STATEMENT OF

TIMOTHY J. MURIS
FOUNDATION PROFESSOR,
GEORGE MASON UNIVERSITY SCHOOL OF LAW
AND OF COUNSEL, O'MELVENY & MYERS LLP

BEFORE THE

U.S. SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

SUBCOMMITTEE ON CONSUMER PROTECTION, PRODUCT SAFETY, AND INSURANCE

ON

THE ECONOMY AND FRAUD: PROTECTING CONSUMERS DURING DOWNWARD ECONOMIC TIMES

WASHINGTON, D.C.

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Chairman Pryor, Ranking Member Wicker, and Members of the distinguished subcommittee, my name is Tim Muris. I am Foundation Professor at the George Mason University School of Law and Of Counsel at O'Melveny & Myers LLP. Most relevant for today's hearing, I held four positions at the Federal Trade Commission, most recently as Chairman from 2001-2004. I am also the only person ever to direct both of the FTC's enforcement arms, the Bureau of Consumer Protection and the Bureau of Competition. I believe strongly in the importance of the FTC as a consumer protection agency. Serving as Chairman was the greatest honor of my professional career, and I am especially proud of our consumer protection accomplishments, such as our work on the fraud program and in protecting the privacy of Americans, including creation of the National Do Not Call Registry. The United States Chamber of Commerce and United States Chamber Institute for Legal Reform have asked me to discuss the important subjects of today's hearing, and I want to thank the committee for giving me the opportunity to appear today. The views I express are my own.

I. THE ROLE OF THE FTC

As a nation, we use markets to organize and drive our economy. We derive vast economic benefits from these markets and the competition that helps markets function properly. These benefits should not be taken for granted; they are not immutable. The nation's consumer protection policy can have profound effects on such benefits by strengthening the market. The policy also can reduce these benefits, however, by unduly intruding upon the market and hampering the competitive process. The Federal Trade

Commission has a special responsibility to protect and speak for the competitive process, to combat practices that harm the market, and to advocate against policies that reduce competition's benefits to consumers.

The FTC protects consumers through its responsibility to prevent "unfair or deceptive acts or practices."[1] The FTC, and other public authorities, operate against a backdrop of other consumer protection institutions, most notably the market and private common law. In our economy, producers compete to offer the most appealing mix of price and quality. This competition spurs producers to meet consumer expectations because the market generally imposes strict discipline on sellers who disappoint consumers and thus lose sales to producers who better meet consumer needs. These same competitive pressures encourage producers to provide truthful information about their offerings. Market mechanisms cannot always effectively discipline deceptive sellers, however, especially when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, another institution can mitigate these problems. Private legal rights provide a set of basic rules for interactions between producers and consumers, such as do not lie to your customers and keep your contractual promises. Government also can serve a useful role by providing default rules, which apply when parties do not specify rules. These rights and default rules alleviate some of the weaknesses in the market system by reducing the consequences to the buyer from a problematic exchange. Notwithstanding the strengths

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[1] 15 U.S.C. § 45.

of private legal rights, in some circumstances – as when court enforcement is impractical or economically infeasible – they may not be an effective deterrent.

When consumers are vulnerable because market forces are insufficient and the common law is ineffective, a public agency, such as the Federal Trade Commission, can help preserve competition and protect consumers. The FTC's consumer protection and competition missions naturally complement each other by protecting consumers from fraud or deception without restricting their market choices or their ability to obtain truthful information about products or services. The Commission attacks conduct that undermines competition, impedes the exchange of accurate information, or otherwise violates the common law rules of exchange.

Because of its antitrust responsibilities, the agency is well aware that robust competition is the best, single means to protect consumers. Rivalry among incumbent producers, and the threat and fact of entry from new suppliers, fuels the contest to satisfy consumers. In competitive markets, firms prosper by surpassing their rivals. In turn, this competitive market has important implications for the design of consumer protection policies to regulate advertising and marketing practices.

