

**PREPARED STATEMENT OF
THE FEDERAL TRADE COMMISSION ON
"INTERNET FRAUD"**

**Before the
COMMITTEE ON FINANCE
UNITED STATES SENATE
Washington, D.C.
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Mr. Chairman, I am Hugh Stevenson, Associate Director of the Division of Planning and

and permanent injunctions to halt the targeted illegal activity, as well as redress for injured consumers. Where redress is impracticable, Commission actions generally seek disgorgement to the U.S. Treasury of defendants' ill-gotten gains. As discussed below, these tools have proven to be effective in fighting a broad array of fraudulent schemes on the Internet, in spite of the sheer size and reach of the Internet.

B. The Growth of Ecommerce and Internet Fraud.

The growth of the Internet and ecommerce has been explosive. The number of American adults with Internet access grew from about 88 million in mid-2000 to more than 104 million at the end of the year.⁽⁵⁾ Just this past holiday season, consumers spent an estimated \$10.8 billion shopping on the Internet -- a greater than 50 percent increase over the \$7 billion they spent online during the same period in 1999.⁽⁶⁾ Total ecommerce sales for 2000 were an estimated \$25.8 billion, .8 percent of all sales.⁽⁷⁾

Unfortunately, but not surprisingly, the boom in ecommerce has opened up fertile ground for fraud. The Commission's experience is that fraud operators are always among the first to appreciate the potential of a new technology to exploit and deceive consumers. Long-distance telemarketing attracted con artists when it was introduced in the 1970's. They swarmed to pay-per

development of the Internet. In addition, the Internet enables con artists to cloak themselves in anonymity, which makes it necessary for law enforcement authorities to act much more quickly to stop newly-emerging deceptive schemes before the perpetrators disappear. And because the Internet transcends national boundaries, law enforcement authorities must be more creative and cooperative to successfully combat online fraud. These novel challenges are discussed in greater detail below.

A. Combating Internet Fraud Requires New Methods of Collecting and Analyzing Information.

The Commission is developing new methods of collecting and analyzing information about both the offline and online marketplace, drawing upon the power of new technology itself. A central part of this effort is Consumer Sentinel, a web-based consumer fraud database and law enforcement investigative tool.⁽¹⁰⁾ Consumer Sentinel receives Internet fraud complaints from the FTC's Consumer Response Center ("CRC"), which processes both telephone and mail inquiries and complaints.⁽¹¹⁾ For those consumers who prefer the online environment, an electronic complaint form at www.ftc.gov first available in May of 1998, permits consumers to channel information about potential scams directly to the CRC and the fraud database.

Consumer Sentinel also benefits from the contributions of many public and private

- x Internet Auction Fraud
- x Internet Service Provider Scams
- x Internet Web Site Design/Promotions ("Web Cramming")⁽¹⁷⁾
- x Internet Information and Adult Services (unauthorized credit card charges)
- x Pyramid Scams
- x Business Opportunities and Work-At-Home Scams
- x Investment Schemes and Get-Rich-Quick Scams
- x

through the Consumer Response Center and Consumer Sentinel are complemented by a proactive program to uncover fraud and deception in broad sectors of the online marketplace through "Surf Days." Surf Days use new technology to detect and analyze emerging Internet problems. While Consumer Sentinel provides data on broad trends and the volume of complaints prompted by particular Internet schemes, Surf Days allow the Commission to take a "snap shot" of a market segment at any given time. The Commission also uses Surf Days to reach new entrepreneurs and alert those who unwittingly may be violating the law.

On a typical Surf Day, Commission staff and personnel from our law enforcement partners -- often state attorneys general, sister federal agencies or private organizations like the Better Business Bureau -- widely "surf" the Internet for a specific type of claim or solicitation that is likely to violate the law. When a suspect site is identified, the page is downloaded and saved as potential evidence, and the operator of the site is sent an email warning that explains the law and provides a link to educational information available at www.ftc.gov Shortly thereafter, a law enforcement team revisits the previously warned sites to determine whether they have remedied their questionable

Pyramid schemes are the most notable example of a fraud whose size and scope are magnified by the Internet.⁽²²⁾ By definition, these schemes require a steady supply of new recruits. The Internet provides an efficient way to reach countless new prospects around the world, and to funnel funds more efficiently and quickly from the victims to the scammers at the top of the pyramid. As a result, the victims are more numerous, the fraud operator's financial "take" is much greater, and the defense is typically well-funded and fierce when the FTC brings suit to stop a pyramid scheme operating online.

