

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," 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.

or “the Act”).⁴ This statute directed the Commission to establish a central federal repository for identity theft complaints; to make available and to refer these complaints to law enforcement for their investigations; and to provide victim assistance and consumer education. Thus, the FTC’s role under the Act is primarily one of facilitating information sharing between public and private entities. The Commission also works extensively with industry on ways to improve victim assistance,⁵ including providing direct advice and assistance in cases of security breaches involving sensitive information of customers or employees.

To fulfill the ID Theft Act’s mandate, the Commission established a toll-free hotline and online complaint program for ID theft victims. This system achieves two significant goals. First, it provides ID theft victims with immediate access to information and resources that allow them to begin to recover from what is often a devastating event.⁶ Second, the complaint information provided by the victims becomes part of the information in the Commission’s ID Theft Clearinghouse. This information is made available to more than 850 criminal and civil enforcement agencies throughout the nation through the Commission’s Consumer Sentinel network, a secure online tool for data sharing and law enforcement coordination.

Because ID theft strikes all segments of the population, it is not surprising to find that older Americans are also targets of this crime. In 2003, 214,905 complaints were filed in the

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 distributed more than 1.3 million copies of its 26-page booklet, *Identity Theft: When Bad Things Happen To Your Good Name*, which also can be downloaded from the ID theft website. See <http://www.consumer.gov/idtheft>. The Commission has created a standard ID Theft Affidavit in both English and Spanish for victims to use in resolving debts.

⁶ See <http://www.consumer.gov/idtheft> for the online complaint form and consumer education material.

Clearinghouse.⁷ The ID Theft Clearinghouse provides insight into how ID theft affects seniors. Of the nearly 200,000 complaints received in 2003 where victims reported their age, slightly more than 19,000, or about 10%, came from consumers who are age 60 or over.⁸

Although the Clearinghouse data provides a window into current trends in this increasingly common crime, the Commission has collected additional data to aid in its understanding and response to the problem. In 2003, the Commission conducted a nationwide survey to assess the cost and prevalence of ID theft.⁹ The results were dramatic. The survey showed that in the course of one year, about 3.2 million consumers had new accounts opened, or other fraud committed, in their names. Another 6.7 million consumers experienced misuse of an existing account. The monetary losses associated with victims trying to repair the damage done by the theft and misuse of their information were equally striking, costing businesses about \$48 billion, and consumers \$5 billion.¹⁰

Identity theft appears to affect older Americans in distinct ways. For example, while 33% of all consumers who filed ID theft reports experienced some sort of credit card fraud, 44%

⁷ Federal Trade Commission, National and State Trends in Fraud & Identity Theft (January- December 2003) (hereinafter, “National Trends”), p. 4. This publication is available at <http://www.consumer.gov/sentinel/pubs/Top10Fraud2003.pdf>.

⁸ National Trends, “Identity Theft Complaints by Victim Age,” *supra* n.7, p. 11. This percentage is less than the proportion of seniors in the population at large. Population Division, U.S. Census Bureau, Table NA-EST2002-ASRO-01 - National Population Estimates - Characteristics (Release Date: June 18, 2003) (hereinafter, “Census Estimates”).

⁹ Federal Trade Commission, Identity Theft Survey Report (Sept. 2003). A private research firm conducted a random sample telephone survey of over 4,000 U.S. adults in March and April 2003 for the Commission. The full report can be found at <http://www.consumer.gov/idtheft/stats.html>.

¹⁰ This does not include time costs. About 16% of the victims surveyed were age 60 or older, which directly reflects their 16.4% representation in the population at large, according to the most recent census data. Census Estimates, *supra* n. 8.

