. (1) It would set the stage for duplication or concurrent regulation by the FTC and the Department of Justice and the states. The eleven unfair practices enumerated in the proposal would also be covered by state law. There would be duplicative or overlapping state and federal procedures. Furthermore, in dealing with the broad and general concepts, inevitably disagreements will occur between state and federal authorities which may very well result in conflicting procedures and incompatible rules of substantive law. Should the taxpayers be asked to bear increased costs of an already large overburdened regulatory agency to merely duplicate some functions already assumed at the state level? This certainly seems inconsistent with the trend to retain or move functions back to the states—a trend which is so viable to a federal system. Or, (2) S. 3201 might be construed as creating a federal preemption of this field or ultimately lead to this result. If this occurs, a more narrow and less protective ssytem of regulation would supplant a more comprehensive time tested system of state regulation.

[11] *FTC* v. *National Casualty Co.*, supra.

My question is this: in light of current criticisms of the FTC's failure to perform its delegated functions,[12] why continue to dilute its current or proposed activities by having the FTC perform those functions already being adequately performed by the several states?

In this connection it is worth pointing out that the state insurance departments have offices in every state. Some states maintain multiple offices providing easier access to the public. Thus, at the state level, complaints can be processed close to home. In sharp contrast, the FTC has field offices in only 13 states. Furthermore, unlike the state insurance departments which specialize in insurance problems, the FTC offices—already understaffed and underbudgeted—must dilute their efforts over the entire spectrum of American business.

Furthermore, comments in the 1968 report of the FTC are quite germane. The FTC said that between fiscal 1962 and 1968, Congress increased its appropriation from $10.3 million to $15.2 million. However,

"Most of this increase was consumed by mandatory pay increases and new responsibilities placed on FTC by Congress. During these years, the number of employees increased only from 1126 to 1200."

"Obviously, with so small a staff—the 1200 included clerks and stenographers—it was impossible to accord each application for complaint the same weight."

The FTC also said:

"Still another approach to bring its workload down to manageable proportions was to actively encourage the states to move more effectively against business chicanery."

The report stated:

"The general counsel's office also conducted the Commission's program for encouraging the states to enact laws, like the FTC Act, to protect the public from deceptive and unfair business practices."

Speaking of a closer working relationship with the states under local "FTC Acts," the Commission said:

"Certainly if the rackets can be stopped by state or local action before they grow into problems of interstate proportions, the need for federal action will be reduced, and the FTC can devote more energy to problems of regional or national significance."

The FTC stated that it had received 7,500 complaints from the public. For those complaints that lent themselves to broad scale treatment, the Commission could offer industry guides, trade regulation rules, and advisory opinions. Individual offenders could be halted by appropriate action. The Commission also received requests from Congress, the Executive Branch, and on its own motion. Its report contained a long list of areas in which it functioned—automobiles, cigarettes, fair packaging and labeling, food and drug cases, soft wood lumber, home improvements, the analgesic drug industry, advertising of economic poisons, monitoring of radio, T-V, newspaper, and magazine advertising, deceptive debt collection, stationery tents, pre-fab homes, unordered stamps, nursing products, sewing machines, jewelry, sleep products, mortgage financing, employment counseling services, correspondence schools, raising chinchillas, franchises, the watch industry, photographic film and processing services, decorative wall panels, cat and dog food industry, glass fiber and drapery fabric industry, deceptive transistor counts on radios, quick freeze aerosol sprays, wool act cases, fluid milk industry, furniture manufacturers, food products by operators of chain food stores, liquid petroleum gas, sugar, corn products, rice and other products, the newspaper industry advertising rates and T-V advertising rate structures, industrial laundry and linen supply business, chinaware, the clothing industry, cement industry, food distribution industry, grocery products manufacturing, the plastic industry, glass and plastic coated containers, clorox, promotional allowances by the public utility industry, enforcement of the Packers and Stockyards Act, supervision of the Webb Pomerene Export Trade Act, the Lanham Trademark Act, etc.

A 1967 survey of state insurance departments' statistical data (the 1968 is now being completed) showed that in that year, the state insurance departments had 4499 employees, including examiners, and the budgets of the departments totaled $40.4 million. Some of the larger states had a sizable number of employees, i.e. New York—729; Texas—463; Massachusetts—301; California—299; Florida—215; Illinois—203. Some of the intermediate-sized states had good sized departments, Virginia—77; Washington—88; Wisconsin—80; Maryland—94; Kansas—90; etc.

[12] Report of the ABA Commission to Study the Federal Trade Commission, American Bar Association (1969).

Our point is a simple one. To us it seems inconceivable that Congress, confronted by staggering federal budgetary needs, would add new regulatory powers and budgets affecting insurance to the Federal Trade Commission and the Department of Justice already inadequately staffed and over-burdened in handling every conceivable business in the United States when the states now provide a regulatory machinery with existing offices in 50 states, budgets of over $40 million, and approximately 4,500 employees available to regulate the problems of one specific business, i.e. insurance.

The inclusion of "insurance services" poses two fundamental issues for consideration. First, this bill would enable the FTC and the Attorney General to enter into the insurance regulatory field. Second, it would make available the federal courts for individual and class consumer actions against insurance companies after successful prosecution of a FTC or U.S. Attorney General suit. As to the first question, which we have just discussed, it would be inappropriate and unfortunate for Congress to foster the intrusion of the FTC and Attorney General into insurance regulation. This is particularly true in the absence of a documented case proving the need for such action in an area already subject to detailed regulation. This bill would emasculate the application of the McCarran Act. Neither the FTC nor the Administration has shown that such a radical move is required. If the McCarran Act is to be repealed, it should be done only after the same careful type of legislative investigation as was conducted in 1944 and 1945 before the McCarran Act was adopted.

As to the second question, the NAIC has not taken a position either for or against class actions. Mr. McLaren, a strong proponent of S. 3201, argues that establishing a federal private right to bring class action is subject to serious abuse.[13] To safeguard against abuse, S. 3201 would not permit a class action until the FTC or Attorney General prosecutes a successful action. If Mr. McLaren's argument for safeguards is accepted, the basic issue would then seem to be the avoidance of federal intrusion in insurance regulation and the absence of class action safeguards (or the absence of class actions) *versus* the use of such safeguards along with federal intrusion.

In balancing these considerations, certain additional factors need to be considered. Unlike most business areas to which the eleven enumerated items in S. 3201 would apply, the insurance business is subject to intense regulation *on behalf of the consumer*. The insurance commissioner's function is to protect the consumer. Hence the need for private class action is less than in other areas. In fact, it was the inadequacy of private remedies through the judicial process that gave rise to insurance regulation in the first place. Furthermore, as an alternative to a private suit, the public has recourse through the commissioner which many believe to be far more effective in providing consumer protection.

It has been said that "The licensing power is the staple administrative tool of the insurance departments".[14] However, it does not stand alone. Other powers include cease and desist orders, suits for injunctions, monetary and criminal penalties, removal of management, etc. As a result, when the public brings a complaint to the attention of the commissioner, he occupies a strategic position possessing extraordinary influence to compel redress of justified complaints. When a member of the public has been wronged, it is quite common for a commissioner to revoke the Certificate of Authority, to cause a rescission of a contract, refund or premium payment of claims.

A classic example occurred in 1956 when certain insurers, operated by finance companies, had misclassified thousands of automobile insurance policies resulting in overcharges to the policyholders. The state insurance departments with the assistance of coordination through the NAIC, required these insurers to make refunds on a nationwide basis. This illustrates effective class actions through the administrative process at relatively little or no cost in time or money to the insurance buying public under the existing system of state insurance regulations. Such results can be achieved without the necessity of long trials, rules of evidence, etc. (Of course, insurance department action is subject to judicial review).

In short, the NAIC believes that S. 3201's inclusion of "insurance services" would be contrary to consumer interest. First, it would introduce a relatively narrow form of federal insurance regulatory control into an area which has been long and more comprehensively occupied by the states. This, in turn, would

[13] See his testimony before House Subcommittee on Commerce and Finance, February 17, 1970.

[14] Patterson, *The Insurance Commissioner in the United States* 21 (1927).

generate, at a minimum, overlapping and conflicting regulating and at worst, a superseding of state regulation. Second, even if other appropriate safeguards against abuses to class actions cannot be devised, thereby necessitating abandoning the class action approach in the insurance area, more effective alternatives are available. These include the complaint with multiple remedies available to the Commissioner, as well as the application of regulatory controls which mitigate the number and likelihood of complaints. Thus the NAIC submits that the inclusion of "insurance services" is contrary to the consumer and public interest and that it should be deleted from S. 3201.

If, however, Congress still thinks that a federal class action in the insurance area should be sanctioned, it should be done in such a way to avoid the intrusion of the federal government into insurance regulation. If safeguards against harassment suits are desirable, it is not necessary to tie them to federal regulatory activity. For example, a consumer bringing a class action could be required to show that he has first filed a bonafide complaint with the insurer and with the state insurance commissioner and that no relief was forthcoming. Another approach would be to parallel the S. 3201 technique at the state level. That is, instead of conditioning a class action on successful FTC or U.S. Attorney General action, condition it on successful action by the state insurance regulatory official. Under the S. 3201, the agency which has the direct responsibility for regulating the business and its practices is ignored. Instead the responsibility is placed on the FTC and the Attorney General's office which have only oblique responsibility in this area and none if the standards of the McCarran Act are observed. In short, we submit that federal sanctioning of class action can be done in a manner so as to avoid overturning the existing insurance regulatory structure.

Senator Moss. We will now hear from Mr. John F. McCarthy, Sales and Marketing Executives, International, Inc.

Mr. McCarthy, we are glad to have you. We appreciate your being here and waiting over to this afternoon.

STATEMENT OF JOHN F. McCARTHY, SALES AND MARKETING EXECUTIVES, INTERNATIONAL, INC.

Mr. McCarthy. Thank you Senator. I prefer to testify this afternoon because I know you have a very busy schedule, as all of us do, and I think the sooner we can get most of this out of the way the better, so if you are willing to wait, so am I. I will go ahead with my prepared statement because when I start ad libbing I seem to talk longer than if I sat down and——

Senator Moss. I find that is sometimes the case.

Mr. McCarthy. First, let me explain who I am and what Sales and Marketing Executives, International, Inc. is. I am an assistant vice president of United Utilities, Inc., presently heading up that firm's Washington Office. However, I am appearing before this committee as a member of and in behalf of Sales and Marketing Executives, International.

Sales and Marketing Executives is an affiliation of sales and marketing executives clubs located in some 148 of the principal commerce centers in 44 States and the District of Columbia. Sales and Marketing Executives membership is limited to qualified sales and marketing managers, or executives, whose job function it is to establish sales policies; to supervise, manage, direct, and train the sales and marketing personnel of his company, business or branch thereof, and to perform other managerial aspects of distribution, merchandising and marketing. These clubs have a total U.S. membership of some 20,000 professionals.

Sales and Marketing Executives has existed for quite some time but for the first time they have felt moved to appear before a Senate com-

mittee or any national legislative committee because of the consumer issue and how important it is to this group.

We also are undertaking to try to help with consumer education in working with Virginia Knauer, the Special Assistant to the President for Consumer Affairs.

Senator Moss. I commend you for that; fine.

Mr. McCarthy. Let me preface my expression of the views of Sales and Marketing Executives on the consumer protection legislation before this committee by informing you that I am not a lawyer, rather, I am speaking as an experienced marketing executive.

Now, let me turn to S. 3201, the "Consumer Protection Act of 1969."

Sales and Marketing Executives, International fully supports this legislation which would provide increased protection for consumers—strengthen the Federal Trade Commission Act—make 11 specific unfair or deceptive acts or practices unlawful—and provide a right of action by the Federal Trade Commission or the Attorney General to restrain any such unlawful acts or practices.

FEDERAL TRADE COMMISSION REINFORCEMENT IS MY FIRST SUBJECT

Taking cognizance of the February 4, 1970, testimony of Caspar W. Weinberger, Chairman of the Federal Trade Commission, before the House Interstate and Foreign Commerce Committee, Subcommittee on Commerce and Finance, Sales and Marketing Executives not only supports the additional enforcement authority granted the Federal Trade Commission by the provisions in title I of S. 3201—this, by the way was lifted entirely from your own bill, and I read it—but in addition, supports the FTC in its request that its power to issue substantive rules be made more explicit—that it be given stronger and more comprehensive tools in the form of greater authority to assess penalties and damages—and that the list of unfair or deceptive practices deemed unlawful in title II of the act be expanded to specify other commonly experienced acts and practices which heretofore have been shown to be injurious to consumers.

CREDIT TRANSACTION PROVISIONS OF THE ACT ARE NOT CLEAR

We believe, that title II of the act should be clarified to insure that the unfair or deceptive acts or practices defined in section 201 apply to all consumer transactions, whether they be cash, credit or barter. We also suggests that section 204 be clarified to make it explicit that the consumer shall "recover actual damages," including carrying charges or interest related to credit purchases.

DEPARTMENT OF JUSTICE'S ROLE IN CONSUMER PROTECTION IS ESSENTIAL

Sales and Marketing Executives particularly supports the provisions of section 204 of the bill which would give the Attorney General the authority to institute court proceedings to restrain violation of the act. We believe, that deliberate unfair or deceptive acts or practices in commerce are of a criminal nature. The Department of Justice, being the agency primarily responsible for law enforcement in the area of criminal activity, is, in our opinion, the best equipped and most qualified agency to investigate evidentiary problems such as proving fraudulent or deceptive business practices.

Furthermore, we believe, that a person, partnership, corporation, or firm enjoys greater protection under the Department of Justice's prosecution of a fraudulent or deceptive practice because of the evidentiary nature of such proceedings. This is in contrast to the regulatory agency that can make administrative decisions with less burden of proof required for their actions. Such regulatory agencies generally take into account in their proceedings factors which are not evidence in their proceedings.

SUITS BY CONSUMERS UNDER S. 3201 PREFERRED TO S. 3092

Sales and Marketing Executives supports the provision for consumer's cause of action and for the recovery of actual damages, costs, and reasonable attorney fees. In this regard, we particularly support the provision of S. 3201 which provides for consumer actions after the Department of Justice or the Federal Trade Commission has successfully enjoined unfair or deceptive acts or practices enumerated in section 201 of the bill. We also support the provision of that bill which makes the final judgment or decree entered into by the courts in such injunctive proceedings prima faci evidence against the defendant in subsequent consumer civil actions.

To be more specific, we prefer the provision of S. 3201, which limits consumer class actions to those instances wherein the Attorney General or the Federal Trade Commission has successfully enjoined a deceptive act or practice because:

1. Consumer groups initiating class actions under restrictive legislation, such as S. 3092, will have the whole burden of proof placed upon them in such evidentiary proceedings. This burden of proof, of a certainty, will entail undertaking a costly investigation which must be done professionally in order to obtain admissable evidence. We believe, that consumers, in general, will want to avoid underwriting these costs.

2. In our opinion, Federal Trade Commission or Department of Justice subpenas of company records, obtained under the provisions of S. 3201, will be far less objectionable to business than subpenas obtained by individual consumers, or groups of consumers, under the provisions of S. 3092. This is because we are fearful that subpenas obtained by consumers under the pretext of an alleged "unfair or deceptive act or practice," will in reality be obtained to facilitate witch-hunting expeditions. That these fears are well founded is best illustrated by my quoting from an article on "consumerism" by James Ridgeway, cofounder and editor of Mayday-Hard Times, the December 1–8, 1969, issue of Hard Times in which he says:

> The most important advocates of consumer protection are the trial lawyers, who are loosely organized through the American Trial Lawyers Association. This is a maverick group with occasional populist-progressive tendencies.

He continued:

> In recent years, the trial lawyers have mounted a devastating attack on American corporations. Their suits begin simply as damage claims, then broaden into attacks on the conduct of the corporation, tracing in the most fundamental radical manner the injury of individuals back through the corporation hierarchy. They show in great detail how corporate officials engage in calculated plunder and injury of the populace. Discovery procedures of the court enable the lawyers to obtain and introduce into court records documents revealing precise details of corporation activity. Juries are convinced and damages running into the millions have been set against companies. Congressional committees spend time assembling and reprinting documents from these cases.

James Ridgeway went on:

> The effects of this legal attack are profound. Not only do the courtroom victories enhance the power and prestige of the trial lawyer . . . but they turn the court into a legislature . . . since the court has become the arena where the post-industrial economy is adjusted, every citizen needs a lawyer—not a legislator—to look after his interests.

3. When the Justice Department or the FTC first obtains a final judgment or decree from, the courts which, under the provisions of S. 3201, serves as a prima facie evidence against the defendant, it will be simpler, (and therefore more economical), for the individual consumers or groups of consumers to obtain appropriate redress. This, we believe, will not be the case under the provisions of S. 3092 permitting unrestrictive class actions because of many delays which can and doubtless will take place.

4. Consumer class actions on an unrestrictive basis as permitted under the provisions of S. 3092 will likely also lead to many unfounded suits being brought into the U.S. district courts, thereby encumbering the court machinery even more than is now alleged. And this problem could even be more acute when you take cognizance of the fact that there is now pending before this Congress, sociological legislation which would provide for class actions in the pension and pollution fields.

5. We deplore the potential harassment of business because of unfounded class actions which will likely result from unrestrictive class actions as permitted under the provisions of S. 3092. We abhor even more the increased operating costs which business will have to meet in defending itself against such unfounded actions. Such expenses, of a certainty, will be borne by all consumers, not just those taking irresponsible class actions, because they will be borne in the form of increased prices. This is best exemplified in an interview of Richard W. McLaren, Assistant Attorney General for Anti-Trust, as published in a recent Washington, D.C. Sunday Star, in which he pointed out that for just one case the costs could run to a million dollars before a man (or business) could ever get his case to trial.

Sales and Marketing Executives is of the opinion that S. 3201, the Consumer Protection Act of 1969, in itself, is an appropriate first step in legislation to protect consumers. Furthermore, as previously stated herein, we do not object to strengthening the act to the extent that the Federal Trade Commission proposed in their appearance before the House Subcommittee on Commerce and Finance. The Congress is well aware that it has the authority to amend this act to strengthen it if experience should indicate this to be necessary in the future. Finally, Congress certainly is aware that progress and order are the natural outgrowths of "evolution," not "revolution."

In conclusion, let me say that the members of Sales and Marketing Executives, International find deplorable the employment of unscrupulous sales techniques which deliberately mislead consumers into buying inferior merchandise—buying beyond their means—and buying at overstated values. We are now working and will continue work, to improve the integrity of the marketplace.

Thank you again for the opportunity to appear here today to present the views of the Sales and Marketing Executives International, Inc., on this important matter of consumer protection.

Thank you.

Senator Moss. Thank you, Mr. McCarthy. We appreciate your statement on the matters which you have put before the committee and your judgment as to what would occur under the bills that you have cited here today.

I am pleased to see you support Chairman Weinberger's suggestions for amendments to S. 3201 to strengthen the hand of the FTC.

I agree that this will much strengthen our approach in this consumer area. You may have noted that I have proposed that, for intentional deception and fraud, this be made a crime and that the Attorney General have the authority to prosecute with jail sentences and fines.

Would you support a measure that strong?

Mr. McCarthy. I think by inference I did. It was implicit in our testimony that we feel it is of criminal nature.

Senator Moss. I noticed that in your testimony you, of course, fear that if there is not a triggering device to screen out these cases, that there will be a deluge of them and this will be difficult or impossible to handle. But on the other hand, many of our witnesses fear if we have the triggering device, that the consumer is insulated so that he can't have his opportunity for remedy unless the Department moves. If the Department is slow, dilatory or for some reason unimpressed, he is then totally cut off on this.

Would you support a bill that has some reasonable access other than this trigger device if you felt that it would not result in the deluge you talk about?

Mr. McCarthy. The abuses we fear. Yes; I am certain we would, Senator Moss.

I might point out that one of the reasons we feel that triggering device is adequate is that there are so many good consumer protection agencies on the State level and we felt that this in itself would protect many of the consumers that we are concerned about and that this might, in itself, any favorable action by a State consumer protection agency could result in prosecution at the State level and would trigger the FTC or Department of Justice into action.

Senator Moss. The terms of the bill require it be the Attorney General.

Mr. McCarthy. I appreciate that. I am stating that the Attorney General having seen this would be moved to act more quickly for political reasons if nothing else. I am not saying that that becomes an automatic trigger. I think that having seen somebody else move he will move too.

Senator Moss. It might be persuasive on him to move.

Mr. McCarthy. Yes, sir.

Mr. Cary points out this really brings into play still a third party that acts first at the State level and then we go to the Attorney General level before he consumer himself has this chance.

I noticed that you felt that there would be a good many unfounded cases or rather crank cases that would get into the courts and burden the courts. You are aware, I am sure that under rule 23—in fact under the General Rules of Federal Procedure—that there is a pretrial proceeding where the court issues its preliminary order before it goes on to trial. This is a screening level that a person would have to pass, and particularly under rule 23 where the class has to be established.

This would be the screening level that would cut out what are purely unfounded cases. There has to be a reasonable cause at that point or it wouldn't go any further.

Mr. McCarthy. I understand that, Senator Moss. As I think Mr. Barger said, 35 percent of the complaints that they get are legitimate out of a hundred the other 65 are not legitimate.

I would presume rule 23 would eliminate the 65 percent easily. Maybe not quite that much but say 60 percent. But even 5 percent of the cases, if they got through, at the potential cost of a full investigation, would be a tremendous—I would hazard a guess that the firms which will be attacked by unfounded suits are the major firms because they are large, and because they could possibly afford to pay damages, rather than a small firm that may not have enough resources to pay if they did get a judgment against them.

Our fear is that you are going to offset any good by increasing operating costs of the companies to protect themselves against even the 5-percent unfounded cases if it should be that great.

Senator Moss. Well, I guess there would be no denying that some cases would be tried ultimately that could not be proved to get a final judgment and if that is only 5 percent, that is keeping it pretty low. On the other hand, the testimony of Mr. Barger was that 35 percent of the complaints seemed to be legitimate and so we might turn it around and say, what if we are screening off a major number of these 35-percent people? We have done greater damage the other way; haven't we?

Mr. McCarthy. That is true but I find it difficult to believe that that could happen with as much protection being afforded both—having once found that there was a fraudulent or deceptive practice being accomplished or perpetuated by a company on a State level, I would suspect that the court would act quickly in granting relief.

So what I am saying is I feel there are enough protective measures in existence that I don't believe we are going to be screening out too many of the 35 percent. The abuses, I think, would be greater than those which had a legitimate claim which was not acted upon.

Senator Moss. Would you consider it broadening the act too much if the FTC could also be a trigger agency in addition to the Department of Justice?

Mr. McCarthy. I think in my testimony at one point I said we assumed that if Mr. Weinberger's requests for additional enforcement authority was acted upon, this in a sense would trigger the mechanism and serve as prima facie evidence. What I am saying there I guess is if the FTC was able to assess a penalty, even though it didn't go through the court, this might be enough for the court to accept it as prima facie evidence on a civil action.

Senator Moss. One of the inhibiting problems with regulatory agencies is that there is also chronically a shortage of manpower. We are always talking about needing more staff and more money. If we didn't have to use the regulatory agencies so fully, we in effect release the manpower and the energy of the private citizen who then causes the thing to move without being required to go to the public regulator and this is what we are trying to find: How this could be done without being unfair and jeopardizing legitimate business and certainly, the specter of the strike suit, the lawyer ambulance chaser among consumers, must be averted if it is at all possible to do so.

That is the reason we are interested in having your point of view representing your group as well as others who come before us.

I appreciate your opinions and your comments very much. We will be glad to have then in our record when we look it over trying to make the legislation.

Mr. McCarthy. Thank you, Senator.

Senator Moss. Thank you very much, Mr. McCarthy. We are glad you came this afternoon to testify for us.

Mr. Thomas Nichol, Jr., general counsel of the Gas Appliance Manufacturers Association, is the next witness.

Good afternoon Mr. Nichol.

STATEMENT OF THOMAS NICHOL, JR., GENERAL COUNSEL, GAS APPLIANCE MANUFACTURERS ASSOCIATION, INC.

Mr. Nichol. My name is Thomas Nichol, Jr. I am a member of the Bar of the State of New York and am general counsel for Gas Appliance Manufacturers Association, frequently called GAMA. Our members manufacture a wide assortment of gas-fired products such as ranges, water heaters, incinerators, clothes dryers, air conditioners, and heating equipment for buildings or parts of buildings; also components for these products, such as valves, pressure regulators, controls and the like. Another segment of our membership manufactures equipment used in the production and distribution of gas. We have some 620 members, who produce more than 90 percent of the gas appliances and equipment used in the United States.

Like your committee, we are also very much concerned with consumers and any problems which they may have with our products or with us. Consumers are the people who ultimately buy our products and keep us in business; so they are important to us. In the course of the consumer movement over the past couple of years, I have heard it charged more than once that manufacturers are insensitive to consumers problems. I would remind you that the gas appliance and equipment industry cannot indulge in that attitude because we are in constant competition with the electrical appliance industry for the consumer's dollar.

We have come a long way since President Johnson's consumer message in February 1968. When I see the things which have been happening since then in the trade association which I represent, and in the industry which it serves, I can only admire the effort which has been made and the progress which has resulted.

Let me quickly add that we know there is still much to be done, but I think we need not apologize for what has been—and is being—accomplished in the direction of meeting some of the recommendations made by the Presidential Task Force.

1. We have had a continuous activity with our members toward the simplification of warranties, with encouraging results.

2. We have been active in the development of Fact-Tags to be attached to products to give the user important information he should have.

3. We are engaged in a review of consumer literature—the printed items which go from the manufacturer to the consumer in connection with the purchase, use, and maintenance of the appliance—in an effort to see that such items are clear and understandable and complete.

4. With the Association of Home Appliance Manufacturers, GAMA has established a council to receive complaints from consumers regarding pertinent categories of appliances; to forward such complaints promptly to the manufacturer concerned; and then to make a follow-up to see that complaints have been properly handled.

5. We have prepared a guide against deceptive advertising of gas ranges which is being widely distributed.

All of these things have been—and continue to be—accomplished without being required by legislation by Congress. I submit that this is an important point to be considered and remembered. I think it helps to explain why we feel strongly that if there must be legislation, it must be approached with great care in order to avoid having over-reaction produce something unwise.

We are concerned here today with four bills—S. 2246, S. 3092, S. 3201, and S. 3338—all of which are designed to aid the consumer by giving him—or some agency in his behalf—weapons against the manufacturer or supplier. Two of them provide for class actions by consumers.

We do not deny that there are situations which need correction. Investigations by the Federal Trade Commission, the White House Office of Consumer Affairs, the Department of Commerce, and the Department of Labor, culminating in the January 1968 Report of the Presidential Task Force, disclosed numerous instances of consumer dissatisfaction. Principal among these were:

Dissatisfaction with performance of the product.

Dissatisfaction with warranties.

Dissatisfaction with servicing.

The reported instances are all, or substantially all, individual situations presumably involving one customer, one appliance, one dealer, and one manufacturer.

We did not note any situation in which all, or substantially all, of the consumers who had a certain type or brand of appliance were complaining. There may have been uniformity in the fact that all those who complained were dissatisfied, but we think it is debatable that the questions of law or fact common to the class predominated over the questions of law and fact affecting the individuals, which is required for a class action.

Before awarding to consumers the right to bring a class action without regard to the amount and merely because they are consumers, I suggest that we should consider whether this would provide the type of remedy desired.

Is a class action going to get for the consumer the type of relief he really wants? Is a class action going to make Mrs. Doe's malfunctioning refrigerator work?

Is a class action going to make the serviceman who calls at Mrs. Roe's more competent?

Is a class action going to get you or me quicker service when our television tube breaks down?

In other words, the consumer wants and needs something.

What does the consumer want?

We believe strongly that what the consumer really wants is to have his appliance work the way it is supposed to work. We believe he wants this much more than he wants damages and an opportunity

to join in a protracted litigation which may or may not bring him satisfaction, and probably will cost him some money. It seems small comfort that if his refrigerator breaks down, he may get an award of damages several years later.

While we cannot deny the usefulness of a class action in the particular types of litigation suited to it—for example, civil rights suits, stockholders' suits, and suits attacking municipal assessments, et cetera—we do not see the consumer action as coming within this extraordinary remedy.

Rule 23 of the Federal Rules of Civil Procedure is a complicated rule and action brought pursuant to it may be complicated action. In its earlier form, the rule generated so many questions that a general overhaul was considered necessary and was completed in 1966. The rule contains prerequisites and limitations designed to prevent its application for use in situations not suited to it. None of these safeguards is a requirement of a jurisdictional amount in controversy, and we can assume that there was no reason to insert such a safeguard because it already existed in the Federal Statutes establishing the jurisdiction of the U.S. district courts. We question whether the framers of the rule would have omitted such a requirement if they had believed that any claim—no matter how small—could be asserted in the U.S. district courts under rule 23.

As previously stated, we believe that the consumer wants an expeditious remedy. Litigation does not seem to offer such a remedy. In some districts it takes from 3½ to 6 years before a suit can be brought to trial.

The proposed removal of the statutory requirement that, in order to invoke Federal jurisdiction in such cases, the amount in controversy must exceed $10,000 opens the U.S. district courts to claims of, say, $5, provided such claims are asserted by consumers. One wonders why these courts, already seriously overburdened, are to entertain $5 claims of consumers (just because they are consumers) but still refuse to hear the claims of other plaintiffs in the amount of $9,999.

Some strange situations may arise in a class action. In a case now pending in the southern district of New York, initiated by a single plaintiff (whose damages were estimated at $70) on behalf of a class estimated to consist of 3,750,000 people, the case has twice been to the circuit court of appeals and, I was informed this week, a trial on the merits has not yet been held. The defendants are two brokerage firms and the New York Stock Exchange. One can imagine the legal fees already incurred and what they would do to a small business.

We are forced to view the type of class action contemplated as being an invitation to litigation. We wonder how many consumers will actually desire a suit, although they may be willing to go along on the recommendations of the attorneys involved. It has been suggested that the real beneficiaries of this type of action are the attorneys, and I don't think we want that result.

We think that the class action would be an uncertain blessing to consumers. Provided the class could in some way be ascertained, some might be willing to go along in a suit and others might merely fail to request exclusion and thus be bound. In such situation, if the members actually carrying on the suit lost it, all members of the class would

be bound by the decision—in other words, they would have lost their case also.

We believe that consumers want their appliances to work much more than they want litigation. We believe gas appliance manufacturers are making a genuine effort to correct existing problems.

I am informed that, although not in the bills mentioned above, a question before this committee is the establishment of an Office of Consumer Affairs. I am authorized to say that we advocate that such an office, with statutory powers, be established in the Executive Office of the President.

Thank you, Mr. Chairman.

Senator Moss. We had two other witnesses who were unable to remain for this afternoon's hearing. We are trying to get arranged a special time next week when we can hear those two additional witnesses.

This then completes what we had for this afternoon and we will now stand adjourned.

(Whereupon, at 4:55 p.m., the subcommittee was adjourned.)

CONSUMER PROTECTION

THURSDAY, APRIL 9, 1970

U.S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE FOR CONSUMERS,
Washington, D.C.

The subcommittee met at 9:30 a.m. in room 5110, New Senate Office Building, Hon. Frank E. Moss (chairman of the subcommittee,) presiding.

Present: Senators Moss and Pastore.

Senator Moss. The subcommittee will come to order.

This is the time set for further hearings on three bills which are pending before this subcommittee: S. 2246, the Deceptive Sales Act; S. 3092, the Consumer Class Action Act; and S. 3201, the Consumer Protection Act.

Senator Moss. We have had some testimony from various experts on this matter. We have two very fine witnesses to hear this morning regarding these bills. We look forward to hearing from them.

Our first witness will be Mr. Thomas A. Rothwell, of the National Small Business Association.

Mr. Rothwell?

Mr. LEWIS. I am John Lewis. Mr. Rothwell will be here in just a moment.

Senator Moss. It is all right. We will turn around and hear the second man first, and then Mr. Rothwell.

Mr. Richard Barrett is here. He is general counsel for Procter & Gamble, and we will be pleased to hear Mr. Barrett and then we will go to Mr. Rothwell.

STATEMENT OF RICHARD W. BARRETT, LEGAL COMMITTEE OF THE GROCERY MANUFACTURERS OF AMERICA; ACCOMPANIED BY GEORGE KOCH, PRESIDENT, GROCERY MANUFACTURERS OF AMERICA

Mr. BARRETT. My name is Richard Barrett. I am appearing here today as a representative of the legal committee of the Grocery Manufacturers of America. Accompanying me is George Koch, the president of the association.

The Grocery Manufacturers of America represents approximately 200 manufacturers of products sold mainly in grocery stores.

Our members' products are in every home and our business importantly consists of ascertaining the wants of the consumer and fulfilling those wants. Our interest in the consumer is long standing and

will continue as long as we are in business. This should be emphasized because of the growing tendency to assume that Government and business are in different camps in the matter of consumer interests and that the consumer and business, absent some protection from Government, are working at cross purposes. I should like to begin my comments today by asserting that this is not true—either of business in general or of that part of the business community which I represent in particular. It is from our own industry's standpoint—since we know that best—that we will approach the question of consumer legislation.

The average unit cost to the consumer of grocery products in the supermarket is 43 cents. The consumer normally uses up our type of product in a short period of time; for example, in one meal or the course of doing one week's laundry. The average consumer makes about two trips a week to her supermarket. While there, she is exposed to a wide variety of suitable competitive products of roughly comparable price. These products beckon to her from the shelves, reminding her in turn of the advertising messages she has seen on television or read in her newspaper or magazine. If a manufacturer has promised her something which his product does not deliver, the consumer, on her next visit to the store, simply rejects it and buys that of his competitor. Between each one of her frequent trips to the store, the consumer puts our brands to the test in her home.

Although the consumer invests very little to purchase one of our products, our members risk very substantial amounts in making and marketing them. Millions of dollars are risked on each brand.

Thus, it is to our own financial interest to be sure that the consumer is satisfied with our products. Before a new or improved product is introduced, we conduct consumer surveys and attitude studies to be as certain as we can that the product pleases her. Modifications are made to meet her desires. After these surveys, we conduct test markets to further confirm our judgment of what she wants. These tests are run in selected metropolitan areas and the new product sold to stores in the area in the same fashion as established products normally are sold. This type of selling lasts for months, and even a year is not uncommon. We want to be sure that the product will continue to please her and that she will come back for repeat purchases.

We know that the interval between her purchases is short and that our competitors will also be trying to win her back to their own brands. Misrepresenting or overselling our type of products is foolhardy and shortsighted where the consumer has such a wide choice and frequently exercises that choice at very low cost.

You can see, therefore, that we do our best to satisfy the consumer. On occasion, however, she finds when she gets home that the package is damaged or in some way is defective. These are rare occasions, but we are human and we can make mistakes. When this happens, it is common practice in our industry to either replace the package or to refund the price. It is not uncommon to do this on a "no questions asked" basis because we want that consumer to continue to be our customer.

Now turning to the bills, S. 3092 would permit a class action in the Federal courts in the case of any violation of section 5 of the Federal Trade Commission Act or any violation of consumers' rights under any

State law. The breadth of field for possible lawsuits which would be opened up by this legislation is obvious.

S. 3201 takes a different approach by defining certain "unfair or deceptive practices" which will provide the basis for Federal class action suits by consumers following the bringing of a successful proceeding by the Justice Department or the Federal Trade Commission. Eleven types of deceptive practices are enumerated in this bill.

This committee may be surprised to learn that products such as ours are affected by this bill, since the bulk of the practices enumerated are so-called hard-core consumer frauds which are alien to today's grocery market. Thus, item 3 makes it a deceptive act or practice to state that "services, replacements, or repairs are needed with knowledge that they are not." Similarly, it is a deceptive practice under item 4 to represent "that the consumer is legally obligated to pay for, safeguard, or return unsolicited goods knowing that the consumer is not," while item 7 makes it a deceptive practice to represent "that goods are of a particular standard, grade, quality, style or model knowing they are not." These practices are characteristic of the kind of local "hit and run" tactics that we all think of when the term "consumer fraud" is used; they are not characteristic of the grocery products business.

We must point out to you, however, that two or three items will affect our business depending on how they are interpreted. Item 11 is a case in point. As drafted, it raises the spectre of a possible consumer damage action in the Federal courts for practically every sales effort a manufacturer or vendor might contemplate making. Item 11 makes it an "unfair act or practice" to knowingly represent, among other things, that goods or services have "characteristics of performance" or "benefits" that they do not have. This wording is so broad and so subject to multiple interpretations that a company would face the threat of a class action lawsuit whenever the Government raises the question of whether an advertising claim accurately describes the performance of a product.

Let me illustrate by using item 11 on the laundry list as an example. Judging the validity of an advertising claim is often a difficult matter of language interpretation and sometimes hinges on the definition of a single word. It is always dependent upon the context of the advertising, a prediction of how consumers will reasonably understand the claim, and many other gray areas. Our members, in fact, try very hard to not mislead or deceive consumers because they know the business they will lose through loss of repeat sales if the consumer is disappointed in expectations for a product. At times, however, our members do encounter disagreements with the Federal Trade Commission over the meaning or interpretation of an advertisement. They cooperate with the FTC to resolve these questions when raised. Such cases are not hard-core frauds. Yet they are classified with them in the proposed legislation and our members would run the risk of class action damages. I cannot overemphasize the stultifying effect this could have on the pursuit of legitimate business activities if the businessman has continually hanging over his head the threat of class action lawsuits.

Furthermore, the threat of class action lawsuits could make it almost impossible for a reputable company to settle a relatively minor matter with the Federal Trade Commission via a consent order, be-

cause such consent order could trigger off class action lawsuits. A businessman faced with the prospect of a consent order might well conclude that he has no choice but to fight the matter through the courts.

Others have come before you to describe how cumbersome and how complex the class action remedy is. We heartily endorse this and say that a 4 year, or even a 1-year, lawsuit is no great favor for a consumer to secure a refund of a 43-cent price. It is also no favor for a consumer who has paid several hundred dollars for adurable product and is deprived of the use of this much larger sum for so lengthy a period of time. We have made inquiry, and we have found not one Federal class action case brought under the present rule 23 which has been fully litigated, the damages determined by the court and paid to the members—and this rule is now 4 years old.

Please bear in mind that even after a victory for the class, each member of the class must somehow appear, give evidence of her purchase, her injury and her damages. With a consuming population as mobile as ours and with the passage of the years consumed by these class action suits, the only one of the original class likely to be around at the end of the suit is the lawyer who brought it. Where the class consists of 10 million purchasers of a 43-cent grocery brand, the task assigned to the court becomes well-nigh impossible.

It is obvious from my comments that we believe these actions will constitute a real burden for our Federal court system. This, in itself, should not be the basis for discouraging a remedy which offers the best redress for a legal wrong. We cannot believe, however, that the benefits which can be derived by consumers from the class action remedy are fairly balanced by the price which our Federal judicial system would have to pay.

Finally, in practice, the actual targets of class action litigation will inevitably be legitimate and established firms selected because they have the resources to pay large damage awards. The marginal vendors and the "hit and run" operators, who account for the real "hard core" consumer fraud, are normally judgment-proof or simply unavailable for suit, and those inclined to bring class action suits know this. Those who should be will not be the targets of these suits.

With these comments as background, there are several specific points we should like to register with this committee:

1. The best approach to consumer frauds is that of prevention to the maximum extent possible rather than providing for relief after they have occurred. To this end, the Grocery Manufacturers of America supports the legislation before this committee which would strengthen the enforcement powers of the Federal Trade Commission by enabling it to deal with those purely intrastate matters which affect commerce and to obtain from the courts preliminary injunctions in certain situations. Thus, the GMA supports Senator Moss' bill S. 2246 with some exceptions.

2. In addition to the contemplated injunctive powers of the Federal Trade Commission, we call to your attention the movement among the States to adopt the Uniform Deceptive Trade Practices Act. This act grants to anyone likely to be injured by a deceptive practice power to bring injunction proceedings against the offender. The list of consumer frauds contained in Senate bill 3092 apparently came from that act, for they are virtually identical. The act has been passed in 12 States.

We have included in the appendices a copy of the act and a list of the States in which it has been enacted.

3. In spite of the best prevention efforts, however, there will still be consumer frauds, and hence there must always be redress for aggrieved consumers. However, we believe that consumer frauds are essentially local in nature, that they can best be handled at the State and local level, and that Federal policy should favor State and local action in this area.

4. The first and obvious place the consumer should look for relief is to the store where she bought the product or to the company which made it. This is an effective remedy which should be encouraged. Where it is in existence, the class action remedy seems superfluous and unfair. If the remedy is enacted this practice may be abandoned lest voluntary adjustment constitute an admission of guilt.

5. If this self-help remedy fails, the consumer has redress in the State courts—for damages or for refund of the price, or perhaps for both. The entire development of the fraud cases in this country has been in the State courts at common law and has been recognized in the States' uniform sales act and now the uniform commercial code. This substantive law exists in all States today to give money remedies for consumer frauds without the need of further legislation.

We have included in our appendices some material with respect to the uniform commercial code.

6. Over the years, the States have also developed special courts to handle smaller claims such as these. Even in States where separate small claims courts are not provided for, the courts of general jurisdiction often set up special small claims divisions or procedures to handle these cases.

In appendix 3 we have listed the small claims forums for all of the States.

7. For those situations where group action appears more expeditious, there are State class-action remedies in practically all of the States, and these also have been summarized for you in appendix 4.

8. For the poor consumer who needs help and cannot afford an attorney, there is a network of Legal Aid Societies who have developed an expertise in consumer fraud cases. There are over 650 legal aid offices in the United States.

We have included in the appendices a directory showing the location of these offices.

9. There are also 130 Better Business Bureaus throughout the country to assist in preventing consumer frauds and to help victims secure redress. In 1969, the Better Business Bureau in my hometown, Cincinnati, Ohio, handled 14,500 informal inquiries concerning completed consumer transactions and processed about 4,200 written complaints. We are told that in these latter cases their efforts are generally 80 to 90 percent successful.

It was our thought that some of this detail about the existing system for consumer protection at the State and local levels would be of interest of the committee.

Although we favor leaving the redress of consumer frauds to the States, our association has been in favor of increasing the authority of the Federal Trade Commission in preventive measures. We see the White House Office of Consumer Affairs as also serving this purpose

and are in favor of the legislation establishing this office. Such an Office would fit in very well with the existing consumer protection system which has just been described. This White House Office could do a number of things:

1. Alert State and local agencies to the existence of consumer problems.

2. Refer specific complaints to appropriate State and local agencies for assistance and action.

3. Serve as a clearinghouse for information useful to organizations and individuals involved in consumer protection and redress.

4. Conduct public education programs oriented toward helping consumers understand their legal rights.

5. To the extent that evidence is developed concerning a regional or national pattern of injury to consumers at the hands of particular offenders, alert the Federal Trade Commission to the necessity for investigation and possible action.

In addition to these functions, the Office would possess the rather awesome power of spotlighting in public the existence of consumer problems and bringing the authority of the executive department to bear on them. An article concerning the extent of this power appeared in the Tuesday, March 10, 1970, edition of *The Wall Street Journal*, and is submitted to you as appendix 6 of this statement. This article speaks at some length of the effectiveness of this power as exercised by the Office of Consumer Affairs in its present form. Even while Mrs. Knauer has been campaigning for recognition of her Office, her Office has been effective in this way.

I think it appropriate to note that this power in the wrong hands could be abused, and certain safeguards on its exercise may be called for. For example, it seems to us that an opportunity for voluntary corrective action by the business organization concerned prior to any "spotlighting" by the Office of Consumer Affairs would be the fairest approach for business and consumers alike.

If I may observe, the White House Office may also serve to spotlight or prod other Government agencies. Since the Office is new and is plowing new fields, it may be helpful to have some of the established agencies detail or loan experienced personnel of their agencies to the White House Office, both to advise and assist and also to serve a liaison function. I have in mind the Federal Trade Commission, the Food and Drug Administration, the Office of Auto Safety, and so on.

In summary, the Grocery Manufacturers of America urges the following:

1. We believe that, in general, American business is ethical and well-intentioned in the matter of serving consumer needs. Legislation to prevent and correct existing consumer frauds and abuses should not be so in discriminate as to create undue burdens for businessmen honestly seeking to comply with the law and serve their consumers.

2. The grocery products business in particular is qualitatively different from those involving items infrequently purchased. In our business, the consumer has a constant opportunity, at a nominal cost, to compare competing brands and abandon a given manufacturer's products. This situation serves both to motivate manufacturers to deliver what is promised and to offer a simple remedy in the event of dissatisfaction—a switch in brands and even a refund.

3. The class action remedy itself in any event is drastic, cumbersome, burdensome to the courts, ineffective for the typical consumer, and unlikely to be applied to the perpetrators of real "hard core" fraud. It is particularly inappropriate in the grocery field because of the nature of the products.

Finally—

4. There is an existing and extensive body of State and local consumer protection legislation with a network of agencies and courts, including small claims forums, which provides good framework for consumer protection. Efforts should be made to improve prevention of consumer fraud through the Federal Trade Commission, but fraud and its redress are essentially local matters and should remain in local hands. The proposed Office of Consumer Affairs could, however, render valuable assistance to local agencies and consumers in utilizing the existing framework of consumer protection.

Thank you for your attention. If I may answer any questions for you, I would be pleased to do so.

Senator Moss. Thank you, Mr. Barrett, for your statement and for furnishing the appendixes here that have a great deal of information. The appendixes will appear in the record immediately following your oral testimony.

I appreciate your addressing yourself to the three bills that are before us. As between S. 3092, the Class Action Act, and S. 3201, which is the Administration Consumer Protection Act, I understand that you feel that the latter is much preferable?

Mr. Barrett. I think there is more in the latter that pleases us, although if item 11 remains in the act, there seems to us to be very little difference between the two bills because item 11 is virtually as broad as section 5 itself.

Senator Moss. Of course, you are speaking for the Legal Committee of the Grocery Manufacturers of America and are talking about the rather small items that come in the supermarket ordinarily. Do you think there is any way that the class action proposal might be limited in some way so that it did not deal with the small items like that, and still be available for larger, more expensive items?

Mr. Barrett. Yes, I think that is a possibility. But we have tried to point out that the remedy itself is not a very satisfactory remedy, whether it is for a small item or a large item.

It is quite clear that an exemption for small damages would take care of our situation. But we are concerned about the consumer and we have to point out in fairness to you, I believe, that it is not a very satisfactory remedy for any consumers.

Senator Moss. You indicated your concern with overburdening the Federal courts. Would this arise from the number of suits brought, or from the complexity of the individual suits, in your opinion?

Mr. Barrett. Well, I think it is from both. As I understand it, the Federal judiciary is even now concerned with the class action remedy and is reviewing it to see if changes should be made. If this legislation is passed for the consumer, after it has been built up as a great method of taking care of their problems, it is likely to flood the courts with new consumer class action cases; and every one of them is complicated.

I think it is the complexity of the type of case as well as the number of cases which will result.

Senator Moss. Do you have any way of estimating how many cases you think would come into the Federal courts under this class action?

Mr. BARRETT. I do not believe we do, sir.

Senator Moss. Of course, we have been speaking only of the Federal courts, but as for the number of cases, there are likely to be fewer brought if they can come in class actions than if we use these small claims divisions that you point out in here of the various States. It would simply shift into larger cases which could be tried in the Federal court; is that right?

Mr. BARRETT. Well, we do not have any of these cases in the Federal court now. As I understand it, they are not brought in the Federal court because of the diversity requirement and the jurisdictional amount. So the effect of this legislation is to open up the Federal courts to this type of case.

I do not know that it is going to be any great benefit to the State courts because they have for years been dealing with matters of this kind and are geared up to do so.

Senator Moss. But class actions are brought under rule 23. It is not an inventing of the class action, but rather a broadening of the jurisdictional scope?

Mr. BARRETT. That is quite right. The present form of rule 23 has been in existence for about 4 years, and it is just simply opening up a large number of additional types of cases to the Federal court. The class action remedy that the Federal court then provides is utilized for these new actions.

Senator Moss. Your testimony indicated that there is fear of unwarranted suits, perhaps nuisance type suits. Do you not think that is covered in rule 23 where the court, first of all, may require establishment of a class, and at that point has power to dismiss the action as an improper class, or dismiss the action or render summary judgment right at that point?

Mr. BARRETT. The courts are trying to deal with this remedy. The discretionary powers that the rule gives to the trial judge are an attempt to take care of what you are talking about.

But we are suggesting that the situation is pretty bad now and that it is going to be worse if the judges have to deal with more of these cases.

We have also in mind the length of time that it is going to take to bring these cases to trial and the length of time that it takes to try a class action case.

I made the very broad statement that I do not know of a single class action case that has been brought under the present rule which has been fully tried, the class determined, the liability determined, and the damages assessed. I do not know of a single one.

Senator Moss. Do you have any figures on the number of class actions filed that have been disposed of in pretrial orders of the court determining that this was not an effective class action to be brought?

Mr. BARRETT. No, sir; I do not.

Senator Moss. As I read rule 23, the court is not only given considerable power, but in effect is enjoined to have a preliminary proceeding

very early to guard against some of these things that you have raised as possible objections, the so-called strike suits and matters that may have been promoted by someone in order to represent a class, and various things. The rule tries to give the court the power to weed this out right at the beginning.

Where there is a genuine grievance that involves a class, then class action is an economical way to deal with a whole problem, to have it in one suit. That is the rationale behind it.

Mr. BARRETT. I am sure that is the rationale behind it. And you are quite right that the first step in a class action case is to determine the propriety of the class and the propriety of the representation of the class.

I am in one right now, and the defendant—who has no business being in the case in the first place—has to participate through months and months of work to determine whether it is a proper class to begin with. And he cannot even register with the court the fact that he does not belong there at all. And it is a great burden on the defendant. And, as our statement says, particularly in our kind of association where we are dealing with products that are worth 43 cents, it seems like a very cumbersome way to secure relief for our types of consumers.

