



## **Federal Trade Commission, 2003**

Timothy J. Muris	Chairman
Mozelle W. Thompson	Commissioner
Orson Swindle	Commissioner
Thomas B. Leary	Commissioner
Pamela Jones Harbour	Commissioner

## EXECUTIVE SUMMARY

The Federal Trade Commission is submitting this report to Congress and the Small Business and Agriculture Regulatory Enforcement Ombudsman pursuant to Section 4 of the Small Business Paperwork Relief Act of 2002 (“SBPRA”).<sup>1</sup> That provision of SBPRA builds on requirements of the related Small Business Regulatory Enforcement Fairness Act (“SBREFA”),<sup>2</sup> concerning the agency’s small business civil penalty leniency program. This report discusses the FTC’s enforcement actions during Fiscal Year 2003 in which a civil penalty was assessed, the number of enforcement actions in which a civil penalty was assessed against a small entity, the number of such enforcement actions in which the civil penalty was reduced or waived, and the total monetary amount of the reductions or waivers. As provided in SBPRA, the report also includes the agency’s definitions of “small entity,” “enforcement action,” and “reduction or waiver.”

The report explains that the Commission has a wide range of remedy options, including civil penalties for certain types of violations; that civil penalties are not mandated for any violation; and that, in some cases, the Commission determines that other remedies are more appropriate. The report explains further that, whenever the Commission does seek civil penalties, it endeavors to ensure that civil penalty amounts, particularly for large companies, are not viewed simply as a “cost of doing business.” The report notes that the Commission rigorously reviews proposed civil penalty settlements to be certain that penalties achieve the ,” Fremddetermrent aeffctiand that, itogeher twithother remeoa-0.23dterm the setre the

figures also include two settlements involving small businesses in which the Commission waived all civil penalties, amounting to \$350,000. The reductions and waivers for the small businesses ranged from 50% to 100%.

The report further notes that, in the seven enforcement actions involving large businesses, the Commission accepted staff's recommendations to file settlements requiring the payment of civil penalties that were reduced from the initial civil penalties the staff sought by a total of \$2,755,000, or 56.8% of the preliminary penalty amounts. The reductions for the large businesses ranged from 15% to 75%.

The total amount of civil penalties obtained by the Commission was \$5,588,000. The total amount reduced was \$2,865,000 and the total amount waived was \$350,000. The grand total of reduced and waived civil penalties was \$3,215,000.

## INTRODUCTION

The Federal Trade Commission (“Commission or FTC”) has prepared this report pursuant to Section 4 of the Small Business Paperwork Relief Act of 2002 (“SBPRA”). This provision of SBPRA builds on the requirements of the related Small Business Regulatory Enforcement Fairness Act (“SBREFA”). That statute required agencies to establish a small business compliance assistance program and a small business civil penalty leniency program, and required a report on those programs. Section 4 of SBPRA requires that each agency file a report for fiscal years 2003 and 2004, specifically providing information on the number of enforcement actions in which a civil penalty is assessed, the number of enforcement actions in which a civil penalty is assessed against a small entity, the number of such enforcement actions in which the civil penalty is reduced or waived, and the total monetary amount of the reductions or waivers. The reports are to include the agency’s definitions, for purposes of the report, of the terms “enforcement actions,” “reduction or waiver,” and “small entity.”

## BACKGROUND

The Federal Trade Commission is a small agency<sup>3</sup> with a big mission: to maintain a free and fair marketplace for both business and consumers. The Commission enforces the FTC Act, 15 U.S.C. § 41 *et seq.*, and has enforcement or other responsibilities under 50 additional statutes. The Commission enforces 22 rules promulgated pursuant to specific statutory directive and 13 trade regulation rules promulgated under the rulemaking authority of the FTC Act. The Commission has always been aware of and attentive to the special needs and interests of small businesses subject to its jurisdiction.