Without a continual reminder of the benefits of competition, consumer protection programs can impose controls that ultimately diminish the very competition that increases consumer choice. Some consumer protection measures – even those motivated by the best of intentions – can create barriers to entry that limit the freedom of sellers to provide what consumers demand. While I was Chairman, for example, the Commission participated in a court challenge to a state law that banned anyone other than licensed funeral directors from selling caskets to members of the public over the Internet. While recognizing the state's intent to protect its consumers, the Commission questioned whether the law did more harm than good. In an amicus brief, the FTC noted that "[r]ather than protect[ing] consumers by exposing funeral directors to meaningful competition, the [law] protects funeral directors from facing any competition from third-party casket sellers."[2] The synergy between protecting consumers from fraud or deception without unduly restricting their choices in the market or their ability to obtain truthful information should undergird all of the Commission's consumer protection initiatives.

II. THE FTC AND CONSUMER FRAUD

Preventing fraud is a crucial part of the Commission's support of the market system and the common law. More than half of the Commission's budget and staff is devoted to consumer protection, with a significant focus on fraud. Fraud is essentially theft. Fraud distorts market forces and limits the ability of consumers to make informed choices. Fraud leads to inefficiency, causing consumers to allocate their resources unproductively. Fraud also reduces consumer confidence and the efficacy of legitimate advertising, thereby further diluting the amount of useful information to guide consumers' choices. This effect also raises costs for legitimate competitors, who must offer more assurances of performance to overcome consumers' wariness.

The costs of fraud to consumers are enormous. Fraud takes many forms from fraudulent credit repair services, to unauthorized billing, to deceptive weight loss products. A survey released by the FTC in 2007 showed that an estimated 13.5 percent

[2] Memorandum of Law of *Amicus Curiae* Federal Trade Commission, *Powers v. Harris*, Case No. CIV-01-445-F (W.D. Okla. Sept. 5, 2002), *available at* http://www.ftc.gov/os/2002/09/okamicus.pdf.

of U.S. adults, approximately 30.2 million consumers, were victims of one or more of the frauds covered in the survey, and that an estimated 48.7 million incidents of these frauds had occurred during the previous year.[3]

The victims of fraud are as varied as the form of the fraud. For example, the AARP has shown that investment fraud victims are more likely to be male, 55-61, more financially literate, college-educated, higher income, and more optimistic.[4] Lottery fraud victims are more likely to be female, over 70 years old, less financially literate, less educated, and have lower incomes.[5]

Because fraud is often national in scope, and scarce federal criminal law enforcement resources are primarily used against such matters as drug trafficking and terrorism, fraud will go largely unchecked without the active leadership of the nation's consumer protection agency. We created the FTC's modern anti-fraud program in 1981 when I was Director of the Bureau of Consumer Protection. The development of a vibrant anti-fraud program at the FTC is a major success story. Fortunately, the legal tools for such a program already existed; in 1973, Congress had amended the FTC Act to allow the Commission to sue in federal district court and obtain strong preliminary and permanent injunctive relief – including redress.[6]

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[3] *Consumer Fraud in the United States: The Second FTC Survey*, FTC Staff Report, at s-1 (Oct. 2007), *available at* http://www.ftc.gov/opa/2007/10/fraud.shtm.

[4] FTC Fraud Forum, Presentation, Day One: Panel 1 (Doug Shadel, State Director, AARP Washington, *Advances in Fraud Prevention Research*), at slide 31 (Feb. 25, 2009), *available at* http://www.ftc.gov/bcp/workshops/fraudforum/index.shtm#presentations.

[5] *Id.* at slide 32.

[6] The Commission uses the "second proviso" of § 13(b), "in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." Trans-Alaska Pipeline Authorization Act, Pub. L. No. 93-153, § 408(f), 87 Stat. 576 (1973).

