

Chairman Pryor, Ranking Member Wicker, and members of the Subcommittee, I am David Vladeck, Director of the Bureau of Consumer Protection at the Federal Trade Commission (“Commission” or “FTC”).¹ I appreciate the opportunity to appear before you today to examine the types of fraud the Commission has seen during the economic downturn, describe the Commission’s anti-fraud law enforcement program, and recommend changes in the law and resources the Commission needs to enhance the FTC’s ability to protect consumers. During these difficult economic times, the Commission is on the job, enforcing the law, and working with a heightened urgency. This testimony will highlight *Operation Short Change*, a law enforcement sweep the Commission recently announced that has targeted entities defrauding American consumers hit by the economic downturn.

Job losses, foreclosures, and dwindling retirement accounts are forcing increasingly more Americans to search for ways to make ends meet. Opportunistic fraudsters have quickly adapted their schemes and sales pitches to take advantage of consumers during the economic downturn, with some capitalizing on the economic stimulus package. They use come-ons that offer the lure of free government grant money, guaranteed job placement, investments promising recession-proof income, access to credit cards, or debt relief services. These and other schemes have defrauded hundreds of thousands of consumers out of millions of dollars, and have been the

¹ The views expressed in this statement represent the views of the Commission. t nsEyeffapItTEM

practices that aid or abet violations of the FTC Act.⁴

I. Financial Distress Fraud

The downturn in the economy has had a severe impact on American consumers. The unemployment rate in the United States is now 9.4 percent,⁵ and the national foreclosure rate is

⁴ Commissioner Kovacic dissents from the Commission's endorsement of authority to use, for promulgating all rules respecting unfair or deceptive acts or practices under the Federal Trade Commission Act, the notice and comment procedures of the Administrative Procedure Act. While other agencies have the authority to issue significant rules following notice and comment procedures, the Commission's rulemaking authority is unique in its range of subject matter (unfair or deceptive acts or practices) and sectors (reaching across the economy, except for specific, albeit significant, carve-outs). Except where Congress has given the Commission a more focused mandate to address particular problems, beyond the FTC Act's broad prohibition of unfair or deceptive acts or practices, Commissioner Kovacic believes it prudent to retain procedures beyond those encompassed in the APA. However, he would be willing to consider whether all the procedures currently required to issue, repeal, or amend these rules are necessary.

Commissioner Kovacic also dissents from the Commission's endorsement of across-the-board civil penalty authority. The existing consequences attendant to a finding that an act or practice is unfair or deceptive under the FTC Act include an administrative order (whose violation would then subject the respondent to civil penalties) or a court-issued injunction (which can contain such equitable remedies as redress and disgorgement). In his view, these are generally appropriate remedies, and they are consistent with the goal of developing FTC law to develop new doctrine and to reach new and emerging problems. The routine availability of civil penalties, even if subject to a scienter requirement, would in his view risk constraining the development of doctrine, much as judicial concerns about the availability of private litigation with mandatory treble damages appear to be constraining the development of antitrust doctrine. *See, e.g., Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 558-59 (2007). Commissioner Kovacic would prefer that Congress grant more targeted authority to seek civil penalties, particularly in matters where existing remedies are likely to be inadequate. *See* Prepared Statement of the Federal Trade Commission on the Commission's Work to Protect Consumers and to Promote Competition, and on a Bill to Reauthorize the Commission before the Senate Committee on Commerce, Science, and Transportation, Apr. 8, 2008, *available at* <http://www.ftc.gov/os/testimony/P034101reauth.pdf>.

⁵ *See* Bureau of Labor Statistics Data (June 5, 2009), *available at* <http://www.bls.gov/news.release/empsit.nr0.htm>.

over 12 percent.⁶

searching for jobs as janitors and/or maintenance workers, using classified advertisements online and in newspapers.⁸ The complaint alleges that the defendant told job seendant to search

is worth the investment, hucksters sometimes give prospective purchasers the names of shills – phony references of prior customers who are purportedly experiencing significant success with the business opportunity.