The Commission has a wide range of remedies available to it in obtaining compliance with the laws and regulations it enforces. Remedies for certain statutory and regulatory requirements may include asking a court to order civil penalties. With one exception,<sup>4</sup> the Commission is not authorized to assess civil penalties itself, but can only seek a civil penalty award in a court action brought on its behalf by the Department of Justice. None of the statutes or rules provides for mandatory imposition of civil penalties and none provides for non-discretionary penalty amounts. The Commission sometimes determines in certain cases that it would be more appropriate to pursue other remedies, such as injunctive relief, consumer redress or disgorgement, without negotiating civil penalties. In such cases, the core business of the entity may be structured to violate the FTC Act or other statutes the Commission enforces; should the Commission seek civil penalties, this factor militates against leniency.

Whenever the Commission does seek civil penalties, however, it endeavors to ensure that the civil penalty amounts, particularly for large companies, are not viewed simply as a “cost of doing business.” The Commission rigorously reviews proposed civil penalty settlements to be certain that penalties achieve the desired deterrent effect and that, together with other remedies in the matter, they serve the public interest.

In no case has the Commission sought a civil penalty that was greater than a small

Section 223 provides that the policy or program is “[s]ubject to the requirements of other statutes,” and thus does not supersede existing law on penalties.

In its civil penalty leniency policy statement applicable to small businesses, the Commission explained that it has long exercised its discretion in a variety of contexts to consider mitigating factors when selecting penalty amounts to seek in court actions.

First, Section 5(m)(1)(A) of the FTC Act, 15 U.S.C. § 45(m)(1)(A), authorizes the Commission to seek, in federal district courts, up to \$11,000 per violation of certain Commission rules,<sup>7</sup> *if* the defendant had actual knowledge or knowledge fairly implied on the basis of objective circumstances that its acts were unfair or deceptive and are prohibited by the rule. In determining the appropriate amount of a penalty, the courts are directed by Section 5(m)(1)(C), 15 U.S.C. § 45(m)(1)(C), to take into account the degree of culpability; any history of prior such conduct; ability to pay; effect on ability to continue to do business; and such other matters as justice may require. The Commission also evaluates these factors to determine appropriate penalties in cases that are not litigated.

Second, one Commission rule has a special penalty assessment and mitigation mechanism. As noted, under the Energy Policy and Conservation Act, 42 U.S.C. § 6303(a), the Commission has authority to assess civil penalties, up to \$110 per violation, for violations of its Appliance Labeling Rule, 16 C.F.R. Part 305. The Commission’s Rules of Practice provide that factors to be considered in determining the amount of penalty include the respondent’s size and ability to pay; the respondent’s good faith; any history of previous violations; the deterrent effect of the penalty action; the length of time involved before the Commission was made aware of the violation; the gravity of the violation, including the amount of harm to consumers and the public caused by the violation; and such other matters as justice may require.<sup>8</sup>

Third, civil penalties also may be imposed for violations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (“HSR Act”). Under the HSR Act, acquisitions above a certain amount,<sup>9</sup> involving businesses above certain sizes,<sup>10</sup> cannot be consummated unless certain information is filed with the Commission and with the Department of Justice and certain waiting periods are observed. By statute, civil penalties of up to \$11,000 for each day a person is in violation of the HSR Act may be imposed in a federal court action brought by DOJ. The Commission is charged with administering the premerger notification program established by the HSR Act, and recommends actions and penalty amounts to DOJ. The Commission considers the firm’s ability to pay when recommending appropriate penalties. The Commission generally will not seek an enforcement action for a violation of the HSR Act that appears to be truly inadvertent and where the filing is made promptly after discovery of the oversight. If the violation is the firm’s first, and is not the result of gross negligence or a reckless disregard for the filing obligation, the Commission staff generally sends a letter calling attention to the filing obligation but indicating that no further action will be taken if the filing requirement is promptly met.

Fourth, judicial opinions interpreting Section 5(l) of the FTC Act, which provides for

civil penalties of up to \$11,000 per violation of FTC administrative orders, are instructive. The statute does not set forth criteria for determining specific penalties for Section 5(l) violations, but the Third Circuit Court of Appeals in *United States v. Reader's Digest Ass'n*, 662 F.2d 955, 967 (3d Cir. 1981), *cert. denied*, 455 U.S. 908 (1982), set out five factors bearing on the selection of an appropriate civil penalty or remedy: the good or bad faith of the respondent; the injury to the public; the respondent's ability to pay; the desire to eliminate the benefits derived from the violations; and the necessity of vindicating the Commission's authority. In each penalty case, the Commission selects an appropriate penalty amount after weighing the above factors, along with the litigation risks and penalties imposed in similar cases.