Senator MOSS. In this case you refer to, are you still trying to get the class defined and determined before the court?

Mr. BARRETT. Right; yes, sir. I do not want to appear as an expert on class actions. I have read considerably about it, and I am currently involved in one. But the determination of the class is usually at least as difficult as the determination of the legal liability.

You can also have several classes, as I am sure you are aware. With the Tydings bill, which brings in State law, you can have a variety of State laws that would bear on this so that if you have a different cause of action in each one of the States that is involved, or if you just have States that line up differently on the liability, you cannot dispose of it in one class but have to have several classes and several suits.

Senator MOSS. Does this case you are talking about involve a small purchased item—one that you talked about generally in your testimony?

Mr. BARRETT. No, sir. The one I am speaking of is an antitrust case.

Senator PASTORE. Would not the class ordinarily be the petitioners or the plaintiffs? The class would not be the defendant. I do not follow you. You say you are having difficulty in determining the class, and yet you represent a defendant?

Mr. BARRETT. The question is the propriety of the plaintiffs; that is right; and not every plaintiff has the same—not every plaintiff is in the same situation. And unless they are in the same situation—they have to be affected alike—they cannot be all in one class. If the are affected differently, they have to be treated in separate classes.

Senator PASTORE. It was always my understanding—and you correct me if I am wrong in this interpretation or understanding of the problem. Of course, insofar as the good manufacturers are concerned, who I think you represent, my experience has been that most of the people are, as you have pointed out in your statement—I have looked through it hurriedly—very much interested in continuing the quality of their products. I do not think any reliable firm that has a na-

tional reputation is going to try purposely to deceive or misrepresent something although once in a while, of course, certain elements might arise that were not even known to the manufacturer himself.

I will give you an example. This question arose because of the conflict of Arthur Godfrey, let us say, with the company that he represents, on the advertising of Axion. And until he made an issue of it, no one knew it was a pollutant. And maybe the company itself does not know it. Maybe they do. But the fact still remains, there could be an injury that could result from that. And yet, if you left it up to the one individual in the case of a deception, not so much of an injury, because I think the party could sue on his own; he would not have to have assistance of the class. But in many, many cases of deception, you just say, well, if a person does not like the product—I read a few of your pages, you see—then, the next time they go to the market—and you say they go twice a week; I think that is about the minimum; sometimes it is three and four times.

Mr. BARRETT. We tried to be conservative.

Senator PASTORE. You say the next time they will not buy the product. And yet the deception continues. And the little guy just cannot enforce his rights against the deception because it is not worth the time and the bother. He is only a little guy and the whole purpose of those laws as we are looking at them, of course, is to assist the consumer through this class makeup.

Now, I realize it leads into a lot of difficulties. But what we are trying to get after is the so-called deceptive ones. I was going to use the word "shyster," but I do not know if that is a good word to use here. But those are the people we are trying to get after.

I think, by and large, as far as the good manufacturers are concerned, it would be a good protection for them because they are competing against deceptive forces, and that happens every day.

Mr. BARRETT. Senator, I cannot avoid saying that the products that our industry makes are not polluting this world. I do not know whether Mr. Godfrey is saying so or not, but they are not polluting the waters and streams; and this is a matter that, of course, is receiving a lot of interest not only by Congress but by everyone.

Senator PASTORE. Do you represent the company?

Mr. BARRETT. No, sir; I do not.

Senator PASTORE. All right, the fact still remains he has received permission to say that there may be an element of pollution involved in this product, but not so much, and that they are working on it. I had reference to this specific case, and I know about it.

Mr. BARRETT. The industry is working very hard—I think perhaps we are having trouble over words, and perhaps this is not the place to discuss it. In answer to your question about how we would suggest dealing with what you have in mind, we have stated that we are in favor of giving the injunctive power to the Federal Trade Commission. And as we see it, the way to deal with the problem that you are talking about is——

Senator PASTORE. You misunderstood. I only gave this as an illustration sometimes of how even a legitimate manufacturer, you see, himself, in the production of a product—and that goes for a lot of antibiotics. Many, many times an antibiotic is made to cure one sickness, and there may be a byproduct to it, and that has often happened.

It may be something that takes care of something, but there might be a hormone, masculine or feminine, whatever the case may be; and in many, many cases the things are not discovered until later on, after a vast use of the product; and yet there was no deception intended on the part of the manufacturer at the time.

You see, I only gave that as an example that sometimes even a very legitimate manufacturer may wake up to find out that the product that he is selling legitimately, and in which he is putting up the integrity and reputation of his firm, just happens to produce a byproduct that he could not know at the time; and I just gave that as an example.

Mr. BARRETT. But in those cases, Senator, I believe no legislation is needed to bring a case like that into the Federal court, even as a class action.

Senator PASTORE. I realize that. But the point I am making is this: If you leave it up to the one individual, this is why the illustration, the apotheosis comes in, you see, in my questioning of you. If you leave it up to that one individual to bring about the remedy that should be brought about, that person is not potent enough or financially affluent enough, you see, in order to do it on his own; and that is the reason for the class legislation.

I think we have to be very careful how we do it, of course.

Mr. BARRETT. Senator, in our industry—and I should confine my comments to that because I know that best—it is common practice in our industry, if a consumer does not like the product, to go to the grocery store where she bought it and ask for her money back. That is all it takes. She does not have to get a lawyer. She does not have to join a class. All she has to do is ask for her money back.

Senator PASTORE. But, if she got a bellyache, and somebody else might too, she gets her money back, but that does not cure the second and the third bellyache. That is what I am talking about.

You have to have something here, even though one individual is injured and that individual in and of himself cannot bring about the proper remedy on behalf of the consumers, you need some kind of an instrumentality. Whether this is the answer or not, I do not know. An instrumentality whereby at least that product—you see what I mean—can be attacked in such a way as to not keep causing this injury time and time and time again.

Now I am giving that again as an example case. This idea that you go to the store and get your money back is not the answer to it.

Mr. BARRETT. Senator, as for the example that you give of the person that has the bellyache, assuming that it is something more than an innocent bellyache, product liability cases are tried in the Federal courts today and there is no need for legislation—this legislation will not bear on that. But product liability cases are normally not class action cases, sir.

Senator PASTORE. You still do not see my point. That bellyache lasted for 2 hours, and it is not worth the while to bring a case in the Federal court; you know that. The person will not buy the product again; but will that stop another thousand bellyaches on the part of another thousand people—and that is the question—unless you have a class action?

Mr. BARRETT. If our products produce the bellyache, we are not going to be successful. We are not going to be continuing to make those products. That was the early part of my statement. This is the most important discipline that affects us. If our products give a bellyache or do not please—it is not a question of hurting. It is a question of satisfying a want. If our products do not do that, we are in trouble.

And we do not need to have the discipline of a class action to make us any more careful.

Senator PASTORE. I am afraid sometimes without the discipline of a class action it might not even be brought to your attention.

Mr. BARRETT. Sir, we try to find this out. We go to great effort to determine how our products do affect the consumer. We do this before the product is marketed. We do it at all times. And if we find that the product does not satisfy the consumer, we change it.

Senator PASTORE. I realize that. I am not questioning the integrity of the people you represent. I am speaking in generalities here. I am not saying that your people are doing this. I am not even saying you are producing merchandise or foods that cause bellyaches. I am just giving that as an example.

I have found that over a period of time, unless an individual person has the assistance of a class group—and we have been wrestling with this for the longest time, and I do not say that this is maybe the answer; but there has got to be some kind of remedy in instances where that individual does not have the means or, chances are, the circumstances are such that acting individually this matter could never be resolved. How do you do this without disturbing our free enterprise system? How do you do this without ultimately ending up with the consumer spending more for the products he buys? These are very, very intricate problems, and they have to be resolved.

I am not challenging you. I am just giving you the argument why sometimes there is no remedy unless you have a class action. And there are instances; and that is the reason why we are here. If we had no problem before this Congress on this question, we would not have to be here today. There is a problem involved.

Now, how do you meet the problem? I am not saying we have got the answer. I am not saying that we have the answer. And I think you are making a fine presentation from what I have read here.

All I am saying is that somehow we have got to institute some kind of procedure without harassment, without this tremendous cost; because ultimately the money you have to spend for lawyers and long delayed judicial processes will have to ultimately be added on to the price of the product. I know that. That is fundamental.

The question here is that we have a problem. Now how do we resolve it?

Mr. BARRETT. You always want to present to the consumer a satisfactory solution to this problem.

Senator PASTORE. That is right.

Mr. BARRETT. And what the burden of my statement has been is that to give her a 4-year stint in the courts is not a satisfactory solution to that problem.

I do not say that we are submitting to you that in our industry this problem does not exist. We are consumers, too, and we have experienced in isolated situations the consumer fraud.

Senator PASTORE. Let me ask you a hypothetical question. If the problem did exist, what would be your solution in these cases?

Mr. BARRETT. The solution that we have suggested is to utilize the tremendous power of publicity of the White House Office, to endorse the establishment of the White House Office as a permanent office with the power to spotlight problems as they are doing; that is one thing.

Secondly, to give the Federal Trade Commission the power to go to court and get injunctions.

Senator PASTORE. You mean on the complaints being made to it?

Mr. BARRETT. Right. And the White House Office, if they are aware of complaints which are not being acted on by the Federal Trade Commission, can advise the Federal Trade Commission as they are doing; and the same is true for the other Federal agencies that are charged with these responsibilities and have this kind of injunctive power.

Now, we also feel that encouragement should be given to the business community to have these money-back guarantee programs which our industry has. We think that the Federal Government should help the State courts that are already in existence—give them knowledge, give them information about frauds that they are not aware of, because they have the facilities, facilities tuned to cases of this kind. They have the legal aid societies.

We think that we ought to try to make our present system better before we try this other very drastic and very burdensome system.

Senator PASTORE. I see. In other words, rather than have independent class actions, you would leave the responsibility to official Government agencies?

Mr. BARRETT. And the State courts.

As a law student I worked in the legal aid society in Cincinnati. The kind of cases that the legal aid society deals with every day are what we now call consumer fraud. This was over 30 years ago. The kind of cases that come into an agency of that kind is what we are calling a consumer fraud. And you become experts in how to handle it.

I can remember men coming in who were laborers and who had gone into a jewelry store and been sold a very expensive watch on an installment plan. And if they kept on paying for that watch, they never would get it paid for.

Well, we had the knowledge and the skill to deal with those problems and we dealt with them very effectively. And it did not cost the consumer but a quarter. We used to insist that they pay a quarter because we thought that this was the right thing to do. It should cost them something.

Senator PASTORE. We do that in my State, too.

I did have a situation not too long ago—and there is law on the subject and criminal statutes under our criminal code—but in my own State of Rhode Island, we are a jewelry State, as you well know, and we had instance after instance where certain articles were being sold as 14 carat gold, and they were just plain brass. And of course, this is a little different than buying an edible product because, like you say, if it causes you any harm, it is instantaneous, and the next time you go there you buy something else. But if you buy a piece of jewelry, after all, you cannot bite it to see if it is 14 carat. If they tell you it is 14

carat, you have to just accept that. But we had instance after instance where it was just plain brass, and the industry itself came in and asked that it be given class prerogatives to sue and cease and desist for the simple reason that the Justice Department, being as big as it is, with all its problems, could not be bothered with these cases.

I give that as an instance where this fraud was being perpetrated. Of course, this would not apply to a detergent or a piece of soap or to a cereal or something of that kind, but there you are. Without this class action we could not get any remedy at all; but yet we did have the Justice Department that was charged under the law to enforce the law; but because these cases were considered to be trivial and small and involved one person at a time, they could not bother with it.

Until the industry itself got together—this was the industry—they wanted their organization to bring action against these deceivers, and that is the whole point, to get at the deceivers, not to harass legitimate manufacturers. And it is not an easy thing to solve.

Mr. BARRETT. Right; it is not an easy thing to solve.

I think we have suggested that the Federal Trade Commission's jurisdiction be extended to the local matters that affect intrastate matters and are not a part of interstate commerce, which I think would be helpful in this area, too.

Senator Moss. Thank you for your testimony, Mr. Barrett.

We are glad that Mr. Koch was here to join you and sit at the table. We are glad to have your point of view.

I think Senator Pastore made the point that there are indeed problems. We do have small claims courts. We have State courts to deal with these problems; but it is just because they are not apparently being adequately dealt with that this Federal class action has been proposed. And as Senator Pastore says, this may not be the optimum answer, but there has to be some answer someplace, and that is what we are looking for.

Do you have a statement, too, Mr. Koch?

Mr. KOCH. Yes. I would like to submit it for the record, if I may, please, and it emphasizes why we strongly support your bill for preliminary injunction and the extension of the FTC power, with just a few modifications and clarifying language.

We also stress in here the matter of why class action is not an effective remedy, because of the maze—and we even have drawn a graph to show the steps which you and Mr. Barrett had colloquy on, regarding the preliminary proceedings. And we also go into detail on some statistics of how clogged at this point the Federal courts are, which I am afraid will further delay over and beyond the 4 years that Mr. Barrett mentioned, sometimes as high as 7 years before you get into the preliminary proceedings to determine the propriety of the class action.

With your permission, I would like to introduce my statement in the record.

Senator Moss. Thank you, Mr. Koch. It will be printed in full in the record; and we appreciate having that comment accompanying it, and we are pleased to have you here this morning.

(The appendixes and statement follow:)

APPENDIX 1

UNIFORM DECEPTIVE TRADE PRACTICES ACT

Adopted in substantially the form affixed hereto in the following states:

Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Nebraska, New Mexico, Ohio and Oklahoma

39-278 O—70—pt. 2——13

REVISED UNIFORM DECEPTIVE TRADE PRACTICES ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS SEVENTY-FIFTH YEAR
MONTREAL, CANADA
JULY 30-AUGUST 5, 1966

WITH
PREFATORY NOTE AND COMMENTS

APPROVED BY THE AMERICAN BAR ASSOCIATION AT ITS MEETING IN
MONTREAL, CANADA, AUGUST 9, 1966

UNIFORM DECEPTIVE TRADE PRACTICES ACT

SECTION 1. [*Definitions.*] As used in this Act, unless the context otherwise requires:

(1) "article" means a product as distinguished from its trademark, label, or distinctive dress in packaging;

COMMENT

This is substantially the definition utilized by the Supreme Court in *Sears, Roebuck & Co.* v. *Stiffel Co.*, 32 U.S.L. Week 4206 (1964) in defining the scope of state ability to enjoin the copying of articles. See subsection 2(a) for use of the defined term.

(2) "certification mark" means a mark used in connection with the goods or services of a person other than the certifier to indicate geographic origin, material, mode of manufacture, quality, accuracy, or other characteristics of the goods or services or to indicate that the work or labor on the goods or services was performed by members of a union or other organization;

COMMENT

A certification mark indicates that goods or services meet the standards or specifications of the certifier. See Restatement (Second), Torts § 715B, comment (Tent. Draft No. 8, 1963). Examples are the Good Housekeeping Seal of Approval and the seal of Underwriters' Laboratories. The definition is substantially the equivalent of the definition of "certification mark" in the Lanham Trademark Act, § 45, 60 Stat. 443 (1946), 15 U.S.C. § 1127 (1958). See subsection 4(b) for use of the defined term.

(3) "collective mark" means a mark used by members of a cooperative, association, or other collective group or organization to identify goods or services and distinguish them from those of others, or to indicate membership in the collective group or organization;

COMMENT

"Collective mark" refers both to a trade or service mark used by members of an organized group to identify goods or services with the organization rather than with individual vendors and to emblems used simply to indicate membership in an organized group. See Restatement (Second), Torts § 715A, comment

(Tent. Draft No. 8, 1963). Examples are the "Quality Court" mark used by a group of independent motels, e.g., *Lyon* v. *Quality Courts United*, 249 F.2d 790 (6th Cir. 1957), and American Automobile Association decalcomania. The definition is substantially the same as the definition of "collective mark" in the Lanham Trademark Act. § 45, 60 Stat. 443 (1946), 15 U.S.C. § 1127 (1958). See subsection 4(b) for use of the defined term.

(4) "mark" means a word, name, symbol, device, or any combination of the foregoing in any form or arrangement;

(5) "person" means an individual, corporation, government, or governmental subdivision or agency, business trust, estate, trust, partnership, unincorporated association, two or more of any of the foregoing having a joint or common interest, or any other legal or commercial entity;

COMMENT

This definition is substantially the same as the definition of "person" in Uniform Commercial Code § 1-201 (28) and (30) (1962 official text with comments).

(6) "service mark" means a mark used by a person to identify services and to distinguish them from the services of others;

(7) "trademark" means a mark used by a person to identify goods and to distinguish them from the goods of others;

COMMENT

The definitions of trademark and service mark parallel those of the Lanham Trademark Act and several state statutes. § 45, 60 Stat. 443 (1946), 15 U.S.C. § 1127 (1958), as amended, 15 U.S.C. § 1127 (Supp. IV, 1963); e.g., Ill. Ann. Stat. ch. 140, § 8(a) (Supp. 1963); N.Y. Gen. Bus. Law § 360(a) & (a-i) (Supp. 1963). See subsection 4(b) for use of the defined terms.

(8) "trade name" means a word, name, symbol, device, or any combination of the foregoing in any form or arrangement used by a person to identify his business, vocation, or occupation and distinguish it from the business, vocation, or occupation of others.

COMMENT

The definition is substantially the same as the definition of trade name in the Lanham Trademark Act and several state statutes. § 45, 60 Stat. 443 (1946), 15 U.S.C. § 1127 (1958); e.g., Ill. Ann. Stat. ch. 140 § 8(f) (Supp. 1963); N.Y. Gen. Bus. Law. § 360 (a-iii) (Supp. 1963). See subsection 4(b) for use of defined terms.

SECTION 2. [*Deceptive Trade Practices.*]

(a) A person engages in a deceptive trade practice when, in the course of his business, vocation, or occupation, he:

(1) passes off goods or services as those of another;

COMMENT

Passing off has been said to be "a convenient name for the doctrine that no one should be allowed to sell his goods as those of another." *Vogue Co.* v. *Thompson-Hudson Co.*, 300 Fed. 509, 512 (6th Cir. 1924). Passing off originally denominated unauthorized use of trade identification but today the term is also applied to covert substitution of a different brand of goods for the one requested by a customer. E.g., *Coca-Cola Co.* v. *Foods, Inc.*, 220 F. Supp. 101 (D.S.D. 1963).

(2) causes likelihood of confusion or of misunderstanding as to the source, sponsorship, approval, or certification of goods or services;

COMMENT

The "likelihood of confusion" test is referred to in the Restatement (Second), Torts § 729, comment *a* (Tent. Draft No. 8, 1963) as "a phrase which has long been used in statutes, Federal and State, and in court opinions. . . ." In encompassing probable confusion as to commercial source, approval, endorsement, or certification of goods or services caused by trademarks, service marks, certification marks, or collective marks likely to be associated with preexisting trade symbols, this subsection reflects the trend of authority. E.g., *Triangle Pub., Inc.* v. *Rohrlich*, 167 F.2d 969 (2d Cir. 1948); *L. E. Waterman Co.* v. *Gordon*, 72 F.2d 272 (2d Cir. 1934); *James Burrough, Ltd.* v. *Ferrara*, 8 Misc. 2d 819, 169 N.Y.S.2d 93 (Sup.Ct. N.Y. County 1957). See Restatement (Second), Torts § 717 & comments (Tent. Draft No. 8, 1963); Comment, "The Anti-Competitive Aspects of Trade Name Protection and the Policy Against Consumer Deception," 29 U.Chi.L.Rev. 371, 373-75 (1962).

(3) causes likelihood of confusion or of misunderstanding as to affiliation, connection, or association with, or certification by, another;

COMMENT

This subsection concerns likelihood of confusion caused by misleading trade names, e.g., *Viser* v. *Macres*, 214 Cal. App. 2d 249, 29 Cal. Reptr. 367 (1963) (defendant opened up a competing florist shop with the same name as plaintiff's at plaintiff's former location after the latter had moved across the street).

(4) uses deceptive representations or designations of geographic origin in connection with goods or services;

COMMENT

This subsection applies to deceptively misdescriptive representations and designations of geographic origin. If geographic terms or symbols are used in a non-geographic sense and are unlikely to be considered descriptive, e.g., "Everest" as a trademark for wrist watches, the subsection is inapplicable. Section 43(a) of the Lanham Trademark Act contains an analogous provision. § 43 (a) 60 Stat. 441 (1946), 15 U.S.C. § 1125 (a) (1958); *Federal-Mogul-Bower Bearings, Inc.* v. *Azoff*, 201 F. Supp. 788 (N.D. Ohio 1962), rev'd on other grounds, 313 F.2d 405 (6th Cir. 1963).

(5) represents that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have or that a person has a sponsorship, approval, status, affiliation, or connection that he does not have;

COMMENT

This subsection deals with false advertising of goods, services or businesses. It includes false representations that a person is the representative, successor, associate, or affiliate of another, e.g., *Alaska Sales and Service, Inc.* v. *Rutledge*, 128 F. Supp. 1 (D. Alaska 1955) (false representation of automobile dealership franchise), false representations that goods or services were designed, approved, or sponsored by another, e.g., *Parkway Baking Co.* v. *Freihofer Baking Co.*, 255 F.2d 641 (3d Cir. 1958) (false representation of trademark license), and false representations concerning goods of which another is truthfully represented as the commercial source, e.g., false representations by a retailer concerning "Arrow" shirts. See Restatement (Second), Torts § 712, comment *d* (Tent. Draft No. 8, 1963). Section 43 (a) of the Lanham Act, § 43 (a), 60 Stat. 441 (1946), 15 U.S.C. § 1125 (a) (1958), and Idaho Code Ann. § 48-412 (Supp. 1963) authorize similar private actions.

(6) represents that goods are original or new if they are deteriorated, altered, reconditioned, reclaimed, used, or second-hand;

COMMENT

The conduct referred to in this subsection has been condemned both at common law, e.g., *Champion Spark Plug Co.* v. *Sanders*, 331 U.S. 125 (1947) (alternative holding) (requiring disclosure that spark plugs were repaired); see Restatement (Second), Torts § 714 (Tent. Draft No. 8, 1963), and by a few statutes, e.g., Cal. Bus. & Prof. Code § 17531.

(7) represents that goods or services are of a particular standard, quality, or grade, or that goods are of a particular style or model, if they are of another;

COMMENT

The conduct referred to in this subsection has been condemned both at common law, e.g., *Burlington Mills Corp.* v. *Roy Fabrics, Inc.*, 91 F. Supp. 39 (S.D.N.Y.), aff'd per curiam, 182 F.2d 1020 (2d Cir. 1950) (semble) (forbidding sale of second grade materials as first grade); see Restatement (Second), Torts § 714 (Tent. Draft No. 8, 1963); and by a few statutes, e.g., Idaho Code Ann. § 48-412 (Supp. 1963).

(8) disparages the goods, services, or business of another by false or misleading representation of fact;

COMMENT

This subsection reflects the trend of authority allowing businessmen to enjoin disparagement by competitors, e.g., *Maytag Co.* v. *Meadows Mfg. Co.*, 35 F.2d 403 (7th Cir. 1929), cert. den., 281 U.S. 737 (1930) (bad faith assertions of patent

infringement); accord, *Royer* v. *Stoody Co.*, 192 F. Supp. 949 (W.D. Okla. 1961) (false assertion of product inferiority stated cause of action); *H. E. Allen Mfg. Co. v. Smith*, 224 App. Div. 187, 229 N.Y. Supp. 692 (4th Dep't 1928) (false claims of product inferiority), and noncompetitors, e.g., *Carter* v. *Knapp Motor Co.*, 243 Ala. 600, 11 So. 2d 383 (1943) (dissatisfied customer enjoined from attempting to coerce auto dealer into giving him another automobile by driving vehicle with white elephant painted on it); accord, *Menard* v. *Houle*, 298 Mass. 546, 11 N.E. 2d 436 (1937) (dissatisfied customer enjoined from continuous, malicious campaign designed to convince public that automobile dealer had sold him a worthless vehicle); *Mayfair Farms, Inc.* v. *Socony Mobil Oil Co.*, 68 N.J. Super. 188, 172 A.2d 26 (1961) (allegation that Mobile Travel Guide had arbitrarily given plaintiff's establishments unjustified low ratings stated a cause of action for an injunction).

(9) advertises goods or services with intent not to sell them as advertised;

(10) advertises goods or services with intent not to supply reasonably expectable public demand, unless the advertisement discloses a limitation of quantity;

COMMENT

Subsections 2(a)(9) and 2(a)(10) deal with "bait advertising," a practice by which a seller seeks to attract customers through advertising at low prices products which he does not intend to sell in more than nominal amounts. When prospective buyers respond to the advertisement, sale of the "bait" is discouraged through various artifices including disparagement and exhaustion of a minuscule stock in order to induce purchase of unadvertised goods on which there is a greater markup. A bait advertising scheme which involved disparagement has been held enjoinable at common law by the manufacturer of the "bait." *Electrolux Corp.* v. *Val-Worth, Inc.*, 6 N.Y. 2d 556, 161 N.E. 2d 197, 190 N.Y.S. 2d 977 (1959). A Connecticut statute similarly authorizes private parties to enjoin bait advertising. Conn. Gen. Stat. Ann. § 42-115 (a) (Supp. 1962). Odd lot or clearance sales in which bargains are offered in limited quantities will not run afoul of the proposed statute as long as disclosure is made of the limited stock. Cf. *ibid.*

(11) makes false or misleading statements of fact concerning the reasons for, existence of, or amounts of price reductions; or

COMMENT

This subsection applies to spurious "fire" and "liquidation" sales as well as to fictitious price cuts. Hawaii Rev. Laws §§ 289-14 and 289-15 (1955) and Mich. Stat. Ann. §§ 28.79(7) and (8) (1962) authorize similar private actions.

(12) engages in any other conduct which similarly creates a likelihood of confusion or of misunderstanding.

COMMENT

This subsection permits the courts to block out new kinds of deceptive trade practices. The broad language of Cal. Civ. Code § 3369 (Supp. 1963) has been

interpreted as creating the analogous general standard of "likelihood of public deception." *People* v. *National Research Co.*, 201 Cal. App. 2d 765, 20 Cal. Reptr. 516 (1962).

(b) In order to prevail in an action under this Act, a complainant need not prove competition between the parties or actual confusion or misunderstanding.

COMMENT

This subsection removes the enumerated factors as absolute bars to relief.

(c) This section does not affect unfair trade practices otherwise actionable at common law or under other statutes of this state.

COMMENT

This subsection is intended to ensure that enactment of the Uniform Deceptive Trade Practices Act will not inhibit future development of the law of unfair trading.

SECTION 3. [*Remedies.*]

(a) A person likely to be damaged by a deceptive trade practice of another may be granted an injunction against it under the principles of equity and on terms that the court considers reasonable. Proof of monetary damage, loss of profits, or intent to deceive is not required. Relief granted for the copying of an article shall be limited to the prevention of confusion or misunderstanding as to source.

COMMENT

Deceptive commercial conduct is made enjoyable at the suit of any person including a nonprofit organization, e.g., *Mayo Clinic* v. *Mayo's Drug & Cosmetic, Inc.*, 262 Minn. 101, 113 N.W. 2d 852 (1962) (Mayo Clinic held entitled to enjoin use of similar name by a drug wholesale and packaging operation), provided that there is a reasonable probability that the complainant will otherwise incur actual damage. It is immaterial that the amount of this damage is not provable with certainty or that loss of profits cannot be shown. Similar phraseology determines standing to sue under Section 43(a) of the Lanham Trademark Act, 60 Stat. 441 (1946), 15 U.S.C. § 1125(a) (1958), and some state statutes, e.g., Conn. Gen. Stat. Ann. § 42-115(a) (Supp. 1962) ("any aggrieved party"). A few state statutes treat false or deceptive advertising as a public wrong enjoinable by any private parties who care to bring suit, e.g., Cal. Civ. Code § 3369(5) (Supp. 1963), Hawaii Rev. Laws, § 289-15 (1955).

Among the principles governing the scope of injunctions against misleading trade identification are the privilege of every tradesman to use commercially necessary language in a nondeceptive fashion, *King-Seeley Thermos Co.* v. *Aladdin Indus., Inc.*, 321 F.2d 577 (2d Cir. 1963), and state disability to enjoin the copying of articles because of the preemptive operation of the Federal patent

and copyright laws. *Sears, Roebuck & Co.* v. *Stiffel Co.*, 32 U.S.L. Week 4206 (1964); *Compco Corp.* v. *Day Brite Lighting, Inc.*, 32 U.S.L. Week 4208 (1964).

(b) Costs shall be allowed to the prevailing party unless the court otherwise directs. The court [in its discretion] may award attorneys' fees to the prevailing party if (1) the party complaining of a deceptive trade practice has brought an action which he knew to be groundless or (2) the party charged with a deceptive trade practice has willfully engaged in the trade practice knowing it to be deceptive.

COMMENT

Although there is no comparable statutory authorization, federal courts have awarded attorney's fees as an element of cost when deceptive trade practices were fraudulent or malicious. See, *A. Smith Bowman Distillery, Inc.* v. *Schenley Distillers, Inc.*, 204 Fed. Supp. 374 (District Delaware, 1962). This section gives discretion to state judges to do likewise in appropriate cases whether the prevailing party is the defendant or the plaintiff. The section directs the court to award attorney's fees to the prevailing party unless the court expressly otherwise directs.

(c) The relief provided in this section is in addition to remedies otherwise available against the same conduct under the common law or other statutes of this state.

COMMENT

This subsection preserves a complainant's right to seek damages under the common law or other statutes as well as any available criminal remedies.

SECTION 4. [*Application.*]

(a) This Act does not apply to:

(1) conduct in compliance with the orders or rules of, or a statute administered by, a federal, state, or local governmental agency;

(2) publishers, broadcasters, printers, or other persons engaged in the dissemination of information or reproduction of printed or pictorial matters who publish, broadcast, or reproduce material without knowledge of its deceptive character; or

(3) actions or appeals pending on the effective date of this Act.

(b) Subsections 2(a)(2) and 2(a)(3) do not apply to the use of a service mark, trademark, certification mark, collective mark, trade name, or other trade identification that was used and not abandoned before the effective date of this Act, if the use was in good faith and is otherwise lawful except for this Act.

SECTION 5. [*Uniformity of Interpretation.*] This Act shall be construed to effectuate its general purpose to make uniform the law of those states which enact it.

SECTION 6. [*Short Title.*] This Act may be cited as the Uniform Deceptive Trade Practices Act.

SECTION 7. [*Severability.*] If any provision of this Act or the application thereof to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are severable.

SECTION 8. [*Repeals.*] The following acts or parts of acts are repealed:

(1)

(2)

(3)

COMMENT

State statutes that could be repealed in conjunction with enactment of the Uniform Deceptive Trade Practices Act are:

Alabama—None

Alaska—None

Arizona—None

Arkansas—None

California—Cal. Civil Code § 3369 provides a broad private substantive remedy for "unfair competition" the scope of which is not definitively defined. It is recommended that the Uniform Deceptive Trade Practices Act, which specifically highlights major aspects of actionable unfair competition, be appended to section 3369 as a clarifying amendment.

Colorado—None

Connecticut—The Act should be amended in Section 3(b) to conform to the 1966 amendment of the Uniform Act.

Delaware—the Act should be amended in Section 3(b) to conform to the 1966 amendment of the Uniform Act.

District of Columbia—None

Florida—None

Georgia—Ga. Code Ann. § 106-5 (1963) authorizes a private injunctive remedy for some, but not all, of the conduct condemned by the Uniform Act. It is therefore recommended that present chapter 16-5 be repealed and that the Uniform Act be enacted in its stead. If this course of action is adopted, present sections 106-501 and 106-503 should be re-enacted in those sections of chapter 106-99 which currently incorporate them by reference.

Hawaii—Hawaii Rev. Laws 289-15 (Supp. 1963) authorizes a substantive private action for some, but not all, of the conduct condemned by the Uniform Act. Because section 289-15 differs from the Uniform Act in authorizing a damage recovery as well as injunctive relief it is recommended that the Uniform Act be enacted without repeal of section 289-15.

Idaho—The Act should be amended in Section 3(b) to conform to the 1966 amendment of the Uniform Act.

Illinois—The Act should be amended in Section 3(b) to conform to the 1966 amendment of the Uniform Act.

Indiana—None
Iowa—None
Kansas—None
Kentucky—None
Louisiana—None
Maine—None
Maryland—None
Massachusetts—Mass. Gen. Laws Ann. ch. 266, §§ 91, 91B (1964) authorize a private substantive remedy for some, but not all, of the conduct condemned by the Uniform Act. Because section 91 differs from the Uniform Act in requiring intentional or reckless conduct on the part of the defendant for injunctive relief, it is recommended that the Uniform Act be enacted without amendment of section 91. On the other hand, the private remedy afforded by section 91B duplicates subsections 2(a) (9) and 2(a) (10) of the Uniform Act and it is accordingly recommended that "or any aggrieved party" be deleted from § 91B in conjunction with the enactment of the Uniform Act.

Michigan—Mich. Comp. Laws §§ 28.79 (10) (as amended Supp. 1963) authorize a substantive private remedy for some, but not all, of the conduct condemned by subsections 2(a) (5) and 2(a) (11) of the Uniform Act. However, in view of the additional remedies provided for by §§ 28.79 (10), notably rescission by a purchaser and a court order to pay sales tax, it is recommended that the Uniform Act be enacted without repeal.

Minnesota—Minn. Stat. Ann. §§ 325.141-325.148 (1964) authorize a substantive private remedy for some, but not all, of the conduct condemned by subsections 2(a) (5); 2(a) (7); and 2(a) (11) of the Uniform Act. However, in view of the fact that § 325.147 authorizes recovery of damages whereas the Uniform Act does not provide for a damage remedy, it is recommended that the Uniform Act be enacted without repeal.

Mississippi—None
Missouri—None
Montana—None
Nebraska—None
Nevada—None
New Hampshire—None
New Jersey—None
New Mexico—N.M. Stat. Ann. §§ 49-12-1 to 49-12-7 (Supp. 1965) authorizes a substantive private action with respect to some, but not all, of the conduct

condemned by the Uniform Act. Because the conduct proscribed by §§ 49-12-1 & 2 is not as clearly defined as the conduct proscribed by section 2(a) of the Uniform Act, and because it is desirable that conduct giving rise to a private remedy be as specifically defined as possible it is recommended that section 49-12-5 be amended by striking "or a private citizen" and the last sentence in conjunction with enactment of the Uniform Act.

New York—None
North Carolina—None
North Dakota—N.D. Cent. Code § 51-12-07 (1960) authorizes a substantive remedy for a portion of the conduct condemned by subsection 2(a) (5) of the Uniform Act. In view of the trivial nature of this aspect of § 51-12-07, it is recommended that the last sentence of that section be repealed in conjunction with enactment of the Uniform Act.

Ohio—None
Oklahoma—The Act should be amended in section 3(b) to conform to the 1966 amendment of the Uniform Act.

Oregon—None
Pennsylvania—None
Rhode Island —None
South Carolina—None
South Dakota—None
Tennessee—Tenn. Code Ann. §§ 69-601 to 69-607 (Supp. 1965) authorizes a private substantive remedy for a fraction of the conduct condemned by subsection 2(a) (5) of the Uniform Act. Nevertheless, because §§ 69-601 to 69-607 provide remedies not contained in the Uniform Act, notably damages and rescision, it is recommended that the Uniform Act be enacted without repeal of §§ 69-601 to 69-607.

Texas—None
Utah—None
Vermont—None
Virginia—None
Washington—None
West Virginia—None
Wisconsin—None
Wyoming—None

SECTION 9. [*Time of Taking Effect.*] This Act takes effect .....

APPENDIX 2

UNIFORM COMMERCIAL CODE

(Adopted in all states except Louisiana and adopted in District of Columbia and the Virgin Islands; see attached.)

Section 1-103. Supplementary General Principles of Law Applicable

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

Section 2-721. Remedies for Fraud

Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

TABLE 1

UNIFORM COMMERCIAL CODE

Table of Jurisdictions Wherein Code Has Been Adopted

Jurisdiction	Laws	Effective Date	Statutory Citation
Alabama	1965, Act No. 549	1-1-1967	Code of Ala., Tit. 7A, §§ 1-101 to 10-104
Alaska	1962, c. 114	1-1-1963	A.S. §§ 45.05.002-45.05.794
Arizona	1967, c. 3	1-1-1968	A.R.S. §§ 44-2201 to 44-3202
Arkansas	1961, Act No. 185	1-1-1962	Ark.Stats. §§ 85-1-101 to 85-9-507
California	Stats.1963, c. 819	1-1-1965	West's Ann.Com.Code §§ 1101 to 10104
Colorado	1965, c. 330	7-1-1966	R.S. §§ 155-1-101 to 155-11-102
Connecticut	1959, No. 133	10-1-1961	C.G.S.A. §§ 42a-1-101 to 42a-10-104
Delaware	1966, c. 349	7-1-1967	5A Del.C. §§ 1-101 to 10-104
Dist. of Columbia	P.L. 88-243	1-1-1965	D.C.C.E. §§ 28:1-101 to 28:10-104
Florida	1965, c. 65-254	1-1-1967	F.S.A. §§ 671.1-101 to 680.10-105
Georgia	1962, Act 713	1-1-1964	Ga.Code Ann. 109A-1-101 to 109A-10-106
Hawaii	1965, No. 208	1-1-1967	
Idaho	1967, c. 161	1-1-1968	I.C. § 28-1-101 et seq.
Illinois	1961, p. 2101	7-2-1962	S.H.A. ch. 26, §§ 1-101 to 10-104
Indiana	1963, c. 317	7-1-1964	Burns' Ann.St. §§ 19-1-101 to 19-9-507
Iowa	1965, (61 G.A.) c. 413	7-4-1966	I.C.A. §§ 554.1101-554.10104
Kansas	1965, c. 564	1-1-1966	K.S.A. §§ 84-1-101 to 84-10-104
Kentucky	1958, c. 77	7-1-1960	KRS 355.1-101 to 355.10-102
Maine	1963, c. 362	12-31-1964	11 M.R.S.A. §§ 1-101 to 9-507
Maryland	1963, c. 538	2-1-1964	Code 1957 art. 95B, §§ 1-101 to 10-104
Massachusetts	1957, c. 765	10-1-1958	M.G.L.A. c. 106, §§ 1-101 to 9-507
Michigan	1962, P.A. 174	1-1-1964	M.C.L.A. §§ 440.1101-440.9994
Minnesota	1965, c. 811	7-1-1966	M.S.A. §§ 336.1-101 to 336.10-105
Mississippi	1966, c. 316	3-31-1963	Code 1942, §§ 1-101 to 10-105
Missouri	1963, p. 503	7-1-1965	V.A.M.S. §§ 400.1-101 to 400.10-102
Montana	1963, c. 264	1-2-1965	R.C.M.1947, §§ 87A-1-101 to 87A-10-103
Nebraska	1963, c. 544	9-2-1965	Neb.U.C.C. §§ 1-101 to 10-104
Nevada	1965, c. 353	3-1-1967	N.R.S. 104.1101 to 104.9507
New Hampshire	1959, c. 247	7-1-1961	RSA 382-A:1-101 to 382-A:9-507
New Jersey	1961, c. 120	1-1-1963	N.J.S.A. 12A:1-101 to 12A:10-106
New Mexico	1961, c. 96	1-1-1962	1953 Comp. §§ 50A-1-101 to 50A-9-507
New York	1962, c. 553	9-27-1964	McKinney's Uniform Commercial Code, §§ 1-101 to 10-105
North Carolina	1965, c. 700	7-1-1967	G.S. §§ 25-1-101 to 25-10-107
North Dakota	1965, c. 296	7-1-1966	NDCC 41-01-02 to 41-09-53
Ohio	1961, p. 13	7-1-1962	R.C. §§ 1301.01-1309.50
Oklahoma	1961, p. 70	1-1-1963	12A Okl.St.Ann. §§ 1-101 to 10-104
Oregon	1961, c. 726	9-1-1963	ORS 71.1010 to 79.5070
Pennsylvania	1953, P.L. 3	7-1-1954	12A P.S. §§ 1-101 to 10-104
Rhode Island	1960, c. 147	1-2-1962	Gen.Laws 1956, §§ 6A-1-101 to 6A-9-507
South Carolina	1966, c. 1065	1-1-1968	Code 1962, Title 10.1 to 10.10
South Dakota	1966, c. 150	7-1-1967	SDC 1960 Supp. 1-101 to 10-102
Tennessee	1963, c. 81	7-1-1964	T.C.A. §§ 47-1-101 to 47-9-507
Texas	1965, c. 721	7-1-1966	V.T.C.A., Bus. & C. §§ 1.101 to 9.507
Utah	1965, c. 154	1-1-1966	U.C.A.1953, 70A-1-101 to 70A-10-104
Vermont	1966, No. 29	1-1-1967	9A V.S.A. §§ 1-101 to 9-507
Virgin Islands	1965, No. 1299	7-1-1965	T. 11A V.I.C. §§ 1-101 to 9-507
Virginia	1964, c. 219	1-1-1966	Code 1950, §§ 8.1-101 to 8.10-104
Washington	1965, Ex.Sess., c. 157	7-1-1967	RCWA 62A.1-101 to 62A.10-104
West Virginia	1963, c. 193	7-1-1964	Code, 46-1-101 to 46-10-204
Wisconsin	1963, c. 158	7-1-1965	W.S.A. 401.101-409.507
Wyoming	1961, c. 219	1-2-1962	W.S.1957, §§ 34:1-101 to 34:10-105

APPENDIX 3

SMALL CLAIMS AND JUSTICE OF THE PEACE COURTS OF THE VARIOUS UNITED STATES

(Source: Martindale-Hubbell Law Directory, 1970 Edition, Volume V Part V, Court Calendars)

State	Type of Court	Jurisdiction and Comments
Alabama	Circuit Court	All courts of record (chancery, city and circuit) have been consolidated into one Circuit Court with general civil action jurisdiction above $50 (no floor for libel and slander)
	J.P. Court	Civil cases up to $100 (but not for libel or slander)
Alaska	District Court	Matters not exceeding $3,000 with special small claims procedure for $500 or less
	Magistrate Court	Located in smaller towns; matters not exceeding $500 with small claims procedure
Arizona	Justice Court	Exclusive original jurisdiction up to $200, concurrent jurisdiction with Superior Court from $200 to $500
Arkansas	Justice's Court	Up to $300 in contract and replevin, $100 in damages to personal property
	Municipal Court	May be established in cities and towns, with concurrent jurisdiction with Justices' Courts, and Circuit Courts up to $500 for damages to property or person
California	Municipal Court	In each consolidated city and county and each judicial district with population of 40,000 or more, with small claims court sessions for actions to $300
	Justice Court	Same as Municipal Court but for judicial districts with smaller populations
Colorado	County Court	Court of record up to $500; old justices of the peace and small claims courts have been abolished in favor of County Court system

State	Type of Court	Jurisdiction and Comments
Connecticut	Circuit Court	Special small claims sessions up to $250
Delaware	J.P. Court	Up to $1,500
	Common Pleas Court	Up to $2,500
D.C.	Court of General Sessions	Small Claims and Conciliation Branch for cases up to $150
Florida	County Court	In some counties only, up to $500
	Small Claims Court	Maximum amount varies by county, from $250 to $1,000; some counties have special arrangements such as a magistrate's court or claims court up to $500
	County Judge's Court	For counties without a County Court, for cases up to $100
Georgia	Municipal Court	In 7 larger cities, with various ceilings for jurisdiction starting at $1,500
	County Court	In a number of counties, with jurisdiction in tort or contract up to $500
	J.P. Court	In each militia district for cases up to $200
Hawaii	District Magistrate	Serving as small claims court, with jurisdiction in assumpsit to $150; also has general civil jurisdiction exclusive up to $50, concurrent with circuit court up to $2,000
Idaho	Justice Court	Small claims department of each Justice of the Peace Court up to $200; general Justice Court jurisdiction is up to $300
Illinois	Circuit Court	Circuit Court with jurisdiction to $10,000 has small claims practice and procedure up to $1,000
Indiana	Municipal Court	Marion County (Indianopolis) only, with concurrent jurisdiction with superior and circuit courts up to $10,000 in civil cases; no special small claims procedure
	J.P. Court	One or two per township for civil actions up to $500
Iowa	District Court	Court of general original jurisdiction; no special small claims procedure
	Municipal Court	Thirteen cities have municipal courts for

State	Type of Court	Jurisdiction and Comments
Iowa (cont.)		civil cases up to $2,000, concurrent with District Court but in place of Justice of the Peace Court. Some Municipal Courts have special procedures under $100, especially as to conciliation
	J. P. Court	Civil cases to $100 ($300 by consent of the parties); in each county but no jurisdiction where there is a Municipal Court
Kansas	District Court	In each county; general jurisdiction
	City Court	May be established in city over 9,000; concurrent jurisdiction with District Court to $3,000 or $1,000 depending on statute governing creation
	County Court	In any county without a City or Magistrate Court, with jurisdiction to $1,000
	Magistrate Court	In every county contiguous to 2 cities each with more than 115,000 people, for cases up to $3,000
	Small Debtor Court	May be established by county commissioners for small debts and accounts up to $20; no record of number established
Kentucky	Justice's Court	Jurisdiction to $500, countywide, with 3 such courts for Jefferson County (Louisville)
	Quarterly Court	Jurisdiction concurrent with Justice's Court to $500, one for each county
	Police Court	In smaller cities and towns, with jurisdiction in civil cases concurrent with Justices' Courts of the county
Louisiana	City Courts	City of New Orleans, exclusive to $100, concurrent with Civil District Court to $1,000
	J.P. Court	Outside of New Orleans, to $100
	City Courts	Outside of New Orleans in 25 cities with jurisdictions to $500 or $1,000 depending on size of city, with special oral pleadings for $100 claims or less; may substitute for J.P. Court

State	Type of Court	Jurisdiction and Comments
Maine	District Court	Serves as small claims court for cases up to $100; special procedures and low fee
Maryland	Trial Magistrate	Exclusive civil jurisdiction to amounts which vary by county, from $50 to $1,000, with jurisdiction concurrent with circuit courts of counties and law courts of Baltimore City to amounts which similarly vary by county, from $200 to $3,000; however, see below
	Peoples Court	Instead of Trial Magistrates for Baltimore City and certain counties, with jurisdiction as set forth for Trial Magistrates
Massachusetts	District Court	Small claims procedures and fee for claims up to $200; one for each county
	Municipal Court	Several for Boston with small claims jurisdiction as for District Court of county
Michigan	District Court	Small claims division up to $300, except for Detroit
	Common Pleas Court	Detroit only, with conciliation division which serves as small claims court up to $100
Minnesota	Conciliation Court	Four counties, with jurisdiction of $200 or $250; any municipal corporation with a municipal court may establish a conciliation court for cases to $250
Mississippi	Justice's Court	To $200
Missouri	Magistrate Court	Civil actions to $2,000-$3,500 depending upon population of county
Montana	J.P. Court	Two in each township with countywide jurisdiction (organized townships only), for cases to $300
Nebraska	Municipal Court	In various cities, in lieu of J.P. Court; jurisdiction to $2,000 in Omaha
	J.P. Court	Civil cases to $200
Nevada	Justice Court	Civil cases to $300
New Hampshire	District Court	Special small claims procedure for cases under $200, with minimal fee

State	Type of Court	Jurisdiction and Comments
New Jersey	County District Court	Civil jurisdiction to $1,000; County Board of Freeholders may establish small claims division for cases to $100
New Mexico	Small Claims Court	Any county with more than 100,000 people may establish for cases to $2,000 (only Albuquerque at present)
	Magistrate Court	One per county minimum for cases to $500, except Albuquerque to $2,000
New York	Small Claims Court	One for each borough in New York City and each district but one in Nassau and Suffolk Counties, and for each city outside New York, for cases to $300
	Justice Court	Cases to $1,000, in each town
	Municipal and City	In several cities, with limited local jurisdiction
North Carolina	Superior Court	Small Claims Division, in several counties, with widely varying jurisdictional ceilings
	Justice's Court	Civil actions in contract to $200 and other civil actions to $50
	Recorders', City or County Court	Intermediate courts specially created, with jurisdiction concurrent with Justices' Courts
	Magistrate's Court	Small claims to $300, under General Court of Justice which will gradually replace older system by December, 1970
North Dakota	Justice Court	Civil actions to $200
	County Court	In certain counties for civil actions to $1,000 concurrently with District Courts
	Board of Conciliation	Designated County Debt Adjustment Board for negotiation between debtor and creditors
Ohio	Small Claims Court	To $150; established by municipal and county courts
	Municipal Court	In many municipal corporations, to $5,000 generally but to $7,500 in two and $10,000 in Cleveland
	County Court	Anywhere there is not a municipal court, for cases to $500

State	Type of Court	Jurisdiction and Comments
Oklahoma	District Court	Small claims docket for cases under $400
Oregon	District Court	Small claims department exclusive to $20, permissive to $200
	Justice's Court	Same as District Court
Pennsylvania	Philadelphia Municipal	Civil claims to $500
	J.P. Court	Contract cases to $500
	Community Court	May be substituted by vote for J.P. or Municipal Court
Puerto Rico	District Court	Civil matters to $2,500
Rhode Island	District Court	Civil matters to $5,000, special small claims procedure for actions on account to $300
South Carolina	Magistrate Court	Civil actions to $200, except for a few counties where the limit is slightly higher, with one at $1,000
South Dakota	All Justice, Police, Municipal and District County Courts	Small claims procedure for tort or contract actions to $100
Tennessee	J. P. Court	Equity cases to $50, general civil cases to $3,000; two for each civil district of each county
Texas	Justice's Court	Small claims court function for cases to $150; general original jurisdiction to $200; 4 to 8 per county
Utah	Justice's Court	Civil actions to $300, with special small claims department to $200
	City Court	Special small claims department to $200
Vermont	District Court Judge	May be designated as trial justice in small claims proceedings to $100
	J.P. Court	May be designated as trial justice in small claims proceeding to $100; regular jurisdiction to $200
Virginia	Civil Justice Court	In larger cities, to $3,000
	Municipal or County Court	In other cities and in the counties, to $3,000

State	Type of Court	Jurisdiction and Comments
Virgin Islands	Municipal Court	Small claims division to $300
Washington	Justice Court	Civil actions to $1,000
West Virginia	Justice's Court	Actions to $300
Wisconsin	County Court	Small claims procedure to $500
Wyoming	J. P. Court	Civil suits to $200 with special small claims jurisdiction to $50

APPENDIX 4

STATE CLASS ACTION PROVISIONS

I. Classification

Similar to Alabama or Ohio:	Alabama, Arkansas, California, Connecticut, Florida, Maryland, Nebraska, New York, Ohio, Oklahoma, Oregon, Puerto Rico, South Carolina, Wisconsin
Taken from old Federal Rule 23:	Alaska, Colorado, Georgia, Hawaii, Idaho, Iowa, Kansas, Michigan, Missouri, Montana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Texas, Utah, West Virginia, Wyoming
Taken from new Federal Rule 23:	Arizona, Delaware, Indiana, Kentucky, Minnesota, South Dakota, Washington
Miscellaneous provisions:	Louisiana, Maine, Pennsylvania, Rhode Island
No specific provision but implicitly recognized by statute and also by case law:	Illinois, Mississippi
Use Federal Rule 23:	District of Columbia, Virgin Islands, U.S.A.

