

PREPARED STATEMENT OF
THE FEDERAL TRADE COMMISSION

on

EFFORTS TO FIGHT
FRAUD ON THE INTERNET

Before the

SENATE SPECIAL COMMITTEE ON AGING

Washington, D.C.

March 23, 2004

I. Introduction

Mr. Chairman and members of the Committee: I am Howard Beales, Director of the Bureau of Consumer Protection of the Federal Trade Commission.¹ I am delighted to appear before you today to discuss the Commission's efforts to fight unfair and deceptive practices on the Internet that harm all consumers, including the elderly.² Internet fraud causes significant injury to consumers, and harms public confidence in the Internet as an emerging marketplace. That is why the Commission has maintained an active law enforcement program, bringing 319 Internet law enforcement cases to date.³

The testimony today will discuss the Commission's law enforcement and consumer education efforts to combat fraud and deception on the Internet, addressing identity theft, auction fraud, investment fraud and "Nigerian scams," and cross-border Internet fraud. The testimony also discusses the Commission's cooperative efforts with other law enforcement agencies, and provides information about fraud complaints received from older consumers. The Commission is keenly aware that the Internet's development as a virtual marketplace and means of communication for all consumers requires our continuing vigilance and effort.

II. Identity Theft

Although identity theft may have originated in the offline world, the Internet is also becoming a vehicle for identity thieves. The Commission's primary role in combating identity theft derives from the 1998 Identity Theft Assumption and Deterrence Act ("the ID Theft Act")

¹ The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions you have are my own, however, and do not necessarily reflect the Commission's views or the views of any individual Commissioner.

² The Commission enforces Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45(a), which broadly prohibits unfair and deceptive acts and practices in or affecting commerce, whether in the brick and mortar world or the virtual world of the Internet.

³ This total includes cases announced as of February 29, 2004.

⁴ Pub. L. No. 105-318, 112 Stat. 3007 (1998) (codified at 18 U.S.C. § 1028).

⁵ As part of its consumer education and victim assistance program, the Commission has

of those 60 or older were victims of credit card fraud.¹¹ On the other hand, 21% of the population reported phone or utilities fraud, while only 16% of seniors reported this problem. Not surprisingly, far fewer older Americans reported employment-related fraud (4%) than the population at large (11%). And a greater percentage of older Americans reported ID theft attempts (14%) to the Commission than did the general population (8%).

Most identity theft cases are best addressed through criminal prosecution, and the Commission refers potential cases to criminal authorities because the FTC Act provides no direct criminal law enforcement authority. Under its civil law enforcement authority provided by Section 5 of the FTC Act, however, the Commission may, in appropriate cases, bring actions to stop practices that involve or facilitate identity theft. Our cases have attacked alleged “pretexting,” the use of false pretenses to obtain consumers’ confidential financial information,¹² and “phishing,” the use of spam directing consumers to update or validate their confidential payment information on copycat websites that appear identical to the sites of the legitimate companies with which they do business.¹³ Although the Commission works with businesses on information security problems, the Commission has also taken action against companies that

¹¹ See National Trends, “Credit Card Fraud,” *supra*, n.7, p. 10; Appendix A, p. A-1. It also is worth noting that most of the recent increase primarily involves the account takeover form of identity theft that tends to cause less economic injury to victims and is generally easier for them to identify and fix.

¹² *E.g.*, *FTC v. Corporate Marketing Solutions, Inc.*, No. CIV-02-1256-PHX-RCB (D. Ariz. Feb. 3, 2003) (final order providing \$525,000 for consumer redress, banning defendants from telemarketing, and barring false claims of affiliation with banks, credit card issuers, and consumer agencies); *FTC v. G. M. Funding*, No. SACV 02-1026 DOC (C.D. Cal. May 5, 2003) (final order).

¹³ *FTC v. C.J.*, No. CIV-03-5275-GHK (RZx) (C.D. Cal. July 24, 2003) (final order barring defendant from sending spam purporting to come from AOL that directed consumers to a “look alike” AOL website where the defendant obtained financial information used for his own online purchases).