### **Scope of the Commission's Civil Penalty Leniency Policy**

In light of the Commission's past experience, as well as the factors suggested in SBREFA itself, the Commission adopted the following policy for reducing, or in appropriate circumstances waiving, civil penalties for violations of a statutory or regulatory requirement by a small entity:

When the Commission identifies a small entity as failing to comply with a statutory or regulatory requirement within the Commission's jurisdiction, the Commission will consider the propriety of penalty waiver or reduction. The following factors will weigh in favor of leniency:

1. The small entity reported the violation to the Commission promptly after discovering it.



penalties for violations of the rules and statutes of the small entity's

6. The small entity's violations did not involve willful or criminal conduct.
7. The violations did not pose a serious health, safety, environmental, or economic

harmers or the public.

Each factor to be present for a small entity to qualify for leniency, in particular circumstances, some factors may be weighed more heavily than others. Factors relevant in particular circumstances will be considered, as

well as most of the factors suggested in SBREFA. The one suggested factor that is not included is one that would limit the penalty reduction policy or program to be used by the small entity through participation in an agency-run or self-audit program. The Commission does not have formal self-audit programs. Given the variety and scope of the rules and statutes that impose a parallel requirement, such as a self-auditing program, the availability of penalty waivers or reductions.

The Commission expanded somewhat the scope of two of the factors suggested in SBREFA. One factor suggests excluding entities that have been subject to enforcement action by the agency. The Commission broadened this category to include entities subject to actions for the same or similar conduct by other federal agencies. The law violations prosecuted by the Commission are similar to those prosecuted by other federal, state, and local law enforcement agencies. Therefore, it is appropriate, in considering whether to exclude entities from leniency, to consider whether similar conduct has been subject to enforcement

action. The Commission suggests excluding violations that pose serious health, safety, or environmental harm. In Commission cases, the Commission considers whether the violations pose a serious health, safety, or environmental harm.

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against entities, both small and large, in which the Commission recommended a civil penalty to the court, the number of enforcement actions in which the Commission reduced or waived civil penalties, and the total monetary amount of such civil penalty reductions or waivers.

SBPRA provides that each agency's report shall include definitions, selected at the discretion of the agency, of the terms "enforcement actions," "reduction or waiver," and "small entity." For purposes of the Commission's report, consistent with SBREFA, the term "enforcement action" or "civil penalty enforcement action" will refer to actions in which the agency sought, or anticipated seeking, a civil penalty for violation of a statute or rule enforced by the Commission.<sup>11</sup>

The term "reduction or waiver" will be based on a preliminary civil penalty amount that reflects the staff's initial assessment of the case. The "preliminary civil penalty amount" is not necessarily the maximum civil penalty for which the company might have been liable under the statute. The Commission may accept or seek a reduced amount, or waive penalties, after discussions with the respondent company and production of relevant material, considering all of the circumstances of the case and applying any relevant mitigating or leniency factors. The figures for civil penalties actually sought in court actions reflect any reductions or waivers based on these discussions and factors.

The term "waiver" will apply to cases in which the agency anticipated seeking a civil penalty but waived all penalties in light of relevant mitigating or leniency factors; it does not include cases in which the Commission had the authority to seek civil penalties but preferred other remedies.<sup>12</sup>

The term "reduction or waiver" will also include partial or total suspension of civil penalties. Settlement agreements in some Commission enforcement actions suspend civil penalties due to a defendant's financial situation, premised upon the truthfulness, accuracy and completeness of the defendant's financial condition as represented in sworn financial statements submitted to the Commission. Suspensions may be revoked and the full amount become due if the defendant's financial submissions are found to be false.