II. Alphabetical by Jurisdiction

Alabama	Code Title 7, § 128	". . . when the question is one of a common or general interest of many persons, or where the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all." (Equity Rule 31 provides for class actions in equity cases, based on old Federal Rule 23.)
Alaska	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23)

Arizona	Rules of Civil Procedure, Rule 23	(Taken directly from new Federal Rule 23)
Arkansas	Statutes 1947 Annotated, § 27-809	"Where the question is one of a common or general interest of many persons, or where the parties are numerous, and it is impracticable to bring all before the court within a reasonable time, one or more may sue or defend for the benefit of all."
California	Code of Civil Procedure (West's) § 382	". . . and when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the Court, one or more may sue or defend for the benefit of all."
Colorado	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23.)
Connecticut	General Statutes Annotated § 52-105	"When the persons who might be made parties are very numerous, or that it would be impracticable or unreasonably expensive to make them all parties, one or more may sue or be sued or may be authorized in the court to defend for the benefit of all."
Delaware	Chancery Court Rules, Rule 23	(Taken directly from new Federal Rule 23.)
District of Columbia	Federal Rule 23	(Federal Rule 23 available regardless of Federal question.)
Florida	Rules of Civil Procedures, Rule 1.220	"When the question is one of common or general interest to many persons constituting a class so numerous as to make it impracticable to bring them all back before the court, one or more may sue or defend for the whole."
Georgia	Code § 81A-123 (Civil Practice Act § 23)	(Taken directly from old Federal Rule 23 with omission of 23(a) (3).)

Hawaii	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23.)
Idaho	Rules of Court, Rule 23	(Taken directly from old Federal Rule 23 with additional subsection (d), entitled "Orders to insure adequate representation.")
Illinois	Annotated statutes, Chap. 110, § 52.1 (Civil Practice Act § 52.1)	"An action brought on behalf of a class shall not be compromised or dismissed except with the approval of the court and, unless excused for good cause shown, upon notice as the court may direct." (No specific provision for class actions, but recognized as indicated; see also Leonard v. Bye, 361 Ill. 185, 197 N.E. 546 (1935).)
Indiana	Rules of Civil Procedure, Rule 23 (Chapter 191, 1969 Acts)	(Taken directly from new Federal Rule 23.)
Iowa	Rules of Civil Procedure, Rules 42-47	(Based closely on old Federal Rule 23.)
Kansas	Rules of Civil Procedure § 60-223	(Taken directly from new Federal Rule 23.)
Kentucky	Rules of Civil Procedure, Rule 23	(Taken directly from new Federal Rule 23.)
Louisiana	Code of Civil Procedure, Articles 591 and 592	"A class action may be instituted when the persons constituting the class are so numerous as to make it impracticable for all of them to join or be joined as parties, and the character of the right sought to be enforced for or against the members of the class is: (1) Common to all members of the class; or (2) Secondary, in the sense that the owner of a primary right refuses to enforce it, and a member of the class thereby becomes entitled to enforce the right." (Article 591) "One or more members of a class, who will fairly insure the adequate representation of all members, may sue or be sued in a class action on behalf of all members." (Article 592)

Maine	Rules of Civil Procedure, Rule 23	"(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued." (Remainder is taken directly from old Federal Rule 23 (b) and (c).)
Maryland	Rules of Civil Procedure, Rule 209(a)	"When there is a question of law or fact common to persons of a numerous class whose joinder is impracticable, one or more of them whose claims or defenses are representative of the claims or defenses of all and who will fairly and adequately protect the interest of all may sue or be sued on behalf of all."
Massachusetts		(Class actions apparently recognized; see Spear v. H.V. Greene Co., 246 Mass. 259, 140 N.E. 795 (1923); see 132. A.L.R. 750.)
Michigan	General Court Rules of 1963, Rule 208	(Taken directly from old Federal Rule 23.)
Minnesota	Rules of Civil Procedure, Rule 23	(Taken directly from new Federal Rule 23.)
Mississippi	Code Annotated Vol. 2, § 1583.5	"Where a party hereafter institutes a suit for the benefit of himself and all others similarly situated, and thereby there is in such suit recovered or preserved property or a fund for the common benefit, the chancery court may make an allowance to such party of the reasonable costs incurred, which costs shall include the necessary disbursements, and reasonable solicitor's fees, out of the property recovered or preserved for the common benefit." (No specific provision but class actions appartently recognized as indicated; see also Floreen v. Saveier, 200 Miss. 428, 27 S. 2d 557 (1946).)

Missouri	Rules of Civil Procedure, Rule 52. 08	(Taken directly from old Federal Rule 23.)
Montana	Rules of Civil Procedure, Rule 23	(Taken directly from old Rule 23, with additional subsection (d) re: "Orders to Ensure Adequate Representation. ")
Nebraska	Revised Statutes, 1943, § 25-319	"When the question is one of a common or general interest of many persons, or when the parties are very numerous, and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of all. "
Nevada	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23.)
New Hampshire		(Class actions apparently recognized; see Textile Workers v. Textron, Inc. 99 N. H. 385, 11 A. 2d 823 (1955).)
New Jersey	Court Rule 4:36-1	(Taken directly from old Federal Rule 23; see Branch v. White, 99 N. J. Super. 295, 239 A. 2d 665 (1968).)
New Mexico	Statutes 1953 Annotated, Chapter 21, Rules of Civil Procedure, § 21-1-1 (23)	(Taken directly from old Federal Rule 23.)
New York	Consolidated Laws (McKinney's), Civil Practice Laws & Rules Par. 1005(a)	"Where the question is one of many persons or where the persons who might be made parties are very numerous and it may be impracticable to bring them all before the court one or more may sue or defend for the benefit of all. "
North Carolina	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23.)
North Dakota	Rules of Civil Procedure, Rule 23 (a)	(Taken directly from old Federal Rule 23.)

Ohio	Revised Code § 2307. 21	"Where the question is one of a common or general interest of many persons, or the parties are very numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all."
Oklahoma	Statutes Annotated, Title 12, § 233	"When the question is one of common or general interest of many persons, or when the parties are very numerous, and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of all."
Oregon	Revised Statutes S 13. 170	"When the question is one of a common or general interest of many persons, or when the parties are very numerous, and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of the whole."
Pennsylvania	Rules of Civil Procedure, Rule 2230(a)	"If persons constituting a class are so numerous as to make it impracticable to join all as parties, any one or more of them who will adequately represent the interest of all may sue or be sued on behalf of all, but the judgment entered in such action shall not impose personal liabilities upon anyone not a party thereto."
Puerto Rico	Laws Annotated Title 32, § 316	". . . when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all."
Rhode Island	Rule of Court, Rule 23	(Taken from old Federal Rule 23, with deletions.)

South Carolina	Code of Laws (1962) § 10-205	"When the question is one of a common or general interest to many persons or when the parties are very numerous and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of the whole."
South Dakota	Rules of Civil Procedure, § 15-6-23(a)	(Taken directly from new Federal Rule 23.)
Tennessee		(Class actions apparently recognized; see Covert v. Nashville, C. & St. L. R. Co., 186 Tenn. 142, 208 S. W. 2d 1008, 1 A. L. R. 2d 154 (1948).)
Texas	Rules of Civil Procedure,	(Taken from old Federal Rule 23; see also Security State Bank of Fort Worth v. Green, 258 S. W. 606 (Tex. Civ. App. 1924).)
Utah	Rules of Civil Procedure,	(Taken directly from old Federal Rule 23.)
Vermont		(Class actions apparently recognized; see Dewey v. St. Alban's Trust, 60 Vt. 1, 12 Atl. 224 (1888).
Virginia		(Class actions apparently recognized; see O'Hara v. Pittston Co., 186 Va. 325, 42 S. E. 2d 269 (1947); Goodloe v. Woods, 115 Va. 540, 80 S. E. 108 (1913).)
Virgin Islands, U. S. A.		(Federal Rule 23 available in U. S. District Court.)
Washington	Revised Code § 4. 08. 070 and Court Rules, Rule 23	"When the question is one of common or general interest to many persons, or where the parties are numerous and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of the whole." (Court Rule taken directly from new Federal Rule 23.)

West Virginia	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23.)
Wisconsin	Statutes annotated § 260. 12	". . . when the question is one of a common or general interest of many persons or when the parties are very numerous and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of the whole . . . ."
Wyoming	Rules of Civil Procedure, Rule 23	(Taken directly from old Federal Rule 23.)

Appendix 5

Directory of Legal Aid and Defender Services 1970[1]

(National Legal Aid and Defender Association, American Bar Center, Chicago, Ill.)

Appendix 6

[From The Wall Street Journal, Tuesday, March 1, 1970]

Mrs. Knauer Uses New 'Powerline' To Win Some Victories for Individual Consumers

By Ronald G. Shafer

Staff Reporter of The Wall Street Journal

Washington.—"Please dear lady Knauer. My wife and I beg of your help. We are poor people. One year this month, our refrigerator has been in the repair shop," read the letter from Danielson, Conn.

Until recently there was little that Virginia Knauer, Special Assistant to the President for Consumer Affairs, could do about such problems except—as she puts it—write "mealy-mouthed" sympathy letters back to the consumer.

In the past few months, however, armed with White House authority, Mrs. Knauer has begun carrying many such complaints directly to the heads of the companies accused, asking them to look into the matters and let her know what they find. The initial indication is that, while the "Knauer Powerline" can't settle every grievance, it has won some victories for consumers.

Though admitting that "what we do may be just a drop in the bucket," Mrs. Knauer contends that it could start a tidal wave. "One letter from me on White House stationery to a company president could eventually affect all consumers using that company's products," she says.

HANDLING ONE GRIPE AT A TIME

For the time being, the Knauer staff, coping with more than 2,000 complaints a month, is content to catalog its accomplishments one household at a time. The "poor people" in Connecticut are an example.

By the time a staffer phoned them, the refrigerator had been returned from the repair shop, but it still wasn't working properly. During its stay in the shop its five-year warranty had expired, and the dealer wouldn't make any further free repairs. Mrs. Knauer's staff got in touch with the manufacturer, and as a result the warranty was extended another year and the refrigerator was fixed without charge.

If a consumer can't get action on a valid complaint, Mrs. Knauer says, he should "write us, and we'll see what we can do about it."

The Knauer Powerline isn't the Government's only listening post for consumer gripes. The Federal Trade Commission recently announced it intends to set up consumer advisory boards at 11 of its nationwide field offices, in an effort to determine what local consumer problems are and how they might be solved. The boards will include representatives from community groups, government and business.

PROGRAM IS GENERALLY PRAISED

In its early stages, Mrs. Knauer's complaint-handling program generally is drawing praise from businessmen and trade groups because of its stress on voluntary cooperation. "We need feedback" from customers, M. H. Broffman, chief executive officer of the John Morrell & Co. meat packing subsidiary of AMK Corp., wrote in an approving letter. There is concern among some businessmen, however, that the complaints might be exaggerated.

Private consumer groups also applaud the Government effort, but they note that Mrs. Knauer's office hasn't any power beyond persuasion. "The more they can do, the better," says David Swankin, Washington representative of Consumers Union, which publishes Consumer Reports, "but that office really isn't the place to settle complaints on more than a token basis." Mr. Swanking believes gripes can best be handled at the local level, closer to the source.

Whatever the outcome of individual complaints, the growing number of consumer letters is likely to be used by Mrs. Knauer's office as the basis for future

[1] Directory not reproducible, placed in committee files.

legislative proposals that could affect all consumers. Many letters, for example, raise questions about the warranty runaround among dealers, distributors and manufacturers. Others pose doubts about some warranty terms. A California man complained that the "lifetime" guarantee on a malfunctioning massage-chair promised "free" repairs only if the chair was mailed back to the factory at his expense.

"I think we will have to have legislation on warranties," Mrs. Knauer recently told a Senate hearing. A proposal by Sen. Magnuson (D., Wash.) would establish requirements when the term "guaranty" is used.

SUCCESS STORIES NOTED

So far the Knauer staff's self-styled "success stories" number about 100. An auto company agreed to repair an Arizona man's car engine under warranty after previously rejecting the claim. A retail chain corrected a billing error that threatened to damage the credit of a Cleveland economics professor. The maker of an Alabama woman's mobile home fixed numerous defects after ignoring her complaints for nearly three years.

(The files of the President's Committee on Consumer Interests are opened to reporters only with the proviso that the names of companies and consumers can't be used. This policy originated in the Johnson Administration after Mrs. Knauer's predecessor, Betty Furness, incensed businessmen by allowing a national magazine to quote her complaint letters without any restriction.)

Gripes to the Knauer Powerline run the gamut from undelivered merchandise to defective products. The biggest percentage involves service and warranties for automobiles and household appliances.

A Ramsey, N.J., man wrote that when the picture tube went out on his year-old color television set, he couldn't obtain service under the three-year warranty on the tube. The retailer denied there was a warranty, the customer said in his complaint. A company representative said that ordinarily there was a warranty, but that this one was "no good" because the retailer "didn't send his money" from the purchase price to the manufacturer to cover warranty repairs.

Shortly after Mrs. Knauer's office wrote the company's president, a company official replied that the New Jersey man's picture tube indeed was under warranty and added, "He will receive a picture tube free of charge." The official said, "I wish to thank you for calling this matter to our attention." The New Jersey family reports the TV set is working just fine.

SOME COSTLY SETTLEMENTS

Some more costly consumer problems also have been settled. A Laurel, Md., housewife wrote that the aluminum siding on her house was so shoddy it couldn't pass the town's building inspection. The company refused to fix the siding and was pressing court action for the $2,500 owed on the $4,779 job, the woman said. Mrs. Knauer first advised getting a lawyer, then turned the case over to two home-improvement trade associations. The result was an out-of-court settlement that "was very satisfactory to me," the woman said in a thank-you note.

That isn't to say that every complaining consumer goes away happy. Even some settled cases have left the consumer unsatisfied.

A Washington man wrote a long letter complaining that his new-car warranty was voided after he went to a second dealer for numerous repairs because of poor service by the selling dealer. A representative of the auto maker, after meeting with Mrs. Knauer's staff, agreed to reinstate the warranty if the auto owner would return to his original dealer as required by that company's warranty agreement. "That's no good. I'll never go back to that dealer," vows the man, who adds bitterly, "I'm still out almost a thousand bucks for repairs."

Every complaint isn't acted on. The staff tries to weed out obvious crank letters or those that don't appear to have legitimate gripes. When a complaint is pursued, however, "cooperation has been really good," a staffer says, remarking that most companies at least respond. Some make adjustments for "consumer good will," even if they don't consider the gripe valid, the staffer adds. In fact, some companies involved in trival complaints settle up with such fanfare that skeptics wonder if it's mainly a public relations ploy to disarm Mrs. Knauer.

When the 18 staffers on the Consumer Interests Committee do settle a gripe, they often win a lifetime fan. "It is people like you, Mrs. Knauer, that restore my faith in Government officials," wrote a Fargo, N.D., consumer, after the committee won a $39.95 refund on a set of pots and pans said to be defective. Even some of those who aren't helped write back that they were "pleased to hear that someone would at least listen to our problem."

STATEMENT OF MR. GEORGE W. KOCH, PRESIDENT,
GROCERY MANUFACTURERS OF AMERICA, INC.

We are here today on behalf of Grocery Manufacturers of America, Inc. The members of this trade association are manufacturers of food and nonfood grocery products -- products that are used daily by virtually all American consumers.

The recent Time Magazine cover story on Ralph Nader makes the statement that American consumers are the best-fed, best-clothed, most pampered people in history -- yet they are dissatisfied. [1]

The observation is absolutely correct on both counts. As far as the grocery industry is concerned, there is no country in the world where the consumer is offered the quality, variety and service available in this country.

Everything, however, is not perfect in the marketplace. There are those who take advantage of the consumer through fraudulent or deceptive acts or practices. This is harmful to the consumer. It also is harmful to GMA member companies and every other reputable businesss whose livelihood depends on the good reputation of the marketplace.

GMA is vitally interested in seeing that deceptive and fraudulent practices that discredit the marketplace in the minds of consumers are corrected. For that reason, last December we recommended before a Senate Subcommittee that sufficient funds be appropriated to insure adequate enforcement of the Fair Packaging and Labeling Act. Our companies and other reputable businesses have complied with that Act.

Now we come before this Subcommittee to recommend that you report out a bill which will effectively and directly stop frauds against consumers. Our companies do not want to be associated with the small minority of businessmen who make a living by defrauding the public. GMA wants a law that hits that kind of businessman hard -- hits him fast -- and hits him wherever he operates.

This Subcommittee has before it a proposal by Chairman Magnuson and the Administration that would give the Federal Trade Commission jurisdiction over consumer fraud that affects interstate commerce.[2] What this means in non-legal terms is that the FTC would be given the power to reach down into the local marketplace and stop the great majority of consumer frauds. We want FTC to have that power.

The marketplace is basically a local institution, even though many of its products arrive through interstate commerce. If the reputation of the marketplace is to be preserved, it is important that the power to deal with consumer fraud be effective where the consumer lives, shops and may be preyed upon by the unscrupulous.

We want the FTC to deliver on its promise of last month to vitalize the Commission's regional offices and make them a real grass roots consumer protection network.[3] We want the Congress to make sure that the FTC can keep its promise. Congress can do this because of its oversight power on the activities of FTC. Indeed, this oversight power is lodged in the very Committee of which this Subcommittee is a part.

In this regard, two proposals by Chairman Moss and the Administration would arm the FTC with a powerful economic weapon.[4] They would grant FTC the power to go to court and get a preliminary injunction against deceptive practices. If you want to stop consumer fraud, this is the way to stop it -- and stop it quickly.

Previous witnesses have pointed out that there is a need for clarifying language in these proposals concerning the application of equity principles by the courts; for the need of prior filing of a complaint before filing a petition, and for deleting reference to temporary restraining orders.[5] We recommend that the Subcommittee adopt these changes. These are legalistic, but important points.

FTC preliminary injunctions will be "consumer fast actions." The court could quickly enjoin businessmen or even a group of companies from engaging in a particular deceptive act or practice.

One of the basic reasons that Congress created the FTC was because self-help through the courts was not an effective remedy in many areas. Consumer fraud is one of those.

When the consumer class action bills were first proposed, we thought that we might favor them. Proponents of these proposals said that class actions would get at the small minority of dishonest businessmen.

Then we looked at Rule 23 of the Federal Rules of Civil Procedure. This is the rule upon which all the class action bills would depend to get the consumer redress. We looked at the 50 state class action requirements and the decisions under them. We looked at the federal courts' Manual for Complex and Multidistrict Litigation. Our conclusion is that federal consumer class actions are <u>not</u> the answer to the abuses that this Subcommittee is trying to correct.

If Congress enacts a federal consumer class action right similar to any before this Subcommittee, it will have created a remedy over which it has no oversight control. Rule 23, upon which the class action proposals are based, is not directly controllable by Congress. The federal courts are responsible for drafting,

amending and applying the Federal Rules of Civil Procedure.

Federal class actions are today a highly sophisticated and complicated legal vehicle. Legal commentators have described them as an admitted experiment.[6]

Let us illustrate in the simplest possible terms the legalistic maze that Mrs. American consumer will face in her pursuit of redress under Rule 23.

FIRST, the consumer will have to retain an attorney at some point in the proceeding -- preferably at the very beginning.

Then, under the Administration bill, as a SECOND step, the consumer or the attorney would have to alert the Justice Department or FTC to the occurence of the fraud if these agencies were not aware of it already;

THIRD, the FTC or Justice Department would have to make an official determination that the matter lies within their federal jurisdiction;

FOURTH, the FTC or Justice Department would have to investigate the charges and determine that the matter merits prosecution; and

FIFTH, the FTC or Justice Department would have to prosecute the case in court successfully under one or more of the eleven specific definitions of deceptive practices listed in the bill.

Now, under any of the proposed bills before this Subcommittee a SIXTH step through the maze would find the consumer's attorney filing a civil action in the name of the class of all persons defrauded;

SEVENTH, the consumer's attorney, to be allowed to proceed with a class suit, must demonstrate to the satisfaction of the court that (a) "the class is so numerous that joinder of all members is impracticable," (b) "there are questions of law or fact common to the class," (c) "the claims or defenses of the representative parties are typical of the

claims or defenses of the class, and" (d) "the representative parties will fairly and adequately protect the interests of the class."

Having done that, an EIGHTH step through the maze would require the consumer's attorney to demonstrate to the satisfaction of the court that "questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy;"

NINTH, in making his decision on whether the action is appropriate under the test given in Step 8, the judge is directed to consider: (A) the interest of members of the class in individually controlling the prosecution . . . of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by . . . members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum: and (D) the difficulties likely to be encountered in the management of a class action.

The TENTH step would find the judge directing that "the members of the class [receive] the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. That notice must advise each member that "(A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any other member may enter an appearance through counsel";

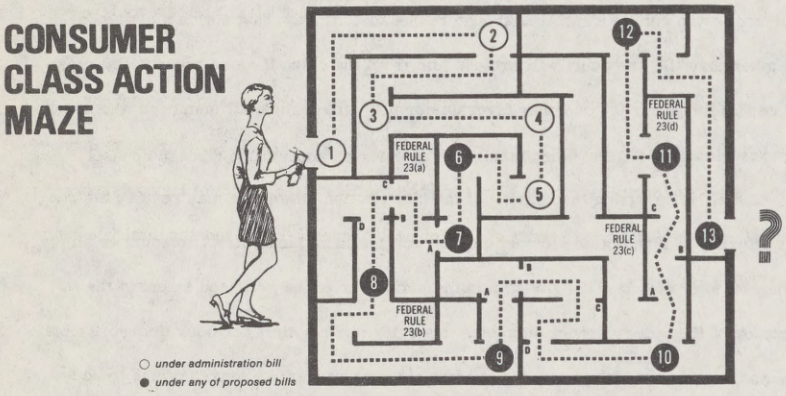
ELEVENTH, during the hearing of the class action, the judge may require the consumer's attorney to give notice "in such manner as [the judge] may direct to some or all of the members [of the class] of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action;"

TWELFTH, the consumer's attorney cannot settle or drop the case without the approval of the court and until he gives notice of the proposed settlement or dismissal to all -- I repeat all -- members of the class;

Finally, the THIRTEENTH step, assuming a verdict in favor of the class, each member of the class must appear in court and prove her particular injury (both that it occurred and the amount involved) before she is awarded recovery. The defendant would have a right to cross examine the consumer on both of these points and introduce evidence that her claim is invalid in some aspect.

The question, therefore, is still open, after all this time, as to whether Mrs. Consumer will collect on her claim.

Now this is not an exaggerated description of the consumer class action maze. In fact, considering limitations of time, we eliminated a large number of complicated steps provided under Rule 23 -- steps which would, however, not be eliminated for the consumer who seeks redress under pending proposals.



Is this an effective remedy? Is this speedy redress? In the grocery industry, all the consumer usually has to do is write a letter to one of our members saying she is dissatisfied. She gets her money back or a substitute product if she wants it with no questions asked.

The greatest single beneficiaries of federal consumer class actions would be strike lawyers. However, few consumer class actions would be brought against the real perpetrators of consumer frauds because these fly-by-night operators usually don't have enough money to pay consumer damages. And if they do, they are smart enough to hide either their assets or themselves.

Antitrust Chief Richard McLaren told a Senate Subcommittee that it could cost a million dollars before a class action even gets into the courtroom.[7]

Furthermore, many unsophisticated consumers, or those who have a fear of the courts and legal processes, would not go out and tell their problems to a lawyer. Yet these are the people who are most often the victims of thieves in the marketplace.

Another problem area of the proposed federal consumer class action would be their effect on an already overburdened federal court system.

The median time from filing a complaint to entering the federal courtroom for civil trial rose from 18 months in fiscal 1967 to 19 months in fiscal 1968. It rose to over 40 months in the Southern District of New York and the Eastern District of Pennsylvania, and 77 months in the Southern District of California.[8] Seventy-seven months until you get to court. Over six years!

When you add to this the time factor of two to six years involved with trying a class action, you have to ask again whether this is an effective way to attack consumer problems.

From the point of view of our courts, it is worthy to note that the only law review article that we have been able to find on the proposals before this Subcommittee expresses great concern over the probability that consumer class actions "could be a crushing blow to the federal district courts."[9] The article, by Professor James E. Starrs of George Washington University, makes the following points particularly applicable to S. 3092, after stating that the motives of the sponsor were undoubtedly to protect the consumer:[10]

> Nevertheless, [provisions in S. 1980 and S. 3092] could be a crushing blow to the federal district courts for [they] would bring a staggering number of exclusively state claims into the Federal courts in the cumbersome, time-consuming form of a class action, inevitably requiring the expenditure of considerable judicial time and energy -- which is already at a premium. Such an onslaught of new and complex cases might well cause the federal judiciary to bristle to the extent that the seeming liberality of Federal Rule 23 would soon end -- not only for consumers but everyone.
>
> The point is simply that revised rule 23 concedes tremendous discretionary authority to the federal district judges. That discretion could be exercised, as the rule's draftsmen obviously intended, to unshackle the class action and to make it more usable or it could be employed to impose deadening limits upon the class action. It is my thought that a federal district judge who is forced to the wall by a mounting caseload attributable largely to the [provisions of these bills] will react negatively by curtailing the use of the class action under the supervisory control afforded him in the revised rule. Indeed, this fear of a rule 23 backlash may well have stimulated the decision of Justice Black in Snyder v. Harris.

The thrust of our statement today is that GMA believes that Congress should take immediate action to stop consumer frauds. This can be done through a preliminary injunction, a consumer fast action. Injunction petitions get preferential treatment in

the courts. We urge this Subcommittee to report out such a bill immediately, an action for which the Subcommittee would be applauded.

Thank you for this opportunity to express our views.

NOTES

1. Time, December 12, 1969, page 92.

2. S. 3201, Section 101.

3. See Federal Trade Commission News Release, February 5, 1970.

4. S. 2246 and S. 3201, Section 102.

5. See, for example, the statement of Mr. Edward Dunkelburger before this Subcommittee, February 5, 1970, pages 188-194 (typed transcript).

6. On the question of new Rule 23 being an experiment, see Kaplan, Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I), 81 Harvard Law Review, 356, 398 (1967); Frankel, Some Preliminary Observations Concerning Civil Rule 23, 43 F.R.D. 39, 52 (1967); McDonough, Supplemental Report, Committee on Federal Rules of Civil Procedure, Judicial Conference -- Ninth Circuit (1965) 71, 92 (1965); Mr. Justice Black's statement on proposed amendments to the Federal Rules of Civil Procedure, 39 F.R.D. 69, 274 (1966).

7. Testimony before the Senate Government Operations Subcommittee on Executive Reorganization, January 22, 1970, page 692 (typed transcript).

8. Assistant Attorney General Richard Kleindienst, Speech of June 27, 1969.

9. Starrs, The Consumer Class Action, Part II, 49 Boston U. L. Rev. 407 (1969), at 494.

10. Ibid, at 494-495.

Senator Moss. We will now hear from Mr. Thomas A. Rothwell of the National Small Business Association.

We are glad to have you before this committee once again, Mr. Rothwell.

STATEMENT OF THOMAS A. ROTHWELL, NATIONAL SMALL BUSINESS ASSOCIATION; ACCOMPANIED BY JOHN LEWIS, EXECUTIVE VICE PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. ROTHWELL. May I introduce my colleague, Mr. John Lewis, who is the Executive Vice President of the National Small Business Association?

Senator Moss. Very glad to have you, too.

Mr. ROTHWELL. And I apologize to the Senator and the committee for inadvertently being out of the room earlier today. It had been my understanding I was No. 2 in the batting order this morning.

Senator Moss. It did not inconvenience the committee at all. It caused you to stay an hour longer, however.

Mr. ROTHWELL. It has been my pleasure, Senator.

Mr. Chairman, and members of the subcommittee, this opportunity to appear and testify in reference to the consumer class action bills, S. 3092 and S. 3201, respectively, is very much appreciated. The views stated herein are as authorized by the National Small Business Association, a voluntary organization of some 35,000 small business enterprisers, typically small manufacturers, operating in more than 500 different industry categories.

We would like to focus and limit this testimony to a vital feature common to the legislative proposals being considered by this committee. That vital element is the proposal to establish more readily available class actions for consumers, whether independent of governmental action as in the Tydings bill, S. 3092, or as following a successful lawsuit by a Government agency as in the administration bill, S. 3201.

There surely can be no great dispute that there are substantial and perplexing problems involved in the marketing of consumer goods, and that it is surely a most fit subject for legislative action. At the same time it should be noted that as yet there has been no sustained effort made to determine the precise nature and extent of consumer fraud and damage problems in any meaningful quantitative sense. For example, we do not know what types of marketing abuses are the most prevalent, or the economic and social circumstances of those upon whom differing categories of abuse may impinge. We do know that some of the proponents of these legislative proposals and certain consumer spokesmen point to the fraudulent and near-fraudulent marketing devices practiced on the residents of the inner city—the so-called ghetto areas. If indeed this be the central problem, there is clearly a need for a specific and an imaginative remedy targeted on the area of primary concern. Such an approach was used, for example, in the Headstart program, directed at the educational deficits among the children of the inner city areas.

The legislative proposals relating to class actions being considered by this subcommittee are of broad and general application; they are not designed to assist or bring relief to any particular economic strata in

our culture. Nor are the legislative proposals oriented in a demographic fashion. This strongly suggests that the class action proposals spring from a conviction that abuses of consumers by the shabby marketing practices of producers, wholesalers, and retailers constitute a major problem of grave national import, cutting across economic classifications and geographic boundaries. We respectfully point out that there is little in the way of empiric evidence to afford support for such a conviction.

We wish to emphasize that the National Small Business Association agrees that consumers are entitled to a redress of their grievances, whenever they occur, and whatever such grievances may be. However, it is our understanding that the work of this committe is not to engage in a balanced appraisal and make overall judgments as to the benefit-detriment index of business affairs from the point of view of the consumer. Once it is postulated that grave problems do exist, statements concerning the consumer orientation of many businesses become irrelevant and self-serving. The fact that Company "A" does such-and-so to meet and eliminate the justifiable grievances of its consumers has little if any significance to the consumers of the products of Company "B", whose marketing activities may be in derogation of the consumer's interest.

We have one further area of agreement with most of the proponents of the consumer class action legislation. Namely, that in many instances the legal remedies presently available to consumers are inadequate. Yet we suggest and earnestly urge that the class action proposals now pending before this committee do not really remedy the legal inadequacies now confronting consumers, and may involve a great deal more potential harm to business generally, with no corresponding or compensating benefit to those consumers who need assistance.

The consumer class action proposals really involve two underlying ideas which, on examination, may be seen to be contradictory and even mutually inconsistent.

The first idea is to add small claims jurisdiction to the Federal courts. Now there is no need to labor the point that the historic function and role of the Federal judicial superstructure has been at the opposite end of the legal spectrum than that occupied by small claims courts. Although Congress undoubtedly has the power, to create such jurisdiction in Federal courts, it is a disconcerting and perhaps even a frivolous proposal, to suggest that the Federal courts' jurisdiction be extended to small claims. However, the frivolous nature of the underlying proposals is masked by a most brilliant stratagem, that of permitting consumers to aggregate their small claims, so that the dollars at stake would be, to say the least, most significant.

Thus the Federal small claims court idea has been wedded to the mathematics of astronomy, and, at the same time, attractively garbed as needed consumer protection. Who can possibly oppose that? And why?

Many of the prior witnesses have pointed to the potential burdens for the Federal judiciary involved in opening the floodgates of class action litigation. Since it is within the power of Congress to create additional posts to which Federal judges may be appointed, and to appropriate sufficient funds for the smooth functioning of such courts, it may be that those who support class action legislation view such arguments as expedients or perhaps even an exercise in sophistry

However, it is altogether fair and reasonable for the opponents of the class action to inquire, and we suggest that the committee ask the pertinent questions: How many additional Federal judges will be necessary to cope with the anticipated quantity of class actions? And how much additional money will be needed to support this additional function?

For the enactment of class action legislation without providing additional judicial machinery might well create a logjam in the Federal courts of unprecedented proportions and in effect make the administrative burdens on the existing Federal judiciary an intolerable one.

Parenthetically, it is no doubt ironic to note that in the area of personal injury litigation, arising primarily from automobile accidents, that many States are now engaged in efforts to relieve the judicial burdens and courtroom congestion by adopting administrative procedures for the resolution of most personal injury liability cases. The approach being employed, I believe we are all aware, is compensation for those injured, with no inquiry or determination being made in reference to fault. Class action proposals, of course, look in exactly the opposite direction.

National Small Business Association opposes the enactment of legislation providing for an expansion of existing class action jurisdiction in the Federal courts on the following grounds:

1. Class actions would not serve to inhibit, control or provide redress for grievances to those consumers who are victimized by the small, unscrupulous fly-by-night, and shady operators. Focusing on the inner city—or ghetto area—consumer abuse problem, it is precisely the perpetrators of such consumer abuses that would not be the inviting targets for class action litigation. The unscrupulous and shady operator is almost always judgment-proof. There is simply no incentive or possibility of bringing a civil action for damages against the cheats and swindlers that corrupt our commercial life. The class action net simply will not catch this kind of fish.

2. The existence of a class action remedy builds into the superstructure of existing business an explosive charge with a small fuse in reference to the entire population of responsible businesses. It is small comfort to note that the larger and more financially able corporations would probably be the primary targets for class action.

3. The existence of a class action remedy would tend to create and multiply dissatisfaction by making it profitable for some to stimulate and encourage discontent, and consumer-dissatisfaction reactions would be engendered only in the hope of a reward.

4. The class action remedy would serve to discourage innovation, which is a primary reliance of small business. It would raise additional market entry barriers and needlessly exaggerate the basic risks of engaging in business.

5. To the extent that the class action approach would be employed to redress technical and inadvertent violations, it would be unduly and unreasonably harsh in its application, especially as to small business.

6. The settlement by consent or by private action of incipient controversies would be discouraged. The class action approach tends to write off relief for consumers that is administratively obtained, such as voluntary compliance in the Federal Trade Commission context, or

even a simple refund or other adjustment of a legitimate consumer grievance.

7. The costs of defending a class action as to small business could well be overwhelming, even if the defense were successfully made.

8. The existence of an expanded class action remedy in the Federal courts would provide an opportunity for the redistribution of assets and wealth. The money would be taken from the owners, the stockholders, and employees, and redistributed first, to lawyers, and second, to some consumers.

9. The class action remedy might have exactly the opposite effect intended by making it more risky to be honest and ethical in business and by making it more profitable to be a fly-by-night transient with hidden assets.

10. The class action proposal would tend to elevate every small consumer grievance to the status of potential business catastrophe.

In lieu of the class action feature of the proposed consumer protection measures, National Small Business Association suggests the following:

1. The preliminary injunction remedy be made available to the Federal Trade Commission. The proposal is to permit the FTC to obtain a preliminary injunction as against unfair and deceptive acts and practices, in court and in the normal and time-tested manner, subject to the usual balance of convenience and probability of prevailing standards applicable to preliminary injunctions. This proposal differs from that made in prior congressional sessions, that of permitting the FTC itself to issue preliminary injunctions. This latter version was not a very attractive idea.

I might add that this constitutes, by and large, an endorsement of S. 2246, the bill as introduced by the distinguished chairman of this subcommittee, with some technical changes for the purposes of clarification.

As a second suggestion by National Small Business Association, we point out that there is presently existing a system of Federal masters that work in conjunction with the Federal bankruptcy courts. It is suggested that this or a similar group of subordinate Federal officials would be better equipped to handle and process numerous small claims as compared to the rather ponderous procedures employed by Federal judges.

3. It is earnestly recommended that a study be undertaken with adequate funds being made available, together with a deadline for the study results to be submitted to Congress. The nature of the study would be as indicated in the earlier part of this testimony; namely, to determine the realities of consumer fraud. Which are the most prevalent; what are the circumstances conducive thereto; et cetera? Such a study is suggested as a supplement to present action, not in lieu thereof.

4. In the event the Congress should feel that the need is pressing, and that heroic measures are required, consumer courts could be established in areas where the need exists, and on a cooperative Federal-State basis. It would seem that the need could be better met by summary procedures to be made available on an individual basis in neighborhood consumer courts, rather than by going through the massive, elaborate and most protracted procedures involved in any class action proposal.

In summary, our testimony as it relates to the economic and social desirability of additional class action legislation is that it is an overly effective sanction, so overwhelmingly effective that it may well defeat its own purpose. By way of analogy, it may be that the farmer might need some rain to help his crop through a dry period. However, it is not advisable to blow up an adjacent dam in order to meet the need for moisture.

Historians may well view our era as one that marked a titanic struggle for the minds and hearts of man. The tumult and shouting, the divisions and disturbances that now beset us make for all a time of confusion, perplexity and even agony. What we truly need is less division among us, not more. What we do not need is an additional legislative device that would serve but to set class against class, and evoke large-scale mischief and distress for a most uncertain purpose.

Thank you.

Senator Moss. Thank you, Mr. Rothwell, for your statement given on behalf of the National Small Business Association.

I understood you to say that you felt that the present system for settling these grievances was not adequate. Is your remedy what you set forth in the latter part here—that the preliminary injunction be available to the Federal Trade Commission?

Mr. ROTHWELL. That is correct, Senator.

Senator Moss. And the possible appointment of something similar to the masters in the bankruptcy courts?

Mr. ROTHWELL. That is correct, Senator.

Senator Moss. Do you feel that the Federal courts would be so overwhelmed by class actions that they actually would be inundated if this were granted?

Mr. ROTHWELL. Well, Senator, I think that the best approach we can make to that is speculative. Frankly, I do not know; and furthermore, I do not think it makes any difference because if experience proved that to be the case, if there was an overwhelming inundation of the Federal courts with class action litigation, Congress has the remedies at its disposal: just get some more Federal courts and more courtrooms and more judicial machinery.

If this is the remedy that is needed, then I do not think this business of the logjam of the Federal judiciary is an argument that really goes to the merits.

Now it should, of course, and it is proper to bring to the attention of Congress that to create a remedial device without the mechanical procedures to supplement it is not a particularly desirable or praiseworthy way to go; and I think the criticism should stop at that point. And that is to say that if experience shows that this Federal logjam is created, why, then, that can be remedied with additional people.

But there is another dimension to the problem, and I think the Federal courts as they are presently constituted simply do not provide that kind of forum that is suitable to try and dispose of a small claim.

Now whether the small claim is multiplied by one, two, or one million, it still is the truth that the Federal judiciary, the procedures, the Federal rules of civil procedures, the whole calendar rules of the various courts, the local rules, the pace and tempo of things, the formidable environment, is not the kind of forum that should be

utilized and employed by handling the kinds of problems that more nearly approach, you know, traffic violation grievances.

Now that is why we suggest to the Congress that if Congress is determined to put this jurisdiction in the Federal judiciary superstructure, that it not confine its view to the Federal judges alone; that there are other possibilities:

No. 1, the system of masters which was pointed out; and

No. 2, that if Congress should feel that the need warrants the measure, that neighborhood consumer courts could feasibly be set up on a cooperative Federal-State basis, perhaps with the familiar formulas of matching grants; Federal standards to be set up, and when the State needs the Federal standards, have the activity turned over to the States.

That would be proceeding in a manner much more consistent with the traditions of our Anglo-Saxon jurisprudence as represented, in our today's court structure, Senator, so that it is not only a matter of a logjam; there is a qualitative element also involved.

Senator Moss. Well, of course, I would agree the proposed legislation does not envisage having the Federal courts become a small claims court. But if you have a lot of problems that are the same, and they can be put together, then you do not have one small one or a lot of small ones; you have one big one.

Mr. ROTHWELL. I agree, of course.

Senator Moss. And for instance, if General Motors puts a defective wheel on its cars, we get some callbacks and that sort of thing now. But oftentimes something like that has to be forced and adjudicated before it will be done.

Mr. ROTHWELL. Senator, unlike some other philosophic approaches that one hears before these subcommittees, ours is not one of dismay at Government intervention, and total disapproval of any Government action at all. We do not take that position.

We take a somewhat different position. And I would like to utilize, if I might, to illustrate the point, the Senator's own analogy and example.

If you start out with a presumption of liability and fault, the defective transmission on the General Motors' automobile, and then you say, "Why force 50,000 consumers to bring 50,000 lawsuits when we can do that within the ambit of one?"

Now, Senator, I do not think there can be much argument that that is the more efficient and effective and sensible way to go at it. But I think we are being beguiled by the ease of the hypothetical because, Senator, that is not what would happen. That is not what would happen.

We start a lawsuit, not with an assumption of liability and an assumption of guilt. We start a lawsuit from the other end of the spectrum. And it is usually not an open-and-shut thing such as a defective transmission; but a very vague and shadowy thing.

I would point to the recent and highly publicized case of the Campbell Soup Co., and its deceptive advertising. To show the richness and fulsome recipe employed in their soup, they take a picture of soup in a bowl. As I understand the merits, as this comes across on television, it looks like water. So, in order to give a realistic appearance to the television image, at the consumer end of the screen, the technicians

put glass marbles in the bottom of the bowl, which cause the solid substance to be adequately reflected in that rather unique dimensional plane of the television receiver at home.

Now the Federal Trade Commission launched proceedings which ultimately resulted in a rather strange celebrity for that litigation, because of the intervention of the student group, the so-called SOUP, the local group of students; and I think we are familiar—perhaps the committee is more familiar with the particular play-by-play action of that little drama even than I. But I do know that the net result is that, on a consent basis, the Campbell people and their advertising agency agreed not to do that.

Now I believe, and I think that perhaps I represent a minority, but I believe this is rather a silly, trivial, and even an outrageous result as to that litigation. But it only affects Campbell and only affects one methodology of projecting a television image. I am sure they can do better. Perhaps the result of the lawsuit will stimulate the television people to do better.

But now if there is a class action proposal, you see what happens. What about the letters and the bulletins that go out to consumers saying "How many of you feel tricked, defrauded, and deceived because of this commercial?"

Now we start there with the finding of liability, you see.

Campbell's Soup is not a member of this organization, and Campbell's Soup, I think, is one of those few firms that would have the resources to stave off and even survive such a challenge. But if you reduce the order of magnitude by 10, such a challenge to an existing business might very well or could represent the final catastrophe as to that business.

Senator Pastore was here a few moments ago, and he articulated the hypothetical of the bellyache, the common and prosaic bellyache. Well, certainly, if a consumer has a bellyache, to give the consumer the price of the can of vegetables back is ironic; the consumer should be compensated for the pain, the suffering, the inconvenience; and there may be even the need for some punitive measures to be taken.

Those procedures and those devices do exist.

But the point that we make, Senator, is that if a consumer has a bellyache, do we start circulating the neighborhood of that store with letters of inquiry to all consumers saying "did anyone get a bellyache after buying this" You see the mischief that would be done, whether the answer were "yes" or whether the answer were "no." Now, these are the practical results.

Senator Moss. Is this not the power of the judge under rule 23 right now, to determine whether there was a solicitation?

Mr. ROTHWELL. Before he can exercise the power, the inquiry would have to be made.

Senator Moss. Yes, there would be a suit filed in his court in order for them to be there, but that is the first place he proceeds?

Mr. ROTHWELL. Right. There would be a suit filed, and it would be denominated a class action. The very first element to decide would be to decide: "is there as class?"

In deciding that element, the business might disappear. That is the point. Whether or not that bellyache was a fancied one, or one that occurred from ptomaine poisoning.

So in a very strange sense this class action remedy is at one and the same time too effective, and not effective. It is too effective in that it would serve to increase the risks as to those things at stake in every normal day-to-day business marketing decision. It would make innovation of marketing, of products, of technique, extraordinarily more risky than it is today, so in that sense it is too effective.

At the same time it is not effective because if we are to credit—for example, Mrs. Grant, who is the consumer affairs commissioner of the city of New York, when she appears here in Congress, she talks about the fraud practiced on the people that reside in the ghetto areas of New York City. When the Federal Trade Commission study was published in 1968 about consumer fraud, the latter part of August or September of 1968, I believe it was, the thrust of that study was the marketing practices and their effect on the impoverished people, the economically disadvantaged and relatively poorly educated people who resided right here in the District of Columbia.

Now we make the point, and I suspect that it is one that should be stressed, that I do not think that we know enough about consumer fraud problems, other than in the context of the inner city, disadvantaged areas, to truly devise in good faith an effective remedy.

I do believe that the remedy that has been proposed represents very much of an overkill. And the suggestions that are made in my testimony, Senator, are some suggested alternatives for the subcommittee's and the Congress' consideration.

Senator Moss. Thank you, Mr. Rothwell, for you presentation, and Mr. Lewis, for your being here this morning. I think you have helped make our record and given us some more things to think about as we wrestle with the problem.

As I said to the previous witnesses, a problem exists and we are trying to find the way properly to deal with it; and I appreciate having the testimony from the National Small Business Association.

Mr. ROTHWELL. Thank you, Senator.

Senator Moss. This concludes our hearings this morning; and so far as we know, concludes the hearings on these three bills. If there is reason to open up any of them, we will give adequate notice before we have any further hearings.

(Whereupon, at 11:05 a.m., the subcommittee was adjourned.)

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF AARON M. FINE, ESQ., PHILADELPHIA, PENNSYLVANIA
ANTITRUST LAW SECTION CABANA MOTOR HOTEL

At the August, 1966 meeting of this Section in Montreal, one month after Amended Rule 23 took effect, Mr. Fales of White and Case said, "It is my prediction that we will not see it used in all but the rarest of antitrust cases and that all the types of cases formerly brought under old Rule 23 will be, to the benefit of both plaintiffs and defendants, relegated to the more manageable 'common question of law or fact' rules, Permissive Joinder of Parties, Rule 20, and Permissive Intervention Rule 24(b) and (c)." Vol. 32 A.B.A. Antitrust Law Journal, p. 293. That reminds me of my prediction that we would win the NOERR case in the Supreme Court. We lost nine to nothing. Times change, as they say, usually in Latin. Messrs. Fales and White and Case are now the acknowledged champions in the use of the antitrust laws to protect the industrial establishment against the upstart conglomerate. And Rule 23 is alive and well in treble damage actions in Philadelphia and Chicago.

When Francis DeLone discussed the Rule last November in Atlanta, Eisen, the odd-lot trader had won twice in the Second Circuit—first on the issue of appealability and second, obtaining a reversal of the district court's dismissal of his class action. Judge Kraft had dismissed the class action in the HARPER & ROW case in Philadelphia, doubting the validity of the new rule, apprehensive that he would personally have to answer the telephone when recipients of the class notice called for advice, and finding that common questions of law or fact did not predominate over individual questions. Judge Fullam had upheld class actions in the brass mill tube and pipe cases, and the notice was just going out. And the Judicial Panel on Multidistrict Litigation was considering its first cases.

What is the situation today? As antitrust lawyers we need not concern ourselves with SNYDER v. HARRIS, U.S. (1969) in which the Supreme Court held that claims of class members cannot be aggregated for the jurisdictional amount, except to note Professor Benjamin Kaplan's appraisal that: "The net effect of the decision is to disfavor the small fellow and thereby to defeat a main purpose of the Rule revision. These and other iniquities of the majority opinion are set out in Justice Fortas' discerning and persuasive dissent. We may hope that the Supreme Court's aberration will be temporary." Benjamin Kaplan, A Prefatory Note To A Symposium on Federal Rule 23, Boston College Industrial and Commercial Law Review, Vol. X No. 3. Where jurisdiction is not a problem, there seems little doubt that the Supreme Court will give full scope to the Rule, as it has to Rule 19. PROVIDENT TRADEMENS BANK & TRUST CO. v. PATTERSON, 390 U.S. 102 (1968). In antitrust, Judge Kraft's decision in Philadelphia has been reconsidered by Judge Decker in Chicago, who received a lateral pass from the Multidistrict Panel, and proceeded to sustain the national class action which Judge Kraft had dismissed. Judge Fullam's notice has gone out, and rescued from oblivion and the statute of limitations $50,000,000 in brass mill tube and pipe purchases, including those of the City of Dallas. A national settlement offer of $120,000,000 is pending in the antibiotics cases, and if you can find your prescriptions in the next few days, you can respond to the advertisements addressed to the consumer class.

The Ninth Circuit has knocked part of the plaintiff's delight out of the CHICKEN DELIGHT case by eliminating from the notice in a mandamus proceeding reference to the allegations of retail price control, holding that those issues, unlike the others, involved "significantly different evidence and separate factual determinations as to each separate franchise . . . ," a form of interlocutory review of the merits of class action issues not to be encouraged. CHICKEN DELIGHT, INC. v. HARRIS, 1969 Trade Cases ¶72,817.