Despite the extensive resources required to pursue an online pyramid case, the

In addition to providing regular Internet training, the Commission also provides its staff with the tools they need to investigate high-tech fraud. The FTC's Internet Lab is an important example. With high speed computers that are separate from the agency's network and loaded with the latest hardware and software, the Lab allows staff to investigate fraud and deception in a secure environment and to preserve evidence for litigation.

The Commission has used its training and tools to stop some of the most egregious and technically sophisticated schemes seen on the Internet. For example, the FTC's lawsuit against Verity International, Ltd.,⁽²⁶⁾ was prompted by the influx of hundreds of complaints in the last weeWmr6(T)1(C)egular Interne>-6(t)-(11(at)-6568.8 Tm [(c)401.3

The globalization of the marketplace poses new and difficult challenges for consumer protection law enforcement. Anticipating this development, the Commission held public hearings in the fall of 1995 to explore business and consumer issues arising from technological innovation and increasing globalization. Over 200 company executives, business representatives, legal scholars, consumer advocates, and state and federal officials presented testimony, and the Commission published a two-volume report summarizing the testimony and the role of antitrust and consumer protection law in the changing marketplace. As reported in, "Anticipating the 21st Century: Consumer Protection in the New High-Tech, Global Marketplace," there was a broad consensus that meaningful consumer protection takes: (1) coordinated law enforcement against fraud and deception; (2) private initiatives and public/private partnerships; and (3) consumer education through the combined efforts of government, business, and consumer groups.⁽³²⁾ These principles have guided FTC policy regarding the Internet ever since.

In addition to gathering information through hearings and workshops, the FTC has gained practical knowledge about the effects of globalization and ecommerce through its litigation. In this respect, the Commission has found that pursuing Internet fraud often involves a difficult and costly search for money that has been moved off-shore. For example, in *FTC v. J.K. Publications*⁽³³⁾ the Commission obtained an *ex parte* temporary restraining order, a preliminary injunction and an asset freeze against defendants that allegedly made unauthorized charges of \$19.95 per month on consumers' credit or debit cards for purported Internet services. Based upon evidence gathered by Commission staff, the defendants may have charged over 900,000 consumers a total of \$45 million for unordered or unauthorized Internet services. According to the receiver appointed in this case, the defendants moved millions of dollars to the Cayman Islands, Liechtenstein, and Vanuatu in the South Pacific. The Commission continues to litigate this case, and the receiver continues to attempt to locate defendants' foreign assets and repatriate them to the U.S.

In *FTC v. Fortuna Alliance*, one of the pyramid schemes described above, the Commission found that the defendants had transferred \$2.8 million to Antigua, West Indies. With the assistance of the U.S. Department of Justice's Office of Foreign Litigation, the Commission obtained an order from an Antiguan court freezing those funds and a stipulated final judgment in U.S. court that required the defendants to repatriate that money for consumer redress. In the process, however, it cost \$280,000 in fees alone to litigate the case in foreign court.⁽³⁴⁾

In addition to fraud proceeds moving off-shore quickly, fraudulent online operators may

agencies in Canada, the United Kingdom, and Australia.⁽³⁵⁾

The Commission's actions in *FTC v. Pereira* represent significant strides in the right direction. In that case, the Commission realized that the defendants' "pagejacking" and "mousetrapping" scheme had operated through Web sites registered with a U.S.-based company. Thus, in its request for a temporary restraining order and preliminary injunction, the Commission asked that the registrations for these Web sites be suspended, thereby effectively removing the defendants and their deceptive Web sites from the Internet, pending a full trial. At the same time, the Commission reached out to its international colleagues in Portugal and Australia. The Australian Competition and Consumer Commission (ACCC) proved especially helpful in providing information about the defendants and their business operations in Australia. The ACCC also began its own investigation, executed a number of search warrants, and began pursuing potential legal action against the defendants in that country.