We began by targeting the fraudulent sale of various types of unconventional investments.[7] The double-digit inflation of the period that made traditional investments relatively unattractive propelled these "alternative investment" scams. The first case involved defendants that fraudulently sold $300 million worth of diamonds for investment.[8] Similar actions against boiler rooms selling advisory services for the federal oil and gas lease lottery followed as did actions against the sellers of worthless oil and gas leases themselves. In this initial period the Commission brought three cases against sellers of gemstones and five cases involving oil and gas.[9]

Before the shift to federal court, most of the Commission's consumer protection work used its administrative process. Most investigations relied upon voluntary production of requested documents and information from the investigated targets, who had every incentive to delay. This process had obvious drawbacks for addressing fraud. Federal district court cases proved much more effective, enabling the Commission to bring fraudulent schemes to an immediate halt, to take the targets by surprise so that

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[7] *See, e.g.*, John Villafranco, *Looking Back on the Muris Years in Consumer Protection: An Interview with Timothy J. Muris*, ANTITRUST, Summer 2004 80, 82-83. From the beginning of the § 13(b) program, the Commission has used this tool against a wide variety of scams, including real estate equity schemes, *FTC v. Rita A. Walker & Assoc.*, No. 83-2462 (D.D.C. filed Oct. 5, 1983); business opportunity scams, *FTC v. H. N. Singer Inc.*, 668 F.2d 1108 (9th Cir. 1982), *FTC v. Kitco, Inc.*, No. 83-467 (D. Minn. filed Apr. 9, 1983); and travel scams, *FTC v. Paradise Palms Vacation Club*, No. 81-116 (W.D. Wash. filed Sept. 25, 1981).

[8] *FTC v. International Diamond Corp.*, 1983-2 TRADE CAS. (CCH) ¶ 65,725 (N.D. Cal. 1983). The Commission previously had pursued administrative cases against unconventional investments. *American Diamond Corp.*, 100 F.T.C. 461 (Sept. 28, 1982) (complaint and consent order).

[9] In these initial consumer protection § 13(b) cases, Commission staff began the practice, still followed today, of working closely with other government agencies, such as the Department of the Interior's Bureau of Land Management, and federal criminal enforcement authorities such as the United States Postal Inspection Service and the Secret Service in developing investigations and litigating cases. Parallel investigation and prosecution by both the FTC and criminal authorities have remained an important aspect of the Commission's § 13(b) program.

money might be available for redress, and to prevent destruction of records showing the extent of the fraud and identifying injured parties.

Almost from the inception of the § 13(b) program, the Commission has used this tool not only to obtain court orders halting fraudulent schemes, but also to obtain consumer redress and other potent equitable remedies. Very early in the § 13(b) consumer protection cases, the Commission began to seek, as ancillary to issuance of permanent injunctions, provisional remedies such as a freeze of assets, expedited discovery, an accounting, and the appointment of a receiver on the ground that these remedies would insure the effectiveness of any final injunction ordered.[10]

To make the best use of this approach, the Agency used modern investigative techniques geared for speed and stealth. The agency also developed a group of professional investigators trained to uncover fraudulent schemes, determine ownership and control of such schemes, trace assets, develop evidence, preserve evidence for trial, and testify in court. More recently, Commission investigators have become experts in Internet investigative techniques and have provided training for thousands of local, state, federal, and international criminal and civil law enforcement offices.

Once launched, the fraud program grew in importance and success. Each succeeding FTC Chairman has expanded its scope and improved its operation. During the 1990s in particular, the agency formed strong, working relationships with state and local law enforcement agencies, leading sweeps against targeted types of fraud, thereby

[10] *FTC v. H.N. Singer, Inc.* 668 F.2d 1108 (9th Cir. 1982) is a seminal case establishing the Commission's authority to seek, and the district courts' power to grant, all the traditional equitable remedies inherent in the authority granted by § 13(b) to obtain permanent injunctions. *Singer* was the first § 13(b) case to attack a business opportunity scam.

greatly increasing the program's effectiveness. By 2004, when my tenure as Chairman ended, there had been a total of 78 sweeps, resulting in 2,200 law enforcement actions.[11]