The HARPER & ROW defendants have questioned the authority of the Archdiocese of St. Paul in purporting to represent all Archdioceses and Dioceses

in the United States. I cannot understand such parochial limitation to national boundaries. The Republic of India recovered $1,000,000 in the Electrical cases.

National class actions of governmental bodies or others are awaiting determination in plumbing fixtures, quinidine, gypsum board, water meters and central station alarm services. A mutual fund shareholder has dared to bring suit on behalf of all mutual fund shareholders in his own funds, the funds themselves and other funds and their shareholders against a representative group of investment fund advisers and the directors they have in common with the funds themselves. KAUFFMAN v. THE DREYFUS FUND, INC., D.N.J. Civil Action No. 1348-68. The defendants are so excited at that one that they are referring to it as the DREYFUS case, but have not yet retained Emile Zola Berman for the defense. The case is already so complicated that preliminary motions are being argued in three waves—a term borrowed from the modern French cinema and the Co-ordinating Committee on Multiple Litigation. A single meeting of defense counsel is said to cost $50,000.

Class actions have received considerable encouragement from the Courts.

The Tenth Circuit, for example, has said, in a securities case:

". . . taking the issue in the context of the securities laws and realizing that 'the ultimate effectiveness of the federal remedies . . . may depend in large measure on the applicability of the class action device,' 3 Loss, Securities Regulation 1819 (2d ed. 1961) . . . the interests of justice require that in a doubtful case . . . any error, if there is to be one, should be committed in favor of allowing the class action." ESPLIN v. HIRSCHI, 402 F. 2d 94, 101 (10th Cir. 1968), cert. denied U.S. (1969).

And see GREEN v. WOLF CORP., 406 F. 2d 291 (2d Cir. 1968), cert. denied U.S. (1969).

Or, this from Judge Decker: "Upholding the national class action will facilitate private antitrust litigation and will discourage future violations." STATE OF ILLINOIS v. HARPER & ROW PUBLISHERS, INC., 1969 Trade Cases ¶72,795 (N.D. Ill. 1969).

Can the role be carried too far? At the spring meeting of this Section in Washington, the Attorney General suggested that antitrust lawyers might turn their skills to breaking up the combination of the Mafia. A number of defense counsel pointed gleefully to me, envisaging me as counsel for a class of drug addicts gouged by Mafia prices. That would be going too far. It would probably fit into Rule 25 better than Rule 23. P. T. Ryan, of Philadelphia, not related to Sylvester, last month warned the Ninth Circuit Judicial Conference that Rule 23 goes entirely too far in giving poor litigants a chance to combine their resources, and might lead to the Welfare State, reminding us all of the Duke of Wellington's strong opposition to the development of British railroads because "they would encourage the lower classes to move about. . . ."

It is still true that most class actions under Rule 23 are brought in the civil rights field or for damages under the Securities Act or treble damages under the antitrust law. A recent example combines all three. In CONTRACT BUYERS LEAGUE v. F. & F. INVESTMENT, 13 FR Serv 2d 23(b)(3), Case 1 (N.D. Ill. 1969), fifty Negro buyers of used residential property under installment sales contracts were held entitled to maintain a class action against certain sellers, lending agencies and mortgage brokers charging them, in essence, with a scheme to exploit the plaintiffs' class by blockbusting, price-fixing and so forth. The complaint alleged violations of the Civil Rights Act, the Federal Securities law, the antitrust laws, common law regarding fraud, usury and unconscionable contracts.

The defendants, of course, argued that each contract raised individual issues, over which common issues did not predominate, so that there could be no 23(b)(3) class action. Judge Will, however, held that the gist of the complaint was that a broad pattern of similar conduct underlay all transactions, involving common issues of law, supplying the necessary "predominance". He also held that the action qualified under 23(b)(2) which provides for a class action where "the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole." On the other hand, Judge Will held 23(b)(1), involving the need to meet a threat of inconsistent adjudications, inapplicable, since different results could be distinguished on the grounds of different facts.

It does not stop there. Plaintiffs also sued defendants as a class, which the Court did not sustain. The named defendants were required to furnish plaintiffs

a list of persons known by them to fall in plaintiffs' class, so that they could be given individual notice. Others were to receive notice by publication.

This question of notice brings us back to EISEN, who alleged a conspiracy to monopolize odd-lot trading and to fix the odd-lot differential at an excessive amount, estimating that there were 3,750,000 class members. You will recall that he was allowed to appeal dismissal of his class action, because his individual damages were estimated at only $70, so that without the combined resources of a class he could not proceed with expensive antitrust litigation, and would be left without a remedy. EISEN v. CARLISLE & JACQUELIN, 370 F.2d 119 (2d Cir. 1966), cert. denied 386 U.S. 1035 (1967). The Court of Appeals then reversed dismissal of the class action, holding that Rule 23 should be liberally interpreted; that an individual claimant could be an adequate representative of the class; ("If we have to rely on one litigant to assert the rights of a large class then rely we must."); that "the representative party cannot be said to have an affirmative duty to demonstrate that the whole or a majority of the class considers his representation adequate"; and that common questions of law or fact, the so-called "common nucleus of operative facts", predominated over individual questions. EISEN v. CARLISLE & JACQUELIN, 391 F2d 555 (2d Cir. 1968).

Did EISEN get his class action? Not yet. The Second Circuit directed the District Court, before allowing the suit to proceed, to conduct a further inquiry into the mechanics involved in administration of the action, to ascertain whether there was any real prospect of class members' sharing in any recovery, whether the recovery would be absorbed in expenditures for paper work, printing, postage, fees for Special Masters, and so forth, and what difficulties individual members would be likely to encounter in filing claims. But that was not the major problem. What really concerned the Court was the notice required to be given class members.

The Second Circuit held that the burden of furnishing notice must rest on the class representative. EISEN argued that mail notice would cost him $400,000 and therefore he should be permitted to give notice by publication, otherwise he could not proceed. The Court held that the issue should be considered by the District Court, but said:

". . . if the Court finds that a considerable number of members of the class can be identified with reasonable effort, and financial considerations prevent the plaintiff from furnishing individual notice to these members, there may prove to be no alternative other than the dismissal of the class suit."

In the original proceedings defendants had filed affidavits stating that there was no way in which odd-lot customers could be identified or readily separated from round-lot customers. After the Second Circuit's decision they obligingly volunteered a list of 2,000,000 names and addresses. The parties are now engaged in trying to stipulate the facts necessary to decision on the questions of administration and notice.

The expense of notice can be alleviated by applying Judge Decker's Order in the library editions of children's books cases in Chicago. STATE OF ILLINOIS v. HARPER & ROW PUBLISHERS, INC., ET AL. AND RELATED CASES N.D. ILL., NO. 67 1899. On June 2, 1969 he entered an order on class action notification requiring the representative plaintiffs to prepare prescribed forms of notice for mailing to their potential class members, and to deliver them to the clerk unsealed in properly addressed envelopes. The clerk was required to send the notices by registered mail, including return envelopes, also addressed by the plaintiffs. The return envelopes are also franked.

Even notice by publication, allowed by a number of decisions, can be expensive. In HERBST v. ABLE, 13 F.R. Serv. 2d 23a, 52, Case 1 (S.D.N.Y. 1969), the Court allowed the plaintiffs in five cases under the Securities Act to publish a single notice three times in the New York Times and Wall Street Journal. It comes to about $5,000 a case. There are, of course, other possible solutions.

The question of appealability of an order dismissing a class action, decided in the plaintiff's favor in EISEN, came before the Second Circuit again in GREEN v. WOLF CORP., supra a securities case, in which, since the plaintiff's damages were only $1,000 the EISEN rule of appealability was applied, and the order dismissing the class action reversed. However in the concrete pipe cases, the result was different. In the District Court Judge Ryan, for whom the new rule holds no special charm, had held, among other things, that common questions did not predominate over those affecting only individual members, so that the action could not be maintained as a class action.

The plaintiff appealed. The Second Circuit, over the dissent of Judge Hayes, dismissed the appeal as interlocutory. City of New York v. International Pipe and Ceramics Corp., 410 F. 2d 295 (2d Cir. 1969). It distinguished EISEN on the ground that his individual claim was so small that he could not afford to proceed without a supporting class. To reject his class action appeal would be the death-knell of the action. In the pipe case the plaintiff and intervenors had substantial enough resources of their own to finance the litigation, so that refusing an interlocutory appeal did not put them out of court. The second Circuit, famous last year for Chief Judge Lumbard's dissenting epigram that EISEN's class action was a Frankenstein's monster, coined another in the pipe case, to wit, "courthouses are not Coliseums."

Last year defense counsel were still congratulating themselves on their victory in the Harper & Row case in Philadelphia. The City and School District of Philadelphia had brought suit against the publishers and wholesalers of library editions of children's books on behalf of themselves and all state and municipal libraries and all public school systems of a certain size. Judge Kraft, in the first decision applying the amended rule to a treble damage action dismissed it as a class action.

On the basis of the defendants' affidavits, he found that common questions did not predominate at that time. He underscored the words "at that time" perhaps with some premonition of the future course of the case.

After Judge Kraft's decision the government filed and settled promptly by consent decrees eighteen civil actions against the book publishers. Whereupon new treble damage actions burgeoned in various districts, and, on order of the Judicial Panel on Multidistrict Litigation, were transferred to Chicago, where they were assgned to Judge Decker. A number of these were statewide class actions brought by attorney generals. Judge Decker upheld those class actions. Moreover, he granted the application of the Philadelphia plaintiffs to reinstate their national class. He held that Judge Kraft had expressly made his decision as of a certain time, and that now that the facts were more fully known, the requirements of Rule 23 were satisfied. State of Illinois v. Harper & Row Publishers, Inc., et al., supra.

There is no doubt that the same factors which persuade the Multiple Litigation Panel to transfer all actions to a single forum for pre-trial purposes, also speak strongly in favor of sustaining class actions, although the statutory test is not the same. As you have heard a § 1407 transfer is predicated on existence of one or more common questions of fact, on a determination that transfer will be for the convenience of parties and witnesses and will promote the just and efficient conduct of the actions. Judge Decker alluded to the relationship between class actions and multidistrict transfer as follows:

"Recognizing the desirability of concentrating this interwoven, far-flung litigation in a single forum, the Judicial Panel transferred all cases to this Court for consolidated pre-trial proceedings. Intensifying the concentration, class actions will promote desirable economies of time, effort and expense. For example, plaintiffs will no longer need to file new lawsuits, most of which would eventually be transferred here anyway."

Judge Kraft had seen a liberal grant of permissive intervention as a preferable alternative to the class action device. The defendants, naturally, argued the same position to Judge Decker. He dealt with the point as follows:

"In response, defendants suggest that permissive intervention and joinder is preferable. The recent history of this litigation dramatically illustrates the impracticality of these alternatives. In 1966 there was a single suit purporting to be a class action. (That was the original Philadelphia action.) The entire litigation might have been concluded without further complexity. But defendants successfully opposed the class suit, with the result that lawsuits have blossomed throughout the country. Rather than the original handlful of attorneys, lawyers are now so plentiful that the entire courtroom is filled at each pre-trial conference. Section 1407 consolidation became mandatory. When returned for trial, the subsequently filed cases will consume substantial amounts of the transferor courts' time. The prospect of further intervention and joinder combined with the inevitable proliferation of lawsuits, is inimicable to economical adjudication."

Judge Decker also dealt with the problem of overlapping classes, since state class actions brought by attorney generals overlapped the national class action. Judge Decker assumed that class members situated in a given state would prefer to be represented by the attorney general of that jurisdiction. He there-

fore decided that notice in the national class action would not be sent to any named plaintiffs nor to any members of other class actions. However, such members were left free to notify the court if they desired to be included in the national class. See also Minnesota v. United States Steel Corp., 44 F.R.D. 559, 576 (D. Minn., 1968).

That option is significant because a state class action may have been instituted after the expiration of the statute of limitations. To the extent that the national class action, filed before the statute ran, is held to toll the statute, intervention in that action would save such a state from the bar of the statute.

Another interesting aspect of class actions arose in the cases before Judge Decker as a result of settlements negotiated by defendants. Some states originally filed class actions, then, perhaps discouraged by Judge Kraft's decision, amended to drop their class action allegations. Thereafter they negotiated settlements, claiming that they had settled for all their political subdivisions, which their attorney generals canvassed for their purchases. The defendants asked the Court to exclude from the list of those to be sent notice in the national class all schools and libraries in the settling states regardless of the fact that they no longer had class actions.

Judge Decker properly held that such a procedure would deny members of the national class their right to receive notice from the Court under Rule 23, and would subvert the requirements as well as the reasons for the Rule. He also said that it would emasculate the Rule.

I have mentioned the tolling effect of a class action on the statute of limitations. If a class action is sustained, class members whose claims are asserted after the statute has run, have the benefit of the filing date of the class action. This was true is spurious class actions under the old Rule. Union Carbide & Carbon Corp. v. Nisley, 300 F.2d 561 (10th Cir.), appeal dismissed Sub nom. Wade v. Union Carbide & Carbon Corp., 371 U.S. 801 (1963); Escott v. Barchris Construction Corp., 340 F.2d 731 (2d Cir. 1965), cert, denied 382 U.S. 816 (1965), Foster v. City of Detroit, 405 F.2d 138 (6th Cir. 1968). It has been held to be true, a fortiori, under the new Rule, since class members who do not opt out are bound by the judgment either way, eliminating the unfairness of one-way intervention. Green v. Wolf Corp., supra; Esplin v. Hirschi, supra; Minnesota v. United States Steel Corporation, 44 F.R.D. 559 (D. Minn., 1968); Philadelphia Electric Co. v. Anaconda American Brass Co. 43 R.F.D. 452 (E.D. Pa. 1968). In the brass mill tube and pipe cases tolling the statute saved $90,000,000 in purchases, now settled at about 18%.

Assuming that the Court decides that an action may be maintained as a class action, with the result that the statute of limitations is tolled, is there a cut-off which can be placed on the right of class members to participate in any recovery?

Judge Fullam in the brass mill tube and pipe cases decided that class members who did not exercise their election to be excluded should be required to file by a cut-off date a statement of their intention to prove a claim for damages with an estimate of purchases, or be forever barred from recovery. The reason for requiring such a statement is that class members by making no response at all to the notice become part of the action and bound by the judgment. The Court and the original parties have no way of knowing whether they intend to make claims or not, unless some affirmative statement is required. If they do know, it is easier to settle.

Judge Neville, in the structural steel cases, required a verified proof of claim. Minnesota v. United States Steel Corp., supra. The notice approved by Judge Decker in the Harper & Row cases requires less than Judge Fullam's statement of intention with its estimate of purchases under penalty of being barred. It requests class members to check whether or not they wish to participate in the class action, and, if they do, to state that when requested they will furnish a list of purchases. But no bar is provided, at least initially, for failure to respond at all. State of Illinois v. Harper & Row Publishers, Inc., and related cases, supra, Order of June 2, 1969.

Under the old Rule, in spurious class actions, some courts established cut-off dates prior to trial barring potential class members from intervention thereafter. See e.g. City of Philadelphia v. Morton Salt Co., 385 F.2d 122 (3d Cir. 1967). Of course, they were free to file their own suits, but the statute of limitations might have run.

Certainly under the new Rule at some stage of the litigation class members who want to share in any recovery must come forward and prove their claims.

Rule 23 in giving them the right to appear by counsel does not impose any requirement that they actually intervene as formal parties. Those who do not opt out on receipt of a notice are bound, whether they intervene formally or not. If they do intervene they apparently assume the obligations of parties at that time, and may be required to answer interrogatories. Postponing intervention to gain more time for assembling transaction data or to await developments in discovery which may make it easier to evaluate a claim, may have some risk. Formal intervention before the statute of limitations runs protects against the bar of the statute. Reliance on a class action may be misplaced if the class action is not allowed to be maintained as such or a class action finding is set aside.

If the class action is dismissed, for example, because common questions do not predominate, Judge Fullam has held that:

". . . it would seem reasonable to conclude that such negative determination also relates back to the filing of the complaint. If there never really was a class to be represented, members of the purported class can scarcely be heard to claim that they started suit, vicariously, before the limitations period expired." Philadelphia Electric Co. v. Anaconda American Brass Co., supra.

On the other hand, he said:

"But if the reason for the negative determination stems from a weighing of various considerations of judicial housekeeping, it may well be that the decision should not relate back to the commencement of the action and that at the very least, an opportunity should be presented for proof of reliance upon the pendency of the purported class action sufficient to toll the statute of limitations."

I have no time to cover the antibiotics cases, except to say that the use of the class action device to bring about national settlements covering all sorts of potential claimants shows great imagination on the part of counsel on both sides. Those cases are said to be sui generis, a Latin phrase meaning that if a large enough class sues, the settlement is bound to be generous. The next speaker, Lee Freeman, knows as much about them as anybody.

The antibiotics cases include claims of some states of the right to sue on behalf of all their consumers of antibiotics on a parens patriae theory. That was consented to as part of the settlement and so was not a litigated issue. The issue was recently decided by Judge Pence in State of Hawaii v. Standard Oil Co., (D. Hawaii) Civil Action No. 2826. He held that a state may not recover treble damages on a parens patriae theory for damages sustained by individual consumers, but may sue in appropriate circumstances in that capacity for injury to the economy of the state as a whole. He allowed an interlocutory appeal, for which application is now pending in the Ninth Circuit. The issue is also being litigated in the plumbing fixtures cases, all of which have been transferred to the Eastern District of Pennsylvania under 28 USC § 1407.

Lest counsel for defendants in the mutual fund case leave with the impression that defendant classes are not being allowed this year, one was sustained in Research Corp. v. Pfister Associated Growers, Inc., ATRR no. 415, 6/17/69, at A–5 (N.D. Ill. 1969).

Finally there is at last a decision holding a class action judgment binding in a subsequent suit. In Wren v. Smith, 410 F.2d 390 (5th Cir. 1969) some prisoners in the Georgia State penitentiary sued "pro se" to enjoin desegregation of the prisoner facilities. Integration had been ordered in a class action by a three judge court in Wilson v. Kelley, 294 F.Supp. 1005 (N.D. Ga. 1968). The Fifth Circuit held the pro se plaintiffs barred by the 23(b)(1) decision in the class action. Since it was not a 23(c) class action, I doubt whether they had been given any privilege of opting out. The Wilson case also sustained a defendant class.

THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS,
1922 F Street NW., Washington, D.C., April 9, 1970.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee, Committee on Commerce, U.S. Senate, Old Senate Office Building, Washington, D.C.

DEAR SENATOR MOSS: The National Association of Life Underwriters (NALU) would like to submit the following comments for inclusion in the record of the hearings on S. 3201, the proposed Consumer Protection Act. For the information of your Committee, NALU is a trade association of 950 state and local associations across the country, with a total individual membership of more than 100,000 life insurance agents.

Our concern is that Section 201 of the bill includes insurance, thus giving the Federal Government the power to proceed against insurers in the federal courts in cases of alleged unfair or deceptive acts or practices.

The aims and purposes of S. 3201 are laudable, and certainly no industry can claim freedom to engage in the practices at which the bill is aimed while government stands by, looking on, powerless to protect the people.

It is precisely because insurance does not occupy such a position that we suggest that S. 3201 should not encompass insurance. Insofar as the bill would protect the insurance-buying public, it would be duplicative and unnecessary, since each of the 50 states has already developed an effective regulatory framework which governs the insurance business in general, and the acts and practices which would be reached by S. 3201 in particular. Each of the states has enacted an unfair trade practices act which, in substantial effect, S. 3201 would only overlap as far as insurance is concerned.

In reviewing the testimony heard by your Committee relating to the insurance business, NALU has found especially persuasive that of Richards D. Barger, Insurance Commissioner of the State of California, on behalf of the National Association of Insurance Commissioners on March 19. Commissioner Barger has outlined for the Committee the function of state insurance regulation as regards the matters with which S. 3201 is concerned, and has provided valuable insight into the practical effect of state insurance regulation on the consumer and the seller. We endorse his testimony wholeheartedly.

NALU believes that to the extent S. 3201 might displace or duplicate state regulation of the insurance industry, the consumer would not gain any protection that he does not now have. In other words, it is not necessary to include insurance in the bill. Therefore, NALU would urge that Section 201(f), as it relates to insurance services, be amended to exclude insurance.

Very truly yours,

JOHN P. MEEHAN,
Chairman, Committee on Federal Law and Legislation.

STATEMENT OF THE NATIONAL CONSUMERS LEAGUE

The National Consumers League appreciates this opportunity to submit testimony on S. 3201, the Administration's Consumer Protection Act and S. 3092, Sen. Tydings' Class Action Bill, and S. 2246, Sen. Moss' Bill.

For over 70 years the League has been an active advocate of strengthened consumer protection, supporting legislation to improve protection against unfair practices in the marketplace. At present the Federal Trade Commission, the government agency which should be protecting the consumer is severely hampered by lack of injunctive powers. The League favors legislation which would allow the FTC to seek temporary injunctions or restraining orders in the courts, since the extensive damage suffered by consumers during the long periods which elapse while the FTC seeks to stop the unfair and deceptive practices can be most harmful. While the 29 years it took for the Holland Furnace case may be an isolated instance, there are many cases which have taken up to 10 years, during which time the gouging of American consumers continued. Legislation which would give the Federal Trade Commission a tool to stop the practices much sooner, while not depriving industry of its right to court action, would enable the FTC to protect the consumer much more effectively than is possible today. Moreover, by broadening the FTC's jurisdiction to activities "affecting commerce" consumers would be protected against deceptive practices local in nature but having an effect on interstate commerce. The League therefore supports S. 2246.

As for the bills before you dealing with class action suits, the National Consumers League believes that S. 3092 will be much more effective in protecting the consumer against unfair business practices since it does not include the unnecessary restriction of needing to wait for successful government action as provided for in S. 3201 and does not limit its coverage to only certain frauds.

The mere threat of private suits could be the strongest deterrent against fraud and deception in the market place. Legislation which gives a cheated consumer the legal right to get a judgment against a company is not enough, since the cost of obtaining such a judgment for a small claim is too high to justify the pursuit. These suits are so expensive that individual consumers rarely find it feasible to sue when they have been cheated out of a hundred dollars or less, and lawyers are not eager to spend time on cases involving such limited amounts. By consolidating numerous claims of consumers who have been injured by the same practice, court action becomes economically feasible. The aggregate claim is generally large enough to attract competent counsel, and an effective weapon

against fraud is brought within the reach of all consumers. Only by consumer class action can the inability of individual consumers to obtain justice in the market place be compensated for.

In giving consumers this new right, I feel that we should not hold up high hopes which then turn out to be one more big disappointment. Unfortunately S. 3201 would prove to be just that kind of a disappointment to the consumer. It sets up a huge obstacle to his right of court action—government bureaucracy. By making it necessary for the defrauded customer to await successful government action by the Federal Trade Commission or the Dept. of Justice, we are practically discouraging any action on his part. The slow processes of the government agency would inevitably delay and add one more major frustration to the injured party. If he must, as S. 3201 states wait upon "the successful termination of a government suit" this law will do little to restore an era of justice for the consumer.

We are anxious to see the climate improved, not eroded further. S. 3201, rather than helping, may create new injustices by bringing politics into the picture. Who will decide which cases take priority? Why should the agencies rather than the injured party determine which consumers are given full and effective protection, and which are denied this right? Why limit the kinds of fraud? Fraud is fraud, and a consumer who has been bilked by a referral sales scheme is entitled to as much redress as if he had been bilked in the same amount by the representation of used commodities as new. S. 3201 covers only 11 categories of fraud. Many types of frauds not mentioned in the bill readily come to mind, e.g. referral sales schemes; excessively priced credit life insurance contracts; "missing heir" schemes; and breach of contracts. There are probably many other oversights. It is difficult to anticipate all acts of fraud. If we are readying a war on fraud, let it then be a total war.

Actually many states now have consumer protection laws which cover areas beyond the 11 mentioned in the Administration's Bill. S. 3092, Sen. Tydings' Bill would allow suits to be brought for violations of these State Consumer Protection laws in the Federal Courts. It also places no limitation on domicile of the parties. S. 3092 has still another legislative advantage. It clearly waives the $10,000 jurisdictional amount that now bars many smaller claims from the Federal Courts.

The League believes that an effective Class Action Bill will have far-reaching effects in restoring a healthy climate to the market place in the decade of the Seventies. It will provide a meaningful tool for effective consumer protection and for protection of the ethical businessman as well, in its deterrent effect on market place deception.

We are not alarmed at the notion that S. 3092 would flood the already busy Federal Courts. It is most unlikely that record numbers of consumers would be undertaking such action. And since the laws are there to protect consumers, there will be less of a strain on the courts by class suits than if consumers were forced to sue individually. We believe that the legalizing of effective class action would itself act as a deterrent to the market practices which are the basis for such action.

The National Consumers League, therefore wishes to go on record in favor of an effective Class Action Bill. We heartily endorse Sen. Tydings' Bill, S. 3092, and respectfully urge the Committee to act promptly and affirmatively on this legislation.

STATEMENT OF PAUL B. COMSTOCK, GENERAL COUNSEL, NATIONAL ASSOCIATION OF BROADCASTERS

The National Association of Broadcasters, with headquarters at 1771 N Street, N.W., Washington, D.C., is a non-profit organization of radio and television stations whose membership includes 2,237 AM stations, 1,133 FM stations, 553 television stations, and all of the national radio and television networks.

S. 3201, S. 3092 and S. 2246 were introduced to provide consumers greater protection through a strengthened Federal Trade Commission and federal judicial remedies. While the NAB supports wholeheartedly the concept of truthful advertising and adequate measures to protect the public from deception, it recomends that basic principles of due process and equity be preserved and that judicial process be directed only against those who willfully and knowingly deceive.

The broadcasters' commitment to the public interest in truthful advertising is expressed in the Radio Code and the Television Code of NAB. Section IX, paragraph 2 of the General Advertising Standards of the Television Code provides as follows:

"A commercial television broadcast makes his facilities available for the advertising of products and services and accepts commercial presentations for such advertising.

However, a television broadcaster should, in recognition of his responsibility to the public, refuse the facilities of his station to an advertiser where he has good reason to doubt the integrity of the advertiser, the truth of the advertising representations, or the compliance of the advertiser with the spirit and purpose of all applicable legal requirements."

A similar provision exists in the Radio Code (II. Advertising Standards, A. General Advertising Standards, 1.) Copies of these Codes are submitted for the records of the Subcommittee.

Additionally, there are numerous specific prohibitions against deceptive actions such as "bait and switch" advertising.

Beyond these measures, the Code Authority utilizes, as necessary, the technical expertise of specialists in a variety of fields—medicine, dentistry, engineering, to name just a few—to ascertain the legitimacy of claims, and test results and statements beyond the lay person's range of knowledge.

These voluntary measures are not recent reactions to the current interest in protection of the consumer, but reflect years of on-going concern with the problems of advertising.

In defining unfair or deceptive acts or practices S. 3201 in Section 201 wisely indicates that knowledge is an essential element to liability. We would recommend, however, that the legislative history of the bill make it clear that no party should be subjected to suits or actions for damages unless he has actual and not just presumptive knowledge of the deception. It should be made equally clear that the legislation is directed toward the "supplier" of goods or services rather than the advertising media who do not have actual knowledge of the deception.

Clearly the purpose of this type of legislation is to prevent unethical advertising from being offered to deceive the consumer and to grant him redress for any harm incurred. But the medium of delivery, whether radio, television or print, should be held to be accountable *only* if its reliance on the accuracy of advertising copy furnished was not in good faith justified.

The public would not be served if mere opportunists were permitted to use the proposed legislation to attack innocent third parties. One could foresee a great potential for mischief on the part of those who are disgruntled by the news or editorial content of the media and surely it is not the intent of the Congress to open the door to such abuse.

With regard to the issue of granting the FTC authority to seek preliminary injunctions, NAB believes that certain additional safeguards, such as the need for the FTC to issue a complaint before seeking an injunction, appear desirable measures to guarantee the traditional rights of due process and equity. The legislation should be amended to incorporate safeguards.

Temporary restraining orders should be subject to similar safeguards. Such temporary restraining orders are a form of emergency equitable relief and they can be more easily obtained than injunctions under circumstances not requiring notification to and response from the defendants. These are drastic remedies requiring the exercise of great care to preserve traditional guarantees of due process. Irreparable injury could result if an advertisement or indeed a whole campaign in which timeliness might be an essential factor were halted just long enough to destroy its value. It would be a travesty if the advertising were then found to be acceptable and the restraining order improvidently granted.

The purpose of all legislation of the kind under consideration here is to serve the public interest. Protection of consumers is an important part of that purpose. So, too, are guarantees of due process, protection of the innocent and fostering of truthful, competitive advertising in media free of unnecessary restraints. NAB believes that diligent enforcement of the law and proper support of existing agencies including the Federal Trade Commission, the Department of Justice and the Consumer Affairs Office will prevent abuses. Encouragement of industry self-regulatory efforts will further enhance the quality of all advertising and, more importantly, the quality of service that the news media render to the public.

Statement of the Farm and Industrial Equipment Institute

The Farm and Industrial Equipment Institute (FIEI) submits the following comments with respect to the various proposals for consumer class action legis-

lation (S. 3092, H.R. 14585, S. 3201, H.R. 14931) now pending before both Houses of Congress.

The FIEI is an industry association of agricultural and power equipment manufacturers whose 240 active member companies make more than 90% of all farm and industrial equipment manufactured in the United States. Customers of member companies are generally farmers and contractors buying equipment for use in their businesses.

The FIEI urges that a law which invites massive class action lawsuits based on largely undefined standards of "fairness" to purchasers should not be enacted. We do not doubt that existing procedures for assuring fair treatment of consumers need to be strengthened. Some method for providing more practical and realistic legal recourse for consumers with legitimate complaints is a worthwhile goal. But for reasons set out below, we feel strongly that class actions are not the answer, at least not in their present state of development.

Class action suits are relatively new and untested procedurally. Their history has been one of infrequent use in state and federal courts. Federal Rule 23 is a very broad rule which in practice is still in an embryonic stage of development. It provides no direction at all with respect to how many difficult procedural aspects of class suits are to be handled. In each suit brought under Rule 23 the courts continue to face unique and increasingly complex problems, many of which remain in need of resolution.

Allowing consumer access to the class action against this background of unresolved confusion would be irresponsible. The numbers of persons involved in such consumer suits will not only compound existing problems but present new ones of gigantic magnitude. Matters otherwise easily handled in administering a lawsuit of lesser proportion will involve procedural complexities never before encountered.

Until further refinement of class actions is accomplished the procedure is highly susceptible to abuse. In its present state of development fee oriented plaintiffs' attorneys will be openly encouraged to file sham consumer class actions for the sole purpose of forcing settlements and thereby generating substantial legal fees. While years hence these suits might be proven non-meritorious if allowed to proceed the full course of litigation, each would involve a certain nuisance value which the corporate defendant could be forced to agree to as an alternative to costly and protracted litigation of unpredictable results. At present the procedure has not evolved to that degree of refinement whereby such inequities are foreclosed from occurring. Any bill reported must contain adequate safeguards against these results. Preferably, the FIEI urges restraint in opening the door to consumer class actions until all of these problems can be carefully analyzed and resolved.

The FIEI strongly opposes any federal legislation granting consumers private substantive rights unless the conduct proscribed is clearly and unambiguously defined. It is only fair and right that the businessman be given notice of what type of conduct he will be held responsible for in the marketplace. This is especially critical when the businessman faces the possibility of massive liability of the type envisioned in class action litigation.

A general standard of "unfair or deceptive acts or practices" does not afford the businessman sufficient notice. Nor is a list of broadly stated prohibited practices satisfactory. A broad, loosely phrased standard of conduct may be acceptable when administered by an agency which brings a degree of expertise to bear on the problem, but should not be administered by the courts generally. The court is not sufficiently expert in all cases to judge whether particular business conduct is acceptable and should not be allowed the unbridled opportunity to exercise an uninformed discretion. Moreover, when an agency determines that such a standard has been violated this usually results in only a general prohibition against future occurrences of the same or similar conduct. This is quite different from the situation which would exist in a consumer class action where the court could find the defendant liable for sizable money damages on a finding of a violation of the standard after the conduct has ceased.

The FIEI submits that premature extension of the class action mechanism to consumers will be detrimental not only to business but to consumers as well. We urge Congress to give this matter very careful attention.

RUBBER MANUFACTURERS ASSOCIATION,
1346 Connecticut Avenue NW., Washington, D.C.
April 24, 1970.

HON. FRANK MOSS,
Chairman, Consumer Subcommittee, Committee on Commerce, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In behalf of its member companies, the Rubber Manufacturers Association submits this statement for the record of hearings held by your subcommittee on S. 3092 and S. 3201, proposed measures that would authorize "class action suits" and other legislative remedies as means of redressing alleged consumer abuses.

The basic thrust of both S. 3092 and S. 3201 and their House companion proposals, H.R. 14585 and H.R 14931, is that consumer abuses in the United States do exist to the degree and in such frequency that class action suits are necessary as a remedial device. Indeed, the language of S. 3092 states that class actions are "the most effective machinery" for redress of consumer wrongs.

It is highly questionable whether class actions would in fact provide such an effective avenue of redress. Most observers agree that the vast majority of consumer abuses that may exist results from unethical practices of the "fly-by-night" type of business operation which preys upon unknowing consumers. The limited size of such businesses, the lack of a long-standing geographical base of business operations and the minimal loss of corporate image or goodwill that might result from successful class actions against such a business would seem to preclude the likelihood that class actions would ever be used against such firms.

Conversely, large corporations that are interstate in nature, with their sizeable financial resources and corporate reputation to protect, would be attractive targets for those who might use class actions imprudently. The injustice of a class action brought under such circumstances would be compounded by the adverse publicity that a large corporation would suffer.

The nature of consumer problems was underscored by the statement of Mrs. Virginia Knauer, Special Assistant to the President, before the House Commerce Subcommittee on Commerce and Finance on February 17, 1970. She indicated that the greatest source of consumer complaints over the past two years has been in the area of appliance repairs, fraudulent home improvements and repairs, magazine subscription sales, and fraudulent sales of new and used cars. This does not suggest that all business concerns engaged in the sale of the products are operating beyond the confines of law; it merely delineates the types of business transactions where consumer abuse most commonly exists.

In recognition of the limited nature of the commercial areas in which consumer abuse appears to exist in great degree, it is somewhat anamolous that both S. 3092 and S. 3201 would provide initiative to consumers to initiate class actions against large interstate businesses which have the highest settlement potential, but which may have a low incidence of consumer abuse problems. This fact, coupled with statutory provision for the amount of attorneys' fees in S. 3092, would seem to make such businesses particularly vulnerable's to frivolous suits.

Prominent business organizations such as the Chamber of Commerce of the United States and the National Association of Manufacturers have pointed out that a far more effective remedy of consumer abuses might be realized by granting the Federal Trade Commission expanded power to address itself to such problems.

Specifically, the suggestion has been offered to the Subcommittee on Consumers that:

The Federal Trade Commission should be granted the authority to involve itself in acts that "affect" interstate commerce, as well as those that are actually "in" interstate commerce. Such an expansion of authority would allow the FTC to institute actions against the types of businesses that are the actual source of many consumer problems.

The Federal Trade Commission should be granted the authority to seek injunctions in appropriate Federal courts to halt frauds and deceptions. The use of this authority, however, should be only a "proper showing of need" and subject to equitable principles and safeguards of the rights of legitimate business. Moreover, this recommendation does not suggest that the FTC should be given the authority to issue temporary restraining orders under its own initiative.

Such an expansion of the Federal Trade Commission's realm of authority, coupled with a reorganization of the Commission to maximize its effectiveness as

a consumer protection arm of the Federal government, would appear to be realistic alternatives to class actions.

Accordingly, the Rubber Manufacturers Association associates itself with the position that the goals of S.3092 and S.3201—integrity in the American marketplace and control of consumer abuse—can be realized with the least degree of burden on legitimate business by statutory expansion of the authority of the Federal Trade Commission as is suggested above. Such action, in concert with vigorous enforcement of existing consumer protection statutes, should insure ample protection for the rights of American consumers.

Sincerely yours,

W. J. SEARS,
Vice President.

JANUARY 29, 1970.

Mr. JAMES T. LYNN,
General Counsel, Department of Commerce,
Washington, D.C.

DEAR MR. LYNN: In reviewing your testimony before the Consumer Subcommittee of the Senate Committee on Commerce with respect to S. 3074,[1] the Consumer Products Guaranty Act, I have become concerned that some confusion may have been created with respect to the obtaining of preliminary injunctions by the Federal Trade Commission under present law.

At pages 88 and 89 of the transcript of the January 20th hearing on that bill, Mr. Sutcliffe inquired of you whether as a lawyer you could go to a court on behalf of the Federal Trade Commission *tomorrow* and seek a preliminary injunction against a manufacturer selling his product with a 36 month guaranty based upon test information showing that the product had a normal life expectancy of 18 months.

This presumably was intended to refer to the powers of the FTC under existing law. The previous question had been directed to the powers of the FTC after passage of the Administration's initiated Consumer Protection Act (S. 3201), which would specifically grant the FTC the power to seek preliminary injunctions. As a result, the transcript is unclear as to whether your response to the effect that the Commission might be able to do so is directed to the powers of the FTC under existing law or subsequent to passage of amendments thereto as recommended by the Administration.

For clarification of the record, I submit to you the following question so that your views on this important subject will not be subject to misunderstanding:

"Mr. Lynn, is it your view that under existing law the Federal Trade Commission is empowered to seek preliminary injunctions in connection with proceedings before it other than in those areas (identified in the report of the ABA Commission to Study the Federal Trade Commission, dated September 15, 1969) in which it has been expressly given the statutory authority to do so."

Your reply to the above question will be appreciated so that it, together with this letter, may be incorporated into the record of these proceedings.

Yours sincerely,

NORRIS COTTON,
U.S. Senator.

GENERAL COUNSEL OF THE DEPARTMENT OF COMMERCE,
Washington, D.C., March 17, 1970.

Hon. NORRIS COTTON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR COTTON: This is in response to your letter of January 31, 1970, and to the following question that you posed to me:

"Mr. Lynn, is it your view that under existing law the Federal Trade Commission is empowered to seek preliminary injunction in connection with proceedings before it other than in those areas (identified in the report of the ABA Commission to study the Federal Trade Commission, dated September 15, 1969) in which it has been expressly given the statutory authority to do so?"

I cannot claim any special expertise in this area of the law. However, it is my impression that most commentators doubt that any such general injunctive power exists.

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[1] See Committee on Commerce hearing Serial No. 91–52.

In *FTC* v. *Dean Foods*, 384 U.S. 597 (1966), the Supreme Court, on the facts presented, held that the Federal Trade Commission could obtain a preliminary injunction to restrain a merger that allegedly violated Section 7 of the Clayton Act and Section 5 of the Federal Trade Commisison Act. However, it is my understanding that notwithstanding *Dean Foods*, there is widespread doubt in the legal community as to whether the FTC has the power to obtain preliminary injunctions generally.

I think that the Commission itself has similar doubts as evidenced by its support for legislative action that would expressly confer this power. While it is possible, as the ABA Commission has recognized (p. 63n. 97a), to read the *Dean Foods* case broadly and conclude that a general preliminary injunction power exists, I understand that the courts have not gone that far.

Sincerely yours,

JAMES T. LYNN.

INSURANCE AND THE CLASS ACTION: THE EMERGENCE OF COUNTERVAILING POLICYHOLDER POWER

(By Herbert S. Denenberg, Loman Professor, Wharton School of Finance and Commerce, University of Pennsylvania)

The class action is already beginning to work miracles for the consumer. It has been or is being used—

to protect the purchasers of antibiotics from overcharges resulting from anti-trust violations;

to protect purchasers of season tickets to professional football games from being required to buy tickets to exhibition games as well;

to protect the public from damages arising out of pollution;

to protect the buyers of pick-up trucks from losses due to the negligent design, manufacture, and inspection of wheels and other component parts;

to protect credit insurance policyholders from losing dividends which they are entitled to;

To protect workmen's compensation claimants from losing interest due on their awards;

to protect mutual policyholders as well as all kinds of stockholders against loss from negligence or dishonestry of boards of directors or other management.

The class action has even been used by prisoners to stop brutality and, in another Southern prison, to end racial segregation. (As far as I know, it has not been used to set anyone free).

It has been touted as the answer to the problems of everyone, including the silent majority. The silent majority is silently saying:

The very poor are being accorded all sorts of special protection and help; the very rich have always had the money and power to get the help they need. We're caught in between, without the special protection of either group.

The class action is in the wings, ready to come to the aid of the now deprived middle class. The class action can even be viewed as providing special protection to the ghetto resident. He now has access to legal help, but only through legal aid services, which may not always be willing or able to provide the legal help he needs. The class action will give the ghetto resident (or any other member of those encompassed by a class action) an entree to the best of legal services, as a matter of right, without the taint of charity and public assistance that affects legal aid and related programs.

Consumerism has already brought the class action into our everyday vocabulary. The class action enables consumers or other groups, with similar claims, to assert their rights together in one lawsuit. One or more members of the class represent the entire group. The court has discretion to define the classes and to insist on procedures to protect their rights.

There are arguments against the class action, but they are not persuasive. Sometimes the arguments must even evoke amusement, when the source is considered. Consumer advocates seem to be uniformly enthusiastic about the class action, but the opponents of the class action, such as the Association of Home Appliance Manufacturers, have argued that "class suits are neither swift nor effective instruments for redressing consumer wrongs." Like other opponents, the Association prefers to place responsibility for protecting the consumer in the

Federal Trade Commission. It is not only amusing but heart-warming to hear the opponents of the class action describe how best to protect the consumer.

It is also argued that the class action is slow. But *no* remedy at all is slower still. It is argued that the class action will consume the time of the courts and cause further judicial congestion. But the class action is the most efficient method of adjudicating a multiplicity of small claims. In fact, it is the only practicable method to do so. It is argued that the class action is the wrong remedy, as we should concentrate on preventing wrongdoing in the first place. But the threat of a class action has a great therapeutic effect. Today, the corporate wrongdoer can often proceed with immunity from effective consumer action. The class action will give him pause to consider. Other arguments could be considered, and rebutted with equal ease and facility.

The class action, for better or worse, is clearly the wave of the future. It has already made its mark on insurance, perhaps more than any other industry. The class action of the mutual policyholder has a long history, and products liability cases have given liability insurers some experience with this consumer remedy. Currently, credit life insurers are involved in a class action to recover dividends paid to the group policyholder, rather than the individual debtor, and compensation insurers are on the receiving end of an action to recover interest on compensation awards for the time elapsing between award and payment.

The future will undoubtedly see more products liability litigation involving the class action. Many confidently predict that products liability litigation will soon surpass automobile insurance litigation in volume. This prospect is sending chills down the backs of many manufacturers, and the spector of the class action on behalf of all affected consumers is even more chilling.

Insurers are also involved in the defense of class actions by virtue of their experience in writing directors and officers liability insurance. The liability of directors and officers, covered by these policies, may arise by virtue of a class action (i.e. for the benefit of all stockholders) or by virtue of a derivative action (for the benefit of the corporation). Directors and officers insurance is now perhaps the most "over-advertised" but "undersold" line in the property-liability portfolio. Companies have infinitely more enthusiasm for presenting the coverage in grandiose advertisements than for actually selling it. But directors and officers liability and related insurance, however, is likely to assume increasing importance in the years ahead.

The policyholder and stockholder bringing class actions against alleged corporate wrongdoers is likely to be an event of increasing frequency. Opportunists, reformers, and activists are likely to perceive the class action as a powerful tool to achieve their objectives and to right real or imagined corporate wrongs. This kind of activity closely relates to new-founded attempts to mobilize proxies to achieve specified social purposes.

The consumer class action may also soon become an important supplement to the insurance regulatory process. The regulator often lacks the resources to handle the individual complaints submitted to him. The class action will shift some of this burden to the private attorney prosecuting the class action. The class action can thus be viewed as an application of competition and free enterprise: *Competition* because the regulator will compete with the class action to best serve the public interest; *Free enterprise* as the class action will transfer the work of the government lawyer to the private practitioner, one of our last great bastions of free enterprise.

The class action will also contribute needed countervailing power to the insurance regulatory area. For it will permit the growth of a consumer bar. Under the class action the attorney is paid for his services to the class, and fees can be astronomical. Lawyers like other people, noble and ignoble, are where the money is. Like General Motors or the insurance industry, the consumer is going to have to find a way to pay lawyers handsomely, if the best of legal talent is to be obtained. The class action will help provide a way.

When there is money to be found in representing consumers, a new breed of consumer lawyers will appear. They will not only be able to fight the judicial battles of the consumer, but also the legislative battles. The consumer effort in legislative matters involving insurance is now nil, and this failure has contributed to an insurance law which often protects the consumer last, if at all.

Power may corrupt absolutely or partially, but corrupt it must. The answers of our system are checks and balances; federalism and the decentralization it implies; and an assorted arsenal of countervailing power. The consumer class action is about to become a crucial building block in our growing edifice of countervailing power.

STATEMENT OF JOSEPH M. BELTH

I am Joseph M. Belth, professor of insurance, Graduate School of Business, Indiana University, Bloomington, Indiana. I am author of *The Retail Price Structure in American Life Insurance* and various other studies in the area of life insurance price measurement.

This statement was prepared at the request of Chairman Moss. I am not being compensated for its preparation. The views expressed in the statement are my own and not necessarily those of any institution, organization, or other individual.

I. INTRODUCTION

Life insurance contracts generally are long-term financial instruments that perform useful functions in our society. In my opinion, however, the sales and advertising practices of life insurance companies sometimes are deceptive. The purpose of this statement is to examine one fundamental characteristic of life insurance—the critical importance of the interest factor—that is the basis for a variety of questionable practices. Included in the statement are several illustrations of these practices.

II. BACKGROUND

Except at very young ages, the likelihood of death increases as age increases, and with increasing rapidity. Life insurance sometimes is written on a one-year renewable term basis, with premiums increasing in a manner designed to offset the increasing likelihood of death. Under such an arrangement, however, the insurance company experiences a phenomenon called "adverse selection," in which policyholders with deteriorating health tend to renew their policies and policyholders in good health tend to discontinue their policies. This adverse selection leads to a deterioration in the "quality" of the group, and to a larger than anticipated number of death claims relative to premium payments. An attempt to anticipate the adverse selection by more rapid premium increases tends to aggravate rather than solve the problem.

Level-premium life insurance, under which the premium remains constant, is a technique adopted by the life insurance industry in an attempt to minimize adverse selection and at the same time make it financially feasible for policyholders to continue their protection even to advanced ages. Such an arrangement, however, requires that the policyholder be overcharged (relative to mortality costs, expenses, and profit) in the early policy years to offset the inadequacy of premiums in the later policy years. The level-premium arrangement and the legislation requiring cash surrender values make life insurance companies major financial institutions and transform what would otherwise be an insurance transaction into a combination or package transaction involving both insurance protection and a savings medium.

Because of the package aspect of cash-value life insurance contracts, it is necessary to distinguish between the "premium" for the contract and the "price" of the protection element of the contract. To compute the price of the protection element, it is necessary to separate the protection element of the policy from the savings element, at least in a theoretical sense. Since the separation involves the making of assumptions, no single price figure can be established as *the* price; rather, any price figure must be accompanied by a statement concerning the assumptions used in computing that figure.

The nature of a life insurance price figure may be illustrated by an analogy. Assume that an individual is purchasing a package AB that consists of an item A and an item B. When only the price of the package AB is given, no single figure can be established as the price of either A or B alone. To caculate the price of A, it is necessary to make an assumption about the price of B, and vice versa. Thus, any figure established as the price of A must be accompanied by a statement about the assumed price of B, and vice versa.

In life insurance, the two parts of the package are protection and savings, and any figure established as the price of the protection must be accompanied by a statement about the assumed rate of return on the savings element. Conversely, it is possible to make a statement about the rate of return on the savings element only if an assumption is made the rate of return on the savings element only if an assumption is made about the price of the protection. In short, the price of protection and the rate of return on the savings element are two sides of the same coin—either can be used to make comparisons among policies.

III. AN ANALOGY

The complexity of life insurance is a major barrier to an understanding of the full implications of the sales and advertising techniques illustrated later in this statement. As a preliminary step, therefore, I have developed a simple analogy that strips away the protection element and illustrates the fundamental problem.

Assume that an individual puts $1,000 per year into a savings account, and that the account is credited annually with 5 percent interest. The growth of the account over a period of ten years is shown in the accompanying table, with the figures rounded to the nearest dollar.

GROWTH OF $1,000 PER YEAR AT 5-PERCENT INTEREST

Year	Deposit at beginning of year	Interest credited for year	Amount in account at end of year
1	$1,000	$50	$1,050
2	1,000	103	2,153
3	1,000	158	3,310
4	1,000	216	4,526
5	1,000	276	5,802
6	1,000	340	7,142
7	1,000	407	8,549
8	1,000	477	10,027
9	1,000	551	11,578
10	1,000	629	13,207

Consider the tenth year. The saver starts the year with $11,578 and add $1,000 to it. At the end of the year, his account is credited with interest of $629 (5 percent of $12,578), making his account $13,207 at the end of the year.

Of the $629 interest in the tenth year, $50 is attributable to the tenth year's deposit of $1,000, and the other $579 is attributable to the previous deposits made during the first nine years. *In my opinion, it is deceptive to state, suggest, or imply that the $629 of interest in the tenth year is attributable in its entirety to the tenth year deposit of $1,000.* In other words, the rate of return here is 5 percent, and I regard as deceptive any presentation that states, suggests, or implies that the saver is earning 62.9 percent interest on his tenth year deposit of $1,000. This form of deception is the basic characteristic of each of the illustrations in the remainder of this statement.