Finally, the term "small entity" as used in the Commission's report in which the Commission recommended a total suspension of civil

The Commission reduced or waived civil penalties (including partial or full suspensions) in all twelve Commission civil penalty enforcement actions. The total amount of civil penalties reduced or waived in small business cases was \$460,000, or 84.6% of preliminary penalty amounts. These figures include three cases in which the Commission accepted staff's recommendations to file settlements requiring the payment of civil penalties that were reduced from the initial civil penalties the staff sought by 56.7%, or a total of \$110,000. The figures also include two cases involving small businesses in which the Commission waived all civil penalties, amounting to \$350,000. The reductions and waivers for the small businesses ranged from 50% to 100%.

In the seven enforcement actions involving large businesses, the Commission reduced the civil penalties it sought by a total of \$2,755,000, or 56.8% of preliminary penalty amounts. The reductions for the large businesses ranged from 15% to 75%.

The total amount of civil penalties sought in court actions by the Commission was \$5,588,000. The total amount reduced was \$2,865,000 and the total amount waived was \$350,000. The grand total of reduced and waived civil penalties was \$3,215,000.

#### ***Small Business Reductions and Waivers***

In three of the enforcement actions involving small businesses, the Commission *reduced* the civil penalties it sought by a total of \$110,000. In each instance, the small business settled FTC charges, filed in federal district court, alleging violation of a statute or rule enforced by the Commission. The size of the company was the most significant factor considered by the FTC in determining how much to reduce the civil penalty sought in each case. Applying the mitigating factorstatr.5 ose. Applyingt waived was

small business was financially unable to pay the usual penalty, and even a reduced penalty would have impaired the small business's ability to do business or to compete effectively.

In the first civil penalty waiver case, the FTC's complaint charged that a mail order company and its owner had violated the FTC's Mail Order Rule by making unsubstantiated shipment representations, failing to provide delay option notices in delayed shipment situations, and failing to make full refunds to consumers when the Rule so required. In this case, the settlement included a judgment for a civil penalty, but based on the defendant's financial condition it was suspended.

In the second civil penalty waiver case, the FTC's complaint charged that another mail order company and its owner had violated the FTC's Mail Order Rule by failing to ship products when promised, failing to have a reasonable basis for expecting to ship on time, failing to notify consumers about shipping delays, and failing to deem delayed orders cancelled and promptly refunding consumers' money. In this case, the Commission waived the preliminary civil penalty amount.

### ***Large Business Reductions***

In seven enforcement actions involving large businesses, the Commission accepted staff's recommendations to file settlements requiring the payment of civil penalties that were reduced from the initial civil penalties the staff sought by a total of \$2,755,000. In each instance, the large business settled FTC charges, filed in federal district court, alleging violation of a statute or rule enforced by the Commission. Applying the factors enunciated in Section 5(m)(1)(C) of the FTC Act, the Commission reduced the civil penalties sought in each of these seven cases primarily because of the degree of culpability of the business (*i.e.*, the degree of culpability did not warrant penalties at the highest end of the spectrum); because the business, although large, was financially unable to pay the usual penalty; or because the usual penalty would have impaired the business's ability to do business or to compete effectively. The federal district courts accepted each settlement without modifying the civil penalty amounts the Commission sought from the businesses. The Commission did not waive all civil penalties in any of its large business enforcement actions.

In the first case, the complaint charged that a publishing company had violated the FTC's Negative Option Rule, the Unordered Merchandise Statute, the FTC's Telemarketing Sales Rule and the FTC Act by misrepresenting its free trial book offers, by failing to disclose all the terms and conditions of its offers, by sending consumers rejection forms that did not tell consumers how to use the form to reject additional merchandise, by failing to inform consumers that they would receive merchandise unless they returned the forms, by failing to disclose promptly, clearly and conspicuously the nature of the company's goods or services, and by sending and billing consumers for books they did not agree expressly to receive.

In the second case, the complaint charged that a computer company had violated the FTC's Mail Order Rule and Pre-Sale Availability Rule by failing to inform consumers in

advance that their deliveries would be delayed, by failing to provide consumers with an opportunity to cancel or consent to the delay, by failing to send consumers cancellation refunds within the time-frame required by the Rule, and by not clearly and conspicuously providing consumers with the warranties covering the products or services they purchased, or information on how the warranties could be obtained, before the purchases were made.