¹⁸ The web page can be found at <http://www.ftc.gov/onlineshopping>.

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resources to preventing consumers from being taken in by investment scams.²¹ For the last two years, with increased criminal enforcement and the Commission's increased consumer education activities, investment fraud has not appeared among the Consumer Sentinel "Top 15" categories of scams affecting seniors age 60 and over.²²

²¹ In 2003, 392 of the 166,617 Internet-related fraud complaints received by Consumer Sentinel concerned investment scams. Appendix A, p. A-4.

²² Appendix A, p. A-3.

²³ National Trends, "Top Products/Services for Internet-Related Fraud Complaints," *supra* n.7, p. 8.

²⁴ Appendix A, p. A-3.

²⁵ In the most recent sweep, "Project Busted Opportunity," state and federal participants brought 77 law enforcement actions. See <http://www.ftc.gov/opa/2002/06/bizopswe.htm>. The Commission also recently announced a stipulated final judgement in an Internet business opportunity case which required the defendants to pay \$500,000 in consumer redress for victims. *FTC v. End70 Corp., et al.*, No. 3:03-CV-0950-N (N.D. Tex. Dec. 11, 2003). The press release appears at <http://www.ftc.gov/opa/2004/01/bizoppsweep.htm>.

²⁶ The alert can be found at <http://www.ftc.gov/bcp/conline/pubs/alerts/nigeralt.htm>.

²⁷ Because Nigerian scams tend to require victims to engage in criminal activity, they are best evaluated and pursued by criminal authorities.

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scams, foreign money offers, advance-fee loans, and foreign lotteries – all common cross-border schemes.³¹

³¹ See Appendix A, p. A-3.

³² The website appears at: at <http://www.ftc.gov/bcp/online/edcams/cureall/coninfo.htm>.

³³ *FTC v. CSCT, Inc., et al.*, No. 03-C-00880 (N.D. Ill. Feb. 12, 2004) (final order).

³⁴ These proposals are reflected in two bills now before Congress – S. 1234 and H.R. 3143.

four main components.³⁵ First, the Commission seeks to strengthen its ability to cooperate with foreign counterparts, including the ability to share information on a confidential basis and to assist in investigations. Second, the Commission requests enhancements to its information-gathering capabilities, including the ability to obtain information from third parties without triggering advance notice to investigative targets that may prompt them to move their assets offshore. Third, the Commission asks for improvements to its ability to obtain consumer redress in cross-border litigation by clarifying the agency's authority to bring cross-border cases, and expanding its ability to work with the Office of Foreign Litigation of the Department of Justice to pursue offshore assets. Finally, the Commission wants to strengthen international cooperative relationships by obtaining authority to facilitate staff exchanges and provide financial support for joint projects. The Commission's proposals would provide authority comparable to that of various other federal agencies.

VI. Other Cooperative Internet Enforcement Efforts

The Commission also has cooperated with other government agencies to attack Internet fraud. Working with the Department of Justice and Postal Inspection Service, the Commission has contributed cases to two FBI initiatives targeting Internet scams, "Operation E-Con" in May, and "Operation Cyber Sweep" in November 2003. In one, the Commission obtained \$247,000 in consumer redress from defendants who allegedly promised \$125,000 in annual earnings from a

³⁵ Although these legislative proposals, if adopted, will significantly assist the Commission in its efforts, difficulties will remain in investigating cross-border fraud cases given differences among foreign countries regarding information-sharing.

prepackaged Internet business that was nothing more than a pyramid scheme requiring purchasers to replicate the defendants' website and sell it to others.³⁶

We have also worked closely with criminal authorities on egregious cases of Internet fraud. As recently as February 26, 2004, for example, a federal judge in the Southern District of New York sentenced Commission defendant John Zuccarini³⁷ to 30 months in prison following his December 10, 2003, guilty plea to a 50 count indictment obtained by the U.S. Attorney.³⁸ This case, the first of its kind to be brought under the Truth in Domain Names Act of 2003,³⁹ exemplifies the benefits of interagency cooperation, with significant contributions from the U.S. Attorney for the Southern District of New York, the Postal Inspection Service, and the Commission.