IV. ILLUSTRATIONS

The Harris Article

In the February 1970 issue of *Life Insurance Selling* magazine, there is an article by Richard F. Harris, Jr., entitled "I Tell Corporations, 'Put the Difference in Permanent.' " The article is reproduced in Appendix A.

In this article, $989 per year is the difference between a decreasing term premium and a straight life premium. Mr. Harris attributes the full amount of the cash value increase in any given year to the $989 difference paid in that year. For example, in the tenth year, he shows an "annual increase in assets" of $1,427. He attributes that increase to the $989 difference paid in the tenth year, and then he shows the "annual % tax free profit" that year as 44.3 percent.

The cash surrender value of the straight life policy at the end of thirty years is $45,134. Implicit in the relationship between a $989 annual deposit and an accumulation of $45,134 at the end of thirty years is an annual interest rate of about 2.6 percent. If an adjustment were made for the different amounts of protection under the decreasing term policy and the straight life policy, the implicit annual interest rate would be about 3.8 percent. Such rate of return figures are not mentioned in the Harris article. Instead, after a negative figure in the first year, the "annual % tax free profit" figures range from 15.6 percent in the second year to 77.5 percent in the thirtieth year. These figures correspond to the figure of 62.9 percent used in the analogy in part III of this statement.

Mr. Harris denies that he is discussing compound interest. Actually, the question of simple versus compound interest is a relatively minor part of the problem here. Consider the analogy in part III of this statement. Of the $629 interest in the tenth year, $500 is attributable to the ten deposits themselves (5 percent of $10,000), and $129 is attributable to interest on the interest on the nine previous years' deposits. In other words, about one fifth of the interest in the tenth year is attributable to the effect of compound interest.

The sales presentation described in this article involves the manipulation of figures in such a way as to show an inflated rate of return. In my opinion, such a presentation is deceptive.

The American General Advertisement

In the January 28, 1967, issue of *The National Underwriter* (life insurance edition), there is an advertisement for the American General group of companies. One of a series of "Back Page" advertisements written by Benjamin N. Woodson, American General's president, the article is entitled "Policy #367,285 Revisited." The advertisement is reproduced in Appendix B.

In this advertisement, Mr. Woodson discusses the thirty-seventh policy year of his contract. He states:

> . . . the *increase* in value from 1966 to 1967 amounted to $85.90, which grew out of the payment, just made, of an annual premium less dividend of only $60.26 . . . which means that my cash value increased this year at the rate of $142.54 for each $100 deposited! [Emphasis in original.]

Mr. Woodson attributes the entire cash value increase of $85.90 in the thirty-seventh year to the payment of $60.26 in that year. Actually, a substantial part of the $85.90 increase is attributable to interest on the savings element developed during the preceding thirty-six years.

The Ledger Statement

Many companies utilize the so-called ledger statement as a part of their sales material. An example of the ledger statement is reproduced in Appendix D.

This advertisement involves the manipulation of figures in such a way as to suggest a very low (substantially negative in this case) price of protection. In my opinion, such an advertisement is deceptive.

The Northwestern Mutual Advertisement

In the April 1964 issue of *Successful Farming* magazine, there is an advertisement by The Northwestern Mutual Life Insurance Company. The advertisement is reproduced in Appendix C.

In this advertisement, the price of Mr. Schany's $72,600 of "protection" is determined by making a comparison between the current year's premium and the current year's increase in cash value (including the increase in his dividend account). The result is "only $97 a year."

The effect of this advertisement is similar to the effect of the American General advertisement described above. Actually, a substantial portion of the $1,548 cash value increase is attributable to interest on the savings element developed during earlier years. Furthermore, the amount of protection is not the face amount of $72,600, but rather is the face amount minus the savings element of Mr. Schany's insurance.

This advertisement involves the manipulation of figures in such a way as to state a very low (although positive in this case) price of protection. In my opinion, such an advertisement is deceptive.

The effect of this advertisement is to imply that the rate of return on the $60.26 deposit in the thirty-seventh year is 42.5 percent above and beyond the price of the protection that year. On the other side of the coin, the effect is to suggest that the price of the protection that year is *minus* $25.64. If an assumed interest rate of 4 percent were applied to the savings element, however, the price of the protection in that year would be $67.70. Furthermore, the amount of protection in that year is $2,627 (determined by subtracting the savings element from the face amount) rather than $5,000.

In this case, the "net premium deposit" each year is determined by subtracting the "dividend for preceding year" from the annual premium. Then the "years increase in cash value" is subtracted to arrive at the "cost of insurance for year." By the eighth year, the latter figure is negative. In the tenth year, for example, the "cost of insurance for year" is *minus* $284.

The effect of this presentation is similar to the effect of the American General and Northwestern Mutual advertisements described above. Actually, a substantial portion of the $1,815 cash value increase in the tenth year is attributable to interest on the savings element developed during the first nine years.

This presentation involves the manipulation of figures in such a way as to state a very low price of protection. In my opinion, such a presentation is deceptive.

The Traditional Net Cost Method

The most frequently used technique for illustrating the price of life insurance is the traditional net cost method. This method serves as the basis for the price information contained in the two most widely disseminated volumes of life insurance policy data—A. M. Best Company's *Flitcraft Compend* and The National Underwriter Company's *Little Gem.*

Frequently a twenty-year period of analysis is used. The simple total of the dividends for the twenty-year period and the cash surrender value payable at the end of the twentieth year are subtracted from the simple total of the premiums for the period. The result is the net cost.

The method may be illustrated with the figures shown in Appendix D. The simple total of the dividends for the first twenty years is $15,355, and the cash surrender value at the end of the twentieth year is $36,017. The premiums are $2,289 per year; this, the simple total of twenty years' premiums is $45,780. The twenty-year net cost, determined by subtracting the dividends and the cash value from the premiums, is *minus* $5,592.

The twenty-year net cost also may be calculated by adding the first twenty "net cost of insurance for year" figures in Appendix D, and then subtracting the twentieth-year dividend of $1,245. In this sense, the twenty-year net cost figure embodies the entire series of price understatements reflected in the "cost of insurance for year" figures.

The traditional net cost method does not simply understate the price of protection. It also distorts comparisons. For example, since the simple total of dividends is used in the calculations, companies are encouraged to "steepen" their dividend scales. A company is said to have a steeper scale than another company when the former pays smaller dividends in the early policy years and larger dividends in the later policy years than the other company. When a company steepens its dividend scale, it not only benefits from increased interest earnings by deferring the payment of larger dividends, but also it benefits from the fact that many policyholders will either die or discontinue their policies before receiving the larger dividends in the later years.

The traditional net cost method involves the manipulation of figures in such a way as to state a very low (frequency negative) price of protection and to distort comparisons among policies. In my opinion, the method is deceptive.

V. CONCLUSION

Practices of the type described in this statement are widespread in the life insurance industry. Articles and advertisements of the kind illustrated in Appendixes A, B, and C appear sporadically. Premium notices that show the increase in cash value for the year, thus implying a very low (and frequently negative) price of protection for the year, are used by some companies. Ledger statements of the kind illustrated in Appendix D are used by many companies. The traditional net cost method of illustrating the price of protection is very widely used.

Two important recent developments suggest that the life insurance industry is beginning to face up to the problems described in this statement. First, a new volume of life insurance price information was released recently by The National Underwriter Company, a major insurance publisher. The volume includes the traditional net cost method, but it also includes price information based on certain other methods that are substantial improvements on the traditional method.

Second, a high level industry committee has been appointed to look into the problem of life insurance price measurement. At this time, the committee has been at work for about fourteen months, and a report is expected momentarily. Presumably the report will be critical of the traditional net cost method and, at least by inference, of the other practices described in this statement.

Knowledgeable people in the life insurance industry are aware of the questionable practices described in this statement. By and large, however, they seem willing to live with such practices. Among their rationalizations are the following:

(1) All of the life insurance companies use these techniques, so we must use them to stay competitive.

(2) Life insurance is a desirable service and it is very hard to sell, so we are justified in using these techniques to get people to buy.

(3) The money a person puts in life insurance would otherwise be kept in a non-interest-bearing checking account or would be frittered away, so it is reasonable to ignore the interest earnings on the savings element of a life insurance policy.

(4) It would make the sales presentation considerably more complicated if we were to recognize such things as interest, so it is better to use these techniques for the sake of simplicity.

(5) There has been no discernible public demand for an abandonment of these practices.

(6) We are closely supervised by the various state insurance departments, but none of them has challenged us concerning these practices.

In my opinion, these rationalizations add up to a condemnation of both self-regulation and state regulation of the life insurance industry. It is possible that either the industry itself or the state regulatory agencies could correct the situation, but there has been little progress to date.

All of the practices described in this statement have one thing in common—the misallocation of the interest earnings on the savings element of a life insurance contract. Each of the practices involves either an understatement of the price of the protection element or an overstatement of the rate of return on the savings element. In my opinion, such practices are deceptive.

The draft of S. 3201 defines "services" to include "insurance services," and it spells out in some detail the kinds of practices that are to be deemed "unfair and deceptive." If the bill is to retain these characteristics. I would suggest that it be worded in such a way as to encompass practices of the type described in this statement.

Thank you.

Appendix A

By R. F. "DICK" HARRIS, JR.
American General Life Insurance Company
Houston

"Buy term and invest the difference"

I Tell Corporations, "Put the 'Difference' in Permanent"

IN RECENT months I have received a number of inquiries—some have been almost attacks—concerning a concept I have developed and presented in speeches and sales congresses around the country.

I call the concept "corporations should buy term and invest the difference . . . in permanent," and the difficulty arises in the part of the presentation that deals with a corporation's return on capital.

In order to set the record straight, and also to share the idea with additional life underwriters, I would like to present the concept here with special emphasis on the "return on capital" portion.

The concept grows out of the evolution that is taking place in our business, including the evolution taking place in marketing concepts. One example is that of the corporation head who says, "We're going to buy term and invest the difference." We've always heard that, but in years gone by I attempted to change the executive's mind. Now, however, I let the corporation have the term, rather than attempting to argue with the head of the company. Then when I deliver the term policy, I begin the following discussion:

"Sir, does your corporation intend to keep that term policy?"

In Texas he replies, "Is a bluebird blue?"

Then I say, "Now that your corporation has bought the term insurance, where are you going to invest the difference?"

His answer is, "In our corporation,

Richard F. "Dick" Harris, Jr., better known in the life insurance business as "$Cash$," entered the business in Atlanta following his graduation from the University of Georgia in 1939 with a BS in commerce. He moved to Charlotte, North Carolina, where he was an agent and manager for Pilot Life until he became a Texan by moving to Houston in 1961. He joined American General in 1963 and has been a member of the company's Presidents Club five of the six years he has been eligible. A life and qualifying member of the Million Dollar Round Table, he has been a participant in MDRT programs and is a sought-after speaker. As manager of the Business Planning Division of American General's Houston City Agency he engages in much joint work, which together with his individual production accounts for approximately $1,000,000 in permanent life insurance premiums each year (yes, that says premiums!). In addition to his industry activities, he is an active member of the Episcopal Church, the Masons, and other civic and service organizations.

Reprinted from Life Insurance Selling, Vol. 45, No. 2 (February, 1970), pp. 24-26, 28.

that's where, because we can make more on that difference *each year* than your permanent insurance policy will provide." (Please note that he said "each year.")

I say, "Sir, how much *annual* net yield—net after all expenses and taxes—does your corporation earn on its capital?"

He says, "Fifteen per cent," or whatever the actual figure is.

I then ask, "How do you arrive at that figure?" to which he replies, "Well, we divide our capital into our annual net income after all expenses and taxes, and we arrive at the 15% net-yield figure."

Then I say, "That's remarkable!"

"You're darned right it is," he says, "and that's a heck of a lot more than your insurance company will give us, which is why our corporation bought the term insurance instead of that permanent insurance."

I respond with, "I congratulate you on your wisdom and on your idea of having your corporation purchase term and invest the difference in your corporation. Your corporation is doing well and will continue to do so with your keen business acumen.

Exchange the Term

"You've given my company a great idea on buying term and investing the difference, and in appreciation for that idea let me tell you what we're going to do for you. We have designed a special policy called 'Executive 50,' and here it is, right here. I've been authorized by my company to let your corporation have it, provided you exchange that 'Super 100' decreasing term insurance policy for it."

He objects, "But we want and have paid for that decreasing term policy!"

I say, "Sir, this Executive 50 is also *super*, it's also for $100,000, and it has decreasing term insurance built into it.

"You're age 30, so your 'Super 100' term insurance costs you $300 a year. You said you wanted it, and your corporation bought it, and you said you were doing to keep it. But look, if your corporation will exchange that term policy for this Executive 50 and

CORPORATIONS SHOULD BUY TERM AND INVEST THE DIFFERENCE— IN PERMANENT

Male Age 30

	SUPER 100 TERM INSURANCE		EXEC. 50 (*) PERMANENT INSURANCE *(ANNUAL PREMIUM—$1,289.00)				
Year	(1) Decreasing Term Insurance	(2) Term Ins. Premium	(3) Invest the Difference In Exec. 50	(4) Annual Increase in Assets	(5) Annual % Tax Free Profit	(6) Cumulative Available Asset	(7) Net Amount Death Proceeds (Decreasing Term Ins.)
1	$100,000	$300	$989	$ 840	15.1	$ 840	$99,160
2	97,900	300	989	1,143	15.6	1,983	98,017
3	95,700	300	989	1,180	19.3	3,163	96,837
4	93,500	300	989	1,217	23.1	4,380	95,620
5	91,200	300	989	1,254	26.8	5,634	94,366
6	88,800	300	989	1,292	30.6	6,926	93,074
7	86,400	300	989	1,327	34.2	8,253	91,747
8	83,900	300	989	1,362	37.8	9,615	90,385
9	81,300	300	989	1,395	41.1	11,010	88,990
10	78,700	300	989	1,427	44.3	12,437	87,563
11	75,900	300	989	1,424	44.0	13,861	86,139
12	73,100	300	989	1,451	46.7	15,312	84,688
13	70,200	300	989	1,480	49.7	16,792	83,208
14	67,200	300	989	1,508	52.5	18,300	81,700
15	64,100	300	989	1,536	55.3	19,836	80,164
16	60,900	300	989	1,561	57.8	21,397	78,603
17	57,600	300	989	1,587	60.5	22,984	77,016
18	54,300	300	989	1,611	62.9	24,595	75,405
19	50,800	300	989	1,633	65.1	26,228	73,772
20	47,200	300	989	1,652	67.0	27,880	72,120
21	43,500	300	989	1,671	69.0	29,551	70,449
22	39,700	300	989	1,687	70.6	31,238	68,762
23	35,800	300	989	1,703	72.2	32,841	67,059
24	31,800	300	989	1,716	73.5	34,657	65,343
25	27,700	300	989	1,729	74.8	36,386	63,614
26	23,300	300	989	1,739	75.8	38,125	61,875
27	19,000	300	989	1,747	76.6	39,872	60,128
28	14,400	300	989	1,752	77.2	41,624	58,376
29	9,700	300	989	1,755	77.5	43,379	56,621
30	4,900	300	989	1,755	77.5	45,134	54,866

This is the illustration Mr. Harris uses to show the annual profitability of "investing the difference" in permanent insurance.

invest the difference—$989 a year—with my company, we will guarantee to credit to your corporation account an average *annual* amount of $1,505 for 30 years."

He says, "Man, how can you do that?"

My answer is, "Let me show you," and then I refer to the illustration of "corporations should buy term and invest the difference . . . in permanent," which is shown on page 25.

I then explain the illustration in this way:

"Column (1) shows your Super 100 decreasing term insurance. Compare that column with Column (7) for each year.

"Column (2) is your premium for the Super 100 decreasing term—$300 each year.

"Column (3) is the $989 *annual* difference between the premium for our Executive 50 at age 30 ($1,289) and the $300 annual premium for the decreasing term.

"Column (4) is the guaranteed *annual* increase in corporate assets attributable directly to that $989 difference in premium, because your corporation will be paying the $300 each year in either case.

"Column (5) is the corporation's annual percentage of tax-free gain on the $989. Sir, your corporation will not and does not make that kind of *annual* percentage of tax-free gain on its own capital. To arrive at the percentages in Column (5), subtract Column (3) from Column (4) (except year one) and divide the $989 into that difference. For example, in year five, Column (4) is $1,254. Subtract the $989 difference, which leaves $265. Divide the $265 by $989, and the result is .268 or 26.8% return *in that year* on the $989.

"Column (6) is the corporation's cumulative asset.

"Column (7) is the Executive 50's net amount of death proceeds (the decreasing term insurance built in). To arrive at those figures, subtract Column (6) from the face amount. Again for year five, the face amount is $100,000, the cumulative asset in Column (6) is $5,634, leaving net death proceeds of $94,366 as reflected in Column (7).

"Now, I said earlier that we would guarantee to credit your corporation account with an average annual amount of $1,505 for the deposit of that $989 with my company each year. If you will divide the 30th-year cumulative asset figure in Column (6)—$45,134—by 30 years, the result will be $1,505 average annual available cash for the corporation directly attributable to the $989 difference invested in the permanent policy."

Annual Return

At the start of this article I indicated that I have been challenged on this illustration by a number of life underwriters, and invariably the challenge grows out of a misunderstanding of what it is I'm illustrating. *We are not talking about compound interest—we are talking about a corporation's annual return on its capital!* This concept is about corporations, not about personal investments. It has nothing to do with what individuals can do with their private funds placed in their investment programs. That's a different subject altogether. This is apparently where some people get lost—they attempt to relate the net annual yield on the $989 "difference" to compound interest.

Corporate owners and those whose responsibility it is to make corporate annual reports to shareholders are concerned primarily with the year at hand—the one year for which they must account. They think in terms of an *annual* percentage return on their corporation's capital for that year, and they think in terms of one year at a time. Of course, they make plans for more than one year, but when they think in terms of the profitability of the corporation, it is always in terms of *annual* profitability.

I am not naive enough to think that large corporations don't have investment income as well as income from sales, or that they don't consider compound interest on those investments, because they do. However, smaller corporations and closely held corporations seldom have investment income, and therefore their executives are not concerned with compound interest.

But whether they have investment income or not is beside the point; this illustration simply has nothing to do with compound interest. It is an illustration of a corporate net annual return on a capital asset—the $989 "difference," which the corporate head told me he was going to invest in the business.

Compare Profitability

It is important that this point be understood, because an accountant to whom this illustration is shown is likely to talk in terms of compound interest, and the life underwriter who hopes to sell with it must be able to satisfy the accountant that no attempt is being made to compare this return with any form of long-term investment return: it is to be compared with the corporation's profitability, its return on its capital on an annual basis.

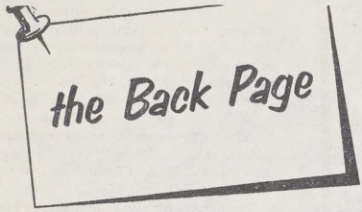
Well, back to the presentation:

After the corporate client analyzes all the columns for each year, he usually says, "Well, I'll be doggoned," and I say, "Me too!"

He agrees his corporation does not earn that kind of annual return on its capital, and I always point out again that for the $989 each year (because we fixed in his mind that he would be paying the $300 each year anyway) his corporation has available an average of $1,505 a year.

This concept and the illustration will answer the constant, "Our corporation is going to buy term and invest the difference." The corporate client *will* buy term with little or no delay, because of the great difference in premium, so I sell him the term with no argument. But I order the permanent policy as an alternate, and I take both policies to the delivery interview. I explain the term policy carefully, and I fix in his mind that his corporation will be paying the term premium—that's the key to this sale. Then I show him the illustration and the permanent policy, and he will exchange the term for the permanent. ••

APPENDIX B



An advertisement of the life companies of the Maryland American General Group, presented regularly in this space for the inspiration and enlightenment of life underwriters everywhere.

POLICY #367,285 REVISITED

AN HOUR AGO I wrote a check in payment of the 38th annual premium on my oldest life insurance policy.

This event brought the policy into my thoughts, and suggested that even though good old #367,285 has already been the subject of discussion on this page, it might be timely to report again on the splendid services which it has rendered me across the years. For this policy, I feel, exemplifies life insurance in action, even though it has been only *silently* at work. No death claim has been paid, no disability income paid or premiums waived, no maturity or surrender value paid, yet Policy 367,285 has been constantly in action—serving to give peace of mind, serving as an investment fund, serving to encourage and indeed force me to save, serving to build my credit and my net worth.

And now it serves also to give a realistic view of life insurance property *in being*, which is much more meaningful than a picture of what a given policy *will do* in the future. There is, for most of us, far more good tangible meaning to the words, *"Here is what this policy has done, and this is what it is today,"* than in the phrase, *"Starting today, this policy will do so-and-so for you in the years to come."*

We are always at a disadvantage when we ask our prospective buyer to look ahead two or three or four decades or more, because the years of the future seem so remote. But the passing of time will convince him that they aren't!

It often strikes me that the difference between looking ahead in life and looking back upon the years gone by is a good deal like looking at the road ahead through the "wrong" end of a telescope, and then using the right end of the glass to look back at the path already traveled. The telescope exaggerates the length of the miles ahead, and foreshortens those behind . . . and, similarly, life itself causes us to feel that the years ahead will be ages and eons in the coming, while the years gone by seem compressed into ever-decreasing length.

Thus it is easier to appreciate what life insurance can do by looking at a policy *in being*, and noting what it *has done*, than by talking about one yet to be conceived and delivered. Therefore I invite you now to look at a 37-year-old policy which seems to its owner to be nearer to 37 months in age, so speedily does time flash past.

* * *

POLICY 367,285, a $5,000 participating whole life contract, was issued on December 4, 1929 to Benjamin Nelson Woodson, age 21, of Chicago, Illinois. The policy was payable to Grace M. Cook, Intended Wife of the Insured. Some seven weeks later, on the following January 25, it became payable to Grace Cook Woodson, Wife of the Insured, as it still is. The policy was applied for and dated the last day before age-change—the last day in all eternity when this particular applicant could buy life insurance at age 21—and it is interesting to note that this was a reason for action quite as impelling 37 years ago as it is today.

Now hear this. Policy 367,285 was bought less than six weeks after that historic Black Tuesday, October 29, 1929, when the stock market collapsed virtually in a single day and precipitated the Great Depression . . . at a time when it seemed that the world had come to its end, when it seemed that the economic future of the nation was as black as the bottom of a well in the middle of the night, when it seemed that no financial promise could be made or trusted.

Yet Policy 367,285 made promises to me from which it has never wavered—even though it could not foresee the decade of depression which lay ahead, nor the decrease in interest rates almost to the vanishing point, nor World War II and Korea and Viet Nam, nor the inflationary increase in operating costs which would drive rents and wages and postage and printing and almost every other item of expense to levels then unimaginable.

For example, the policy promised me on December 4, 1929, that it would stand ready to pay me or lend me $2,319.70 on December 4, 1966. It promised to be ready to pay me or lend me $2,405.60 on that same day of 1967. The 37th-year values were ready and waiting when the date rolled around. The 38th-year values will be waiting for me on the coming anniversary if I want them.

And—not so incidentally—the *increase* in value from 1966 to 1967 amounted to $85.90, which grew out of the payment, just made, of an annual premium less dividend of only $60.26 . . . which means that my cash value increased this year at the rate of $142.54 for each $100 deposited!

* * *

THE VALUES IN the intervening years have been in proportion, of course. They have grown without fail from year to year, and have served me times without number.

The markings on the policy tell eloquently of the several occasions when #367,285 has served me as collateral—*prime* collateral which entitled me to say to my banker (as I *did* say!) "I'm *going* to borrow some money" and not merely "I'd *like* to borrow some money."

Each of those occasions was a profitable one. Once I saved an amount equal to a year's premium on the policy by using it as collateral to finance the purchase of a new automobile at bank rates instead of instalment rates. Later I made a substantial profit on the sale of our first home, when it came time to move, which we were able to buy in the first place only because of the guaranteed borrowing power which was ours. Still later it enabled me to take advantage of an investment opportunity which returned a profit greater than the entire amount I have deposited in the policy to this day.

So my total investment in Policy 367,285 is now a negative figure: that is, my policy's guaranteed borrowing power has brought me more than my total investment in the policy, *and I still have the policy!*

* * *

THE PREMIUM RECEIPTS and dividend memos tell an interesting story, too. They show that my 37 dividends have averaged $24.83, ranging from an early high of $28.90 in 1932 to a low of $19.96 in 1950 and up again to a new high of $31.74 in 1966. Since the annual premium is $92.00, the net premium has averaged $67.17, or some $13.43 per thousand. This, interestingly, is just about the amount which would have bought a good guaranteed-cost policy in 1929, and is actually somewhat more than the outlay which would be required today . . . which emphasizes the fact that life insurance is virtually the only commodity or service on earth which hasn't doubled its price in the past quarter century.

These facts also bear out what you and I and all good life insurance men know, namely, that there isn't enough difference either way between good participating life insurance and good guaranteed-cost life insurance to hurt if it were stuck in your eye.

The important thing, as this actual history dramatizes, is not *which* you choose, but that you have one or the other!

In the case at hand, it is of no earthly consequence to me whether this old friend which has served me so well for thirty-seven years is participating or non-participating. (I know thirty-seven years ago that the results couldn't be far apart, and they haven't been.) But it is of enormous consequence to me that the policy has been mine—that I have experienced this compulsion to save, that I have possessed this peace of mind, this growing and guaranteed asset, this unequaled and indeed unrivaled bit of collateral, this guardian of my family's welfare and my own!

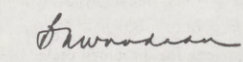
* * * *

AM I GLAD, DO YOU THINK, that I had that age-change on December 4, 1929, and therefore pushed myself around to buy Policy 367,285? *Well, indeed I am!* It was one of the best decisions in economic matters which I have ever made.

. . . Yet, on reflection, perhaps it wasn't such a good decision, after all.

I should have bought ten thousand, not five!

Best wishes,



AMERICAN GENERAL

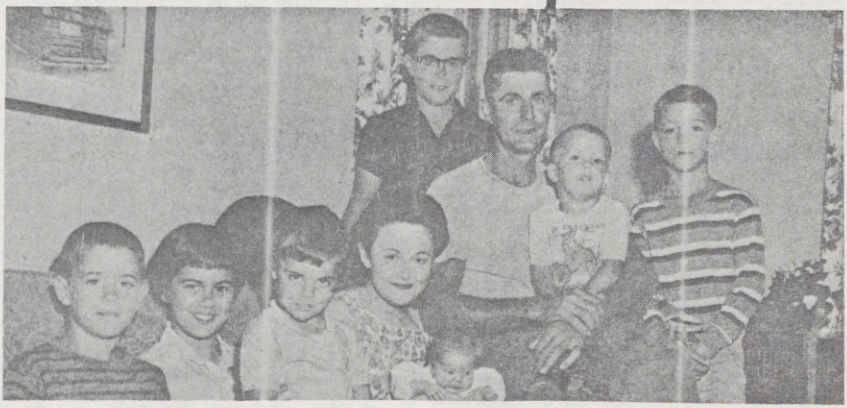
Houston Oklahoma City Pittsburgh *Hawaiian Life*, Honolulu *Patriot Life*, New York

Insurance In Force January 1, 1967 . . . Three Billion, Eight Hundred Fifty-Six Million Dollars

Reprinted from The National Underwriter (Life Insurance Edition), January 28, 1967, p. 19.

APPENDIX C

"I protect my family with $72,600 worth of Northwestern Mutual insurance and my net cost last year was only $97."



William P. Schany, Northwestern Mutual policyowner from West Bend, Iowa, has run a 400 acre farm on a share crop basis for the past 10 years. He feeds 500 head of hogs and 210 head of cattle a year; owns a good supply of machinery.

"In 1954, my Northwestern Mutual agent started me on a program of permanent life insurance. Right now, I pay premiums of $1,645 a year. But the cash values, including the exceptionally high interest and dividends paid by Northwestern Mutual, increased last year at the rate of $1,548 a year. So the $72,600 of protection for my wife and seven children cost me only $97 a year. Besides the protection, part of those policies will provide the $10,000 I'll need for a down payment on my own farm in a few years." ★ ★ ★ ★ ★ New features from Northwestern Mutual can help improve your insurance programs—Owner-option plan allows additional policy purchases without physical examination—Quantity-earned-savings plan provides worthwhile premium reduction in many cases—New budget-type payments of premiums at remarkably low cost. For detailed information about all our new features, talk to the NML agent nearest you. He's listed in your local telephone directory under "Northwestern Mutual."

NML

The NORTHWESTERN MUTUAL LIFE *Insurance Company*

MILWAUKEE, WISCONSIN

"BECAUSE THERE IS A DIFFERENCE"

Reprinted from Successful Farming, Vol. 62, No. 4 (April, 1964), p. 111.

AGENCY

LEDGER STATEMENT 1231

PRECEDING YEARS DIVIDEND APPLIED TO REDUCE CURRENT PREMIUM

PROPOSED INSURED AGE 35 AMOUNT OF INSURANCE $ 100,000.00

PLAN EXECUTIVE SERIES CONVERTIBLE LIFE DATE ANNUAL PREMIUM $ 2,289.00

YEAR	DIVIDEND FOR PRECEDING YEAR	NET PREMIUM DEPOSIT	YEARS INCREASE IN CASH VALUE	COST OF INSURANCE FOR YEAR	TOTAL NET PREMIUM DEPOSITS	GUARANTEED CASH VALUE	TOTAL COST OF INSURANCE	GUARANTEED PAID-UP INSURANCE
1		2,289.00	798.00	1,491.00	2,289.00	798.00	1,491.00	1,837.00
2	126.00	2,163.00	2,029.00	134.00	4,452.00	2,827.00	1,625.00	6,369.00
3	210.00	2,079.00	2,059.00	20.00	6,531.00	4,886.00	1,645.00	10,776.00
4	295.00	1,994.00	1,685.00	309.00	8,525.00	6,571.00	1,954.00	14,189.00
5	379.00	1,910.00	1,710.00	200.00	10,435.00	8,281.00	2,154.00	17,510.00
6	456.00	1,833.00	1,732.00	101.00	12,268.00	10,013.00	2,255.00	20,736.00
7	533.00	1,756.00	1,754.00	2.00	14,024.00	11,767.00	2,257.00	23,870.00
8	609.00	1,680.00	1,775.00	95.00CR	15,704.00	13,542.00	2,162.00	26,914.00
9	684.00	1,605.00	1,796.00	191.00CR	17,309.00	15,338.00	1,971.00	29,870.00
10	758.00	1,531.00	1,815.00	284.00CR	18,840.00	17,153.00	1,687.00	32,740.00
11	832.00	1,457.00	1,835.00	378.00CR	20,297.00	18,988.00	1,309.00	35,527.00
12	869.00	1,420.00	1,851.00	431.00CR	21,717.00	20,839.00	878.00	38,230.00
13	906.00	1,383.00	1,866.00	483.00CR	23,100.00	22,705.00	395.00	40,849.00
14	942.00	1,347.00	1,879.00	532.00CR	24,447.00	24,584.00	137.00CR	43,387.00
15	980.00	1,309.00	1,890.00	581.00CR	25,756.00	26,474.00	718.00CR	45,844.00
16	1,018.00	1,271.00	1,898.00	627.00CR	27,027.00	28,372.00	1,345.00CR	48,220.00
17	1,060.00	1,229.00	1,905.00	676.00CR	28,256.00	30,277.00	2,021.00CR	50,517.00
18	1,104.00	1,185.00	1,911.00	726.00CR	29,441.00	32,188.00	2,747.00CR	52,740.00
19	1,151.00	1,138.00	1,914.00	776.00CR	30,579.00	34,102.00	3,523.00CR	54,887.00
20	1,198.00 1,245.00	1,091.00	1,915.00	824.00CR	31,670.00	36,017.00	4,347.00CR	56,960.00
@55	1,198.00	1,091.00	1,915.00	824.00CR	31,670.00	36,017.00	4,347.00CR	56,960.00
@60	1,413.00	876.00	1,890.00	1,014.00CR	36,466.00	45,544.00	9,078.00CR	66,288.00
@65	1,607.00	682.00	1,797.00	1,115.00CR	40,259.00	54,738.00	14,479.00CR	73,981.00

AVERAGE ANNUAL NET PREMIUM FOR 20 YEARS 1,521.25 AVERAGE ANNUAL INCREASE IN CASH VALUE 1,800.85

THIS ILLUSTRATION INCLUDES DIVIDENDS WHICH ARE BASED ON THE CURRENT SCHEDULE AND ARE NOT GUARANTEED.
THE FIRST YEAR DIVIDEND IS CONTINGENT ON PAYMENT OF THE ENTIRE SECOND YEAR PREMIUM.
UNDER PRESENT TAX LAWS, THE DEATH BENEFIT IS EXEMPT FROM FEDERAL INCOME TAX.

MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY 11-66

THE CITY OF NEW YORK,
DEPARTMENT OF CONSUMER AFFAIRS,
February 3, 1970.

Senator FRANK E. MOSS,
U.S. Senate,
New Senate Office Building,
Washington, D.C.

DEAR FRANK: You have asked me for comments on proposals contained in your letter of January 27, 1970 regarding possible revisions in consumer protection bills, S. 2246, S. 3092, and S. 3201, now pending before the Senate Consumer Subcommittee. Many of the issues dealt with in your letter, especially those concerning private consumer class actions (Section 3 in your letter), are touched on in my testimony before the Subcommittee, to be delivered February 5, 1970. I strongly support each of the three specific proposals outlined in Section 3 of your letter, and, indeed, believe that enactment of a law containing these proposals could well become a moment in the history of the legal protection of the American consumer comparable in importance to the passage of the Sherman Antitrust Act in 1890.

I also agree substantially with proposals (1) and (2) in your letter, expanding the consumer protection powers of the Federal Trade Commission and the Department of Justice, respectively. Enlarging the effectiveness of these two federal agencies could bring great benefits to the consumer—though I still hold that the most important legislative objective for 1970 is the creation of a broad federal basis for private class actions, as contemplated by the present Moss-Tydings bill and by Section 3 of the letter.

I have also a few specific suggestions to add to those in the letter:

1. The following provisions of the Administration bill (S. 3201) are of critical importance and should be retained as introduced even though they are not in the Moss-Tydings and Eckhardt Class Action bills:

   a. Section 101 of S. 3201 expanding the Federal Trade Commission Act ban on deceptive and unfair practices to matters "affecting commerce" as well as "in commerce."

   b. Section 102 of S. 3201 permitting the FTC to obtain preliminary injunctions in consumer cases.

2. It is also of critical importance that 15 USC § 49 which now gives automatic and complete immunity from prosecution to any witness who testifies in response to an FTC subpoena be amended to provide instead that immunity is obtained only if the witness refuses to answer on grounds of self-incrimination and is thereafter ordered by the Commission to answer. This would permit vigorous FTC investigations of consumer fraud utilizing its subpoena power, which is not now possible.

3. The effects given to injunction suits and FTC decrees by sections 204 and 205 of S. 3201 should apply also to criminal prosecutions for conduct defrauding the consumer, e.g. United States v. Zovluck, 274 F. Supp. 385 (S.D.N.Y. 1967), aff'd after conviction, Dkt. No. 32652 (2d Cir. 4/7/69). Similarly, the U.S. Attorney should be able to obtain a preliminary injunction pending trial against illegal uses of the mails (18 U.S.C. § 1341, etc.) and violations of other consumer protection laws. Judgments of conviction in criminal cases should be authorized to contain provisions for injunctions, restitution, and abstinence from specified business practices as a condition of probation, as well as possible fines and imprisonment. Zovluck continued his conduct after indictment and also after conviction pending appeal.

May I express my admiration for the commitment to meaningful and thoughtful reform reflected in these proposals. Because of the dedication of you and some of your colleagues, I find it possible to hope that we will pass genuinely effective consumer protection laws in this session of Congress.

Sincerely,

BESS MYERSON GRANT.

FEBRUARY 9, 1970.

Re: S. 3201, the Consumer Protection Act of 1969.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Committee on Commerce, U.S. Senate, Washington, D.C.

DEAR SENATOR MAGNUSON: The American Life Convention, the Health Insurance Association of America, and the Life Insurance Association of America are three organizations of life insurance companies, health insurance companies, and

life and health insurance companies having a combined membership of 485 United States and Canadian companies, accounting for about 92 percent of the total life insurance in force in the United States and about 90 percent of the health insurance.

Our associations are concerned primarily with Title II of S. 3201, now pending before the Subcommittee for Consumers of the Senate Commerce Committee. This Title would make unlawful eleven specified unfair or deceptive acts or practices in the offering or advertising of "goods or services". Section 201(f) defines "services" to include "insurance services". Violators would be subject to injunction suits brought by the United States Attorney General in the Federal District Courts, and also to cease-and-desist proceedings instituted by the Federal Trade Commission under section 5 of the Federal Trade Commission Act. Following successful termination of such an injunction action, consumers would have the right to bring private suits for recovery of actual damages. Our objection to the bill is that the inclusion of "insurance services" is inconsistent with the McCarran-Ferguson Act (15 U.S.C. 1011–1015).

For well over 100 years the insurance business has been regulated by the states, not the federal government. Prior to 1944, insurance was considered not to be commerce. Thus the federal government was without power to regulate insurance, and the states had full regulatory authority unrestricted by the commerce clause. In *United States* v. *South-Eastern Underwriters Assn.*, 322 U.S. 533 (1944), the Supreme Court for the first time held that insurance is commerce.

Nine months later Congress enacted the McCarran-Ferguson Act. Section 1 of that Act declares that "the continued regulation and taxation by the several States of the business of insurance is in the public interest. . . ." Section 2(a) provides that "the business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." Section 3(a) established a three-year moratorium period during which the Sherman Act, the Clayton Act, and the Federal Trade Commission Act "shall not apply to the business of insurance or to acts in the conduct thereof." Section 2(b) states that after the three-year moratorium these three Federal Acts, as amended, "shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

The purpose of sections 1 and 2(a) was to declare that the states (not the federal government) should continue to have the responsibility for the regulation of the insurance business, and to remove the commerce clause as any possible obstacle to such state regulation. More specifically related to the present issue, the purpose of sections 3(a) and 2(b) was to give the states three years in which to enact legislation covering the areas of the Sherman Act, the Clayton Act and the Federal Trade Commission Act. This was in invitation by Congress to the states to adopt regulation in these areas, with the express declaration that thereafter those three federal statutes would not apply to the extent that the states had adopted such regulation.

All of the states have accepted this invitation. Each state now includes as a part of its insurance code the Model State Fair Trade Practices Act, which is patterned after the Federal Trade Commission Act, and contains the same broad proscriptions against all "unfair methods of competition or unfair or deceptive acts or practices". The Supreme Court of the United States has expressly held that the existence of these state laws makes section 5 of the Federal Trade Commission Act inapplicable to insurance. *Federal Trade Commission* v. *National Casualty Co.*, 357 U.S. 560 (1958).

It is thus apparent that Title II of S. 3201 is inconsistent with this previous action of Congress, and with the action taken by all of the states in pursuance of their earlier Congressional invitation. By virtue of the express reference to "insurance services" in section 201(f), the bill would permit actions against insurance companies by either the Attorney General or the Federal Trade Commission with respect to the eleven specified unfair or deceptive acts or practices. Clearly the Model State Fair Trade Practices Acts cover these eleven areas, and many more. To that extent, therefore, there would be a partial repeal of the McCarran-Ferguson Act. No reason has been given or indicated for this proposed reversal of Congressional position.

Not only is S. 3201 inconsistent with the McCarran-Ferguson Act, but it would as a practical matter inevitably lead to great confusion. If this bill were enacted in its present form, presumably both the state model laws and the new federal bill would apply to the same eleven specified practices. Thus there would be duplicative state and federal procedures. Moreover, in dealing with concepts as broad as those here involved, it would seem inevitable that disagreements between

state and federal authorities would occur. As stated by the Supreme Court in *Garner* v. *Teamsters, Chauffeurs and Helpers, etc.*, 346 U.S. 485, 490–491 (1953): "A multiplicity of tribunals and a diversity of procedures are quite as apt to produce incompatible or conflicting adjudications as are different rules of substantive law."

We note that sections 201(e) and 201(f) of the bill exclude "securities" and "credit", respectively, presumably because they are regulated by other federal statutes. We think there is even stronger reason for excluding "insurance services". Not only does every state regulate in this area, but this regulation has been adopted at the express suggestion of Congress.

We therefore suggest that the words "insurance services" be stricken from section 201(f) of the bill, and that the reasons for this action be included in the Report.

We would welcome the opportunity to discuss this matter further with you or members of your staff. We would also appreciate your making this letter a part of the printed hearings.

Sincerely yours,

AMERICAN LIFE CONVENTION,
WILLIAM B. HARMAN,
General Counsel.

CHICAGO, ILL.

LIFE INSURANCE ASSOCIATION OF AMERICA,
KENNETH L. KIMBLE,
Vice President and General Counsel.

NEW YORK, N.Y.

HEALTH INSURANCE ASSOCIATION OF AMERICA,
PAUL M. HAWKINS,
Washington Counsel.

WASHINGTON, D.C.

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS,
Chicago, Ill., March 6, 1970.

Hon. FRANK E. MOSS,
Chairman, Subcommittee on Consumer Affairs, Senate Commerce Committee, U.S. Senate, New Senate Office Building, Washington, D.C.

DEAR SENATOR MOSS: The National Association of Independent Insurers is a trade association of some 350 fire and casualty insurance companies of all types—stock, mutual, reciprocal and Lloyds. Most of our member companies are engaged in interstate commerce and, hence, have a direct concern over Federal legislation affecting the insurance business.

We are taking this occasion to register the strong opposition of our Association to those provisions of S–3201, an Administration supported bill pending before your Subcommittee, which would without any justification whatsoever bring within the Federal Trade Commission Act certain insurance practices which are and for many years have been fully and adequately regulated by the states.

Title II of that bill makes unlawful eleven enumerated unfair or deceptive acts or practices in the offering for sale or advertising of goods or services. Subsection 11(f), Title II defines services to include "insurance services and similar provisions of intangibles, but does not the providing of credit."

By specifically including insurance in the definition of services this bill would drastically modify the carefully conceived Congressional plan for the regulation of insurance as embodied in the McCarran-Ferguson Act of 1945. That law was enacted by the Congress after a long and searching scrutiny of the insurance business and the state regulatory system. After careful analysis of all possible alternatives, the Congress concluded that the continued regulation of insurance by the states is in the public interest, and that except for conspiracy or acts of boycott, coercion or intimidation, the federal antitrust laws should apply to the business of insurance *only to the extent that business is not regulated by State law.* Central to this Congressional plan of insurance regulation, was the determination to avoid wasteful overlapping or duplication of regulation, by entrusting exclusive regulatory power to the states subject only to the exception as to boycott, coercion and intimidation. The other advantages of state supervision—including its close proximity to the insuring public and the insurance operation, and its experience and expertise in this field—were also well known to the Congress and entered into its carefully weighted decision.

We submit that subparagraph (f) of section 201(a) of S–3201 should be amended to eliminate insurance from the scope of the bill, for the following reasons:

(1) The insurance business is now fully subject to strong, effective regulation under the unfair trade practices laws of every state, which laws were adopted specifically to fulfill the Congressional mandate under the McCarran Act.

(2) Those state laws not only contain general prohibitory provisions as broad or broader than those of the Federal Trade Commission Act, but also contain numerous sanctions directly applicable to and apropos of insurance—of which the FTC Act is completely lacking.

(3) The definitions of "unfair or deceptive practices" which S–3201 would add to the FC Act are, like the existing language of that Act, couched in broad, general trade terms which may be meaningful as applied to most businesses but are ambiguous and highly confusing, if not meaningless, when applied to insurance.

(4) Under their trade practice laws and related statutes, the state insurance commissioners have long possessed, and have never hesitated to use where needed, the most powerful of enforcement tools against violations of the unfair trade practice acts—including severe fines and outright suspension or revocation of license to do business.

(5) There have been absolutely no allegations made or testimony presented to indicate that state supervision in this field has not adequately protected the insurance consumer's interests, or to establish any need whatsoever for superimposing federal regulation thereupon.

(6) Extension of the FTC Act to insurance would thrust costly regulatory responsibilities on the federal government which would be unnecessary, duplicative and wasteful; the broad, ambiguous and inapt language of S–3201 if applied to insurance would confuse and obfuscate the clear-cut, well-defined insurance regulatory framework now provided by the state trade practice laws, with the net effect of seriously weakening overall regulation in the public interest.

Immediately after the McCarran-Ferguson Act was adopted in 1945, a model "Act Relating to Unfair Methods of Competition and Deceptive Acts and Practices in the Business of Insurance" was developed by the National Association of Insurance Commissioners. As recited in the final draft of the Act, dated January 24, 1947, its purpose is "to regulate trade practices in the business of insurance in acordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945 (Public Law 15, 79th Congress.)"

Subsection 4(a) of the bill defines as unfair methods of competition and unfair and deceptive acts or practices, when engaged in by any person in the insurance business:

(1) Misrepresentation and false advertising of policy contracts.
(2) False information and advertising generally.
(3) Defamation.
(4) Boycott, coercion and intimidation.
(5) False financial statements.
(6) Stock operations and advisory board contracts.
(7) Unfair discrimination in specified lines of insurance.
(8) Rebates.

To illustrate the broad sweep of this statute we quote subparagraph 1 and 2 of Subsection 4(a) above noted:

"(1) *Misrepresentation and False Advertising of Policy Contracts.* Making, issuing, circulating, or causing to be made, issued or circulated, any estimate, illustration, circular or statement misrepresenting the terms of any policy issued or to be issued or the benefits or advantages promised thereby or the dividends or share of the surplus to be received thereon, or making any false or misleading statement as to the dividends or share of surplus previously paid on similar policies, or making any misleading representation or any misrepresentation as to the financial condition of any insurer, or as to the legal reserve system upon which any life insurer operates, or using any name or title of any policy or class of policies misrepresenting the true nature thereof, or making any misrepresentation to any policyholder insured in any company for the purpose of inducing or tending to induce such policyholder to lapse, forfeit, or surrender his insurance.

(2) *False Information and Advertising Generally.* Making, publishing, disseminating, circulating, or placing before the public, or causing, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public, in a newspaper, magazine or other publication, or in the form of a no-

tice, circular, pamphlet, letter or poster, or over any radio station, or in any other way, an advertisement, announcement or statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business, which is untrue, deceptive or misleading."

Subsection 4(b) of the Model Act declares that its enumeration of specific prohibited methods, acts and practices "is not exclusive or restricted or intended to limit the powers of the Commissioner or any court of review. . . ." Sections 5 to 8 and 11 prescribe enforcement and judicial review procedures and empower the Commissioner to issue cease and desist orders.

Sections 9 and 10 empower the Commissioner after hearing to report to the Attorney General any unfair method of competition or unfair or deceptive act or practice violative of the act but not defined in Section 4(a), and the Attorney General may institute court proceedings to enjoin same.

Section 11 provides for fines of up to $5000 for each violation of a Commissioner's order—the identical penalty prescribed in the Federal Trade Commission Act. Section 12 states that the powers enumerated in this statute shall be additional to all his other powers to punish violations of orders. The effect of this provision is to additionally subject an insurer or agent to revocation of its license to do business.

All of the states have adopted the commissioner's model unfair trade practices law or comparable statutes. Attached is a list of citations to the unfair trade practices acts of every state.

Not only have the states thereby fully occupied the regulatory area reserved to them by Congress under the McCarran Act, but they have occupied it with legislation designed *expressly* and *exclusively* for the supervision of *insurance* practices. The state unfair trade practice acts contain the most comprehensive prohibitions conceivable—and, most important—those prohibitions are couched in terms which have clear-cut, specific meaning and relevancy to the insurance business.

The same cannot be said either of the existing FTC Act or the definitions of "unfair and deceptive practices" which S–3201 would add to that Act. Both the FTC Act and S–3201 have been designed (and by their very nature must be designed) to stretch across a wide spectrum of business enterprises, and their phraseology must necessarily be very general. Moreover, insurance is diametrically different in most respects from the conventional business enterprises to which the provisions of the FTC Act and S–3201 are basically directed. (This very uniqueness of insurance was one of the factors which caused Congress to adopt the McCarran Act in 1945, giving the insurance business a qualified exemption from the antitrust laws if regulated by the states.)

Thus, many of the definitions S–3201 would add to the FTC Act either have no discernible meaning in the insurance business, or even worse, may because of their inaptness to that business produce a completely inadvertent, unintended meaning.

In short, extension of the FTC Act to insurance would superimpose on the carefully designed, accurately targeted state regulatory system a set of ill-fitting and inappropriate prohibitions which would only obfuscate and confuse the picture, and ultimately weaken the overall regulatory effort.

Insofar as we can ascertain, no case whatsoever has been made for such a move. The statement of Mr. Richard McLaren, Assistant Attorney General, Antitrust Division, on February 17 before the Subcommittee on Commerce and Finance of the House Interstate Commerce Committee regarding HR–14931, the counterpart to S–3201, merely recites, without elaboration, that "it is as important to supplement state and federal legislation in the service sector of the economy as in the manufactured goods sector."

Mr. McLaren's observation may perhaps have validity with respect to service enterprises *not now regulated*. But it provides no basis for superimposing unnecessary, duplicative and inapt federal regulation upon a business which is now being effectively—indeed, stringently—regulated by all the states.

Insofar as the matter of enforcement tools is concerned, it should be noted that the existing state laws not only provide for the imposition of severe fines on any insurance company, agent or other person violating an order under the unfair trade practices act, but they also empower the insurance commissioner to suspend or revoke the offender's license to do business—the most powerful form of sanction that can be applied against any entrepreneur, and one not present in most walks of business. Insurance Departments have not hesitated to

invoke any or all of these enforcement powers where necessary, and their very presence exerts a strong disciplinary influence in the business.

For all the foregoing reasons, we strongly urge this Subcommittee to amend subparagraph (f) of section 201(a) of S–3201 so as to read: "(f) 'services' includes intangibles, but not *insurance or* the providing of credit."