During the late 1990s, the fraud program matured under the strong leadership of Chairman Robert Pitofsky and Bureau Director Jodie Bernstein into the flagship of the Commission's consumer protection program. From fiscal year 1983 until fiscal year 1995 – the first full 13 years that the Commission filed § 13(b) actions – the average number brought was 23 per fiscal year. During the Pitofsky-Bernstein years, that average skyrocketed to 71 filings per fiscal year. Not surprisingly, as the number of filings increased, so has the amount of consumer redress awarded. In fiscal year 2003, for example, nearly $873 million in consumer redress was ordered in 98 judgments.

The Commission's ability to protect consumers from these scams was aided immeasurably by another Pitofsky-Bernstein innovation, the creation of the Consumer Response Center (CRC) – a central facility with trained call center staff and an automated call distribution system to record and respond to consumer complaints and inquiries. The existing telemarketing fraud complaint database, in operation since the early 1990s, was dramatically upgraded and revamped into Consumer Sentinel, a system linking law enforcers through a secure Internet site. The Consumer Sentinel system enabled the CRC staff to enter data from consumer complaint calls in real time. Initially scores, and ultimately hundreds, of law enforcement agencies at the state, federal, and local levels joined the system, gaining access to the complaint database, as well as the opportunity to "cross-walk" their own complaint data into the Consumer Sentinel database. Other

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[11] David R. Spiegel, "Chasing the Chameleons: History and Development of the FTC's 13(b) Fraud Program," 18 Antitrust 43 (2004).

entities, such as local Better Business Bureaus, also were invited to contribute complaint data to the Sentinel database. Consumer Sentinel strengthened the fraud program by improving the staff's ability to spot emerging trends, to identify bad actors more quickly, and to locate potential witnesses to support the Commission's cases.

The Commission also has taken important steps to improve its cooperation with criminal law enforcement agencies. While I was Chairman, we established a Criminal Liaison Unit to coordinate with criminal law enforcement agencies across the country to encourage criminal prosecution of consumer fraud. The unit identifies criminal law enforcement agencies that may bring specific types of consumer fraud cases, educates criminal law enforcers in areas of FTC expertise, coordinates training with criminal authorities to help the FTC prepare cases for referral and parallel prosecutions, and provides Special Assistant United States Attorneys to help prosecute the worst FTC Act violators. Between October 1, 2002, and July 31, 2007, 214 individuals were indicted in telemarketing fraud cases resulting from referrals from the Criminal Liaison Unit.[12]

I also am especially proud of the expansion of the FTC's consumer protection efforts to the Spanish language media. Having grown up in Southern California, and having lived in southern Florida and Chicago, I was aware of the large and thriving Spanish language media throughout the United States. Yet, when I arrived in 2001, the FTC directed very little attention to marketing that appeared in any language other than English. We corrected that problem, hiring numerous attorneys and other staff fluent in Spanish, translating the FTC's excellent consumer education materials into that language,

[12] Prepared Statement of The Federal Trade Commission Before the Senate Committee on Commerce, Science and Transportation, United States Senate, July 31, 2007.

and bringing numerous cases against fraud and other illegal marketing practices that targeted the Hispanic community. That effort has continued. For example, in September 2006, the FTC co-hosted an Hispanic outreach workshop with the U.S. Postal Inspection Service (USPIS), the U.S. Attorney's Office for the Southern District of New York, and the Manhattan Hispanic Chamber of Commerce. During the workshop, the FTC announced three law enforcement actions against scammers targeting Hispanics with their unlawful business practices, as well as the results of a Hispanic Multi-Media Surf conducted by the FTC and 60 partners in the United States and Latin America.