The economic downturn has presented opportunities for those who would seek to capitalize on the misfortune of Americans who have seen their jobs disappear or their incomes slide. As part of *Operation Short Change*, the FTC sued two fraudulent schemes using the home foreclosure crisis as fodder for their scams. First, the Commission alleges that Family Products, LLC runs infomercials pitching money-making programs that are supposedly easy for consumers to replicate.¹⁰

opportunity purchasers – after paying a fee of approximately \$1,500 – could easily earn \$10,000 per month by referring homeowners for Freedom Foreclosure’s loss mitigation services. In fact, the Commission charged, homeowners who turned to Freedom Foreclosure for help routinely lost their homes to foreclosure, and none of Freedom Foreclosure’s 2,500 consultants earned the income they were promised for purportedly “helping” consumers out of foreclosure. On June 1st, a federal district court granted the Commission’s request for an *ex parte* temporary restraining order with a freeze on the defendants’ assets, and the Court later entered a stipulated preliminary injunction.

Other investment scams, such as the one the Commission alleged against an entity using the name Google Money Tree, simply lure consumers into divulging their financial account information. Google Money Tree, the FTC alleges, advertised a low-cost kit (\$3.88) that supposedly would enable consumers to earn more than \$100,000 in six months.¹² The defendants allegedly failed to disclose adequately that the small fee triggered recurring \$72.21 monthly charges for consumers. The Commission charged that by prominently displaying the Google name and logo, and disclosing only a nominal charge, the defendants convinced consumers that submitting their credit card or debit card account information would be a low risk venture. In truth, the complaint alleges, the defendants’ supposed kit does not generate substantial earnings, defendants have no affiliation with Google, and they buried material terms and conditions of their offer in fine print and inconspicuously-placed hyperlinks. On June 23rd, a federal court granted the FTC’s *ex parte* motion for a temporary restraining order to halt the

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some of these cases, the companies allegedly deceived consumers who were seeking help with their credit card bills into paying large up-front fees for debt relief services that were never provided. Some of the companies also falsely promised consumers that not paying their creditors would not hurt their credit ratings, and that purchasing their services would stop debt collectors from calling them. In addition to taking these law enforcement actions, the FTC last year convened a workshop to learn more about the debt settlement industry and develop solutions to the consumer protection problems they cause.¹⁹

E. Loan Modification and Foreclosure Rescue Services

With the rapid increase in mortgage delinquencies and foreclosures, the FTC has stepped up its efforts to protect consumers from mortgage loan modification and foreclosure rescue scams. In a little over a year, the FTC has brought 14 cases targeting these scams,²⁰ and is currently engaged in additional non-public investigations of providers of loan modification and

¹⁹ See Federal Trade Commission, Debt Settlement Workshop (Sept. 25, 2008), Transcript, available at <http://www.ftc.gov/bcp/workshops/debtsettlement/OfficialTranscript.pdf>.

²⁰ *FTC v. Data Medical Capital, Inc.*, No. SA-CV99-1266AHS (C.D. Cal. filed May 27, 2009); *FTC v. Dinamica Financiera LLC*, No. CV09-3554MMM (C.D. Cal. filed May 19, 2009); *FTC v. One or More Unknown Parties Misrepresenting Their Affiliation With the Making Home Affordable Program*, No. CV-09-894 (D.D.C. filed May 14, 2009); *FTC v. Federal Loan Modification Law Center, LLP*, No. SACV09-401 CJC (C.D. Cal. filed Apr. 3, 2009); *FTC v. Thomas Ryan*, Civil No. 1:09-00535 (D.D.C. filed Mar. 25, 2009); *FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla. filed Mar. 24, 2009); *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. Mar. 17, 2009); *l CapitD.N.J. Mar. 17, 2009*; *Mar. 22, 2009*; *C.D. ai70.8sH.ITTQ TfNoT*

foreclosure rescue services.

The FTC's law enforcement actions in this area typically have alleged the following: First, the defendants used terms like "guarantee" and "97% success rate" to mislead consumers about the effectiveness of the services they provide. Second, they charged up-front fees for their services. Lastly, after collecting the fee, the defendants did little or nothing to help consumers obtain a loan modification or stop foreclosure. Such operations not only defraud financially distressed consumers out of desperately needed funds but also may lead them to forgo viable options to help them with their mortgage payments, such as getting assistance from a non-profit housing counselor, or discussing their payment problems with their servicer and continuing their payments.

Sometimes, the defendants allegedly have used copycat names or look-alike websites to misrepresent that they are affiliated with a non-profit or government entity.²¹ The Commission, for example, recently filed two actions alleging that defendants used similar sounding names and other claims to misrepresent that they were part of the legitimate Hope Now Alliance of housing counselors and mortgage servicers.²² Similarly, the Commission recently filed an action alleging that defendants misrepresented that they were affiliated with the Administration's "Making Home Affordable" programs.²³ Defendants also sometimes allegedly misrepresent that members

²¹ See *FTC v. Thomas Ryan*,

of Congress or other government officials endorse their services or products.²⁴

In addition to bringing law enforcement

ent efforts.