We will be happy if requested to elaborate upon any of the points raised in this letter.

Respectfully submitted,

ARTHUR C. MERTZ,
Vice President and General Counsel.

TABLE B.—STATE UNFAIR TRADE PRACTICES ACT

Alabama.—Secs. 90(1) to Sec. 90(14), tit. 28, Ala. Code (1957).
Alaska.—Secs. 21.10.865 to 21.10.880, Alaska Stats. (1962).
Arizona.—Art. 6, Secs. 20–441 to 20–458, Arizona Rev. Stats. Ann. (1956).
Arkansas.—C. 30, Secs. 66–3001 to 66–3026, as amended, Acts 1959, No. 148, Stat. (1947), 1963 Cum. Pocket Part.
California.—Secs. 790 to 790.04, California Ins. Code, 1963 Pocket Part.
Colorado.—Secs. 72–15–1 to 72–15–13, Rev. Stat. Ann. (1953).
Connecticut.—Secs. 38–60 to 38–64, Gen. Stats. Ann. (Rev. 1958).
Delaware.—Secs. 18–531 to 18–538, Del. Ins. Laws (effect 6/13/55).
District of Columbia.—No. 1964.
Florida.—Secs. 626.0600 to 626.0632, Fla. Ins. Code (1963).
Georgia.—Act 748, L. 1950, Secs. 56–701 to 56–714, Ga. Ins. Code Ann. (1960 Rev.).
Hawaii.—Secs. 181–641 to 181–646, Hawaii Ins. Laws (1963).
Idaho.—Sec. 41–1301 to 41–1327, Idaho Ins. Code (1961).
Illinois.—C. 73 Secs. 1028 to 1041, 1963 Cum. Pocket Part.
Indiana.—C. 112, L. 1947, Secs. 39–5301 to 39–5318, Stat. (Burns, 1933), 1952 Replacement Vol., as amended, 1955, Ch. 10, § 1, p. 8.
Iowa.—Secs. 507B.1 to 507B.14, Iowa Code Ann. (1950), 1963 Comm. Pocket Part.
Kansas.—Sec. 40–2401 to 40–2414, Kan. Ins. Laws (1963).
Kentucky.—Secs. 304.924 to 304.945, Ky. Ins. Laws (1961).
Louisiana.—Act 195, L. 1948, Secs. 22–1211 to 22–1217, tit. 22, Rev. Stat. (1950), as amended, Acts, 1960, No. 402 § 1.
Maine.—Secs. 146–158, c. 60, Maine Ins. Laws (1959–60), added c. 317, L. 1961.
Maryland.—Secs. 212–234, art. 48A, Md. Ins. Code (1963).
Massachusetts.—C. 659, L. 1947, Secs. 1–14, c. 176D, Gen. Laws (1954), as amended.
Michigan.—Secs. 2001 to 2088, Michigan Ins. Code (1956), as amended.
Minnesota.—Secs. 72:20–72:33, Minn. Ins. Laws (1963).
Mississippi.—Secs. 5649–01 to 5649–12, Miss. Code Ann. (1956), as amended.
Missouri.—Secs. 375.930 to 375.948, 1962 Cum. Suppl.
Montana.—Secs. 40–3501 to 40–3522. Mont. Ins., Laws (1961).
Nebraska.—C. 170, 1947, Secs. 44–1501 to 44–1521, Rev. Stat. (1943), as amended.
Nevada.—Secs. 686.390 to 686.475, Nev. Ins. Laws (1959 w. 1961 supp.).
New Hampshire.—Secs. 417:1 to 417:17, N.H. Ins. Laws (1963).
New Jersey.—C. 379, L. 1947, Secs. 17:29B–1 to 17:29B–14, Rev. Stat. (1937), 1963 Cum. Pocket Part.
New Mexico.—Secs. 58–9–9 to 58–9–19, N.M. Ins. Laws (1963).
New York.—C. 501, L. 1948, Secs. 270–282, Ins. Law, added c. 501, L. 1948, as amended.
North Carolina.—C. 1112, L. 1949, Secs. 58–54.1 to 58–54.13, Gen. Stat. (1950 ed).
North Dakota.—Secs. 26–30–01 to 26–30–13, N.D. Ins. Laws (1963).
Ohio.—Secs. 3901.19 to 3901.99, Ohio Ins. Laws Ann. (1960), as amended.
Oklahoma.—Secs. 36 § 1201 to 36 § 1213, Okla. Stats. Anno.
Oregon.—Secs. 736.605 to 736.990, Oregon Rev. Stats.
Pennsylvania.—Act 202, L. 1947, Secs. 1151 to 1162, tit. 40, Stat. (Purdon), 1963 Cum. Pocket Part, as amended.
Puerto Rico.—Secs. 27.010 to 27.200, P.R. Ins. Code (1957).
Rhode Island.—Secs. 27–29–1 to 27–29–11, R.I. Ins. Code (1963).
South Carolina.—Act 232, L. 1947, Secs. 37–1201 to 37–1223, Ins. Code (1961).
South Dakota.—C. 144, L. 1947, Secs. 31–11A01 to 31–11A08, Code (1959).
Tennessee.—Secs. 1201 to 1225, Code (Supp. 1961).
Texas.—Art. 21–21, Secs. 1 to 12.

Utah.—C. 63, L. 1947, Secs. 31–27–1 to 37–27–23, Code (1963).
Vermont.—Secs. 4721 to 4738, Vermont Ins. Laws (1963).
Virginia.—C. 317, L. 1952, Secs. 38.1–49 to 38.1–57, Code (1950), as amended.
Washington.—C. 79, L. 1947, Secs. 48.30.010 to 48.30.250, Rev. Code.
West Virginia.—Secs. 3472(8) to 3472(22), W.V. Code (1961).
Wisconsin.—C. 520, L. 1947, Secs. 207.01 to 207.13, Wisc. Ins. Laws (1963).
Wyoming.—Secs. 26–155 to 26–165.5, Wyo. Ins. Laws (1961).

AMERICAN FEDERATION OF LABOR AND
CONGRESS OF INDUSTRIAL ORGANIZATIONS,
Washington, D.C., March 6, 1970.

Hon. FRANK E. MOSS,
Chairman, Subcommittee on the Consumer, Committee on Commerce, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The AFL–CIO is pleased your Consumer Subcommittee is proceeding with prompt consideration of bills to strengthen consumer protection against fraudulent and deceptive sales practices.

We hope the Subcommittee will devise a comprehensive consumer protection statute which will combine and improve upon the best features in the bills which are presently before the Subcomittee. I refer to S. 2246, the Deceptive Sales Act, which you have introduced; S. 3092, the Consumer Class Action Act introduced by Senator Tydings; and S. 3201, the Consumer Protection Act, introduced on behalf of the Administration by Senator Magnuson.

The Administration bill incorporates the Deceptive Sales Act with little change, includes a restricted version of the Consumer Class Action Act, adds an earlier legislative proposal in the 90th Congress to expand the jurisdiction of the Federal Trade Commission, and creates a new role for the Department of Justice in the prosecution of specified types of consumer sales deception.

As you know, the AFL–CIO is on record in full support of needed reforms in the deceptive sales practice field. The pertinent portion of the Consumer Protection Resolution adopted in October, 1969, by the AFL–CIO Constitutional Convention reads as follows:

"Congressional action is needed to deal more effectively with the never-ending stream of consumer gypsters and fraudulent operators, whose principal victims are the poor. Congress should strengthen the tools and the authority of the Federal Trade Commission to proceed against fraudulent and deceptive sales practices.

"The Commission should be authorized to obtain temporary restraining orders, pending completion of complaint proceedings against violators of law. Congress should also extend the jurisdiction of the Commission through a broader definition of interstate commerce and should consider stiffer penalties for violations of the Federal Trade Commission Act. Authorization and funds should be provided for a proposed investigation of home improvement sales rackets.

"Congress should improve the means by which consumers themselves can enforce their claims against fraudulent operators, by specifically authorizing the federal courts to entertain consumer class action suits, when state or federal consumer statutes have been violated."

Accordingly, we are pleased to endorse S. 2246, the Deceptive Sales Act, and similar provisions appearing in Title I of S. 3201, the Administration's Consumer Protection Act. These provisions would enable the Federal Trade Commission to act quickly to enjoin all types of consumer fraud, using the same powers it already has to act against false advertisements of food, drugs, cosmetics and devices. The Senate passed the same bill in 1968, but with weakening amendments which substituted "preliminary injunctions" for "temporary injunctions or restraining orders." We support the stronger provisions now in the bill and hope that these can be retained.

We also support the expanded FTC jurisdiction provided in Title I of the Administration bill, which redifines jurisdiction in terms of "affecting commerce" instead of "in commerce." This change will broaden greatly the reach of the Commission into frauds which are now technically considered to be in intrastate commerce.

Title II of the Administration bill establishes 11 specific categories of deceptive practices which, by definition, would be illegal. It also empowers the Attorney General to seek court injunctions against such practices. Unfortunately, however,

the list would serve to limit the types of consumer class action suits which would be given standing in the Federal courts. Consumer class action rights should be available against any type of consumer fraud or deception rather than being limited to those on a prescribed list.

A further, serious restriction on expanded use of class action suits is the provision that a final action either by the Federal Trade Commission or by the Department of Justice in the form of an order or a court decree must be completed before consumers can begin their own suit. This limitation is nothing short of devastating; it leaves the selection of suits basically in the hands of the government. It also may subject private consumers to lengthy government delays in cases chosen for government action.

We strongly urge the approach to consumer class action legislation which is set forth in Senator Tydings' bill, S. 3092.

There are, in addition, a number of other improvements which would be necessary to an effective, comprehensive attack on deceptive and fraudulent commercial practices which are injurious to consumers. We have reviewed the constructive suggestions outlined in your letter dated January 28, 1970. We support these proposals. They would provide important new enforcement tools for the Federal Trade Commission and the Department of Justice, as well as giving full scope for private consumer class action suits.

The present authority of the Federal Trade Commission to issue "cease and desist" orders is clearly an inadequate remedy against consumer swindlers. This should be supplemented by Federal Trade Commission power to levy civil monetary penalties against offenders and the power to seek criminal penalties by the Department of Justice. The proposals to empower the Commission to order specific reparations for injured consumers and similar power for the Department of Justice to seek court-ordered restitution in the case of certain specific law violations would represent an enormous advance in the protection of the consumer public.

We also support the proposals to enable the Federal Trade Commission to issue consumer protection regulations with the binding effect of law and to streamline FTC internal procedures by setting up an Office of Consumer Protection which would relieve the Commission of detail work in investigating and enforcing the law against individual violators.

We congratulate the Subcommittee on its progress and urge that it report out a truly effective Consumer Protection Act at an early date.

Sincerely yours,

ANDREW J. BIEMILLER,
Director, Department of Legislation.

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

The National Association of Manufacturers appreciates the opportunity to express its views on S. 3201, the Consumer Protection Act of 1969.

The NAM is a voluntary Association of many thousands of member companies, representative of industry of all sizes. Our major interest in the pending legislation stems from the fact that, if enacted, its impact would be directly felt throughout the business community.

Testimony before this Community indicates that some degree of consumer fraud does exist. Insofar as the provisions of S. 3201 are clearly and effectively directed at the elimination of such consumer fraud, it has our support. For reasons which will be explained in the following paragraphs we feel, however, that this bill is, in part, too broadly drawn and where this is true holds out false hope when specific help is needed.

We do not agree that it is either necessary or desirable to create new and concurrent federal enforcement authority within the Justice Department, if the authority of the Federal Trade Commission in the area of consumer protection is enlarged and strengthened under the provisions of this bill. Additionally, if this proposed legislation is to avoid a needlessly adverse effect on commerce generally, certain procedural safeguards must be added. In its present form, S. 3201, when coupled with S. 3240, the other major portion of the Administration's consumer protection program, could easily give to a multiplicity of investigations, charges and lawsuits which might leave even the most blameless business enterprise publicly discredited, if not in serious financial difficulty. Plaintiff's lawyers seem to be the only parties sure to benefit.

Generally speaking, it is our belief that a strengthened Federal Trade Commission would be the most efficient and effective way of halting that consumer fraud which does exist. Since passage of the Wheeler-Lea Act in 1938, which included prohibitions against "unfair or deceptive acts or practices" under Section 5 of the FTC Act, this has been a major obligation committed to the Commission by the Congress.

In spite of our general support, we take issue with those provisions of Section 102(a) of Title I which would authorize the Commission to seek a temporary restraining order or preliminary injunction when the Commission has reason to believe such restraint is necessary pending the issuance of a complaint.

We do not foresee any circumstances which would justify issuance of an *ex parte* temporary restraining order for violation of Section 5(a), i.e., where there has been application by one party and no notice or opportunity for hearing by the party adversely affected. In making this assertion we bear in mind the fact that under Section 13 of the Act the Commission currently has the authority to seek such a temporary restraining order or preliminary injunction where false advertising of foods, drugs, devices, or cosmetics is involved. No possible health or safety considerations attach to the ordinary commercial types of transactions which are left within the ambit of Section 5 and to which this newly contemplated authority to seek a temporary restraining order would apply. In fairness, we feel that the Subcommittee should take into consideration the fact that the kinds of commercial transactions which could be temporarily restrained under the provisions of Section 102(a) require long-term planning, prior commitment of financial resources, and perhaps intricate scheduling of radio, television, newspaper and magazine space. Even a short delay pending hearing could destroy the efficacy of such business plans. Since other procedural devices and remedies already available or contemplated by S. 3201 are adequate to handle any fraudulent or deceptive acts or practices, we recommend deletion altogether of those provisions which would allow issuance of a temporary restraining order.

We are concerned also with the wording of this bill under Title I which would allow the Commission to seek, and the Court to grant, "Upon a proper showing of need," a temporary restraining order or a preliminary injunction. Assistant Attorney General McLaren has now testified on this bill in both Houses and we think it appropriate to point out what he said in this context before the House Subcommittee on Commerce and Finance on February 17, 1970.

"This language ['Upon a proper showing of need'] is intended to make certain that a court would retain discretion to consider the equities of the case before it, including the probability of success of the government action, the damage to the defendant flowing from the issuance of an injunction, and the damage to the general public if the practice complained of were to continue."

We commend this interpretation, but feel that, in order to remove any doubt, safeguards should be added to the bill providing that the court must consider traditional equitable principles before a preliminary injunction can issue. Precedent for doing so was established during debate on similar legislation in the last Congress when S. 3065 was amended to this effect on the Senate floor. Specifically, the language added to the bill read thus:

"The Court, in its sound discretion, may grant such preliminary injunction without bond as it shall deem just in the premises, under the same conditions and principles as injunctive relief against conduct or threatened conduct that will cause loss or damage is granted by courts of equity." (114 Congressional Record, S. 8502, daily ed., July 11, 1968.)

Addition of the requested safeguards become particularly important when one takes into consideration that Title I would amend existing authority for the issuance of preliminary injunctions under Section 13 of the FTC Act. As previously noted, that section deals with false advertisement of foods, drugs, devices and cosmetics and on one or more occasions federal courts have taken the position that an injunction might properly issue when the Commission had reason to believe that a violation had, or was about to occur.

One final point with regard to Title I: Rather than allowing a situation wherein one alleged to have violated the Act would be left under injunction for an indefinite period of time, meanwhile suffering all the financial, competitive and administrative consequences of interrupted business plans, the Trade Commission should be required to file a complaint prior to petitioning for a preliminary injunction. Our reasoning is this: If the FTC has amassed sufficient evidence to support a petition for injunction, it should have enough evidence to support a formal complaint. Otherwise, its petition is premature.

The remainder of this statement will concern itself with those aspects of S. 3201 which provide for class actions and private recovery of damages. The NAM is opposed to the creation of a federal right to consumer class actions arising out of violations of Section 5 of the FTC Act or of Section 201 of the proposed Consumer Protection Act as envisioned by S. 3201.

Perhaps our central objection is that benefits promised by this current consumer "panacea" are very likely spurious. Without giving serious thought to the network of procedural hurdles to be gotten over in order to successfully conclude a class action and see individual members of the class compensated for their claimed loss, champions from various sectors of the economy have seized upon this device and characterized it as a really effective answer. We submit that it is not.

As an instance—under Federal Rule of Civil Procedure 23 governing class actions in federal court, a number of time-consuming procedures must be carried out. First, the make-up of the class itself must be determined and thereafter there are intricate requirements for notice to all parties. These steps can be followed by protracted pre-trial procedures and extensive hearings, all of which would impose a heavy burden on a feedral court system already loaded with a lengthy backlog of pending cases.

Further, there are implications for the Bar to consider. A highly damaging situation might come about which could find lawyers competing to represent a class or filing conflicting class actions. Also, there is the possibility of solicitation of class members and funds, and of misrepresentation of the purpose of the suit and of the possible effect of court orders.

In addition to the foregoing, experience has shown that plaintiffs' attorneys are most likely to seek our defendants with the highest settlement potential rather than go after the fly-by-night operators whose abuses, particularly of the poor and unsophisticated, are most flagrant and most in need of redress.

Mrs. Knauer, the President's Special Assistant for Consumer Affairs, testified before the House Commerce Subcommittee on February 17, 1970, that the biggest sources of consumer complaints during the past two years have emanated from illegal magazine subscription sales, fraudulent and deceptive home repairs and improvements, unsatisfactory and unnecessary TV repairs, and frauds in the sale of new and used cars. Obviously there are thousands of legitimate concerns throughout the country dealing in these goods and services. Just as obviously these are the areas frequently seized upon by the "quick-buck artists." It is the latter who ought to be attacked by public and private forces alike. Realistically, however, fraud by this kind of operator is least likely to stir public-spirited attorneys into action.

For these reasons then, we feel that consumer class actions, filed in federal court with attendant publicity and fan-fare, could in the end have a devastating effect on legitimate, reputable businessmen. At the same time, they would be contributing significantly to consumer dissatisfaction as the time between initiation of a suit and its conclusion lengthens and the promise of recompense begins to fade.

Proponents of federal consumer class actions, as part of their rationale, assert that current state court procedures are inadequate. If this be the case, then it would seem a better answer to improve these procedures rather than overload the federal court system. Indeed, both Assistant Attorney General McLaren and former FTC Chairman Paul Rand Dixon have testified that such an upgrading of state rules and regulations is both necessary and desirable and have urged support for the effort.

At least one directly inhibiting result is sure to follow if Section 204 is enacted in its present form. By providing that a consent decree may serve as the basis for a class action, this bill insures a greatly diminished use of that device. Currently a consent decree, which does not establish fault but rather is an agreement worked out between the parties, is extremely useful in providing a quick means for halting questioned practices, for sparing the government as well as parties defendant the expense and effort of litigating a case, and in keeping the docket clear for other business. Consent decrees ought to be encouraged, not discouraged. No attorney, however, could possibly advise his client to enter into such an agreement if it raised the future possibility of having to defend widespread consumer class actions. Rather, businessmen would be forced to accept the considerable economic burden of defending, in the first instance, actions which they consider to be without fault. It is difficult to ascertain where the greater burden would fall if there was effective

loss of this procedural device: on private parties or on the government. FTC Commissioner Elman publicly testified at one point that over 90 percent of deceptive practice cases brought by the Commission are settled by consent orders. Considering that such orders become effective immediately, any major diminution in their use would have a direct effect on enforcement efforts.

Finally, we would make this point. The Administration proposal, in seeking to establish a specific list of unfair or deceptive acts or practices the violation of which is to be restrained through actions of a new division within the Department of Justice, makes the assumption that because of the magnitude of the task involved it cannot be performed by the Federal Trade Commission. We disagree.

At the present time, in addition to its large staff of lawyers and other personnel trained in various phases of consumer interests, the Commission has field offices and operating staff in Atlanta, Boston, Chicago, Cleveland, Kansas City, Los Angeles, New Orleans, New York City, San Francisco, Seattle and Washington, D.C. Shortly after taking office, Chairman Weinberger announced a broad new attack on consumer fraud and deception, to operate through these eleven field offices with the help of consumer advisory boards. Each board is to be composed of local, state and federal officials plus representatives of private organizations. In addition to making public the schemes and practices of unscrupulous businesses in their areas, if it should be determined that local and state enforcement procedures are insufficient, help will be offered in drawing up new legislation. We feel this kind of federal-state cooperation is laudable and seems designed to effectively get at the real source of major consumer problems.

This kind of approach, coupled with the traditional powers of the Commission to deal on a national level with consumer fraud and deception and strengthened by the authority to seek injunctions in appropriate cirrumstances, seems much more likely to produce definite, identifiable results on a just and rational basis. We do not feel there is any need or justification for adding another layer to the already swollen federal bureaucracy by creating a new division within the Department of Justice. Nor do we feel there is any gain to be made by providing a federal forum for consumer class actions when the positive outcome is in all circumstances a matter of conjecture but the negative results of which—the harassment and coercion of legitimate business for no justifiable cause, the notoriety for the lawyers and organizations involved, and the long and frequently frustrating journey through the courts for uncertain or no reward—are eminently predictable.

STATEMENT OF HOWARD H. BELL, PRESIDENT, AMERICAN ADVERTISING FEDERATION

The American Advertising Federation appreciates the opportunity to present its views with regard to the consumer legislation pending before this Committee.

The Federation, with headquarters in Washington, D.C., and a western region office in San Francisco, includes the many and varied elements of the advertising business. Samuel Thurm, vice president of advertising, Lever Bros. Co., New York, is chairman, John Elliott Jr., chairman of Ogilvy & Mather Inc. New York, is chairman of the AAF Government Affairs Committee.

A fundamental part of the Federation structure includes 180 advertising clubs in communities across the country. There are also company members representing advertisers, advertising agencies and advertising media.

These varied elements come together to further the best interests of advertising and to support and participate in constructive programs.

The Better Business Bureau movement in this country, for example, had its origin within the Federation, whose organizational structure began in 1905. The Better Business Bureau was a part of the Federation until 1926.

The AAF has sought to identify its own interests with those of the public. For example, it supported Truth in Lending legislation and authored the AAF Model Deceptive Practices Act for adoption by states—portions of which have been incorporated into the so-called "little FTC act."

And with the cooperation of the Association of Better Business Bureaus, the Federation developed in 1964 the Advertising Code of American Business, setting forth standards for industry-wide self-improvement.

A new national Ethics Committee, under the chairmanship of Frederick E. Baker, chairman of F. E. Baker-N. W. Ayer Inc., Seattle, Wash., is seeking to

encourage greater implementation of this Code across the country—again in cooperation with the advertising club's traditional partner, the local BBB.

These comments are directed to the legislative proposals contained in S–3201, S–3092 and S–2246.

The Administration proposal—S–3201—is designed to do several things: (1) To strengthen the hand of the Federal Trade Commission through authorization to seek preliminary injunctions and temporary restraining orders; (2) to specify 11 acts or practices considered deceptive under this proposed act; (3) to provide for private class action suits that would enable individuals or groups of citizens to seek monetary resitution from businesses who may have engaged in an act considered deceptive under this bill; (4) to widen FTC jurisdiction to acts "affecting" commerce as distinct from acts "in" commerce, presumably to broaden the Commission jurisdiction to intrastate practices as well as interstate.

S–3092 deals primarily with providing for class action suits against practices considered deceptive under the FTC act.

S–2246 would grant the FTC power to seek preliminary injunctions.

The basic philosophy of strengthening the FTC's hand to make it a more effective regulatory agency is one that we have supported for some time. Recent comments of FTC commissioners and the conclusions of the American Bar Association report on the FTC underscore this need.

Regardless of the sourses of the criticism, it cannot be overlooked that a larger budget coupled with an increase professional staff are needed for the FTC to fulfill its regulatory role, with emphasis given to the meaningful selection of priorities.

We offer these views only because we believe the way to strengthen the FTC's hand in dealing with consumer abuses is not necessarily through more legislation, but rather by enhancing the ability of the regulatory agency to implement already existing—and very adequate—legislative authority and intent.

For example, we support that part of the legislation that would allow the FTC to expand its jurisdiction to matter's "affecting" commerce. However, the Commission itself has pointed out that far greater resources are needed even to accomplish the present task.

In terms of statutory authority, regulatory agencies have not indicated a lack of legislative muscle. This point can be illustrated by the performance of both the FTC and the FCC of the past year. Under pressure from consumer advocates and cries for reform from responsible quarters, both agencies have tackled new and heady issues within the framework of existing authority.

On the issue of giving the FTC power to seek preliminary injunctions, the Federation also supports this authority, as provided for in S–3201 and S–2246, to bring an early halt to abuses that are considered in violation of the FTC Act.

Such preliminary injunctions are to be sought in a federal district court, as specified in this legislation. Certain additional safeguards, such as the need for the FTC to issue a complaint before seeking an injunction, appear desirable measures to guarantee the traditional rights of due process and equity. We respectfully request, therefore, that this safeguard be written into the legislation.

Similar safeguards should be assured with respect to granting the FTC power to obtain temporary restraining orders. Such restraining orders have a distinction in law that should be considered.

A temporary restraining order—as distinct from a preliminary injunction—can be more easily obtained under circumstances not requiring proper notification to and response from the defendant. This is a rather drastic remedy and great care should be exercised in its use for fear of denying due process.

A temporary restraining order which lacks the opportunity for proper notice and hearing on the merits prior to its effect could result in stopping an ad campaign subsequently found to be acceptable. In advertising this works a unique hardship. Bringing an immediate halt to a campaign would have the effect of killing it because of the often short-term nature of given advertising designed to sell specified items within a designated period of time.

Based on the language of President Nixon's consumer message of October 30, 1969, we believe his intent was not to diminish the customry rights of a defendant in defending his interests in a court or governmental proceeding.

With regard to the 11 deceptive acts or practices considered deceptive under this legislation, we support, of course, the purpose and principles of the FTC Act as stated in general language.

While spelling out these practices might be considered necessary to serve as a basis for other provisions of the bill (namely, obtaining preliminary injunctions

and pursuing class action suits), it has been our belief that general strictures dealing broadly with deceptive acts are more effective and more desirable.

The problem with specificity is that such rules turn out, after all, not to be all-inclusive. Moreover, they often contain vague language that is subject to interpretation anyway. This is especially true of the eleventh practice listed in this bill which appears particularly vague and sweeping.

On the issue of class action suits, the Federation respectfully opposes this measure as contained in S–3201 and S–3092.

Numerous witnesses have recounted the weaknesses inherent in using class action suits as a sanction in combatting fraudulent practices.

Class action suits are long, involved, complex and expensive proceedings. As a result, such suits are likely to be brought against the more established businessman based on his ability to pay rather than against the hard-core fraudulent operator—who not only may be difficult to locate but who lacks the resources to make such a suit worth the effort.

Also, such suits can clog the courts, encourage harrassing and needless litigation, prove exceedingly costly to business and the public to pursue, and lack the essential characteristics of being a speedy redress for consumer grievances.

We recognize that the Administration bill sought to answer some of these objections. For example, there is the requirement that a class action suit cannot be brought under S–3201 unless the government has successfully completed an action against a given party.

This in itself may not be very adequate protection in light of the arguments above. Moreover, it still leaves the possibility that the very signing of an FTC consent decree by a businessman can serve as a basis for a class action suit.

Such consent orders have been considered among the more expeditious enforcement tools of the FTC. Through this device a businessman can elect to stop a practice without the necessity for a long drawn out legal battle—and without in any way admitting or conceding wrongdoing.

Consent orders would be discouraged if federal class action legislation passes.

With regard to the advertising industry, the effects of a federal class action remedy would be far-reaching. In an era when government and consumer activists are encouraging more information in advertising, this measure could have the effect of working contrary to those interests. Those preparing advertising would be reluctant to commit campaigns to factual representations for fear that any representation could someday become the basis for a class action. How ironic that would be.

We believe that more thought should be given to the full implications of pursuing this burdensome approach.

Richard W. McLaren, assistant attorney general for the Justice Department Anti-trust Division, has said: "I have made the estimate that it could cost a national manufacturer subject to class action, $1 million on one claim before he ever got to court, before he could ever get his side of the thing heard. It could cost him $1 million for discovery, sending people all through his plants, dredging up all the correspondence, all of the labels, the advertising, the memoranda, the technical specifications, bringing in people for depositions. This could easily run into a million dollars before a man could ever get his case to trial."

In the area of consumer protection, the Federation supports the establishment of a permanent office of consumer affairs to coordinate federal consumer programs and to serve as a clearinghouse for consumer complaints. Perhaps this office should be a part of the FTC thus avoiding a proliferation of efforts. This office coupled with a stronger FTC with broader jurisdiction and the power to obtain preliminary injunctions, would seem to us a very potent government arsenal to deal with deceptive practices at the present time.

To improve the quality of performance of existing machinery may be more significant than increasing the quantity of laws.

It would appear consistent with sound government to see how these measures operate in the marketplace and what affect they have before additional steps are considered.

We seek no special preserve that would allow fraud to exist and grow. The advertising, media and business community at large support meaningful and balanced action to deal with consumer grievances.

Much voluntary work to achieve self-improvement, avoid abuses and respond to consumer complaints goes forward daily by individual businesses as well as trade associations and business organizations.

As current examples, the Better Business Bureau and the U.S. Chamber of Commerce both have announced major new programs to deal with problems at the local level.

We have indicated our own resolve to do more through our local advertising clubs and the Advertising Code of American Business.

There should be adequate procedures for voluntary redress of consumer grievances. Indeed, government should encourage the furthering of local bodies to mediate consumer complaints thus seeking to avoid adjudication in the first place wherever possible.

In conclusion, we believe that the best interests of the consumer should not be isolated from the best interests of the businessman. The reverse also is true. Indeed, the constructive development of the consumer movement in this country should be based on concern for each other's point of view.

STATEMENT OF CLARENCE G. ADAMY, PRESIDENT, NATIONAL ASSOCIATION OF FOOD CHAINS

The National Association of Food Chains ("NAFC") submits this statement of its views on the several bills on consumer remedies being considered by this subcommittee. NAFC is a nonprofit trade association whose membership is comprised of approximately 225 food retailers throughout the country, operating from two stores to four thousand stores.

PRELIMINARY STATEMENT AND SUMMARY

NAFC is firmly committed to the principle that the individual grocery store customer is entitled to honesty and integrity not only on the part of the retailer with whom he deals, but throughout the marketplace as well. Those few businessmen who engage in deceptive and fraudulent practices harm the reputation of honest and legitimate businessmen as well as the consumer immediately affected. It is for both these reasons that NAFC is desirous of Congressional enactment of legislation which will provide a swift, certain and inexpensive remedy for fraud and deception perpetrated by unscruplous merchants. Congress should reject, however, proposed legislation providing only remedial vehicles proven to be costly, time-consuming, uncertain in their effectiveness and thus frustrating in their cumulative effect.

NAFC believes that the creation of private consumer remedies under federal law, with a concomitant encouragement of class actions, is not the most effective means for prevention and redress of fraulent or unfair and deceptive acts or practices injurious to consumers. Rather such legislation would encourage protracted and complex class litigation which would prove costly and frustrating to the individual consumer. Such class litigation would be inefficacious in that inevitably it would be directed not at the marginal, fly-by-night operator whose fraudulent practices should be curbed, but rather at the financially sound company who possesses in resources to pay large plaintiff's attorneys fees but whose law violations are by and large inadvertent, unpremeditated, and occasional. Additional class action authorization would further contribute to already congested federal court dockets.

Congressional consideration should be directed to other remedies for a means of prevention of unfair or deceptive practices which have proven sound and effective over the years. Such remedies as a strengthening of the enforcement powers of the Federal Trade Commission and an intensification of the coordinative powers of the Office of Consumer Affairs are such possibilities.

If after Congress has enacted these measures and afforded them the opportunity to demonstrate their effectiveness in remedying abuses of consumer, it is then thought desirable to provide for private consumer actions, including class actions, then in that event certain safeguards against abuse are absolutely essential. Specifically such federal legislation should prescribe in detail the nature of business acts and practices which might give rise to private litigation, including as an element thereof the factor of knowledge or intent on the part of the person or business committing them, should require that consumer private actions be based on a prior cease and desist order obtained by the Federal Trade Commission, and should afford some protection against strike suits.

In addition, close study of the recently released Report of the American Bar Association Antitrust Section's Special Committee on Consumer Legislation is merited. That Report suggests the utilization of Federal Trade Commission hearing examiners to hear and determine individual consumer claims for relief

only after a company had been determined liable for a knowing violation of clearly defined standards in an action initiated by the Commission or the Department of Justice. The Report concludes that such a mechanism would avoid the costs, delays, and abuses inevitably associated with class actions, provide a deterent effect against the fraudulent dealings of unscrupulous operators, and provide the consumer with swift and certain relief from such frauds.

I.—LITIGATION UNDER FEDERAL RULE OF CIVIL PROCEDURE 23 (CLASS ACTIONS) IS NOT AN EFFECTIVE VEHICLE FOR REDRESS OF WRONGS SUSTAINED BY CONSUMERS IN THAT CLASS ACTIONS WOULD PROVE TO BE AN ILLUSORY REMEDY WHICH WOULD IN TURN AGGRAVATE CONSUMER DISSATISFACTION

Rule 23 of the Federal Rules of Civil Procedure, which was fully revised in 1966, may seem to provide prompt redress for consumers wronged by fradulent sales practices. The United States Court of Appeals for the Second Circuit in describing the development of Rule 23 stated that "[e]quity has long recognized that there is need for a cause which would redress wrongs otherwise unremediable because the individual claims involved were too small, or the claimants too widely dispersed."[1] However, the extensive technical requirements which must be met by parties proceeding under Rule 23, which are necessitated by the Due Process Clause of the Constitution and the provisions of the Rule itself, render the class action approach extremely cumbersome, time consuming and expensive for consumer litigants. By the very nature of class actions in crowded federal courts, recovery ordinarily will be delayed until many years after institution of the action. Moreover, such litigation often involves lengthy discovery, trial, and in the event of an ultimate judgment, possible appellate proceedings. At all of these stages, defendants can be expected to hotly contest every available issue. Thus if recovery for the consumer comes at all, it will come only after protracted and expensive litigation.

A. The Complex and Protracted Nature of Class Actions Denies the Consumer an Effective and Expeditious Vehicle for Redress

Rule 23 provides that a member of a class may sue as the class representative if the class is so numerous that joinder of all members is impractical, there are questions of law or fact common to the class, the claims or defenses of the representative are typical of those of the class, *and* the representative will fairly and adequately protect the interests of the class. In addition, the suit must fit one of three categories of section (b) of Rule 23 in order to be conducted as a class action.

It is unlikely that the typical consumer class action would fit either the (b)(1) or the (b)(2) category. It is much more probable that a consumer action would be in the (b)(3) category. In fact, the Advisory Committee's Note of 1966 to Revised Rule 23, in discussing the (b)(3) action stated that "a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for" this type of action. [39 F.R.D. 69, 102–103 (1966)].

In a category (b)(3) action the court must find that:

> [T]he questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action. [Fed. R. Civ. P. 23(b)(3)]

One of the necessary preliminary steps in any class litigation is the determination of the proper membership of the class, or of subclasses thereof. This process has often proved to be exceedingly time consuming.

In *Union Carbide & Carbon Corp. v. Nisley*, 300 F. 2d 561 (10th Cir. 1962), *cert. den.*, 371 U.S. 801 (1963), a case decided under Rule 23 before it was revised in 1966, it took more than three years for the court to determine the proper class. Undoubtedly there are some situations in which the proper class can be more readily determined, but it is always going to be a time consuming process. Moreover,

[1] Leon Green v. Wolf Corp., 406 F. 2d 291, 297 (2d Cir. 1968).

there is every indication that consumer class actions under revised Rule 23 will often be as protracted as was the experience in *Union Carbide & Carbon Corp. v. Nisley, supra.*

Class actions, more so than ordinary civil actions, tend to be protracted and complex in the extreme. After definition of the proper class by the court and appropriate notice directed to the class members, inquiries from those members can be expected and must be answered. Some members may desire to intervene directly and come into the action, which is allowed by Rule 23. Attenuated discovery by both sides in the action can be expected. The propriety of the case being conducted as a class action in accordance with Rule 23's provisions which are summarized *supra* must be ruled upon by the court. The requirement for commonality of both factual and legal issues is clearly stated in the Rule's provisions. Since each consumer must separately establish his individual right to recovery the question of commonality will regularly be at issue, and controverted. In sum, resolution of the pretrial questions requisite to maintenance of a class action tend to be extremely protracted.

Similarly, once the merits are reached defendant companies can be expected to litigate the trial and appellate stages of such actions with equal vigor. Only if the consumer class representatives can overcome the obstacles certain to be mounted by defendant's counsel, and only if the class representatives' patience does not wane, can they in fact realize redress for their grievances. The prolonged uncertainty inherent in such contested litigation can only contribute to the frustration of the consumer and lead to his questioning the adequacy of a legal system which provides him with such a cumbersome and uncertain vehicle of recovery.

B. Prohibitive Costs of Proper Notice May Necessitate Dismissal of the Class suit

Once the class has been determined, the problems and expenses associated with notifying class members of the initiation of the action arises. Throughout the course of the proceedings additional notice of any step in the action may also be required by the court for the protection of members of the class. The mailing of successive individual notices to thousands of class members is a very expensive proposition which few private individuals could afford.

Section (c)(2) of Rule 23 explicitly requires in a (b)(3) action that notice directed to class members who can be identified through reasonable effort must be personal, individual notice rather than general, public notice by means such as newspaper publication. Section (d)(2) provides that for the other two categories of actions, (b)(1) and (b)(2), the court is to determine what type of notice is proper for the class. In a leading case on the notice complexities of revised Rule 23, the Court of Appeals for the Second Circuit in *Eisen* v. *Carlisle & Jacquelin*, 391 F. 2d 555 (2d Cir. 1968), has explored and set forth clear procedures which must be followed by class action representatives if the Due Process Clause is not to be contravened. Regarding the notice provisions of Rule 23 as they relate to (b)(1), (b)(2) and (b)(3) actions, the court stated that:

> While the Supreme Court has recognized that class actions represent an exception to the general rule under which only parties are bound by a judgment, *the procedure adopted must conform to the requirements of due process and fairly insure the protection of absent parties who are to be bound.* Hansberry v. Lee, 311 U.S. 32, 42, 61 S. Ct. 115, 85 L. Ed. 22 (1940). *Notice, as an integral part of due process must be "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."* Mullane v. Central Hanover Bank & Trust Co. 339 U.S. 306, 314, 70 S. Ct. 652, 657, 94 L. Ed. 865 (1950). The Advisory Committee in its note has suggested that the mandatory notice pursuant to 23 (c)(2) and the discretionary notice under 23 (d)(2) were intended to fulfill the requirements of due process established in *Hansberry* and *Mullane.* Advisory Committee's Note at 107. The Advisory Committee also sought to ensure that individual interests would be respected in (b)(3) cases by giving class members the opportunity to avoid being bound by the judgment if they requested exclusion and so informed the court. 391 F. 2d at 568.

Over the years the Supreme Court has quite properly been concerned with the fundamental right of any individual to receive reasonable notice of the pendency of an action by which he may be bound and his rights and remedies forever foreclosed. The case of *Mullane* v. *Central Hanover Bank & Trust Co.*,

supra, is one of the many cases where the Supreme Court has articulated this fundamental proposition.

There is nothing fanciful about the possibility that a consumer who has sustained serious injury due to a manufacturer's or retailer's fraud would be denied recovery because he had received no actual notice of the pending class action and was barred by the judgment in that case. Legal notices published in the inner sections of newspapers are notoriously inadequate for apprising members of the general public of critical facts.

Recognizing the problems associated with a class member not receiving adequate notice, the Court of Appeals for the Second Circuit held in *Eisen* v. *Carlisle & Jacquelin*, *supra*, that if individual notice could not be directed to the members of the defined class because the plaintiff could not financially afford such an undertaking, then the class action must be dismissed. *Id.* at 569–70.

Typically, consumer classes would be extremely large. In *Eisen* v. *Carlisle & Jacquelin*, *supra*, a case arising under the antitrust laws, the costs of mailing the initial notice of the pendency of the class action was estimated at $400,000. This initial notice is the beginning, not the end, of the expense of such litigation. Inquiries from other members of the class initially notified will inevitably ensue, and these must be answered, accruing greater expenses. Furthermore, pursuant to Rule 23(d)(2) the trial court may require further notice to be sent to members of the class as the action progresses. Practically, it must be admitted that the typical consumer simply cannot financially afford to undertake such expense. Dismissal of a consumer's class action because the class representative cannot financially afford the ultimate expenses only pyramids frustration for the consuming public. For this reason, it is submitted that the Rule 23 class action is not an effective vehicle for the redress of consumer grievances.

C. Consumer Class Action Would Further Congest Already Crowded Federal Courts and Would Not Effectively Deter The Most Flagrant Consumer Frauds

Authorization of complex and time consuming multi party consumer actions would place an enormous burden on already congested federal courts and in many instances on undermanned staffs. In *Snyder v. Harris*, 394 U.S. 322 (1969), a case refusing to allow aggregation of claims by the members of a class for the purpose of satisfying the requisite jurisdictional amount, the Supreme Court expressed grave concern over the rising caseload and existing congested dockets of the federal courts. *Id.* at 340. Thus not only would the addition of such class actions aggravate the present administrative situation, but expeditious resolution of consumers' grievances themselves would be rendered impossible.

Furthermore, the effect of authorizing such class actions would be to make the class representatives' attorney the real party in interest in strike suits against financially responsible companies. Class action defendants would not be selected on the basis of their degree of guilt, but rather on their ability to pay substantial damages and attorney's fees. Plaintiff's attorneys will certainly be loath to proceed against the marginal fly-by-night companies which are probably at the root of the vast majority of consumers' complaints, if there is the slightest possibility that they are judgment proof or do not possess the financial resources to pay out large plaintiffs' attorney's fees. Just as the consumer needs adequate protection against the unscrupulous businessman, the legitimate business enterprise needs protection against such a perverted use of the class action mechanism.

II. PRIOR CONSIDERATION OF OTHER CONSUMER PROTECTION MEASURES

Because of the innovative nature of the private remedy proposals and the substantial question which exists as to their efficacy in providing expeditious remedies against consumer fraud, Congress should consider first a number of other consumer protection proposals. Experience might well establish that these measures are adequate to eliminate the present roadblocks to effective consumer protection and that experimentation with a proposal which could produce costly, time consuming litigation, encouragement of frivolous litigation, and false expectations of prompt elimination of hard core fraud would be unwarranted.

A number of these other proposals are identical or directly related to bills which have been before, and in some instances considered by Congress in prior years.

A. Increased Federal Trade Commission Enforcement Powers

Section 102 of S. 3201 would authorize the Commission to seek injunctive relief pending the final outcome of litigation involving not only food and drug advertis-

ing under section 12 of the Federal Trade Commission Act, but acts or practices which are unfair or deceptive to the consumer and are unlawful under section 5 of that Act.[2] Upon "proper showing of need", the Commission may secure temporary injunctions or restraining orders. Any injunction issued under this proposal would be dissolved if the Commission had not issued its administrative complaint within 60 days after its entry. This legislation is in many respects similar to S. 2246, introduced by Senator Moss, and companion bills which in turn are similar to legislation which passed the Senate in 1968. These proposals, however, contained no requirement that the Commission issue its complaint within any specified time period to prevent dissolution of its injunction.

NAFC supports a grant of increased power to the Commission to seek preliminary injunctions pending final administrative determination of relief against acts or practices unfair or deceptive to the consumer. Such power in the Commission should allay any fears that the acts or practices complained of would continue to be perpetrated during the administrative proceedings. However, because Federal Rule of Civil Procedure 65 allows the issuance of temporary restraining orders without notice and without opportunity for the party charged to be heard in opposition to the issuance of such an order, we oppose the grant of power to the Commission to seek temporary restraining orders. Principles of fairness militate strongly against authorizing such drastic action without the opportunity for views contrary to the Commission's to be heard by the court.

We also feel that no additional burden would be placed upon the Commission by requiring it to issue its administrative complaint against the acts or practices complained of at least simultaneously with its request for a preliminary injunction. If the Commission is prepared to make the showing necessary to obtain a preliminary injunction, it will also be prepared to proceed with its administrative proceedings. Such a requirement would encourage acceleration of the administrative proceedings and be much fairer to the party charged with violation.

B. Expanded Federal Trade Commission Jurisdiction

Section 101 of S. 3201 would enlarge Commission jurisdiction to proceed against unfair methods of competition and unfair or deceptive acts or practices *affecting commerce*, when the public interest justified such a proceeding. Section 5 of the FTC Act presently limits FTC complaint jurisdiction to such methods of competition and acts or practices which are *in commerce*. The proposed amendment would permit the Commission to attack local advertising, sales practices and other conduct of an essentially local nature if there is an effect on interstate commerce, albeit indirect.

The leading Supreme Court case in this area was decided in 1941 and held that a local promotional campaign could not be reached under section 5 of the FTC Act.[3] Section 12 of the FTC Act which prohibits the interstate dissemination or dissemination by mail of false food, drug, device and cosmetic advertising presently has a somewhat broader jurisdictional reach than § 5. At least one Court of Appeals has construed it to cover any media advertising which crosses state lines, irrespective of the insubstantial extent of such advertising.[4]

NAFC supports this extension of jurisdictional powers for the Commission in other areas. This amendment would enable the Commission to reach deceptive acts and practices by large merchandisers whose activities are nonetheless localized within a state's boundaries. We feel that this would be highly desirable.

C. Office of Consumer Affairs.

S. 3240 would accord statutory foundation for the Office of Consumer Affairs headed by a Director. This office was first created by executive action of President Kennedy and has been headed successively by Esther Peterson, Betty Furness and Virginia Knauer.

Many of the functions and responsibilities of the Office and Director would not be greatly different from those presently exercised: to coordinate the widespread and diverse federal consumer activities, present consumer viewpoints in formulation of government policy, receive and act upon consumer complaints and promote consumer information and research. In addition, the Office would be given express authority to conduct hearings, undertake economic studies and evaluate product safety. The legislation would also provide a statutory base for the Consumer Advisory Council.

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[2] The Commission may already possess this authority under the All Writs Act. See FTC v. Dean Foods Co., 384 U.S. 597 (1966).
[3] FTC v. Bunte Bros., 312 U.S. 349 (1941).
[4] Shafe v. FTC, 256 F. 2d 661 (6th Cir. 1958).

The elevation in stature and the Congressional sanction given the Office would enhance its effectiveness to some degree and further improve the expedition with which consumer frauds can be detected and eliminated. NAFC supports this proposal.

A major, novel aspect of the Administration proposals would be the creation by S. 3240 of a Consumer Protection Division in the Department of Justice, headed by an Assistant Attorney General. The Division would be vested with broad powers to request initiation of proceedings by other agencies, to intervene and appear in certain administrative and judicial proceedings, and to conduct wide ranging investigations "concerning the needs, interests, and problems of consumers". Inasmuch as the primary function of the strengthened Office of Consumer Affairs would seem to be *coordination* of the various consumer activities, we question the advisability of creating at this time a powerful separate instrumentality whose function is solely that of *advocacy* in agency proceedings and litigation. The possibilty seems great that the coordinative efforts of the Office of Consumer Affairs might be substantially frustrated by the Division's adversary activities.

III.—STANDARDS FOR CONSUMER PRIVATE REMEDY LAW

If after Congress has enacted some or all of the measures discussed and supported in part II *supra*, and afforded them an ample opportunity to curb the various abuses of consumers now existent, it may then be thought to be desirable to provide for private rights of action in the feedral courts, including class actions. In that event, there are certain safeguards against abuse of the private action remedy which NAFC deems absolutely essential to any fair and just legislation.

A. Precise Standards of Relief

S. 3092 fails to delineate with precision the specific acts and practices to be illegal under the act. Rather, the bills prohibit unfair or deceptive acts or practices within the meaning of section 5(a)(1) of the Federal Trade Commission Act and any act which gives rise to a civil action by a consumer under State statutory or decisional law. The vague and amorphous prohibition of S. 3092 is unfair to businessmen who will henceforth endeavor to tailor their business practices to the law. They simply do not receive adequate notice of what activity hereafter is to be illegal. Since such legislation would create the first comprehensive federal machinery for the recovery of monetary damages by private individuals, legitimate businessmen are entitled to know the exact parameters of acts and practices which will henceforth subject them to liability. To levy severe financial penalties on merchandisers at the same time and in the same suit that new legal grounddefining illegal acts and practices is being broken in contrary to settled practice in American jurisprudence.

For these reasons, if a private right of action ultimately is authorized, we propose that liability thereunder be fashioned after the list of 11 specific offenses enumerated in § 201(a) of Title II of S. 3201. With some modification, this list could provide a clearly defined and comprehensive listing of substantive unfair trade practices which are injurious to the consumer.

B. Government Action as a Predicate to Private Actions and States of Limitations Therefor

The potential for serious abuse of the consumer class action mechanism by "strike suit" class representatives is set out in part IC *supra*. The concept in S. 3201 of a required predicate to a private action in the form of a prior final judgment or cease and desist order entered in a Department of Justice or FTC initiated suit partially alleviates this potential for abuse of the class action mechanism. This "triggering device" for private actions would tend to provide some assurance that frivolous claims would not be initiated solely as a strike suit. For this reason, if a private right of action is ultimately authorized, we strongly urge that it necessarily be preceded by a final FTC cease and desist order.

Although § 207 of S. 3201 provides that an action by a consumer must be initiated within one year after the termination of the government action upon which it is predicated, there is no statute of limitations establishing a time within which the government must itself bring an action. The argument might be made that the unlimited time in which actions may be brought is comparable to the Clayton Act after which this measure is to some degree tailored. However, the Clayton Act does not authorize the government to secure financial

penalties in the first instance from those against whom it proceeds, and the Clayton Act prescribes a four year statute of limitations within which private actions seeking damages must be initiated. Since government actions under the Consumer Protection Act would be in substantial part designed to provide the predicate for private actions seeking monetary damages, it would seem appropriate that a four year statute of limitations between the alleged law violation and the time within which a government action must be initiated be provided for in any legislation which may be finally enacted.