The FTC's vital role as an antifraud agency continues today. Earlier this month, for example, it announced the results of a law enforcement sweep called "Operation Short Change," which included 15 FTC cases and 44 law enforcement actions by the Department of Justice, and actions by at least 13 states and the District of Columbia. The Operation targeted scammers seeking to take advantage of the economic downturn through a variety of schemes from phony debt-reduction services to promises of non-existent jobs. In February 2009, the Commission held a two-day Fraud Forum with representatives from law enforcement, consumer advocates, business representatives, academics, and others exploring the problem of fraud and how the FTC can more effectively protect consumers from fraudulent schemes.

III. THE FTC AND RULEMAKING

As this Committee evaluates policy initiatives aimed at giving the Commission adequate tools to attack fraud, I would like to comment specifically on proposals to expand the Commission's rulemaking authority.[13] I submit that such proposals should be evaluated carefully and considered in the historic context of the Commission's purpose and mission.

A. The Role of FTC Rulemaking.

As I discussed above, the agency has relied on the development of common law principles, supplemented with occasional rules and guides. The cornerstone of the FTC's consumer protection mission is the fraud program, through which the Commission has returned hundreds of millions of dollars to defrauded consumers.

Although many do not think of them as such, these common law principles *are* rules, providing a crucial part of the institutional framework that helps our market economy to function. In most circumstances, these common law rules provide both clear guidance to the business community and an adequate basis for FTC enforcement actions. Although common law rules do not provide civil penalties, there is no need for the civil penalties to combat fraud. The effective limit on the FTC's ability to recover money in cases of fraud is the money available, not any lack of authority to recover the funds.

The common law process is well suited to develop new policy. For example, the Commission has used this process to formulate general rules to protect the security of sensitive consumer information. Using both its deception and unfairness authority, the Commission has brought cases addressing information security, as the growth of the internet and technology have created new vulnerabilities. Attempting to write a rule

[13] While my testimony today does not address proposals to codify third-party liability for FTC Act violations, potential problems could arise depending on the precise legislative language.

defining the scope of liability in advance could have stymied the natural development of this common law process, leading to uncertain results.[14]

Rules seeking to address fraudulent or other practices often are very difficult to write. Unlike the FCC, SEC, or other regulatory bodies, the FTC is not a sector-specific regulator. Thus, the agency generally lacks industry-specific knowledge, expertise, and routine contacts with regulated entities and congressional committees with jurisdiction over those industries.[15] Instead, in its law enforcement experience, the Commission deals with pathology. It is familiar with bad actors, who have demonstrated their unwillingness to comply with basic legal principles.

By their nature, however, rules also must apply to legitimate actors, who actually deliver the goods and services they promise. Remedies and approaches that are entirely appropriate for bad actors can be extremely burdensome when applied to legitimate businesses, and there is usually no easy or straightforward way to limit a rule to fraudulent activities. Rather than enhancing consumer welfare, overly burdensome rules can harm the very market processes that serve consumers' interests. For example, the Commission's initial proposal for the Telemarketing Sales Rule was extremely broad and burdensome, and one of the first acts of the Pitofsky Commission was to develop a

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[14] Although the FTC promulgated the Safeguards Rule at the same time as it was initiating information security cases, the rule was primarily useful in establishing a structure for remedies. Adopted under GLB, the rule set out a flexible, process-oriented approach to providing information security. Because Congress had specified liability for financial institutions that failed to protect sensitive information, the rule did not require a theory of who was liable under Section 5 and under what circumstances. Those theories were developed through the common law process in individual cases, and most of the Commission cases have involved industries not within GLB's jurisdiction.

[15] Of course, the agency and its staff have become quite knowledgeable about certain sectors of the American economy, including, for example, the downstream parts of the oil industry, certain aspects of health care, and credit reporting agencies. For credit reporting agencies, the FTC is *the* regulator, and pursuant to the FACT Act, has promulgated numerous rules in the last few years. These rules, and many others, were promulgated pursuant to congressional direction.

narrower approach to the rule. More recently, the Commission found it necessary to re-propose its Business Opportunity Rule, because the initial proposal would have adversely affected millions of self-employed workers.