III. Consumer and Business Education

Law enforcement alone cannot stop the tide of fraudulent activity on the Internet. Meaningful consumer protection depends on education as well. Consumers must be given the tools they need to spot potentially fraudulent promotions, and businesses must be advised about how to comply with the law. The FTC's consumer and business education program uses the Internet to communicate anti-fraud and educational messages to reach vast numbers of people in creative and novel ways quickly, simply and at low cost. As more consumers and businesses come online, use of the Internet to disseminate information will grow.

A. Fraud Prevention Information for Consumers

More than 200 of the consumer and business publications produced by the FTC's Bureau of Consumer Protection are available on the agency's Website in both text and .pdf format. Indeed, the growth in the number of our publications viewed online between 1996 and 1999 (140,000 vs. 2.5 million) tells the story of the Internet's coming of age as a mainstream medium and highlights its importance to any large-scale dissemination effort. Those 2.5 million page views are in addition to the 6 million print publications the FTC distributes each year to organizations that disseminate them on the FTC's behalf.

B. Link Program

In addition to placing publications on its own Web site, the FTC actively encourages partners - government agencies, associations, organizations, and corporations with an interest in a particular subject - to link to its information from their sites and to place banner public service announcements provided by the FTC on their sites. Links from the banners allow visitors to click through to the FTC site quickly to get the information they're looking for exactly when they want it. Examples of the varied organizations that have helped drive traffic to the valuable consumer information on www.ftc.gov are Yahoo!, American Express, Circuit City, AARP, North American Securities

Administrators Association, the Alliance for Investor Education, the Better Business Bureau, CBS, motleyfool.com, the U.S. Patent and Trademark Office, Shape Up America!, the National Institutes of Health, and the Arthritis Foundation.

C. "Teaser" Pages

Too often, warning information about frauds reaches consumers after they've been scammed. For the FTC, the challenge is reaching consumers before they fall victim to a fraudulent scheme. Knowing that many consumers use the Internet to shop for information, agency staff have developed teaser sites that mimic the characteristics that make a site fraudulent and then warn the reader about the fraud. Metatags embedded in the FTC teaser sites make them instantly accessible to consumers who are using major search engines and indexing services as they look for products, services and business opportunities online. The teaser pages link back to the FTC's page, where consumers can find practical, plain English information. The agency has developed more than a dozen such teaser sites on topics ranging from fraudulent business opportunities and wealth-building scams to weight loss products, vacation deals and investments.⁽³⁶⁾ Feedback from the public has been overwhelmingly positive: visitors express appreciation -- not only for the information, but for the novel, hassle-free and anonymous way it is offered.

D. Consumer.gov.

Following its vision of the Internet as a powerful tool for consumer education and empowerment, the FTC organized a group of five small federal agencies in 1997 to develop and launch a Web site that would offer one-stop access to the incredible array of federal consumer information. On the theory that consumers may not know one federal agency from another, the information is arranged by topic area. Federal agencies have responded well to consumer.gov. The site now includes contributions from 170 federal agencies. Consumers also find it useful, with over 182,500 visits to the site recorded in the first half of FY 2001.

Visitors to consumer.gov find special initiatives, too: The President's Council on Y2K Conversion asked the FTC to establish a Y2K consumer information site; the Quality Interagency Coordination Task Force requested a special site on health care quality; and the U.S. Postal Inspection Service asked that consumer.gov use the site to support the **kNOW Fraud** initiative, an ongoing public-private campaign initiated with the sending of postcards about telemarketing fraud to 115 million American households in the fall of 1999.⁽³⁷⁾ The FTC continues to maintain the site.

E. Business Education for Online Marketers

As part of its mission, the FTC provides guidance on

<http://www.pewinternet.org/reports/toc.asp?Report=30> (stating that comparing figures gathered in tracking survey in May and June with figures gathered between Thanksgiving and Christmas, the number of American adults with Internet access grew from about 88 million to more than 104 million in the second half of 2000).