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).

misrepresent the level of security they provide and required those businesses to take reasonable and appropriate steps to keep consumers' information secure.¹⁴

III. Auction Fraud

In 2003, auction fraud accounted for the greatest number – nearly half – of all Internet-related fraud complaints consumers reported to the Commission's Consumer Sentinel complaint database.¹⁵ Among seniors age 60 and over, auction fraud accounted for 29 percent of all Internet-related complaints in 2003, and ranked third in the list of "Top 15" product or service complaints reported by seniors. In light of this data, the Commission launched "Operation Bidder Beware," an enforcement sweep targeting Internet auction scams on April 30, 2003.¹⁶ The sweep combined the efforts of the Commission, the National Association of Attorneys General ("NAAG"), 29 participating state Attorneys General, and local law enforcers to bring more than 50 criminal and civil law enforcement actions against Internet auction scams,¹⁷ and

¹⁴ E.g., *In re Guess, Inc.*, (FTC July 30, 2003) (consent order available at http://www.ftc.gov/privacy/privacyinitiatives/promises_enf.html); *In re Microsoft Corp.*, (FTC Aug. 8, 2002) (consent order available at <http://www.ftc.gov/os/2002/08/microsoftagree.pdf>). *In re Eli Lilly*, (FTC Jan. 18, 2002) (consent order available at <http://www.ftc.gov/os/2002/01/lillyagree.pdf>).

¹⁵ National Trends, "Top Products/Services for Internet-Related Fraud Complaints," *supra* n.7, p. 8 (48%, or nearly 80,000 of the 166,617 Internet-related complaints in 2003 concerned auction fraud). The online Sentinel database is used by 943 federal, state, and local agencies for civil and criminal enforcement cases.

¹⁶ The press release can be found at <http://www.ftc.gov/opa/2003/04/bidderbeware.htm>. In a prior initiative in February 2000, the Commission, Department of Justice, U.S. Postal Inspection Service, and NAAG members announced the filing of 35 Internet auction fraud cases. *See* <http://www.ftc.gov/opa/2000/02/internetauctionfraud.htm>.

¹⁷ Commission staff trained hundreds of federal, state, and local law enforcement personnel on techniques to investigate auction fraud. Commission staff also provided investigative assistance for a significant number of cases in the sweep.

kicked off an extensive federal-state consumer education campaign featuring a dedicated web page providing consumers with information on how to avoid auction fraud.¹⁸

Many of the “Operation Bidder Beware” cases involved straightforward scams where consumers allegedly “won” an Internet auction for computer software and electronics, sent in their money, but never received the merchandise. In one case, for example, two defendants allegedly continued to change their auction account names to conceal the fact that they never delivered promised merchandise, and later embarked on serial identity theft so that defrauded auction bidders would mistakenly blame the identity theft victims. The Commission obtained a permanent injunction banning both defendants from participating in Internet auctions and requiring consumer redress payments of nearly \$100,000.¹⁹ The two defendants have since been convicted of mail fraud pursuant to prosecution by the U.S. Attorney’s Office for the Northern District of Illinois.²⁰

IV. Investment Fraud and “Nigerian Scams”

The FTC Act gives the Commission authority to pursue many deceptive Internet-related investment scams, which run the gamut from oil and gas leases and FCC license frauds to gemstone, art, precious metals, and rare coin investment schemes. The Commission has successfully pursued several of these scams over the years, as have state and federal criminal authorities. Recently, the Commission has devoted a substantial share of its consumer education

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

¹⁹ *FTC v. James D. Thompson, et al.*, No. 03-C-2541 (N.D. Ill. Aug. 21, 2003) (final order).

²⁰ *U.S. v. Thompson, et al.*, No. 03-CR-745-ALL (N.D. Ill. *filed* July 31, 2003). Defendant Germak is scheduled to be sentenced on March 15; Defendant Thompson, on June 14, 2004.

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

Deceptive business opportunities, in contrast, ranked seventh as a source of Internet-related complaints overall in 2003,²³ and business opportunity and work-at-home promotions filled the last two slots of the "Top 15" scams affecting seniors age 60 and over.²⁴ Consequently, the Commission has actively pursued business opportunity and work-at-home scams by bringing cases and by leading state and federal law enforcement sweeps.²⁵

"Nigerian Scams" are a persistent con in which a purported third-world official or businessman typically offers to share his family's fortune with a consumer in return for help in circumventing his country's currency restrictions by moving assets outside his country to a safe banking haven – but only after the consumer sets up a bank account in the scammer's name with a good faith deposit, which soon vanishes. The Commission has issued a Consumer Alert on

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>.