STATEMENT OF THE NATIONAL ASSOCIATION OF PHOTOGRAPHIC MANUFACTURERS, INC.

The National Association of Photographic Manufacturers, Inc. appreciates the opportunity to present its views on S. 3201. "The Consumer Protection Act of 1969."

The National Association of Photographic Manufacturers is a voluntary association composed of companies domestic to the United States actively engaged in manufacturing photographic products for sale in the open market. Shipments by NAPM member companies account for over 90 percent of all photographic products manufactured in this country when measured on a dollar basis.

The stated purpose of S. 3201 is to amend the Federal Trade Commission Act to provide increased protection for consumers. Our industry believes that consumer fraud cannot and should not be condoned, and in this sense supports the concepts embodied in this legislation relating to deceptive sales.

There are, however, at least two areas in the proposed legislation which have caused genuine concern among our member companies. This concern is directed to portions of Section 102 of Title I and that part of the bill which provides for consumer class actions.

With respect to Section 102 of the proposed legislation, we take exception to the wording which would allow the Federal Trade Commission to seek a preliminary injunction or temporary restraining order. The distinct possibility exists that preliminary injunctions and perhaps more importantly temporary restraining orders obtained in ex parte proceedings could work unrightable wrongs on totally innocent parties joined in the proceedings.

We believe that adequate safeguards for situations that involve the life and limb of our citizens are covered elsewhere, i.e. Section 13 of the Act authorizes the Commission to seek immediate relief where food, drugs, and cosmetics are involved. The additional authority to allow injunctive relief in situations where money damages would prove an adequate remedy appears to us to be wholly unnecessary.

It is common knowledge that modern marketing techniques involve complex and expensive promotion and distribution plans. Most of the consumer goods offered for personal or family use by industry are supported by sophisticated marketing plans involving the coordination of research, manufacturing, and promotion planned months and perhaps years in advance.

A temporary restraining order interrupting these plans for a period as long as sixty days could cause irreparable damage to such an effort and create the very real possibility that the lost momentum could never be regained and the effort must be discontinued. A later determination of innocence provides no recourse.

We, therefore, recommend that the provisions relating to preliminary injunctions and temporary restraining orders be deleted.

If in the judgment of the Subcommittee it is determined that provision for the issuance of a preliminary injunction or a temporary restraining order must remain in this proposed legislation, then we respectfully submit that specific wording should be included in the bill to require the courts to consider the traditional rules of equity before granting such drastic relief.

Such suggested wording as was incorporated into S. 3065 in the 90th Congress would seemingly be appropriate and is quoted below:

"The Court, in its sound discretion, may grant such preliminary injunction without bond as it shall deem just in the premises, under the same conditions and principles as injunctive relief against conduct or threatened conduct that will cause loss or damage is granted by courts of equity." (114 Congressional Record, S. 8502, daily ed., July 11, 1968.)

It is our belief that the vast number of consumer transactions are conducted by legitimate business, those corporations and individuals whose reputation and

growth are based upon consumer satisfaction in the marketplace. Under the proposed consumer class action legislation, these corporations could become the object of harassment in the courts.

Businesses with substantial reserves could become prime targets for class action suits. Legitimate business without substantial reserves would soon find themselves unable to afford the drain in manpower and money. A company would be faced with the alternative of either going out of business or passing on the cost of these actions to the proposed beneficiary of this legislation, the consumer. The details attendant to consumer class actions are not set forth in the proposed legislation. We submit for your consideration that if S. 3201 is enacted as introduced, the already overcrowded Federal Court system would be unconscionably overburdened.

S. 3201 as proposed would allow a consent decree to become the foundation for a consumer class action. Historically, consent decrees have greatly expedited the workings of justice and the administration of existing federal legislation. If a consent decree could serve as the basis for a class action, few attorneys could recommend this expeditious device to their clients, thus adding to the already crowded calendars in the federal courts.

We respectfully request that the Subcommittee give favorable consideration to the views expressed above.

STATEMENT OF THE PROPRIETARY ASSOCIATION

The Proprietary Association is a nonprofit, national trade association established 89 years ago. Its active members, 91 in number, are manufacturers and distributors of over-the-counter medicines advertised and sold directly to the consumer. The Assocation also has 137 associate members, including suppliers, advertising agencies, and other members with various interests in over-the-counter medicines.

One of the major goals of our Association is to strive toward an honest and competitive marketplace for the nation's consumers of proprietary medicines with the least amount of interference with freedom of choice. To the extent that some of the legislative proposals now being considered by this Subcommittee may assist in accomplishing that goal. The proprietary Assocation is pleased to go on record as favoring those proposals.

Specifically, the Association favors expanding the jurisdiction of the Federal Trade Commission to include acts that affect interstate commerce as well as acts in interstate commerce. Many of today's problems in the marketplace stem from people becoming victims of fraudulent and unscrupulous acts at the local level. It is important, not only for the consumer, but also for the future of all commerce, that there be authority to maintain an honest marketplace, free from acts of fraud regardless of such technicalities as whether acts are local or interstate.

The Association also endorses, with clarifying amendments, the proposal to extend FTC's authority to seek preliminary injunctions to restrain violations of Section 5 of the FTC Act in addition to FTC's existing authority to seek preliminary injunctions to restrain violations of Section 12 of the FTC Act. Such authority, with the proper statutory safeguards and manpower, could provide the means by which FTC could take immeditae and effective action to crack down on the unscrupulous merchant. We believe that this broad authority is properly subject to judicial screening, but in this regard the present proposals are incomplete. Specifically, we recommend that the Administration's bill be amended with the same clarifying language that appeared in S. 3065, passed by the Senate in 1968, which also would have given FTC preliminary injunction authority over violations of Section 5 of the FTC Act. That language is as follows:

"The court, in its sound discretion, may grant such preliminary injunction without bond as it shall deem just in the premises, under the same conditions and principles as injunctive relief against conduct or threatened conduct that will cause loss or damage is granted by courts of equity."

The Assocation opposes giving FTC authority to seek temporary restraining orders on the ground that such proceedings are *ex parte* and inconsistent with the concept expressed by President Nixon in his Consumer Message, to create a marketplace that is fair and just to the consuming public as well as to business. We believe that every business should have the right to respond in court when

confronted with accusations before action is taken by government. In today's sophisticated marketplace, restraining orders could result in irreparable injury to a business (even though the action later may prove to be baseless). The authority to seek preliminary injunctions is certainly a more equitable procedure.

The Association opposes the proposals to create statutory rights to class actions. This is an example of a proposal we believe would not result in a long-term gain for the nation's consumers. To waive the present requirement of a minimum jurisdictional amount would create tremendous temptation for the filing of spurious lawsuits for purposes unrelated to the public interest. Indeed, it would be the reputable manufacturer with the "deep pocket" rather than the "fly-by-night" who would suffer. In cases involving low-cost items where monetary damages are minimal, the proper and effective remedy for dealing with consumer fraud is via governmental action. To bring the consumer into actions based on a violation of the FTC Act, which traditionally has been a remedial statute, would, rather than penalize the fraudulent merchant or protect the public, result in unfair harassment of legitimate business, with increased costs being passed on to the consumer.

Any proposal which would waive the minimum jurisdictional amount in controversy would create unmanageable chaos in the federal courts, which are already burdened by overcrowded dockets. The congestion in the federal courts would be increased enormously by the proposed class actions, creating an adverse effect for all citizens—including the government itself in its court actions to protect the consuming public—seeking legal redress in those courts. The overall harm would far outweigh any conceivable benefits to individual members of a class. From the point of view of manufacturers of low-cost proprietary medicines sold at competitive prices, the proposed class actions would not be beneficial to the nation's consumers.

STATEMENT OF BENNY L. KASS, NATIONAL LEGAL AID AND DEFENDER ASSOCIATION

Mr. Chairman and Members of the Subcommittee. My name is Benny L. Kass, and I am engaged in the private practice of law in Washington, D.C. I testify this morning on behalf of the National Legal Aid and Defender Association (NLADA).

NLADA was formed in 1911, and is in an affiliate of the American Bar Association, with headquarters in the American Bar Center, Chicago, Illinois. Our membership includes some 474 offices engaged in civil practice and about 200 defender offices engaged in the defense of those charged with crime, all representing clients who otherwise would be unable to afford and obtain counsel. On behalf of NLADA, I am pleased to state that we support and endorse the concept of consumer class action, and specifically H.R. 14585, introduced by Congressman Eckhardt.

NLADA's historic concern is that a lawyer be provided, free of charge, to all persons who need legal help but cannot afford to pay a fee. While this goal has not been attained, vast strides have been made, particularly in the last few years with the help of the Neighborhood Legal Services programs funded by Congress through the Office of Economic Opportunity.

With this kind of progress, though it has become clear to us that the scales of justice for the poor cannot be balanced merely by providing lawyers. Today, members of NLADA handle an estimated 90% of all civil cases in which legal services are rendered to individual poor people in the United States. In the course of this broad experience, it is strikingly apparent that changes in both substantive and procedural law must be made in order that poor people may really become beneficiaries of that ideal of "fair play" which lies at the heart of our constitutional guaranty of due process of law. Without such changes the scales of justice will never come into balance. One procedural change most urgently needed is presently pending before the Subcommittee, namely consumer class actions.

It is important for this record to show that H.R. 14585 is not substantive law, but a very important piece of *procedural* legislation. Permitting a class to sue for consumer fraud, for example, will not affect the court's determination of whether there is fraud. This still has to be determined on its merits; but if the court makes the positive determination, all those who have been defrauded will find a remedy. Too often, only the rich can finance an individual consumer fraud suit. Our NLADA members provide as much assistance as they can to poor consumers, but our attorneys are overworked, understaffed, and confined to representing persons below a certain income—the poverty level.

Mr. Chairman, this Committee has taken testimony from witness after witness on many aspects of the pending legislation, so we see no reason to be reptitive. We would like to cite some examples, however, where class action would be the quickest, most economical, and above all perhaps the only effective method of halting or eliminating widespread abuse in the consumer field—abuse which is well documented in the files of every one of our members. Consider the following typical complaints:

Elderly citizens enticed to contract for dancing lessons extending over long periods of time, only to find the instruction not to be as represented;

Semi-literate people persuaded to purchase sets of inappropriate books for self-education;

Freezers "full of food" sold or "rented," and the seller refuses to be bound by representations of the salesman;

Owners of homes awarded "showcase" contracts under which they understood they were receiving a gift of siding or other home improvements, but in fact signed promises to pay secured by mortgages.

In many of these cases, and countless others, there is a pattern of misrepresentation throughout the community, sometimes throughout an entire state. Individual suits may be quickly settled, to the relief of the particular client. But this procedure allows the general practice to continue with little danger of real exposure or court injunction.

These are not isolated instances, Mr. Chairman. The number of cases reported to NLADA alone gives some idea of the volume of problems in this critical area. From January thru March, 1969, 98 legal aid offices reported more than 4,000 clients with sales contract difficulties. This was 6% of the total of all cases reported—and the classification does not include other consumer problems such as garnishments, holder in due course, repossession, wage claims, etc.

Let us briefly look at the legislative proposals pending before this Subcommittee. H.R. 14585 permits direct consumer class action, whereas H.R. 14931 requires the Justice Department or the Federal Trade Commission to bring a successful action before authorizing a consumer class action. Even assuming, for the moment, vigorous enforcement by these agencies in the consumer interest, will the Justice Department or FTC involve itself in the myriad of problems facing the consumer? Indeed, do we want these Federal agencies in what is—or should be—matters of state concern? And, of course, underlying our concern is the fact that consumers have no guaranty that the federal government will ever act on these individual cases—leaving the consumer even more confused by the rhetoric of "consumerism." If Congress acts to provide relief for the consumer, this relief should be genuine and complete. Half-way measures merely add to the frustration which the Kerner Commission found to be so widespread in the inner-cities of America.

For those who fear that the Federal courts will be flooded with cases if H.R. 14585 is enacted, we suggest that in all probability the number of actions over a period of time will be reduced, since multiple individual complaints will be disposed of in one hearing. And, we hasten to add, every new legislative proposal to broaden the procedural remedies of wronged persons is always attacked with the boilerplate argument that the court dockets will become overcrowded if the bill is enacted. We respectfully suggest that this kind of argument avoids the merits of the legislative measure.

For those who fear that the direct class action procedure will lead to harassment of the honest business community, we submit that these fears are unfounded. Some have suggested that the class action—with its promise of huge fees not commensurate with work expended—offers a financial bonanza to the lawyer. We submit three reasons why this is just not so. First, the NLADA lawyer is often on salary, and concerned with attaining justice—not cash—for his clients. Second, the Canons of the American Bar Association forbid the "ambulance chasing" and the alleged "harassment" which is feared in the class action. And third, H.R. 14585 permits, in Section 4(d), the court to award attorneys a reasonable fee based on the value of their service to the class—not to exceed 10 per cent of the total judgment. This section provides the attorney with a fee commensurate with the work he performed. Perhaps the Committee might consider, by way of language in the report on this legislation, carefully limiting the attorney's fee to the amount of time and effort put into the case, such amount not to be related to the amount in controversy.

Mr. Chairman. We deem this legislation to be one of the most significant consumer items pending in Congress today. Mrs. Virginia Knauer, speaking last

August to the Consumer Federation of America, stated this significance so well, when she said:

> This legislation (referring to direct consumer class suits) has many advantages. First, it gives consumers affected by the broad spectrum of illegal abuses a cause of action and an appropriate forum in the Federal courts. Secondly, and perhaps most importantly, it enlists the services of the private bar in the fight for consumer protection.

It is the private bar that we look to for assistance. And how can we get private lawyers to help the consumer unless we permit reasonable fees for the value of their services? Congress recognized this in the Truth in Lending Act, which authorizes (in § 130(a)(2)) reasonable attorneys fees as determined by the court. Class actions are permitted right now for Truth in Lending violations, but there has been no flood or court cases, no ambulance chasing, if you will.

We submit that passage of the bill, H.R. 14585, is highly needed, and is in the best interests of all consumers. To quote Mr. Benjamin Kaplan, Professor of Law at Harvard and reporter to the Advisory Committee on Civil Rules, the Committee which formulated Federal Rule 23 dealing with Class Actions, "insofar as class actions will enhance the forensic opportunities of hitherto powerless groups, they will tend to probe the *terrae incognitae* of substantive law."

May I express my appreciation of this opportunity to bring the views of NLADA to the attention of this Committee. If we can be of additional assistance, NLADA and the hundreds of legal services lawyers are anixous to help.

STANDING COMMITTEE ON LEGAL AID AND INDIGENT DEFENDANTS OF THE AMERICAN BAR ASSOCIATION CONCERNING CONSUMER PROTECTION LEGISLATION

The views expressed in this letter are solely those of the majority of the members of this Standing Committee; they have not been approved by the Board of Governors nor do they represent the position of the American Bar Association. The Special Committee on Consumer Legislation of the ABA Section of the Anti-Trust Law has filed with both House and Senate Committees a 46-page report concerning this topic, together with numerous recommendations for legislation which likewise does not represent the views of the association. Since this Committee would take issue with some of the views and recommendations of the Special Committee of the Anti-Trust Section, I am submitting this statement in order that our position be made known to Congress.

The Standing Committee on Legal Aid and Indigent Defendants opposes the recommendation by the Special Committee of the Anti-Trust Section which would require a successful action by the Federal Trade Commission against unfair or deceptive business practices as a condition to the filing of a private suit for damages. Our Committee has long been dedicated to the concept of full access to the courts by all persons regardless of means. This is particularly important at a time when society is striving to convince the disaffected and others that they do have meaningful remedies within our present legal system. The prerequisite suggested by the Anti-Trust Section is inconsistent with this concept. Such a requirement would also cause burdensome and prejudicial delays and might subject legitimate law suits to political pressures.

We support comprehensive legislation which would provide vigorous protection of the rights of the American consumer; however, we oppose measures which would significantly limit the right of injured consumers to pursue their legal remedies through class actions. It is through class actions that many consumers with relatively small claims, which might otherwise be overlooked or never be prosecuted for lack of funds to hire an attorney, can recover damages. In this regard, we would adopt the statement made on behalf of the National Legal Aid and Defender Association by Benny L. Kass before the House Sub-Committee on Commerce and Finance of the Committee on Interstate and Foreign Commerce delivered on Wednesday 18 February 1970 in support of the concept of consumer class action and H.R. 14585. A copy is attached. Class actions can be effective in curtailing wide-spread unfair or deceptive practices, whereas individual law suits can bring relief only to particular plaintiffs. We have found class actions to be effective remedies in many situations affecting the underprivileged and they should enjoy equal vitality in consumer actions.

We would note that responsibly handled class actions would dispose of multiple individual complaints in one hearing with the probable result of decreasing the number of suits filed. The argument that broadened class action remedies will

create excessive litigation in already overburdened federal courts avoids the merits of the issue of expanding the procedural remedies of wronged persons.

We have no reason to believe that H.R. 14585 would result in attorneys "harassing" honest businesses in order to obtain large fees. H.R. 14585 permits in Section 4 (D) a reasonable attorney fee based upon the value of services rendered to the class, not to exceed 10% of the total judgment. In addition, where private practitioners would not handle such cases, some suits would be filed by legal aid lawyers restricted to salaries and unable to receive fees.

I respectfully request that the foregoing statement be placed upon the record of this Committee.

JOHN D. ROBB,
Chairman, ABA Standing Committee on Legal Aid and Indigent Defendants.

STATEMENT BY T. LAWRENCE JONES, PRESIDENT, AMERICAN INSURANCE ASSOCIATION

American Insurance Association is an organization of insurance companies writing all forms of insurance other than life. The annual premium volume of its member companies is in excess of $7 billion.

We are concerned with S. 3201 which has been under consideration by the Subcommittee for Consumers of the Senate Commerce Committee. Title II of the bill sets forth eleven defined unfair or deceptive practices. These defined practices are encompassed in the broad language of Section 5 of the Federal Trade Commission Act. The reason for including these eleven defined practices in Title II of the bill is that additional enforcement provisions and remedies which are newly authorized by this legislation are confined to these eleven specified forms of unfair or deceptive practices. First, the Attorney General is authorized to seek injunctions in the district courts of the United States to restrain these specified unfair trade practices. Second, after an injunction sought by the Attorney General has been ordered or a cease and desist order proceeding by the Federal Trade Commission has been entered, as respects one of the defined eleven practices, a consumer may institute a civil suit for damages.

Section 201(f) of Title II defines "services" to include "insurance services." Thus, the bill, as presently drafted, makes this title applicable to insurance.

Its application to insurance is clearly inconsistent with the McCarran-Ferguson Act (15 U.S.C. 1011–1015). That act was adopted in 1945 and followed the decision in United States of America v. South-Eastern Underwriters Association (322 U.S. 533/1944) in which the Supreme Court held that insurance was commerce and thus subject to the federal anti-trust laws. Congress then enacted the McCarran-Ferguson Act and thereby declared that the public interest would be best served by the continued regulation of insurance by the several states. This law further provides that the anti-trust laws, including the Federal Trade Commission Act, would not apply "to the business of insurance to the extent regulated by state law," except for boycott, coercion and intimidation.

The states promptly responded to this challenge. In the area of the Sherman Act, the states enacted rate regulatory laws, and in the area of the Federal Trade Commission Act they passed a model state Fair Trade Practices Act which was patterned after the Federal Trade Commission Act and recommended by the National Association of Insurance Commissioners.

All of these State Fair Trade Practices Laws encompass the eleven specified unfair and deceptive practices set forth in S. 3201. As respects the business of insurance there is an available and workable mechanism at the state level for dealing with any such practices. This is certainly not the case with most of the providers of goods and services which this bill is designed to cover.

The McCarran-Ferguson Act is a carefully drafted law which has worked exceedingly well. Under it, the states continue to regulate the business of insurance and certain federal laws only apply in the absence of state regulation. S. 3201 partially dismantles the McCarran-Ferguson Act by carving out an area of federal regulation which has been exercised by the states pursuant to that act. We see no reason for erecting another competing layer of regulation applicable to the insurance business when there has been no showing of inffective performance by the state regulatory bodies.

In our judgment it would be most unsound to make this major change in the McCarran-Ferguson Act concept. We therefore urge that Section 201(f) be amended to read:

"Services includes provision of intangibles, but not the providing of credit."

The reasons for the amendment, in our judgment, should be set forth in the Report in order to make it clear that this bill is not intended to have application to the business of insurance.

Respectfully submitted.

T. LAWRENCE JONES,
President, American Insurance Association.

AMERICAN BAR ASSOCIATION,
Chicago, Ill., March 27, 1970.

Hon. FRANK E. MOSS,
Chairman, Subcommittee on The Consumer, Senate Committee on Commerce, New Senate Office Building, Washington, D.C.

DEAR SENATOR MOSS: Pursuant to your letter of February 18, and my subsequent telephone conversations with Mr. Cary, the Subcommittee's staff counsel, I am pleased to enclose a report reflecting the views of the Section of Antitrust Law of the American Bar Association concerning consumer class action and related legislation on which your Subcommittee has recently held hearings.

Responsive to your request, I am pleased to submit the report and recommendations of the Section of Antitrust Law, as approved by the Section's Council on the basis of a report prepared by our Special Committee on Consumer Legislation. We would appreciate inclusion of our report in the record of the Subcommittee's hearing, and would be pleased to further assist the Subcommittee in any appropriate manner.

I would particularly invite your attention to the following Summary of our Report (pp. 2–4):

"The Committee recognizes that the new wave of concern for consumer needs and the desire to provide effective relief for unconscionable practices aimed at the consumer are both timely and generally warranted. It supports the goal of improved consumer protection and believes that it can only be effectively furthered through the development of an orderly and responsive Federal and State legislative framework designed to promote the consumer interest. Realizing that consumer abuses occur both on the national and local level, the Committee believes that effective relief must involve the careful integration of federal and state programs.

"Nationally, we propose strengthening the existing powers of the Federal Trade Commission and the adoption of proposals which create a new Consumer Protection Division in the Department of Justice.

"We further recommend that a streamlined remedy be established to provide effective relief for individual consumers through a simplified, expeditious and convenient procedure. Upon the final disposition of a claim brought by the Consumer Protection Division or the Federal Trade Commission, individual consumers would, under this proposal, be entitled to assert their claims in an application to the Commission leading, if necessary, to a hearing before an examiner of the agency who could determine in a speedy and informal manner the right to specific recovery.

"To facilitate further the enforcement of consumer actions on the national level, we ask the adoption of the standards as proposed in Section 201 of the Consumer Protection Act, (S. 3201), with certain suggested modifications. This will provide the consumer with a clearly defined set of substantive rights which he can readily pursue.

"In addition, the Committee desires to encourage voluntary disposition of consumer disputes by measures which would exempt companies from either Department of Justice or Federal Trade Commission redress proceedings if they agree to arbitration by some established organization such as the American Arbitration Association or participate in other recognized consumer grievance redress procedures. Additionally the work of local and national Better Business Bureaus should be encouraged.

"We believe the Federal Trade Commission Act should be amended to include activities 'affecting commerce' as well as those 'in commerce'. This has particular significance in connection with the demonstration projects recommended by the Report of the ABA Commission to Study the Federal Trade Commission, ('Kirkpatrik Report'), and with regard to the Federal Trade Commission's ability to reach advertising and promotional practices of large merchandisers. We further believe that the Commission should be empowered to seek and, under

proper standards, to obtain preliminary injunctive relief against acts or practices which are unfair or deceptive to the consumer. State and local governmental activities must be broadened and strengthened to encompass those violations which can more effectively be handled locally, or are not within the ambit of federal jurisdiction. Also voluntary local mechanisms for accommodating consumers grievances should be strengthened.

"In essence the total recommended program is designed to be uncomplicated and expeditious, both to make clear to willful violators that they are not going to be able to escape through delay and at the same time to avoid burdening already overcrowded court calendars and to avoid further expense to small claim plaintiffs and encouragement of frivolous law suits.

"The Committee conceives the foregoing proposals as an improvement upon the recurring suggestion in pending legislation that a class action procedure be established. We believe that our program offers a more effective and desirable means of providing relief to the consumer. Experience indicates that class actions do not achieve their goal and in fact militate against effective relief. In many cases, the determination of the class becomes a protracted exercise in patience both for the courts and the parties.

"Nor is the class action appropriate for the resolution of consumer claims which involve very small amounts. The adoption of a class action remedy will tax many over-burdened court dockets thus delaying any meaningful consumer relief as well as unjustifiably deferring resolution of other pending cases."

The enclosed report reflects the views of the American Bar Association's Section of Antitrust Law, which has more than 6000 members through the United States.

The submission of our report was authorized by the Board of Governors of the American Bar Association, which took no position on the merits of our recommendations or the pending legislation, since it has not had the time necessary for a study and discussion of these items. Also, the American Bar Association, as a whole, has taken no position on the merits of the legislation, and other sections and committees of the Association have an interest in the subject matter and may ultimately have views differing from those of the Antitrust Section.

Sincerely yours,

FREDERICK M. ROWE,
Chairman.

cc: Hon. Philip A. Hart; Hon. John O. Pastore; Hon. Vance Hartke; Hon. Daniel K. Inouye; Hon. William B. Spong, Jr.; Hon. James B. Pearson; Hon. Hugh Scott; Hon. Robert P. Griffin; Hon. Charles E. Goodell. Bernard G. Segal, Esq., President, American Bar Association; Edgar E. Barton, Esq., Chairman, Special Committee on Consumer Legislation; Officers and Council, Section of Antitrust Law.

REPORT AND RECOMMENDATIONS OF AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW ON CONSUMER PROTECTION LEGISLATIVE PROPOSALS

REPORT AND RECOMMENDATIONS OF THE SPECIAL COMMITTEE ON CONSUMER LEGISLATION TO THE ANTITRUST SECTION—AMERICAN BAR ASSOCIATION

I. INTRODUCTION

This Special Committee was appointed in December 1969 by the Antitrust Section of the American Bar Association to study consumer remedy measures submitted to Congress by the Administration as well as other major related legislative proposals pending before Congress. For convenience these bills are attached hereto as Appendix A. References to specific sections of pending legislation are to the Administration bills, S. 3201 and H.R. 14931, 91st Cong., 1st Sess., unless otherwise noted.[1]

The Committee endorses the enactment of consumer protection legislation consonant with the recommendations made in the body of this report.

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[1] While it is recognized that Congressional action on consumer remedy legislation may make references to particular bills obsolete, the Committee has for convenience made reference in various parts of this report to specific provisions of S. 3201 and H.R. 14931. It is intended that these references shall apply to such measures in the form originally introduced. Other legislation evaluated by the Committee included S. 2246, 91st Cong., 1st Sess., S. 3092 and H.R. 14585, 91st Cong., 1st Sess., and S. 3338, 91st Cong., 2d Sess.

II. SUMMARY

The Committee recognizes that the new wave of concern for consumer needs and the desire to provide effective relief for unconscionable practices aimed at the consumer are both timely and generally warranted. It supports the goal of improved consumer protection and believes that it can only be effectively furthered through the development of an orderly and responsive Federal and State legislative framework designed to promote the consumer interest. Realizing that consumer abuses occur both on the national and local level, the Committee believes that effective relief must involve the careful integration of Federal and State programs.

Nationally, we propose strengthening the existing powers of the Federal Trade Commission and the adoption of proposals which create a new Consumer Protection Division in the Department of Justice.

We further recommend that a streamlined remedy be established to provide effective relief for individual consumers through a simplified, expeditious and convenient procedure. Upon the final disposition of a claim brought by the Consumer Protection Division or the Federal Trade Commission, individual consumers would, under this proposal, be entitled to assert their claims in an application to the Commission leading, if necessary, to a hearing before an examiner of the agency who could determine in a speedy and informal manner the right of specific recovery.

To facilitate further the enforcement of consumer actions on the national level, we ask the adoption of the standards as proposed in Section 201 of the Consumer Protection Act, (S. 3201), with certain suggested modifications. This will provide the consumer with a clearly defined set of substantive rights which he can readily pursue.

In addition, the Committee desires to encourage voluntary disposition of consumer disputes by measures which would exempt companies from either Department of Justice or Federal Trade Commission redress proceedings if they agree to arbitration by some established organization such as the American Arbitration Association or participate in other recognized consumer grievance redress procedures. Additionally the work of local and national Better Business Bureaus should be encouraged.

We believe the Federal Trade Commission Act should be amended to include activities "affecting commerce" as well as those "in commerce". This has particular significance in connection with the demonstration projects recommended by the Report of the ABA Commission to Study the Federal Trade Commission, "Kirkpatrick Report"), and with regard to the Federal Trade Commission's ability to reach advertising and promotional practices of large merchandisers. We further believe that the Commission should be empowered to seek and, under proper standards, to obtain preliminary injunctive relief against acts or practices which are unfair or deceptive to the consumer.

State and local governmental activities must be broadened and strengthened to encompass those violations which can more effectively be handled locally, or are not within the ambit of federal jurisdiction. Also voluntary local mechanisms for accomodating consumers grievances should be strengthened.

In essence the total recommended program is designed to be uncomplicated and expeditious, both to make clear to willful violators that they are not going to be able to escape through delay and at the same time to avoid burdening already overcrowded court calendars and to avoid further expense to small claim plaintiffs and encouragement of frivolous law suits.

The Committee conceives the foregoing proposals as an improvement upon the recurring suggestion in pending legislation that a class action procedure be established. We believe that our program offers a more effective and desirable means of providing relief to the consumer. Experience indicates that class actions do not achieve their goal and in fact militate against effective relief. In many cases, the determination of the class becomes a protracted exercise in patience both for the courts and the parties.

Nor is the class action appropriate for the resolution of consumer claims which involve very small amounts. The adoption of a class action remedy will tax many over-burdened court dockets thus delaying any meaningful consumer relief as well as unjustifiably deferring resolution of other pending cases.

III. PENDING LEGISLATION AND RECOMMENDATIONS

A. Expanded jurisdiction of the Federal Trade Commission

The Administration proposes to amend Section 5 of the Federal Trade Commission Act to make unlawful all unfair methods of competition and unfair or deceptive acts or practices "affecting commerce". At present Section 5 applies to only such acts and practices as are "in commerce". Enactment of the jurisdictional proposal would broaden the responsibility of the Commission to include, at a minimum, fuller consideration of numerous public complaints received each year which are not acted upon because of their localized nature. It is estimated that as many as 10 percent of inquires received may fall into this category. Enactment of the proposed amendment would be consonant with the recommendations in the Kirkpatrick Report. It is apparent, however, that additional funds would have to be appropriated to enable the Federal Trade Commission to deal effectively with the additional responsibility that would result from enactment of the proposed amendment.

Background.—Although Sherman Act jurisdiction, encompassing activities "affecting commerce", extends to the outer limits of federal authority, *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U.S. 219 (1948), Section 5 of the Federal Trade Commission Act limits the Commission's jurisdiction to unfair methods of competition and unfair trade practices "in commerce". The Supreme Court's decision in *FTC v. Bunte Bros., Inc.*, 312 U.S. 349 (1941), rejected the agency's argument that it could proscribe unfair methods used in intrastate sales when they resulted in a handicap to interstate competition. The Court held that "in commerce among the several states" meant "in interstate commerce", not "affecting commerce", and thus found that a mere effect on the sales of interstate competitors was not a basis upon which to predicate Federal Trade Commission jurisdiction.

Nevertheless, while Federal Trade Commission jurisdiction cannot be based on the effect of a local firm's activities on a competitor's interstate business, it has been held that Commission jurisdiction can reach an interstate firm's local activities stemming from its interstate business. *Holland Furnace Co. v. FTC*, 269 F. 2d 203 (7th Cir. 1959) *aff'd on rehearing*, 295 F. 2d 303 (7th Cir. 1961) *cert. denied*, 361 U.S. 932 (1965).

The Court distinguished *Bunte Bros., supra*, on the ground that in ". . . that case, quite contrary to this, the unfair methods of competition sought to be regulated by the Commission were admittedly confined to activities wholly within the State of Illinois relating to goods manufactured in Illinois and which had been at no time in interstate commerce. In the case here the goods were manufactured in Michigan and shipped from that state into at least forty-four other states to be sold and distributed by the manufacturer's own agents and employees to the ultimate consumers." (269 F.2d at 210).

The Court went on to find that: ". . . the local sales by Holland through its own employees, filled from Holland's warehouses to which its products were shipped in interstate commerce prior to such sales, have *such close and substantial relation to interstate commerce as to bring them within the regulative powers and jurisdiction of the Federal Trade Commission.*" (Emphasis added). (*Id.* at 213).

The *Holland Furnace* rule has also been applied when a manufacturer with a multi-state distribution system engaged in unfair acts in only one state. *Sun Oil Co. v. FTC*, 350 F.2d 624 (7th Cir. 1965), *cert. denied*, 382 U.S. 982 (1966).

In addition, it has been held that an otherwise local transaction is in interstate commerce if subsequent interstate shipment of the goods sold in the transaction is contemplated. *Asheville Tobacco Board of Trade v. FTC*, 263 F.2d 502 (4th Cir. 1959) ; *Bankers Securities Corp. v. FTC.* 297 F.2d 403 (3d Cir. 1961). And in *Surrey Sleep Prods., Inc.*, CCH Trade Reg. Rep. ¶ 18,317 (April 3, 1968), the Commission held that interstate advertising was sufficient to provide jurisdiction even though no interstate sales might result.

As a result of these decisions, it is evident that a business may not be immune from Section 5 of the Federal Trade Commission Act merely because it operates within one state. However, many localized marketing frauds, such as those in ghetto areas, which involve companies whose advertising and selling activities are entirely limited to such areas are very probably beyond the scope of existing

jurisdiction, although other activities would arguably subject such companies to the Commission's jurisdiction under the "affecting commerce" test of the Sherman Act.

Advisability of the Proposed Amendment.—The adoption of the proposed amendment to enlarge the Federal Trade Commission's jurisdiction would both clarify and expand the agency's authority and make unnecessary extensive court challenges to jurisdiction. It is endorsed by the Committee as it empowers the Commission to reach potentially deceptive advertising practices by large, but essentially local, merchandisers. Vesting the agency with this power is desirable for three basic reasons. First it would permit expanded use of "demonstration projects", particularly in the inner cities. Second, the perpetration of an unfair or deceptive act or practice in a single major metropolitan area may abversely affect more consumers than some of such practices which occur in interstate commerce. And finally, the deterrent effect of a well-planned, significant proceeding against one local merchant on others similarly situated should not be overlooked.

The amendment should not prejudice continuation and expansion of the Commission's federal-state cooperation program, which has been in existence since 1965. Pursuant to this program, Federal Trade Commission refers complaints to local enforcement officials when they involve essentially intrastate problems, and the Commission solicits complaints from state and local officials when interstate problems are involved. The Federal Trade Commission also responds to requests from state legislators and other state officials for advice or assistance in drafting legislation, prepares drafts of model legislation for consideration by the states, and appears and participates in conferences and meetings of local enforcement officials. We are informed that the number of matters referred to the states under this program has increased from 100 in 1967 to 121 in 1968 and approximately 160 in 1969.[2] The Federal Trade Commission's office of federal-state cooperation received 281 requests from local officials for advice during the year ending June 30, 1968 and 477 such requests were received during the year ending June 30, 1969.[3]

Since initiation of this program, thirty-five states have taken action to protect consumers from deception and to prevent unfair practices. Some of these states have established consumer fraud bureaus, consumer complaint clearinghouses, or study committees to determine the need for new legislation.[4]

Sufficient funds must be appropriated for the Federal Trade Commission, however, if it is to carry out the enlarged responsibilities it would possess as a result of its enlarged jurisdiction. It is also recommended that Congress should clearly make its intent known that the jurisdiction conferred is concurrent, rather than exclusive, so as to avoid undermining the enforcement activities of state and local agencies.

B. POWER OF THE FEDERAL TRADE COMMISSION TO SEEK INTERLOCUTORY INJUNCTIVE RELIEF AGAINST ACTS OR PRACTICES WHICH ARE UNFAIR OR DECEPTIVE TO THE CONSUMER

One aspect of the Administration program which has been the subject of Congressional consideration for the past several years is the proposal to authorize the Federal Trade Commission to seek interlocutory injunctive relief, under certain conditions, against actual or potential acts or practices which are unfair or deceptive to the consumer. This proposal is embodied in Section 102 of S. 3201 and H.R. 14931 and would amend Section 13 of the Federal Trade Commission Act.[5]

The Committee's conclusions are as follows:

Standards for Issuance of Preliminary Injunction.—S. 3201 would authorize the district courts to issue preliminary injunctions or temporary restraining

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[2] Statement of Gale P. Gotschall, Counsel to the FTC for federal-state cooperation, Dec. 31, 1969.

[3] *Id.*

[4] Statement of Paul Rand Dixon, Chairman, FTC, Before the Subcommittee on the Consumer, Senate Commerce Committee at 3–4, (Dec. 16, 1969).

[5] In connection with this issue, the Committee also considered S. 2246, sponsored by Senators Moss, Cannon, Hart, Inouye, Magnuson and Pastore; S. 3065, 90th Cong. 2d Sess., in the form in which it was approved by the Senate on July 11, 1968, 114 Cong Rec. S848; and a draft proposal approved by the ABA in July 1968.

orders, without bond, "[u]pon proper showing of need" against actual or potential acts or practices which are unfair or deceptive to the consumer.[6] S. 2246, tracks the language of present Section 13 of the Federal Trade Commission Act in describing the statutory standard of such relief as "[u]pon proper showing." Assistant Attorney General McLaren did not, however, explain the import of the words "upon proper showing of need" during his testimony on S. 3201, December 16, 1969; however, it may well be that they would narrow the courts' equity discretion to an assessment of need in the sense of balancing injury, and would preclude judicial consideration of probability of the government's ultimate success.

In *FTC v. Rhodes Pharmacal Co.*, 191 F. 2d 744 (7th Cir. 1951), the Court of Appeals narrowly limited judicial discretion as to the denial of Commission suits for interlocutory injunctive relief in cases under Section 13. The Court concluded:

"We think, however, that it is fair to say that all the Commission had to show was a justifiable basis for believing, derived from reasonable inquiry or other credible information, that such a state of facts probably existed as reasonably would lead the Commission to believe that the defendants were engaged in the dissemination of false advertisements of a drug in violation of the Act . . . This is to say, in the instant case, the court had only to resolve the narrow issue of whether there was reasonable cause to believe that the alleged violation had taken place." (Id. at 747, 748).

While not wholly clear, this language strongly suggests that a court must grant a preliminary injunction or temporary restraining order if, the Commission can show it had both reasonable cause to believe that a violation had occurred or would occur and that such relief is in the public interest. In other words, the district court might not exercise its own sound discretion in these or any other respects.

The *Rhodes* decision conflicts with that of the District Court for Maryland in *FTC v. National Health Aids, Inc.*, 108 F. Supp. 340 (D. Md. 1952). There the court concluded:

"The reasonable belief of the Commission is sufficient to warrant its application for the injunction, but the action of the Court should be based on the general considerations that properly apply in the issuance of preliminary injunctions" (Id. at 346).

Although noting the conflict of authority, the Second Circuit chose to straddle the issue in *FTC v. Sterling Drug, Inc.* 317 F. 2d 669 (2d Cir. 1963). It upheld the district court's denial of an interlocutory injunction, after an exhaustive analysis of the record, on the ground that the lower court had properly found the Commission to be unreasonable in its belief of violation.

It is the view of the Committee that the showing which must be made by the Commission to obtain a preliminary injunction should be no less rigorous than those which must be made by plaintiff under accepted principles of equity applied in the Federal Courts.

Professor Moore describes the conditions upon which a preliminary injunction might issue, where solely private interests are involved, as follows:

". . . the trial court may, in the exercise of its discretion, properly grant an interlocutory injunction when it is satisfied that there is a probable right and a probable danger and that the right may be defeated, unless the injunction is issued; that the plaintiff is in substantial need of protection; and that the damage to him, if the injunction is denied, plainly outweighs any foreseeable harm to the defendant." (7 Moore, *Federal Practice* ¶ 65.04(1) (2d ed. 1968)).

The same conditions have been applied to government injunctive actions under the antitrust laws. See, *United States v. International Telephone and Telegraph Corp.*, 1969 Trade Cas. ¶72,943 (D. Conn. 1969). This approach is also somewhat similar to that described by Commissioner Philip Elman in his statement to the Senate Commerce Committee on S. 3065 in 1968:

"A court would find a "proper showing" to have been made only where (a) it is reasonably probable that the challenged acts or practices will ultimately be

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[6] The inclusion of the words "to the consumer" is apparently designed to limit the provisions of the legislation by excluding interlocutory injunctive authority in cases involving the antitrust-related aspects of Section 5 of the Federal Trade Commission Act. As set forth in the 1968 report of the Senate Commerce Committee on S. 3065, a predecessor proposal, "S. 3065 would preserve the Commission's authority to seek injunctive relief in [the § 12] area, while also conferring this authority upon the Commission in other proceedings involving consumer fraud." S. Rep. No. 1311, 90th Cong., 2d Sess., 2 (1968).

determined to be illegal, (b) the continuing injury to the consuming public during the pendency of the litigation is manifest and substantial, and (c) the balancing of interests, public and private, tips clearly in favor of granting an interlocutory injunction." (S. Rep. No. 1311, 90th Cong. 2d Sess. 2 (1968)).

The 1968 ABA draft proposal would have provided that:

"The court may, in its sound discretion under proper showing and such hearings as the court may deem warranted, issue a temporary injunction, without bond, as shall be deemed just in the premises. . . ."

This proposal would establish that the court not only has discretion to look beyond the Commission's assertion of belief and public interest, but to make its own determinations as to what is just under the facts and circumstances of the case. Almost certainly a court would, under this standard, assess the likelihood of the Commission's ultimate success and would balance public and private injury before taking action on a suit for preliminary injunction.

The ABA draft is moderately framed and would, in our opinion, accomplish the objective of incorporating both the standards of balancing injury and of assessment of government victory in the proposed statute without necessarily incorporating the further burden of proving irreparable injury. It is therefore recommended that the standard for the granting of a preliminary injunction be drawn from the ABA draft.[7]

However, the ABA draft appears to accord the courts some discretion as to the nature of the hearing provided under the statute. In view of the inherent power of the district courts to control the nature and extent of hearings and prevent their abuse of dilatory tactics, it would seem desirable for preliminary injunction proceedings under this legislation to be governed by Rule 65, which provides for hearings as a matter of right other than in very exceptional circumstances.

Application for Temporary Restraining Orders.—Both S. 2246 and S. 3201 would authorize the Federal Trade Commission to seek both preliminary injunctions and temporary restraining orders if the "reason to believe" and "public interest" predicates are satisfied. Considerable controversy surrounds the question of granting the Commission power to seek and the courts to issue temporary restraining orders, very possibly without notice, as provided under Fed. R. Civ. P. 65.

Specifically, the contention has been made that since the Commission would be accorded substantially enlarged enforcement powers under the proposed legislation, principles of fairness dictate that interlocutory injunctions issue only after notice and opportunity for the preservation of views contrary to those of the agency.

The Committee has concluded that in any interlocutory injunctive proceeding initiated by the Commission, the party charged should be assured of notice and the right to be heard in opposition to the issuance of such relief. Such a right is not guaranteed as to temporary restraining orders under Rule 65. Therefore, the Committee recommends that the Commission be authorized to seek and the courts to grant only preliminary injunctions under the proposed legislation.

Pre-complaint Actions for Injunctive Relief.—Under Section 13 of the Federal Trade Commission Act the Commission may seek interlocutory injunctive relief against actual or potential Section 12 vilations "pending" the issuance of its administrative complaint. These concern deceptive advertising practices for food, drug and cosmetics. This statutory language has been construed to mean that the Commission's complaint need not be issued prior to its initiation of the court action. *FTC. v. Thomsen-King & Co.*, 109 F. 2d 516 (7th Cir. 1940).

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[7] The ABA draft proposal is as follows:

"Section 16. Whenever the Federal Trade Commission has reason to believe that any person, partnership, or corporation: (a) is engaged in or is about to engage in any act or practice in commerce within the meaning of section 5 which is deceptive to the consumer; or (b) is liable to a penalty under section 14 or under subsection (1) of section 5 and if it shall appear to the Commission that it would be to the interest of the public, the Commission shall certify the facts to the Attorney General, whose duty it shall be to cause appropriate civil proceedings to be brought in a district court of the United States, or in the United States court of any territory, to enjoin any such act or practice, or to secure such penalty, as the case may be. In proceedings pursuant to sub-paragraph (a) hereof, the court may, in its sound discretion upon proper showing and such hearing as the court may deem warranted, issue a temporary injunction, without bond, as shall be deemed just in the premises pending prompt hearing and review by the Commission of any such act or practice and until the Commission's complaint is dismissed by the Commission or set aside by the court on review, or the order of the Commission to cease and desist made thereon has become final within the meaning of section 5. Any proceeding pursuant to this Section shall be brought in the district court in which such person, partnership or corporation resides or transacts business."

None of the pending proposals would revise this language, although a *proviso* in S. 3201 would dissolve any injunction or order unless the Commission files its complaint within 60 days after the issuance thereof.

The Committee believes that the Commission should be prepared to proceed administratively upon or prior to its action for interlocutory injunctive relief. If the agency is prepared to make the showing necessary to obtain a preliminary injunction, there is no reason why it should not be in a position, at least simultaneously with its suit therefor, to file its admiinstrative complaint and proceed expeditiously thereunder. While compelling the Commission to issue its complaint contemporaneously with or prior to the filing of a court action would impose no substantial burden on the Commission, it would provide at least an initial safe guard to respondents of expeditious action by the agency.

Assurance of Expeditious Administrative Proceedings.—One matter of major concern in connection with preliminary injunctions is the extent, if any, to which a person, firm or corporation subject to such a sanction would be protected from its interminable pendency during extensive administrative proceedings. Although the Commission was organized, in part, to provide expedition in the enforcement of laws administered by it, its record in this regard has been less than superlative.[8] In fact, it has been observed that the need for injunctive relief legislation stems, in part, from excessive delay in agency litigation.[9] Finally comment on delays in the administrative process permeated the 1968 Senate report and debate on S. 3065, although no rectifying amendment was proposed. It may be that the general supervisory powers of a court of equity are such that, without specific legislative provision, the courts could dissolve their injunctions upon showing of delayed proceedings.[10]

The ABA draft provides that injunctive relief may be granted ". . . pending prompt hearing and review by the Commission of any such acts or practice." It does not, however, expressly authorize the courts to dissolve the injunction in the event administrative action is other than prompt.

In view of the substantial economic injury and loss of public good will which might result from the pendency of an interlocutory injunction throughout protracted agency proceedings, the Committee concluded that the legislation should contain express provision for court dissolution of its injunction under appropriate circumstances.

Venue.—Under Section 13 of the Federal Trade Commission Act, an action for interlocutory injunctive relief may be initiated in any district in which the defendant resides or transacts business. Proposals under consideration would preserve this provision with the exception of Section 102 of S. 3201, which makes no provision for venue whatever.

The general federal venue statutes, which would presumably apply under Section 102, are somewhat broader in the instance of both corporations and individuals than the venue provision of Section 13. In the case of a corporation, the additional "license to do business" contact in 28 U.S.C. § 1391(c) may and frequently does include districts where the corporation is not in fact doing or transacting business. Similarly, as to a person or partnership, the place where the claim arose, 28 U.S.C. § 1391(b), may be somewhat remote from both the residence and loci of business, particularly since interstate advertising may often be involved in the litigation.

The Committee deemed it undesirable to group the grant of new extensive enforcement powers to the Commission with broader opportunities for forum-shopping than presently exist. Accordingly, it recommends adoption of a venue provision identical to that in present Section 13.

Representation of Commission in Court.—Section 13 of the Federal Trade Commission Act, S. 3201 and S. 2246 all provide for the appearance by the Commission through its attorneys in actions for interlocutory injunctive relief. Members of this Committee believe that the posture of the Commission's maintaining an unusual, quasi-judicial role in an administrative proceeding and contemporaneously arguing in court the reasonable probability that a respondent has committeed a law violation, has been subjected to strong and justified criticism. This Committee recommends vesting the Commission's General Coun-

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[8] See, *e.g.*, Kirkpatrick Report, 28–32.

[9] See, Statement of Commissioner Elman, *supra*, S. Rep. No. 1311, 7, 8.

[10] By way of illustration, the preliminary injunction issued by the 7th Circuit in Dean Foods was limited to four months duration. See, Dean Foods Co., FTC Dkt. No. 8674, CCH Trade Reg. Rep., 1965–67 Transfer binder ¶17,628, order expediting proceedings (July 25, 1966).

sel with authority to make determinations whether interlocutory injunctive relief should be sought in particularly cases and to initiate and prosecute such actions. These members see this suggested grant by the Commission, not requiring legislation, as providing some balance between the situation which presently exists under Section 13 and the complete removal of the Commission from such proceeding as would result from their reference to the Attorney General.

A minority view would prefer a more distinct separation of functions.

Application of Proposal to Food, Drug, and Cosmetic Device Advertising.—Amendment of Section 13 to include the provisions herein set forth would limit the present powers of the Commission to seek preliminary injunctions and temporary restraining orders against potentially unlawful advertising of food, drugs, cosmetics and devices under Section 12. As a result, the proposal could constitute, in part, a partial step backward in the enhancement of FTC enforcement machinery.

Accordingly, the Committee recommends that a new Section be added to the Federal Trade Commission Act which would cover acts or practices which are unfair or deceptive to the consumer other than those presently covered by Sections 12 and 13.

C. Consumer remedy

The Committee favors enactment of federal legislation to afford the consumer an efficient and expeditious remedy against consumer abuses. We recommend a procedure for securing consumer redress in a simplified format which, we submit, is superior to the approaches contained in any pending legislation.