6. Jupiter Communications, Inc., Online Holiday Sales Increased by 54 percent this Holiday Season, Despite Dot Com Closures and Soft Offline Purchase (Jan. 17, 2001) (estimating Nov. and Dec. 2000 online sales of \$10.8 billion, compared to \$7 billion for those months in 1998) (reported at www.jup.com/company/pressrelease.jsp?doc=pr010117). The Census Bureau of the Department

collection system to charge consumers for telephone-based entertainment programs ("audiotext" in industry parlance) or other so-called "enhanced services" that are not telecommunications transmission but are often billed on consumers' telephone bills. Modem dialers and videotext schemes, like the operation attacked in *FTC v. Verity International*, No. 00 Civ. 7422(LAK) (S.D.N.Y. 2000), described *infra*, are ones that, unbeknownst to a consumer, cause his or her computer modem to disconnect from his or her usual Internet service provider, dial an expensive international telephone number, and reconnect to the Internet at a remote location overseas, charging the consumer as much as \$5.00 or more per minute for as long as the consumer continues online.

19. Consumer Sentinel has also been upgraded and expanded to provide participants access to the Identity Theft Data Clearinghouse, the central repository for federal identity theft complaints

20. The FTC recently has signed an agreement with the Department of Defense to collect consumer complaint from men and women serving in the military through a project called "Soldier Sentinel."

21. The FTC has coordinated or co-sponsored the following Surf Days, listed by date of their announcements: Pyramid Surf Day (Dec. 1996), Credit Repair Surf (April 1997), Business Opportunity Surf Day (April 1997), Coupon Fraud Surf Day (Aug. 1997), North American Health Claims Surf (Oct. 1997), HUD Tracer Surf Day (Nov. 1997), International Surf Day (Oct. 1997), Kids Privacy Surf Day (Dec. 1997), Junk E-mail Harvest (Dec. 1997), Privacy Surf (March 1998), Textile and Wool Labeling Surf (Aug. 1998), Y2K Surf (Sept. 1998), International Health Claims Surf (Nov. 1998), Investment Surf Day (Dec. 1998), Jewelry Guides Surf (Jan. 1999), Pyramid Surf Day II (March 1999), Green Guide Surf (April 1999), Coupon Fraud II Surf Day (June 1999), Jewelry Guides Surf II (January 2000), Scholarship Services Surf (January 2000), GetRichQuick.con Surf (March 2000), False or Unsubstantiated Lice Treatment Claims Surf (April 2000), Credit Repair Surf II (Aug. 2000), Childrens' Online Privacy Protection Act Compliance Surf (Aug. 2000), False Claims of Authenticity for American Indian Arts and Crafts Surf Day (Oct. 2000), and TooLate.Com [Surf of Online Retailers' Compliance with the Mail or Telephone Order Merchandise Rule] (Nov. 2000).

22. Pyramid operators typically promise enormous earnings or investment returns, not based on commissions for retail sales to consumers, but based on commissions for recruiting new pyramid members. Recruitment commissions, of course, are premised on an endless supply of new members. Inevitably, when no more new recruits can be found, these schemes collapse and a vast majority of participants lose the money they invested.

23. To date, the Commission has collected about \$42.6 million in these cases.

24. *FTC v. Fortuna Alliance, L.L.C.*, No. C9899M (W.D. Wash. 1996). See also, *FTC v. JewelWay International, Inc.*, No. CV97-383 TUC JMR (D. Ariz. 1997) (\$5 million in redress for approximately 150,000 investors); *FTC v. Nia Cano*, No. 97-7947-CAS-(AJWx) (C.D. Cal. 1997) (approximately \$2 million in redress); *FTC v. FutureNet*, No. 98-1113GHK (AIJx) (C.D. Cal. 1998) (\$1 million in consumer redress). *FTC v. Five Star Auto Club, Inc.*, 7 F. Supp. 2d 502 (S.D.N.Y. 2000). (\$2.9 million in consumer redress); *FTC v. Equinox International Corp.*, No. CV-S-990969-JBR-RLH (D.Nev. 1999) (pyramid