A. Enforcement of the Telemarketing Sales Rule

The Commission has developed a robust law enforcement program against fraudulent

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Commission has obtained civil penalty orders and equitable monetary relief totaling nearly \$31 million.

B. Enforcement of the Business Opportunity Rule

Like its telemarketing anti-fraud program, since 1981, the Commission has had a vigorous program to pursue fraudulent purveyors of business opportunities, scams which can cost individual consumers thousands of dollars. The Commission uses Section 5 of the FTC Act to pursue business opportunity fraud, often charging violations of the Business Opportunity Rule (formerly, the Franchise Rule), as well.³² Since 1981, the Commission has initiated over 262 actions to halt business opportunity schemes promising money through vending machine routes, medical billing, rack display, Internet kiosk, 900-number ventures, envelope stuffing, and many other schemes.

The Commission routinely works cooperatively with other federal and state law enforcement agencies to combat business opportunity fraud, often leading sweeps of the industry. Since 1995, the Commission has conducted more than 15 business opportunity sweeps

³² Until 2007, business opportunities were covered under the original Franchise Rule, 16 C.F.R. Part 436. In 2007, the Commission amended Part 436 to apply only to business format franchises, and created Part 437 to cover business opportunities. *Final Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities*, 72 Fed. Reg. 15444 (March 30, 2007). The Business Opportunity Rule is identical to the corresponding portions of the original Franchise Rule except that it deletes the definitional elements and references regarding business format franchising that are now covered by the amended Franchise Rule. *Id.*

The Business Opportunity Rule, Part 437, is currently under regulatory review and is in the process of being amended. *See Notice of Public Workshop on the Business Opportunity Rule*, 74 Fed. Reg. 18712 (April 24, 2009). Among other things, the proposed amendments would expand the scope of the rule to cover entities that previously were not covered under the Franchise Rule, such as many work-at-home schemes. The amendments also would simplify the disclosure document that sellers are required to provide prospective purchasers.

to combat persistent business opportunity fraud.³³ These sweeps bring public attention to these types of fraud and heighten consumer awareness of how to avoid losing money in these schemes. Through the Business Opportunity Rule itself, which requires that sellers make certain pre-sale disclosures to prospective purchasers, the Commission aims to put material information into consumers' hands before they make a hefty investment in a business opportunity.³⁴

The Commission values the cooperative relationships it has fostered with the states and other federal agencies. Although the Commission does not have criminal law enforcement authority, it recognizes the importance of criminal prosecution to deterrence and consumer confidence. Accordingly, the Commission routinely refers matters appropriate for criminal prosecution to federal and state prosecutors through its Criminal Liaison Unit ("CLU"). Since October 1, 2002, 349 people have been indicted and 238 have been convicted in criminal cases that arose from referrals made by CLU, including cases where an FTC attorney was designated a Special Assistant U.S. Attorney to help with the criminal prosecution.

In addition to the Commission's law enforcement activities, the agency reaches out to consumers to give them the tools they need to recognize and avoid fraud. In response to the recent economic downturn, the FTC developed several initiatives to help people manage their financial resources, avoid fraud, and be aware of emerging scams. We share our consumer education materials with state attorney general offices and various local organizations to help get the word out to the public.

For instance, with *Operation Short Change*, the Commission developed and released a video to educate the public on business opportunity fraud.³⁵ The video features a former con-artist, Jim Vitale, describing the tools of the trade, including the techniques he used to rush consumers into sending their money. It provides a sobering glimpse into the lives of two individuals who lost money in business opportunity scams, and it gives consumers concrete advice on what they should do before investing in a business opportunity.

In conjunction with a federal-state crackdown on mortgage foreclosure rescue scam operators, the FTC produced a toolbox of mortgage-related resources for homeowners in distress; they are featured on a new web page at www.ftc.gov/MoneyMatters. Indeed, groups including NeighborWorks America, and the Homeowners Preservation Foundation – a nonprofit member of the HOPE NOW Alliance of mortgage industry members and U.S. Department of Housing and Urban Development-certified counseling agencies – are distributing FTC materials directly to homeowners at borrower events across the country, on their websites, in their statements, and even on the phone: when people call the nation's major mortgage servicers, they

³⁵ Available at <http://www.ftc.gov/multimedia/video/scam-watch/fraud-inside-look.shtm>.

hear about the tell-tale signs of a mortgage foreclosure scam while they are on hold. Next month, the agency will distribute to thousands of community organizations, HUD certified housing counselors, and state attorneys general across the nation copies of a new video featuring the stories of real people who are working with legitimate counselors to save their homes from foreclosure.