The crux of this recommendation, as more fully hereinafter explained, is that the federal government through the Federal Trade Commission and the Department of Justice represent the consumer in preventing widespread and significantly deleterious merchandising practices. Recognizing the complexities of this nationwide problem and searching for the proper instrumentalities upon which to place the burden of representing the consumer interest we conclude that the Federal Trade Commission and the Department of Justice are the logical and perhaps only, effective instrumentalities for this purpose. Machinery thus would be established within the framework of the Federal Trade Commission for the prompt and uncomplicated recovery of actual damages by consumers who are injured by such practices.

We believe that this proposal will give full vent to the enhanced enforcement powers and emerging consumer-oriented programs of the Department of Justice and a revitalized Federal Trade Commission. These agencies will not only be able promptly to prevent continuation of frauds on the consumer through power to seek interlocutory injunctive relief and other improved enforcement tools but to ensure consumer redress. Recovery can be accomplished in what is in essence a single proceeding: Basic adjudication as to violation and liability for damages and subsequent, simplified administration of payment of valid consumer claims through the Commission's Hearing Examiners, functioning much like Masters. These recommendations would afford an immediate and effective relief to all citizens whereever they are located without a new expense to them.

We consider this procedure far preferrable both from the standpoints of the consumer and the legal and judicial systems to proposed class action measures.

Federal legislation need not and should not, however, be directed against every type of potentially deceptive or unfair practice which might be engaged in on both national and local levels. On the contrary, such legislation should be part and parcel of a full national program interrelating federal and state enforcement and remedial techniques. Thus, localized abuses not creating widespread harm should more properly be controlled by local agencies and consumer relief should be provided through the state courts in such cases.

In evaluating the consumer protection proposals currently before Congress, the Committee applied four criteria:

1. The nature of the abuse to be remedied;
2. The effectiveness and expeditious nature of the relief afforded;
3. The nature and extent of the effect of the proposal on the existing judicial structure; and
4. The deterrent effect of the proposal.

An underlying feature of all of the current proposals is an apparent attempt to deal federally with major localized abuses. However, the Committee believes that the pending proposals fail to afford meaningful and effective relief against most such abuses. Moreover, the several proposals do not accomplish their

intended remedial and deterrent purposes on the national level, but instead espouse a time-consuming, unwieldly, and inefficient mechanism to confront all wrongs—class actions—which may be more likely to hinder rather than foster optimum consumer protection. In effect, these proposals may provide but a shadow remedy.

The existing proposals may be based on the erroneous belief that one form of relief will best protect the consumer against all types of unfair trade practices and at the same time provide him with an adequate remedy. The multitude of consumer abuses which can be characterized as "unfair trade practices" take many forms, cause various kinds and degrees of harm, and depending upon the size and nature of the businessman engaged in the practice, require different forms of control. The pending legislative proposals do not seem to recognize these differences.

The Committee recommends the adoption of federal legislation which can effectively utilize Federal enforcement agencies; which will provide for swift and efficient relief to injured consumers harmed by significant abuses; which will obviate complex and protracted private proceedings; and which can be harmonized with existing and proposed statutory controls on the state level. Although the Committee's recommendation is generally modeled after the Consumer Protection Act of 1969, S. 3201, and refers to the provisions of that bill as introduced, it has eliminated the provision for consumer class actions, and has substituted therefor a means by which injured consumers can obtain prompt relief upon successful termination of a government suit.

In making its legislative recommendation the Committee recognizes that such legislation may not provide a federal forum to every individual harmed by every unfair trade practice which can be engaged in by businessmen in a manner that affects interstate commerce, even though our proposed remedy will be more often available and effective than would pending class action proposals. However, the Committee's proposal provides for substantial additional enforcement and remedial techniques not presently available in federal courts, and it is believed that they should be carefully analyzed before any further steps are taken on the federal level which could result in excessive federal court congestion and invite litigation whose maintenance would be of doubtful benefit to the consumer.

The Standard of Relief.—In view of the fact that the legislative measures under consideration as well as this Committee's recommendation constitute the first far-reaching, comprehensive proposals for the establishment of federal machinery to secure financial redress for consumers injured by wrongful merchandising practices, it is deemed essential to define with certainty the elements of violation which may subject offenders to liability. Legitimate business is entitled to the basic safeguard of precise definition which would permit it to tailor its practices to compliance with concrete federal law. This is particularly true where monetary liabilities may arise from the first determination that a given course of conduct is unlawful.

Simply to identify as unlawful and as giving rise to monetary liability any act or practice which might violate Section 5 of the Federal Trade Commission Act is inadequate in this regard.[11]

This statute, as amended, broadly attacks unfair methods of competition and unfair or deceptive acts of practices and leaves wide scope to the Commission in the definition of what is unlawful.[12] Indeed much of the flexibility with which the Commission is provided by Section 5 could be washed away in a judicial unwillingness to permit damages to be assessed for conduct not previously known to be prohibited and an awareness that monetary penalties could flow both retrospectively and prospectively.

The foregoing problems of uncertainty and unfairness apply with even more force to legislative proposals which would tie monetary liability not only to violation of Section 5 but to state statutory or decisional law related to consumer protection.[13]

The same considerations of certainty militate for an appropriate statutory element of scienter as a predicate to liability.

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[11] See S. 3338, 91st Cong. 2d Sess., attached hereto as part of Appendix A.

[12] For example, notwithstanding the unanimous contrary holdings in two Court of Appeals decisions, the Supreme Court agreed with the Commission's novel finding of illegality in *FTC* v. *Colgate-Palmolive Co.*, 380 U.S. 374 (1965).

[13] See S. 3092 and H.R. 14585, 91st Cong. 1st Sess., attached hereto as part of Appendix A.

The Committee accordingly urges the adoption of specified offenses as enumerated in Section 201(a) of Title II of S. 3201. It is thought that the delineation of specific abuses affords a clearly defined and comprehensive listing of substantive unfair trade practices which are injurious to the consumer.

Although the Committee supports the enactment of the existing list in principle, it recommends that two changes be made. First, Section 201(a)(6) should be amended to substitute the word "unused" for "new". It is apparent that the purpose of this section is to prevent the sale of second hand goods as new; yet in its broadly drafted fashion, it would reach beyond that purview. There are too many permutations to the word "new" which might result in legitimate practices being termed violations of the act. Second, the Committee believes that Section 201(a)(1)0 should be amended to include a "knowledge" element as in the other enumerated violations. In addition, the Committee has serious reservations concerning the broad and indeterminable scope of Section 201(a)(11).

The Committee further concludes that the element of knowledge be defined as in Section 201(b) of S. 3201.

Additionally, we believe that the basis of federal jurisdiction over the enumerated violations in Section 201 should be clarified. Accordingly, we recommend that the section should be amended to define violations as those abuses "in or affecting commerce.".

Government Enforcement.—The Committee believes that both the Department of Justice and Federal Trade Commission should be granted concurrent jurisdiction in the initiation of proceedings giving rise to liability. This affords maximum effectiveness and flexibility in enforcement, since it permits the full utilization of the resources of two government agencies.[14]

The Commission's recent development of innovative methods of dealing with consumer causes indicates an emerging ability to provide imaginative and effective relief against consumer abuses. Examples of such relief include the "cooling off period" provision in a cease and desist order imposed in connection with bait and switch activities, *Household Sewing Machine Co.*, CCH Trade Reg. Rep. ¶18,882 (FTC August 8, 1969) and the prohibition in another proceeding of misleading assignments which utilize the holder-in-due-course doctrine to deny the consumer any remedy, *All States Industries*, CCH Trade Reg. Rep. ¶18,840 (FTC April 1, 1969). Similarly, the Commission's undertaking to secure restitution of funds in the *Curtis Publishing case*, CCH Trade Reg. Rep. ¶18,789 (FTC Oct. 13, 1969, is another far-reaching effort to aid the consumer.

Either government agency would be entitled to seek injunctive relief and, moreover, either would thus be able to obtain a determination of liability on the part of the wrongdoer which would be the foundation for effective consumer relief.

Individual Consumer Redress.—The Committee proposes that legislative machinery be established for individual recovery of money damages and, where appropriate, restitution, reformation and recission. This will provide consumers within direct, prompt, uncomplicated, inexpensive, and fully effective relief. The objective can be accomplished by radically streamlining the procedures of litigation to take into account the fact that consumer frauds and abuses ordinarily involve small amounts and the persons injured are of limited means. Using such procedures, Federal Trade Commission hearing examiners can hold hearings in geographical areas in proximity to the consumer rather than requiring him either to come to Washington, D.C. or to an often distant federal court.

The individual remedy which the Committee proposes will function in this fashion. As soon as there is a final determination of liability in a proceeding commenced by the Justice Department or Federal Trade Commission, either through a final court judgment or a final Commission order, the Commission will designate a hearing examiner to see that injured consumers are accorded relief. The hearing examiner will immediately initiate a process by which consumers who have suffered from the practice will be made aware that they can obtain monetary recovery and any other appropriate relief.

This process of notice can take place at the expense of the supplier, and may be carried out under the hearing examiner's direction. The exact form of notice

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[14] Other pending legislation, S. 3290 and H.R. 14758, 91st Cong. 1st Sess. provide for the establishment of a Consumer Protection Division within the Department of Justice, which would presumably be responsible for consumer enforcement activities under S. 3201. The creation of such a Division with the consumer interest as the focal point of its attention promises to add substantial governmental enforcement strength.

will depend on the circumstances of the case. If there is a list of consumer customers, mailings can be made. If they are concentrated in certain census tracts, mailings can go out throughout those census tracts. If they are attentive to certain media—whether local newspapers, national magazines, television, or radio—where the initial violation may have been perpetrated, such media can be used to convey the notice. Whatever means are necessary to bring to the attention of the injured consumer the availability of relief will be used.

Once the consumer becomes aware that relief is available, recovery will be expeditious. He can put the process in motion simply by advising the Federal Trade Commission of his interest. The Commission will then ask the consumer to complete a form setting forth the basis for his claim. The agency should devise a simplified form for this purpose which could be adapted on a case-by-case basis. Thus, if the consumer has been defrauded through purchase of an unlawfully priced article of apparel, he might possibly be asked when and where he bought it; and whether he has any record of the purchase or the article itself. The form stating these questions could be made available through the mails in the initial notification of customers, and would be disseminated by the Commission in response to any inquiry about relief.

On receipt of this form, the Commission would forward it to the defendant. In most cases the supplier, rather than undertaking the expense of contesting a claim with every prospect of losing would promptly reimburse the consumer or provide other satisfactory redress. Should he not, the hearing examiner would schedule a prompt hearing at a location convenient to the consumer, in whatever part of the country he might be.

The Committee's proposal would avoid the delays involved in assembling an appropriate class, since the individual can obtain relief without awaiting agreement on group action. Moreover, the consumer will be able to avoid ponderous pretrial procedures, a full dress trial, and the numerous interlocutory appeals which arise when a multiplicity of parties at interest in a single lawsuit are involved. It will avoid necessity of consumers paying one-half to one-third of their needed recovery in the form of legal fees, for the procedure can be so uncomplicated that no lawyer may be required. Thus, the Committee's proposal would avoid a cumbersome and inappropriate format and replace it with a specially designed, expedited procedure which wil lalso avoid court costs and lawyers' fees.

Moreover, the judgment upon which consumer relief will be predicated will be obtained at government expense, and will relieve the consumer of the need to undertake the financial burden of litigation, with its attendant time-consuming duties.

The government has adequate resources to oppose suppliers effectively. But when the supplier does not prevail, the consumer will be able to benefit from the judgment in a very simple fashion; only the most elementary facts need to be proved as a condition for the payment of his claim, and no dilatory tactics will be available. To accomplish this objective, expedited and inexpensive procedures for appeal and enforcement of awards must be provided.

Abbreviated procedures are possible because of the simplicity of the issues in litigation involving widespread consumer frauds. Unlike antitrust litigation, where class actions are frequently employed, there are typically no complex economic issues requiring lengthy trial and highly sophisticated analytical techniques involving expert witnesses and lengthy discovery procedures. In establishing the right to consumer monetary relief, there are involved relatively simple procedures of showing injury which may, however, involve different specific elements as respects different consumers.

The effectiveness of consumer relief would be substantially augmented by predicating it upon a government enforcement proceeding. The creation of the Consumer Protection Division in the Department of Justice, whose sole function would be the furtherance of consumer interests, would permit vigorous government enforcement. This new agency, along with the revitalized Federal Trade Commission, would pursue significant and widespread consumer abuses. It is to be anticipated that those claims to which two government agencies do not respond either would lack merit or be *de minimis* in character.

The courts would continue to offer the consumer a broad spectrum of state and local enforcement and remedial mechanisms, including enforcement agencies and judicial relief in state and local courts of general jurisdiction, state and local small claims courts and otherwise. It would be unfortunate if these state and local programs were relegated to an insignificant role or their growth and

expansion stunted by a misplaced reliance upon Federal action. Thus, the Committee believes that predicating federal relief on the existence of a prior enforcement proceeding should not limit the panorama of consumer remedies but rather would encourage the development of effective state and local programs designed to supplement a vigorous federal program and afford the consumer expeditious and effective relief.

Class Actions.—While the Committee believes that a private monetary remedy is a prerequisite to any effective consumer program, experience establishes that the class action mechanism is not capable of providing an expeditious and judicious determination of legitimate consumer grievances in the courts.

(i) The determination of the proper members of the class has proven an unduly prolonged experience. In *Union Carbide & Carbon Corp. v. Nisley*, 300 F. 2d 561 (10th Cir. 1962), *cert. denied*, 371 U.S. 801 (1963), it took more than three years for the court merely to determine the appropriate class. While there will no doubt be some situations in which the class can readily be determined, the majority of consumer class actions would not seem to be in this category.

(ii) The Committee is gravely concerned that application of the class action mechanism to the broad field of consumer frauds would place an enormous burden upon many already congested federal court dockets. In *Snyder v. Harris*, 394 U.S. 322 (1969), the Supreme Court demonstrated grave convern over the rising caseload of the Federal courts and already existing congested dockets. The Committee shares this concern, and opposes the expansion of permissible use of the class action mechanism in federal courts. Not only would the statutory provision for federal consumer class actions add to the already over-burdened court calendars and pending bases, but expeditious handling of consumer actions will itself be impossible. Thus, this proposed cure for consumer wrongs will aggravate another problem. Further burdens on our overcrowed court dockets cannot serve the interest of justice under any circumstances. The cure may be worse than the disease.

In view of the further congestion the creation of new class actions will have on the courts, we recommend that the Judicial Conference of the United States be consulted prior to the adoption of any such proposal, and that no such proposal should be adopted without at least further provisions for additional judgeships.

The recent bulletin of the Board of Editors for the Federal Judicial Center, which is reprinted as Appendix B, further evidences the concern over the class actions. For one, the Board of Editors was troubled over the more acute and complex problems that are raised by class actions in multidistrict litigation. Consumer class actions will most probably be of a multidistrict nature. Additionally, the Board was concerned by the potential abuses connected with the assembly of the class.

Finally, we believe that consumer class actions will not result in effective enforcement against the types of widespread and unconscionable practices which the legislation is primarily intended to prevent. Nor do we believe that the consumer will necessarily obtain the desired relief. Consider in this regard the class action brought against the Playboy Clubs in which each member of the class received $8.00 worth of chits redeemable over two years, most of which will never be redeemed, and the lawyers received $275,000 in fees. *Grossman* v. *Playboy Clubs Int'l, Inc.* (Civ. Act 882939, L. A. Superior Court 1969). Class action experience under the only recent enactment of consumer legislation providing for this form of relief, the Truth-in-Lending Act, indicates class actions were brought not against flagrant credit frauds but against technical violations of the Act. Two prime examples of this are: *Andrucci* v. *Gimbel Bros.* (C.A. No. 69–905, W.D. Pa. filed 1969); *Ruther* v. *Chemical Bank New York Trust Co.* (69 Civ. 4195 SDNY filed 1969), See in addition, *Isidoro Berkman* v. *Sinclair Oil Corporation*, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2055; *Isidoro Berkman* v. *Sun Oil Company*, U.S.D.C. Northern District of Illinois, Eastern Division, C.A. No. 69C 2045; *Norman M. Garland* v. *Mobil Oil Corporation*, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2165; *Gary M. Adelman* v. *Sinclair Oil Corporation, Atlantic Richfield Company*, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2320; *Norman Kroll* v. *Cities Service Oil Company, Cities Service Company*, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2319; *Isidoro Berkman* v. *Westinghouse Electric Corporation*, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2056; *Stephen L. Marcus* v. *Diners Club Incorporated*, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2321; *Norman Kroll* v. *American Express Company, American*

Express Credit Corporation, U.S.D.C., Northern District of Illinois, Eastern Division, C.A. No. 69C 2318.

Statute of Limitation.—The absence of any period of limitations after the occurrence of the alleged unfair or deceptive act or practice in the majority of pending legislative proposals is one of their major shortcomings. Under these proposals an action could be commenced years after such event or events exposing potential defendants to liability ad infinitum. In addition to undermining judicial economy, the absence of a period of limitations promotes stale claims and results in uncertainty in business practices. Accordingly, the Committee recommends that no action may be commenced by the Department of Justice or Federal Trade Commission which can be the basis for consumer relief unless commenced within two years from the occurrence of the alleged violation.

Venue.—Under the legislation herein recommended, the question of venue relates primarily to actions initiated by the Department of Justice for injunctive relief and consumer redress. It is also relevant to any direct consumer civil actions for damages which Congress may consider, although such a measure is opposed in this report.

The litigating resources of the government are such that fairness dictates its actions under the legislation be brought where the defendant resides or is doing business in a manner related to the alleged violation. The balance of capacity to maintain a lawsuit would be particularly weighted in favor of the government in actions involving small corporations, partnerships, and proprietorships.

Section 206, the venue provision of S. 3201, particularly when considered together with the service of process provision (§ 203), is of very broad scope, and does not take into account these considerations, or adequately provide for the variety of situations which would arise under it. Accordingly the Committee believes that Section 206, as drafted, is inadequate to meet the needs which it should serve.[15]

In sum, Section 206 fails to take into account the kinds of parties who may be involved and the various types of litigation which might occur under it. Moreover, it does not distinguish between those fora which are likely to have a sufficient connection with the parties, witnesses, and the transactions so that they would be logical places for the action initially to be brought, and those fora into which, on the unusual facts of particular cases, it might be appropriate later to transfer the case.

Not even the venue provision of general application in the United States Code, 28 U.S.C. § 1391, which would apply were Section 206 not in the bill, provides the scope of venue of Section 206 of this bill. Ideally, a rational allocation of litigation would proceed under a well drafted single venue statute supplemented by special venue statutes only for unusual classes of cases. Therefore, if Section 1391 is adequate to deal with the cases which would arise under this bill it should be used.[16]

As for government suits under our recommendation, venue should be limited to the district of defendant's residence, incorporation, or principal place of

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[15] Specifically, the Committee felt that the venue provisions as drafted was inadequate in the following regards:

1. Section 206 draws no distinctions among the various parties that may proceed under S. 3201. The government is, for example, likely to have a far broader geographical litigating capacity than even the largest corporation, which in turn is likely to have a far broader capacity than a sole proprietorship or an individual. Yet all of these are lumped together indiscriminately in Section 206.
2. By permitting suit to be brought wherever a potential defendant may be "found," a jurisdiction with no rational nexus to the claim could entertain the action.
3. The failure to define the term "agent" contained in Section 206 could be interpreted to include those with the most attenuated business relationship with the principal, and completely unrelated to the transaction at issue in the suits.
4. Section 206 refers simply to "the defendant" taking no apparent account of the fact that there may be more than one. If "the defendant" really means "all defendants" (the language of 28 U.S.C. § 1391(c)), then complex litigation may be handled irrationally.
5. The language of Section 206 leaves open the possibility that consumer suits might be entertained in state courts.

[16] S. 3092 contains no venue provision, and 28 U.S.C. § 1391 would presumably apply. S. 3338 provides for venue in any district "in which the defendant resides or is found, or has an agent. . . ."

Against individuals, in federal question cases such as those which would arise under § 3201, venue must be laid under Section 1391 in the district "where all defendants reside." This is certainly more sensible than allowing suit against an individual wherever he may be found, on vacation or otherwise, as Section 206 would do. However, it would frequently preclude suit in the most convenient district, such as that where the claim

business, or any district in which the defendant transacts business with respect to the violations on which the complaint is based. Liberal transfer of venue, including acceptance of waiver by either party to fora which would have been improper initially, should also be permitted.

Civil Investigative Demands.—The recommendation of this Committee that the Department of Justice possess concurrent jurisdiction with the Federal Trade Commission to initiate actions which will provide the foundation for individual consumer powers should be accorded the Department. Moreover, the total administration program contemplates that the Department of Justice will be given broadened inquisitorial powers.[17]

The Committee has evaluated this issue and considered analogous investigatory powers exercised in related areas of law. We have concluded that the most reasonable and effective mode of investigation is found in the "civil investigative demand." We therefore recommend its adoption and application to the Department of Justice enforcement of a Consumer Protection Act.

The CID has been thought necessary in some areas of the law to permit the government, where suit is contemplated, to develop necessary information prior to filling a complaint. It has transferred some aspects of pretrial discovery into the precomplaint stage. In so doing it raises obvious dangers of abuse.

There has been no demonstration that the expansive CID powers under the Antitrust Civil Process Act, which are subjected to achieve essentially the same purpose under the antitrust laws as those sought here, have proved inadequate to those purposes. In these circumstances, we cannot agree that there should be a further transference of pretrial procedures to the precomplaint stage.

IV. OTHER CONSUMER RELIEF PROPOSALS

The Committee's review of proposals for consumer relief was not confined to the specific foregoing recommendations. Additional remedial devices which are currently being developed to provide more effective methods of assisting the consumer have much to commend them. While they are not specifically recommended for enactment by the Committee, they deserve continuing serious consideration.

Currently the American Arbitration Association is exploring the establishment of new and expeditious methods of arbitration to facilitate handling the types of complaints and injuries which are the subject of this report. Upon determination of the question of liability, the arbitrator would be empowered to award damages for plaintiffs for their injuries. The mechanism for the distribution of the damages could either be through the arbitration system itself, the utilization of a Master, or the payment into a special fund which could be admiinstered by a court appointed Master or Referee who would make appropriate payments.

In this regard, consideration should be accorded to exempting companies from Federal Trade Commission redress proceedings if they were willing to submit to arbitration of consumer claims or to participate in other recognized consumer grievance redress machinery. The advantage of these approaches would be the expeditious resolution of claims with the greatest informality.

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arose. Moreover, where there is more than one defendant, it may be impossible to bring them together in a common convenient forum. In these respects defects of Section 206 are shared by 28 U.S.C. § 1391.

Under 28 U.S.C. § 1391 a corporation may be sued wherever it is "incorporated or licensed to do business or is doing business." Section 206 would add three bases of venue to the general statute: where the corporation is "found, has an agent," or where "the claim arose." While from the point of view of transfer of venue to the most convenient possible forum these grounds may not be too broad (indeed, perhaps they are too narrow), there is no reason why the initial choice of fora should be so broad. Therefore, even with the difficulties of 28 U.S.C. § 1391, it would be preferable to Section 206 as now written.

In view of the inadequacies of Section 206, it should be redrafted if any direct consumer action is adopted contrary to the proposal of this report. The overall objective should be to secure regularly the ultimate availability of the most convenient forum, while at the same time not opening to plaintiffs the opportunity of harassing defendants by initially bringing litigation in obviously inappropriate places. Particular attention must be given to each type of suit which will be brought under the statute, and the initial choice of fora should be narrowed for each type of suit to the most likely convenient forum.

[17] See S. 3240 and H.R. 14758, 91st Cong. 1st Sess. S. 3240 and H.R. 14758 also propose civil investigative demands, in language closely paralleling that of Section 3 of the Antitrust Civil Process Act (76 Stat. 549; 15 U.S.C. § 1312), and adopts by reference Sections 4 and 5 of that Act. To the extent that the proposal follows the Antitrust Civil Process Act, the Committee approves of it in is present form; to the extent that it deviates, except as necessary to define the different subject matter being investigated, the changes appear both unnecessary and unwise and do not meet with the approval of the Committee.

V. CONCLUSION

The Committee reaffirms its support for federal legislation to provide expeditious means for preventing frauds on the consumer and to provide effective redress therefor. In our opinion, legislation presently pending in Congress, because of its undue and almost exclusive reliance on class actions, fails to promote these ends. We therefore, urge that legislation be enacted consistent with our recommendations herein set forth.

Respectfully submitted.

SPECIAL COMMITTEE ON CONSUMER LEGISLATION.
Edgard E. Barton, Chairman; H. Thomas Austern, Allen C. Holmes, William T. Lifland, Marcus Mattson, W. Donald McSweeney, James F. Rill, Edwin S. Rockefeller, William Simon.

[Identical to H.R. 14931, S. 3201, 91st Cong., first sess.]

A BILL To amend the Federal Trade Commission Act to provide increased protection for consumers, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Consumer Protection Act of 1969".

TITLE I—DECEPTIVE SALES AFFECTING COMMERCE

SEC. 101. Section 5 of the Federal Trade Commission Act, as amended (38 Stat. 719; 15 U.S.C. 45) is amended by changing the words "in commerce" wherever they appear to "affecting commerce".

SEC. 102. Subsection (a) of section 13 of the Federal Trade Commission Act (52 Stat. 115; 15 U.S.C. 53 (a)) is amended to read as follows:

"(a) Whenever the Commission has reason to believe—

"(1) that any person is engaged in, or is about to engage in, the dissemination or the causing of the dissemination of any advertisement in violation of section 12, or any act or practice which is unfair or deceptive to a consumer and is prohibited by section 5, and

"(2) that the enjoining thereof pending the issuance of a complaint by the Commission under section 5, and until such complaint is dismissed by the Commission or set aside by the court on review, or the order of the Commission to cease and desist made thereon has become final within the meaning of section 5, would be to the interest of the public—

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin the dissemination or the causing of the dissemination of such advertisement or any such act or practice. Upon proper showing of need, a temporary restraining order or preliminary injunction may be granted without bond: *Provided, however,* That if a complaint under section 5 is not filed within sixty days of the issuance of the restraining order or preliminary injunction, the order or injunction shall be dissolved and of no further force and effect."

TITLE II—ENFORCEMENT OF CONSUMER INTERESTS

UNFAIR OR DECEPTIVE ACTS OR PRACTICES

SEC. 201. As used in this title—

(a) "unfair or deceptive practice" means any of the following acts or practices—

(1) offering goods or services intending not to sell them as offered;

(2) advertising goods or services intending not to supply reasonably expectable public demand, unless the advertisement discloses a limitation;

(3) stating that services, replacements, or repairs are needed with knowledge that they are not;

(4) representing that the consumer is legally obligated to pay for, safeguard, or return unsolicited goods knowing that the consumer is not;

(5) representing that the consumer will obtain any rights, privileges, or remedies knowing that the consumer will not;

(6) representing that goods are new knowing that they are not;

(7) representing that goods are of a particular standard, grade, quality, style, or model knowing they are not;

(8) making statements of fact concerning (i) the reason for, existence of, or amounts of price reductions, or (ii) savings in comparison to prices of competitors or one's own price, knowing that such statements are false;

(9) representing that goods or services are those of another, knowing they are not;

(10) failing to return or refund a deposit or advance payment for goods not delivered or services not rendered, when no default or further obligation of the person making such deposit or advance payment exists; and

(11) knowingly representing that goods or services have sponsorship approval, origin, characteristics of safety or performance, ingredients, uses, benefits, or quantities that they do not have, or that a person has a sponsorship, approval, status, affiliation, or connection that he does not have: *Provided, however*, That an affirmation by the supplier merely of the value of the goods or services or a statement of his opinion of the goods or services, or similar statements, which do not take unfair advantage of the level of knowledge, ability, experience, or capacity of the consumer shall not be deemed an unfair or deceptive act or practice within the meaning of this paragraph.

(b) "knowing", "knowingly", and "knowledge" refer to actual knowledge, knowledge presumed where objective circumstances indicate that the supplier acted with knowledge, or knowledge presumed where circumstances indicate that the supplier acted in disregard of reasonable safeguards or care in ascertaining the truth of representations made;

(c) "consumer" means any natural person who is offered or supplied goods or services for personal, family, or household purposes;

(d) "supplier" means any person who makes goods or services available to consumers, either directly or indirectly;

(e) "goods" includes real property, but does not include securities or interests in securities; and

(f) "services" includes insurance services and similar provisions of intangibles, but not the providing of credit.

DECEPTIVE ACTS AND PRACTICES UNLAWFUL

SEC. 202. It shall be unlawful for any supplier to commit any unfair or deceptive act or practice as defined in section 201 of this title.

RESTRAINING VIOLATIONS

SEC. 203. The district courts of the United States have jurisdiction to restrain violations of this title upon application by the Attorney General. The court may at any time grant such injunctive relief as it deems appropriate. Whenever it appears to the court that the ends of justice require that other persons should be parties in the action, the court may cause them to be summoned whether or not they reside in the district in which the court is held, and to that end process may be served in any district.

SUITS BY CONSUMERS ADVERSELY AFFECTED

SEC. 204. When a supplier, (i) in any action brought by the Attorney General under section 203 of this title, has been enjoined from committing any act or practice, whether after final adjudication or by consent decree, or (ii) in any proceeding brought by the Federal Trade Commission under section 5 of the Federal Trade Commission Act with respect to acts or practices alleged to be unfair or deceptive within the meaning of section 201 of this title, has been ordered to cease and desist from that act or practice, and the order shall have become final within the meaning of section 5, either after adjudication or by consent decree, any consumer claiming to have been adversely affected by the act or practice giving rise to such injunction may bring suit against said supplier, and may recover actual damages, and the costs of suit, including reasonable attorneys' fees, and, when appropriate, restitution, reformation, recision, and other equitable relief.

Irrespective of whether an attorney's fee is assessed against a defendant, the court may inquire into the reasonableness of the fee agreed upon between the consumer and his counsel, and revise that fee as the circumstances warrant.

JUDGMENT IN FAVOR OF THE UNITED STATES AS EVIDENCE

SEC. 205. A final judgment or decree rendered in any proceeding brought by the United States under section 203 of this title to the effect that a defendant has engaged in an unfair or deceptive practice within the meaning of this title shall be prima facie evidence against that defendant in any action or proceeding brought by any other person against the defendant under section 204 of this title, as to all matters respecting which said judgment or decree would be an estoppel as between the defendant and the United States: *Provided, however,* That this section shall not apply to consent judgments or decrees entered before any testimony has been taken.

VENUE

SEC. 206. An action under this title may be brought in any district in which the claim arose or in which the defendant resides, is found, has an agent, is licensed to do business, or is doing business.

LIMITATION OF ACTIONS

SEC. 207. Any proceeding under section 204 of this title shall be brought within one year after the termination of the proceeding under section 203 of this title or the proceeding under section 5 of the Federal Trade Commission Act on which it is predicated.

CIVIL INVESTIGATIVE DEMANDS

SEC. 208. (a) Whenever the Attorney General has reason to believe that any person under investigation may be in possession, custody, or control of any documentary material, or may have knowledge of any fact, relevant to an unfair or deceptive act or practice within the meaning of this title, he may, prior to the institution of a proceeding under section 203, issue in writing, and cause to be served upon such person, a civil investigative demand, requiring such person to produce the documentary material for examination or to answer in writing written interrogatories pertaining to such knowledge.

(b) Each such demand shall—

(1) state the nature of the conduct alleged to constitute the unfair or deceptive act or practice which is under investigation;

(2) describe the class or classes of documentary material to be produced thereunder with such definiteness and certainty as to permit such material to be fairly identified;

(3) propound with definiteness and certainty the written interrogatories to be answered; and

(4) identify the custodian to whom such material shall be furnished, or the person to whom such answers shall be made.

(c) No demand shall—

(1) contain any requirement which would be held unreasonable if contained in a subpena duces tecum issued by a court of the United States in a proceeding brought under section 203 of this title or if propounded in an interrogatory directed to a defendant in any such proceedings; or

(2) require the production of any documentary evidence, or the disclosure of any information, which would be privileged from disclosure if demanded by a subpena duces tecum issued by a court of the United States, or by an interrogatory propounded, in any proceeding under section 203 of this title.

(d) Demand may be served at any place within the territorial jurisdiction of any court of the United States.

(e) The provisions of sections 4 and 5 of the Antitrust Civil Process Act (76 Stat. 549, 551; 15 U.S.C. 1313, 1314) apply to custodians of material produced pursuant to any demand and to judicial proceedings for the enforcement of any such demand made pursuant to this section.

REPORT BY THE ATTORNEY GENERAL

SEC. 209. As part of his responsibility to protect consumers against unfair or deceptive acts or practices, the Attorney General shall annually report to the President and the Congress on the effectiveness of this title.

OTHER LAWS NOT AFFECTED

SEC. 210. This title shall not annul, alter, or affect in any manner the meaning, scope, or applicability of any Federal or State law, including but not limited to laws concerning the provision of goods and services to consumers, or limit in any way the availability of rights or remedies under such law.

[Identical to S. 3092, H.R. 14585, 91st Cong., first sess.]

A BILL To amend the Federal Trade Commission Act to extend protection against fraudulent or deceptive practices, condemned by that Act to consumers through civil actions, and to provide for class actions for acts in defraud of consumers

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Consumer Class Action Act".

SEC. 2. Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) is amended by adding at the end thereof the following:

"(m) Consumers who have been damaged by unfair or deceptive acts or practices in commerce are hereby authorized to bring consumer class actions for redress of such damages. Such actions shall be brought as consumer class actions in accordance with section 4 of the Consumer Class Action Act."

SEC. 3. (1) Congress hereby declares that the protection afforded under the existing Federal Trade Commission Act is not sufficient to prevent unfair and deceptive acts perpetrated against consumers and that consumers should be allowed to sue directly for redress in the case of such practices. Congress therefore finds and declares that class actions are the most effective machinery for redress of consumer rights.

(2) Congress further finds and declares that many substantive rights to protect consumers are established in laws of the States, but there is no remedy by which many persons, each having a small claim, can obtain effective redress under State law. Therefore, it is in the public interest to embrace as Federal law certain State recognized rights and afford a uniform Federal process, by consumer class actions, as an effective remedy.

(3) Congress further finds that the lack of an effective process and remedy in these respects impairs the free flow of consumer goods in commerce and that there is an overriding Federal interest in achieving candor and fair dealing in the marketplace, an interest which, if not protected, clogs the entire economy.

SEC. 4. (a)(1) An act in defraud of consumers which affects commerce is unlawful and the district courts of the United States shall have original jurisdiction without regard to the amount in controversy to entertain civil class actions for redess of such unlawful acts.

(2) For the purposes of this section an "act in defraud of consumers" is—

(A) an unfair or deceptive act or practice which is unlawful within the meaning of section (5)(a)(1) of the Federal Trade Commission Act, or

(B) an act which gives rise to a civil action by a consumer or consumers under State statutory or decisional law for the benefit of consumers.

(3) A "consumer" is any natural person who is offered or supplied goods, services, interests in land, or intangibles primarily for personal, family, household, or agricultural purposes.

(b) In the case of any class action brought upon the basis that a deceptive act or practice which is unlawful within the meaning of section 5(a)(1) of the Federal Trade Commission Act has violated consumer's rights, the court shall in construing the terms "unfair or deceptive", give great weight to the interpretation given such terms by the Federal Trade Commission and by the Federal courts in applying section 5(a)(1) of the Federal Trade Commission Act; except that nothing in this Act or the amendments made by this Act, shall be construed to require the court to await administrative action by the Federal Trade Commission before applying Federal law to the facts of the case.

(c) In the case of any class action brought upon the basis of a violation of consumer's rights under any State law the court shall, in deciding such action, apply the following criteria:

(1) State law relating to consumers' rights under State statutory or decisional law is adopted as Federal law.

(2) Federal law applicable to each class shall be fashioned upon the law of the State and State statutory and decisional construction shall be applied

as if jurisdiction of the Federal court were based on diversity of citizenship.

(3) In cases of conflict between State statutory and decisional construction and Federal law the latter shall prevail and Federal law governing the case shall be fashioned from State law not in conflict, as near as may be, and from Federal law.

(4) If prior to the date of enactment of this Act, a cause was not subject to removal under section 1441 of title 28. United States Code, the adoption of State law as Federal law by this Act shall not authorize the removal of such a cause on the jurisdictional basis of a Federal question.

(d) Whenever a class of consumers prevails in a class action under this Act, including the amendments made by this Act, the court shall award to the attorneys representing such class a reasonable fee based on the value of their services to the class. Attorneys' fees may be awarded from money damages or financial penalties which the defendant owes to members of the class who cannot be located with due diligence except that an attorney's fee may be awarded from damages or relief that the defendant owes to members of the class who cannot be located with due diligence. Such attorney's fees awarded by the court shall not exceed 10 per centum of the total judgment unless failure to award a greater amount would be manifestly unjust and not commensurate with the efforts of counsel.

[S. 3338, 91st Cong., second sess.]

A BILL To amend section 5 of the Federal Trade Commission Act by providing for suits for damages by parties injured by reason of violations of section 5 and for class actions for such damages, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "1970 Amendment to the Federal Trade Commission Act".

SEC. 2. Section 5 of the Federal Trade Commission Act (38 Stat. 719), as amendment, is hereby amended by adding thereto a new subsection (m) as follows:

"Right of Action of Damaged Parties

"(m)(1) Any person, partnership, or corporation who shall be injured in his business or property by any other person, partnership, or corporation by reason of any unfair method of competition in commerce, or unfair or deceptive acts or practices in commerce forbidden or declared to be unlawful by this section, may sue therefor in any district court of the United States in the district in which the defendant resides or is found, or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

"(2) An order to cease and desist of the Commission which has become final as provided in this section to the effect that the defendant in any damage suit has violated the provisions of this section shall be prima facie evidence against such defendant in the damage suit brought by any other party against such defendant under this subsection as to all matters respecting the violation of this section as declared by the Commission.

"(3) Such suits for damages shall be brought within three years from the commission of the unfair methods of competition or unfair or deceptive acts or practices, or in case of a continuing violation from the commission of the last violation, or be forever barred *Provided*, That the running the three years limitations in respect of each and every private right of action arising under this subsection and based in whole or in part on any matter complained of in the proceedings under this section of the Commission shall be suspended during the pendency of such proceedings and until any order to cease and desist entered therein has become final.

"(4) The several district courts of the United States of America are hereby invested with jurisdiction to receive and proceed with suits under this subsection as in other civil suits in those courts.

"(5) Federal Rules of Civil Procedure for the United States District Courts, rule 23, United States Code Annotated, relating to class actions shall be applicable to actions for damages as provided in this subsection if the prerequisites of rule 23 are satisfied, except as is provided in paragraph 1 of subsection (m) as to the amount in controversy."

[S. 2246, 91st Cong., first sess.]

A BILL To amend the Federal Trade Commission Act, as amended, by providing for temporary injunctions or restraining orders for certain violations of that Act

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Deceptive Sales Act of 1968."

SEC. 2. That section 13(a) of the Federal Trade Commission Act (15 U.S.C. 53(a)) be amended as follows:

"SEC. 13. (a) Whenever the Commission has reason to believe—

"(1) that any person, partnership, or corporation is engaged in, or is about to engage in, the dissemination or the causing of the dissemination of any advertisement in violation of section 12, or any act or practice in commerce within the meaning of section 5 which is unfair or deceptive to the consumer, and

"(2) that the enjoining thereof pending the issuance of a complaint by the Commission under section 5, and until such complaint is dismissed by the Commission or set aside by the court on review, or the order of the Commission to cease and desist made thereon has become final within the meaning of section 5, would be to the interest of the public,

the Commission by any of its attorneys designated by it for such purpose may bring suit in a distirct court of the United States or in the United States court of any territory, to enjoin such dissemination or the causing of such dissemination or any act or practice in commerce within the meaning of section 5 which is unfair or deceptive to the consumer. Upon proper showing a temporary injunction or restraining order shall be granted without bond. Any such suit shall be brought in the district in which such person, partnership, or corporation resides or transacts business."

APPENDIX B

BULLETIN NO. 12

To all judges concerned with complex and multidistrict litigation.

The Board of Editors met in Dallas, Texas on January 9, 1970 to evaluate several proposed changes and additions to the *Manual for Complex and Multidistrict Litigation.* A substantial amount of new material will be released to the publishers of the *Manual* within the next thirty days but because of the urgency and importance of the material relating to the prevention of potential abuses of class actions, the Board directed that *this material* be promptly distributed to all federal judges. This new material is identified by reference (part, section & page) to its probable location in the *Manual.* Your comments and suggestions will be greatly appreciated.

Very truly yours,

JOHN T. MCDERMOTT,
Executive Editor.

PART I—SECTION 1.0

Delete subparagraph (k) and insert:

(k) in potential class actions under Rule 23, F.R. Civ. P., (1) establish a schedule for early determination of the class action questions including a schedule for prompt completion of discovery relative to the class action issue; and (2) enter appropriate orders to prevent potential abuse of the class action.

Following the last full paragraph of Section 1.6, insert:

1.61 Preventing potential abuse of the class action

The class action under Rule 23 is subject to abuse, intentional and inadvertent, unless procedures are devised and employed to anticipate abuse. Among the potential abuses of the class action processes are the following: (1) solicitation of direct legal representation of potential and actual class members who are not formal parties to the class action; (2) solicitation of funds and agreements to pay fees and expenses from potential and actual class members who are not formal parties to the class action; (3) solicitation by formal parties of requests by class members to opt out in class actions under subparagraph (b)(3) of Rule 23; and (4) unauthorized direct or indirect communications from counsel or a

party, which may misrepresent the status, purposes and effects of the action and of Court orders therein, may confuse actual and potential class members, and create impressions which may reflect adversely on the Court or the administration of justice. To anticipate and prevent these abuses timely action should be taken by local rule or by orders in the particular civil action or by both.

In absence of some preventive action by the Court, formal parties to the action or counsel for the formal parties may directly or indirectly, without knowledge or consent of the Court, solicit from the potential or actual members of the class (or subclasses) who are not formal parties, funds for attorneys' fees and expenses, or agreements to pay fees and expenses. The solicitation may be direct or indirect. To the party solicited, solicitation may appear to be an authorized activity approved by the Court, simply by reference to the title of the Court, the style of the action, the name of the judge, and to official processes. Such unapproved solicitation may be of doubtful ethical propriety and may result in well founded dissatisfaction with the judicial management of the action. In order to guard against unapproved action of this sort, it is recommended that each court (1) adopt a local rule forbidding unapproved direct or indirect written and oral communications by formal parties or their counsel with potential and actual class members, who are not formal parties, provided that such proposed written communications submitted to and approved by order of Court may be distributed to the parties or parties designated or described in the Court order of approval. In exceptional circumstances involving numerous class members who do not possess the means of understanding the considerations affecting their interests, the Court may authorize miscellaneous communications by counsel for representative parties without express prior approval of each communication. This may be done by an order prohibiting in general language all practices which would constitute abuse of a class action. A sample local rule and a sample pretrial order on the subject are included in Appendix, 1.61.

When there is more than one proposed class action in a single district involving the same subject matters, these actions should be consolidated before a single judge. If it is determined that one or more of the consolidated actions should proceed as a class action, a choice may be required to be made of the formal party or parties who shall represent a class. The primary considerations concerning designation of the formal party or parties to represent a class (or a subclass) are those set forth in Rule 23, F.R. Civ. P. These include under paragraph (a) (4) that "the representative parties will fairly and adequately protect the interests of the class." Often adequate protection of the interests of the class are dependent upon the skill and resources of counsel for the proposed representative party or parties. If a choice is presented between more than one proposed representative party or groups of proposed representative parties represented by different counsel, the Court should take into consideration the probable cost of legal representation to the members of the class or subclass in question. If the counsel representing the competing proposed representative party or parties have substantially equal skill and have substantially equal resources, the Court may make a choice which will result in the least cost of legal representation to members of the class or subclass. In some instances adequate representation can be provided for the class at less cost to the members of the class by designating as a proposed representative party or parties publicly employed counsel who are natural representatives of the class. For instance, the State Attorney General or other publicly employed counsel (not permitted to make a charge for services in the case) may be willing to serve the class members as the representative of a public body designated as a proposed representative party of the class (or subclass).

No settlement of any class action (in whole or in part as to a subclass) should be permitted and approved without full disclosure of the details of the settlement and the attorneys' fees and other expenses to be charged against the members of the class (or subclass). This disclosure should include the identity of all counsel who will share in the receipt and division of fees, and the amounts thereof. No such settlement should be made without adequate notice and opportunity to be heard on the question of approval of the settlement by all representative parties, other formal parties and intervenors, and, where economically feasible, to the members of the class or subclass affected.

PART II

Following Section 1.6, insert:

1.61 Suggested local rule 3.1. Local rule for prevention of potential abuse of class action

In every potential and actual class action under Rule 23, F.R. Civ. P., all parties hereto and their counsel are hereby forbidden, directly or indirectly, orally or in writing, to communicate concerning such action with any potential or actual class member not a formal party to the action without the consent of and approval of the communication by order of the Court. Any such proposed communication shall be presented to the Court in writing with a designation of or description of all addresses and with a motion and proposed order for prior approval by the Court of the proposed communication and proposed addressees. The communications forbidden by this rule, include, but are not limited to, (a) solicitation directly or indirectly of legal representation of potential and actual class members who are not formal parties to the class action; (b) solicitation of fees and expenses and agreements to pay fees and expenses, from potential and actual class members who are not formal parties to the class action; (c) solicitation by formal parties to the class action of requests by class members to opt out in class actions under subparagraph (b)(3) of Rule 23, F.R. Civ. P.; and (d) communications from counsel or a party which may tend to misrepresent the status, purposes and effects of the action, and of actual or potential Court orders therein, which may create impressions tending, without cause, to reflect adversely on any party, any counsel, the Court, or the administration of justice. The obligations and prohibitions of this rule are not exclusive. All other ethical, legal and equitable obligations are unaffected by this rule.

1.62 Sample pretrial order—No. 3.1

(To be promptly entered in actual and potential class action orders unless there is a parallel local rule)

In this action, all parties hereto and their counsel are forbidden directly or indirectly, orally or in writing, to communicate concerning such action with any potential or actual class member not a formal party to the action without the consent and approval of the proposed communication and proposed addresses by order of this Court. Any such proposed communication shall be presented to this Court in writing with a designation of or description of all addressees and with a motion and proposed order for prior approval by this Court of the proposed communication. The communications forbidden by this order include, but are not limited to, (a) solicitation directly or indirectly of legal representation of potential and actual class members who are not formal parties to the class action: (b) solicitation of fees and expenses and agreements to pay fees and expenses from potential and actual class members who are not formal parties to the class action; (c) solicitation by formal parties to the class action of requests by class members to opt out in class actions under subparagraph (b)(3) of Rule 23, F.R. Civ. P.,; and (d) communications from counsel or a party which may tend to misrepresent the status, purposes and effects of the class action, and of any actual or potential Court orders therein which may create impressions tending, without cause, to reflect adversely on any party, any counsel, this Court, or any administration of justice. The obligations and prohibitions of this order are not exclusive. All other ethical, legal and equitable obligations are unaffected by this order.

PART I

Following the last full paragraph of Section 1.10 add:

1.11 Control of attorney's fees and expenses in class actions

The great potential of the class action for speed and efficiency in the administration of justice is attended with equally great potential for unreasonable charges for attorneys' fees and expenses and for improper solicitation of legal representation. The measures recommended in paragraph 1.61, *supra*, and the implementing suggested local rule and sample order in the Appendix, 1.61, are designed to prevent improper solicitation of funds and expenses and of legal representation from potential and actual class members.

These preventive measures do not expressly deal with the retention of the power by the Court of control over the charges to class members for fees and expenses at the time of conclusion of the class action or thereafter.

If the action is concluded by settlement, the Court should require a statement of all proposed charges for fees and expenses by the counsel for the class and any subclasses, including the identity of all counsel sharing in the fees. Only reasonable charges for fees and expenses should be authorized upon approval by the Court after notice and hearing. All other such charges should be expressly forbidden by Court order.

If the litigation is concluded by determination on the merits, the Court should expressly provide in the judgment, or in one of the earlier class action management orders, for control by the Court or the charges for attorney's fees and expenses. The cost of the legal representation and of expenses seems to be a proper consideration in determining the identity of the representative parties for the class in an affirmative class action determination under Rule 23.

For example, if there is available competent representation for certain formal parties without charge, by a public legal officer (as state Attorney General, for example), this fact should be taken into consideration in formation of the classes in a manner which will minimize legal costs to a class or subclass.

PART I—SECTION 5.5

Following the last full paragraph of Section 5.5 insert:

In multidistrict litigation the acute problem of conflicting class actions seldom can be solved by coordinated action of several district courts involved. A transfer of the multidistrict litigation to a single district under Section 1407 (or in appropriate cases under Section 1404) provides for solution of all conflicting class action questions. Cf. see *In re Plumbing Fixtures Cases*, 298 F. Supp. 484.

Upon receipt of transfer of multidistrict litigation in which conflicting class actions are pending, the transferee court should take the initiative promptly to prevent potential abuse of the class action in the manner described in Section 1.61, *supra*, under the title "Preventing Potential Abuse of the Class Action." Multidistrict litigation involving conflicting class action requests may present more acute and more complex problems than are ordinarily present in actions filed and pending in a single district. For example, in defining the classes (and subclasses) in multidistrict litigation, complex choices will be presented, particularly in designating proposed representative parties (or groups of parties) with different counsel. Here again when all other things are equal, proposed representative parties should be represented by skillful and resourceful counsel who may be expected to serve at the least cost to the class members. For example, all the class members in a single state may be defined as a class (or subclass) to be represented by the Attorney General of the state or other publicly employed counsel in the interest of economy. Or, for example, all members of a horizontal national group, such as an existing trade association, an existing professional association or association of public bodies, may be represented by one or more of their members as representative parties with counsel chosen by the association involved.

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