In the third case, the complaint charged that a food company operating a commercial website had violated the FTC's Children's Online Privacy Protection Act Rule by failing to obtain verifiable parental consent before collecting personal information from children under 13, by failing to post adequate privacy policies, to provide direct notice to parents about the information they were collecting and how it would be used, and by failing to provide a reasonable means for parents to review the personal information collected from their children and to refuse to permit its further use.

In the fourth case, the complaint charged that another food company operating a commercial website had violated the FTC's Children's Online Privacy Protection Act Rule by failing to obtain verifiable parental consent before collecting personal information from children under 13, by failing to post adequate privacy policies, to provide direct notice to parents about the information they were collecting and how it would be used, and by failing to provide a reasonable means for parents to review the personal information collected from their children and to refuse to permit its further use.

In the fifth case, the complaint charged that an office supply company operating a commercial website had violated the FTC's Mail Order Rule by misleading consumers regarding the availability of its office supply products, as well as the company's ability to ship ordered products in the time promised, by failing to notify consumers that their orders were delayed, and by failing to offer consumers the right to cancel their orders rather than accept the delay.

In the sixth case, the complaint charged that a direct marketer of hair-straightening products and weight-loss products had violated the FTC's Mail Order Rule by failing to ship merchandise within the promised time period.

In the seventh enforcement action, the complaint charged that a magazine telemarketing company and one of its officers had violated the FTC's Telemarketing Sales Rule and a prior order by misrepresenting the conditions and costs of purchasing magazine subscription packages, and by refusing to honor cancellation and refund requests. In this case, the settlement included a judgment for a civil penalty, but based on the defendants' financial conditions a portion of it was suspended.

## **SUMMARY AND CONCLUSION**

During the reporting period, federal district courts entered settlement agreements that provided for civil penalties in twelve enforcement actions, of which five involved small businesses. In pursuing these actions, the agency considered relevant mitigating and leniency factors in its decisions about the amount of civil penalties to seek. The number of cases was so small that statistical inferences about the cases are unlikely to be of value. Nonetheless, the civil penalties ultimately sought represented an appropriate reduction from the preliminary amounts sought for small businesses, and a greater reduction for the small businesses than for the large businesses.

1. Pub. L. No. 107-198, 116 Stat. 729 (June 28, 2002), codified at 5 U.S.C. § 601 note (attached as Appendix A).
2. Pub. L. No. 104-121, 110 Stat. 857 (March 29, 1996), codified at 5 U.S.C. § 601 note.
3. In fiscal year 2003, the FTC was appropriated 1,074 FTE (full time equivalents).
4. The Commission may assess civil penalties of up to \$110 per violation of the Commission's Appliance Labeling Rule, 16 C.F.R. Part 305, pursuant to a provision of the Energy Policy and Conservation Act, 42 U.S.C. § 6303(a).
5. 62 Fed. Reg. 16,809 (attached as Appendix B). The policy statements also are available on the Commission's website at <http://www.ftc.gov/os/1997/04/62fr16809.pdf>. Although the statements were drafted specifically with respect to small businesses, similar compliance assistance is available to larger businesses, and some comparable factors for determining civil penalty amounts may be relevant to larger businesses too. These policy statements provide guidance and information only, and do not create any rights, duties, obligations, or defenses, implied or otherwise. The Commission retains the discretion to determine how to proceed in particular cases.
6. Consistent with Section 223 of SBREFA, the Commission's small business leniency policy

11. Thus, like the Commission's report to Congress pursuant to SBREFA, this report excludes actions involving a penalty for violation of a prior Commission order. See n.6 *supra*.

12. For example, in many instances a firm may be liable both for civil penalties and for substantial restitution to injured consumers, and the Commission may focus on restitution and not penalties. The Commission also has an innovative program to increase compliance with its Funeral Industry Practices Rule by focusing on compliance training rather than civil penalties. Under this program, funeral providers may be offered an opportunity to make a voluntary payment to the U.S. Treasury or state Attorney General in an amount generally lower than would have been sought in a civil penalty action, and enroll in an industry-managed compliance program. The program includes a review of the firm's practices, compliance training, and follow-up testing and certification. Matters handled under this program have not been included in the report as civil penalty waiver cases. Although the Commission had authority to seek civil penalties, these are not matters in which the agency anticipated seeking civil penalties, and thus,