VII. Internet Fraud and Older Consumers

In 2003, Consumer Sentinel received 301,835 fraud complaints from consumers, 68% of whom volunteered their age.⁴⁰ Seniors age 60 and over, who represent 16% of the U.S.

³⁶ *FTC v. K4 Global Publishing, Inc., et al.*, No. 5:03-CV-0140-3-CAR (M.D. Ga. Oct. 14, 2003).

³⁷ *FTC v. John Zuccarini, et al.*, No. 01-CV-4854 (E.D. Pa. Apr. 9, 2002) (permanently barring Zuccarini from diverting or obstructing consumers on the Internet and from launching websites or pages that belong to unrelated third parties, advertising affiliate programs on the Internet, and ordering him to pay more than \$1.8 million in ill-gotten gains for consumer redress). The Commission had sued Zuccarini for "mousetrapping" consumers who mistyped popular website names. He had registered some 6,000 misspellings of site names as domain names, so that consumers who mistyped a web address would be taken to his sites. Zuccarini's sites took control of their web browsers, forcing them to view dozens of sites that paid him for advertising their adult content, online gambling, and psychic services. To escape, consumers had to spend as much as 20 minutes to close out Zuccarini's pop-up browser windows, or turn off their computers and lose all their "pre-mousetrap" work. See Benjamin Weiser, *Spelling It 'Dinsey,' Children on Web Got XXX*, N.Y. TIMES, Sept. 4, 2003, Section B (Late Edition), at 1.

³⁸ *U.S. v. Zuccarini*, No. 1:2003-CR-01459 (S.D.N.Y. Feb. 26, 2004). The DOJ press release appears at <http://www.cybercrime.gov/zuccariniSent.htm>.

³⁹ See 18 U.S.C. § 2252B(b).

⁴⁰ National Trends, "Fraud Complaints by Consumer Age," *supra* n.7, p. 7.

population,⁴¹ filed 13% of these complaints.⁴² Last year, seniors filed 6,088 Internet-related fraud complaints providing payment data, and reported payments of \$12.8 million to Internet frauds, with a median loss of \$186 per person.⁴³

Emerging trends in the Sentinel complaint data highlight the increasingly central role of the Internet in consumers' lives. Internet-related fraud complaints exceeded other fraud complaints for the first time last year, comprising 55% of all fraud complaints.⁴⁴ In addition, 2003 was the first year in which consumers reported that the Internet outstripped the telephone as the point of their first contact with a fraudulent scheme.⁴⁵

Internet fraud does not yet appear to be affecting seniors age 60 and over as much as other age groups. During 2003, only 28% of the complaints from seniors concerned Internet-related fraud,⁴⁶ and only 6% of the Internet fraud complaints from all consumers who reported their age came from seniors.⁴⁷ Moreover, 44% of seniors continued to report that their first contact with scammers came by telephone, compared to 28% whose first contact was by Internet

⁴¹ Population Division, U.S. Census Bureau, Table NA-EST2002-ASRO-01 - National Population Estimates - Characteristics (June 18, 2003).

⁴² National Trends, "Fraud Complaints by Consumer Age," *supra* n.7, p. 7.

⁴³ Appendix A, p. A-2.

⁴⁴ National Trends, "Fraud Complaints by Calendar Year," *supra* n.7, p. 4. In 2002, the reverse was true: Non-Internet fraud complaints comprised 55% of all fraud complaints.

⁴⁵ National Trends, "Company's method of Contacting Consumers," *supra* n.7, p. 7. In 2003, 32% of consumers reported that their first contact with scammers came over the Internet; 26%, by email; 18%, by phone; and 13%, by mail.

⁴⁶ Appendix A, p. A-2.

⁴⁷ National Trends, "Internet-Related Fraud Complaints by Consumer Age," *supra* n.7, p. 8.