The agency has focused outreach efforts on a number of other issues faced by people in economic distress, including stimulus scams, rental scams, church “opportunity” scams, offers for bogus auto warranties, and solicitations for phony charities that play on the public’s concern for the welfare of our military troops and public safety personnel, especially at a time when budgets are shrinking.

Finally, in an effort to stem the number of false or misleading claims that consumers see, the agency has a publication for publishers and broadcasters to alert them to the kinds of claims – extravagant earnings promises, for example – that can signal a rip-off. The Commission also offers sample public service announcements that newspapers can run in the business opportunity section of their classified section to remind readers to do their homework before buying a business opportunity.

D. Research and Policy Development

To complement its law enforcement and

Looking ahead, the Commission will be hosting a roundtable this fall to examine consumer protection issues that arise in debt collection proceedings against individual consumers.³⁹

III. Enhancing the FTC's Fraud-Fighting Tools

The cases discussed in this testimony are only part of the Commission's continuous efforts to protect financially-distressed consumers from fraud during the current economic downturn. An effective program depends on communication with the public to help the Commission spot fraud, track complaints, and provide Americans with tools that will help them avoid falling prey to fraud. Fraud investigations are aided by the Commission's considerable investment in technology, such as Consumer Sentinel, a database of complaints collected from consumers. As noted above, the Commission's law enforcement sweeps provide an opportunity to reach the public through media coverage of law enforcement crack-downs on fraud. And, through the use of consumer alerts, such as the Commission's warning to consumers about economic stimulus grant scams (March 2009),⁴⁰ and consumer education, such as the FTC's website "Money Matters" (March 2009),⁴¹ the Commission strives to give consumers the most

(February 25-26, 2009), transcript available at http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/transcripts/022509_sess1.pdf. Vitale's input at the fraud forum was leveraged in making the educational video released as part of Operation Short Change. *See supra* note 33.

³⁹ Available at <http://www.ftc.gov/opa/2009/06/chicagoround.shtm> (press release).

⁴⁰ Available at <http://www.ftc.gov/opa/2009/03/stimulusscam.shtm> (press release) and http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/FTCindex.html#March_4_09 (webcast of press conference).

⁴¹ Available at <http://www.ftc.gov/moneymatters>.

current resources to help them spot and avoid financial scams.

The agency's vigorous pursuit of its consumer protection mission, however, is hampered by the Commission's insufficient resources and its limited authority. Increased resources and certain expansions of its legal authority would improve the Commission's ability to act quickly to protect consumers from scams and would serve to deter would-be fraudsters and those who assist them.⁴² To that end, the Commission first asks Congress to provide the agency with more resources to increase its law enforcement and consumer protection activities. Second, the Commission recommends that Congress authorize the agency to employ notice and comment rulemaking procedures for unfair and deceptive acts and practices under the FTC Act. Third, the Commission recommends that Congress authorize the FTC to seek civil penalties for violations of Section 5 of the FTC Act and, to promote efficiency and expediency, to seek civil penalties in its own right in federal court without being required to refer enforcement of civil penalty proceedings to the U.S. Department of Justice.⁴³

Finally, the Commission believes that an expansion of its authority to include the ability to challenge practices that aid or abet violations of the FTC Act, could be beneficial to the Commission's consumer protection law enforcement program.⁴⁴ Effective law enforcement

⁴² These recommendations are discussed in greater detail in the FTC's April 8, 2008 testimony before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection, which is available at <http://www2.ftc.gov/os/testimony/P034101reauth.pdf>.

⁴³ Please see Commissioner Kovacic's dissent in note 4.

⁴⁴ Since the Supreme Court's ruling in *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), which cast doubt on the argument that Section 5 of the FTC Act could reach "aiding and abetting" another person's violation, the Commission's ability to pursue those who assist and facilitate unfair or deceptive acts and practices has been

consumers by authorizing it to issue consumer protection rules and obtain civil penalties for violations of those rules.

Thank you for providing the Commission with the opportunity to appear before the Committee to describe its efforts in this critical area.