Nigerian scams as part of its consumer education mission,²⁶ and assisted criminal authorities in identifying potential cases.²⁷ Although the representations made in these solicitations may seem far-fetched to many consumers, consumers who fall prey to this scam suffer significant injury. Taking action against these types of scam artists highlights the cross-border issues that can be addressed by our legislative proposals discussed below.

V. Cross-Border Internet Fraud

The Internet knows no boundaries, and cross-border fraud on the Internet is a growing problem. During both 2002 and 2003, approximately 14% of the fraud complaints collected in Consumer Sentinel involved a cross-border component.²⁸ In 2003, 47 percent of these complaints involved the Internet, up from 33 percent in 2002.²⁹ To date, the Commission has had foreign targets in over 60 cases and pursued assets offshore in more than 10 foreign countries.

Older consumers are often the targets of cross-border fraud. In 2003, consumers 60 and over comprised 20% of all cross-border fraud complaints where consumers reported their age.³⁰ Top frauds reported by consumers age 60 and over included prize promotions, sweepstakes

²⁶ The alert can be found at <http://www.ftc.gov/bcp/online/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.

²⁸ Appendix A, p. A-5.

²⁹ *Id.*

³⁰ Appendix A, p.A-6. As of July 1, 2002, persons age 60 and over made up approximately 16.4% of the U.S. population. Census Estimates, Table NA-EST2002-ASRO-01 - National Population Estimates - Characteristics.

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

“Operation Cure.All,” an on-going, coordinated Commission law enforcement and consumer/business education initiative with a bilingual website,³² continues to target deceptive and misleading Internet promotions of products and services that promise to cure or treat serious diseases or conditions affecting seniors and others, such as cancer, heart disease, arthritis, and diabetes. Older consumers constitute a large part of the market for health-related services, and remain vulnerable to misleading claims and fraudulent practices. The Commission strives to ensure that claims (in both traditional media and on the Internet) about the health benefits of over-the-counter drugs, devices, foods, and dietary supplements are truthful, not misleading, and substantiated by competent and reliable scientific evidence. Most recently, the Commission on February 25, 2004, announced a final order banning a Canadian company from offering a bogus cancer therapy on its Internet website which referred U.S. citizens to the company’s clinic in Tijuana, Mexico.³³

The legislative proposals that the Commission has asked Congress to enact would better protect consumers by improving the agency's ability to cooperate and share information in cross-border cases and investigations.³⁴ The recommendations focus primarily on improving the Commission’s ability to combat fraud involving foreign parties, evidence, or assets, and include

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.

website or email.⁴⁸ This may simply reflect the fact that Internet-savvy baby boomers will not begin turning 60 until 2005.

The Commission recognizes that the American population is aging, and therefore issues facing older consumers are becoming even more pressing. In the Commission's experience, however, Internet scams do not target the elderly as a specific group, but seek consumer victims without regard for demographic criteria. Nonetheless, Internet scams that cause significant financial injury can be particularly devastating to seniors, many of whom live on limited or fixed incomes.

Because prevention is often the best medicine, the Commission takes an active role in educating seniors and others about Internet scams. To that end, the Commission has developed a series of publications, launched dedicated Web pages, and worked with numerous federal agencies and private sector partners to develop and disseminate plain-language consumer education materials in English and Spanish to protect all consumers, including seniors, from Internet fraud.

VIII. Conclusion

The Commission is hard at work on efforts to protect all Americans, including the elderly, from Internet scams. Through consumer education outreach efforts and enforcement actions that halt law violations and return money to victims, the Commission seeks both to help consumers protect themselves and to take action when they cannot. The Commission is committed to emphasizing this important work, enlisting the help of private and public partners to maximize the effectiveness of the effort.

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Appendix A, p. A-3.