Of course, rulemaking can be appropriate. For example, the Commission sometimes can provide "rules of the game" that reduce consumer harm in the future. The Commission can establish new default rules and procedures for transference of rights when it is otherwise difficult to do so. Thus, the Commission's Mail Order rule provides that unless the parties agree otherwise, the merchandise must be delivered with 30 days. While seeking to facilitate the exercise of consumer choice, the agency is also highly cognizant of the need to avoid unduly shackling market forces.[16] For example, this balance undergirds the FTC's approach to unsolicited telemarketing calls, through which consumers decide whether or not they wish to receive such calls and express their preferences effectively through the Do Not Call registry. Once these new rules of exchange are established, if transaction costs are low, parties can more easily transfer these rights.[17]

It would be a major mistake for rulemaking to be a substantial component of FTC consumer protection. The FTC went down this road once before, with disastrous consequences. In the 1970s, using its unfairness authority under Section 5 without meaningful standards, the Commission embarked on a vast enterprise to transform entire

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[16] *See, e.g.*, Comment of the Staff of the FTC before the Department of Health and Human Services Food and Drug Administration, In the Matter of Food Labeling: Health Claims; Dietary Guidance, *Docket No. 2003-0496* (Jan. 2004), *available at* http://www.ftc.gov/os/2004/040126fdacomments.pdf.

[17] *See* R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 15-16 (1960) ("Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about.").

industries. Over a 15-month period, the Commission issued a rule a month, usually without a clear theory of why there was a law violation, with only a tenuous connection between the perceived problem and the recommended remedy, and, at best, a shaky empirical foundation.[18] The enterprise foundered because of the internal inadequacies of the Commission's procedures and because of intense congressional opposition.

As it did before, the FTC will fail in its mission to protect consumers if it seeks to become the second most powerful legislature in Washington. This is surely an unsuitable task for five unelected representatives, not closely supervised by the White House or a Cabinet department.

Regardless of the procedures, rulemaking is a resource-intensive activity that inevitably draws resources away from enforcement. While I was Chairman, the agency was pursuing subprime lending cases involving failure to disclose adequately key terms of the transaction. In 2005, however, as more and more dubious loans were made, the agency diverted substantial resources to rulemakings to implement the FACT Act. The FTC asked for rulemaking authority in one narrow area (risk-based pricing); it ended up with statutory mandates for more than a dozen separate rules and studies. Whatever their value, those rules and studies consumed resources the Commission could have productively employed on cases.

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[18] For similar criticisms of the FTC's rulemaking binge, see the extensive, contemporaneous studies by Barry Boyer (Report to the Administrative Conference of the US, Trade Regulation Rulemaking Procedures of the Federal Trade Commission, 1979) and Teresa Schwartz (*Regulating Unfair Practices Under the FTC Act: The Need for a Legal Standard*, 11 Akron L. Rev. 1 (1977)). *See also* Muris, *Rules Without Reason – The Case of the FTC*, 6 Regulation 20 (Sept./Oct. 1982).

B. Magnuson-Moss Procedures Are Appropriately Tough, But Usable.[19]

Rulemaking is an exercise in generalization. The FTC should determine whether a problem occurs often enough to justify a rule, whether the problem has a common cause in a sufficient number of cases to justify the remedy, and whether that remedy can correct the problem without imposing excessive costs. Because the FTC cannot generalize simply from its own experiences or from the horror stories of others, it should rely on projectable evidence such as surveys of consumers and econometric studies of industry behavior.

The Magnuson-Moss procedures force the Commission to be clear about its theories and focus its evidence on the key questions. Otherwise, the procedures can make the rulemaking almost interminable. The ability of rulemaking participants to designate disputed factual issues and cross examine witnesses on those issues is very useful in testing the Commission's theories. Properly focused, Magnuson-Moss procedures are workable.

The Commission's recent experience in the Business Opportunity Rulemaking is a reminder of the useful aspects of the Magnuson-Moss procedures. The Commission proposed a wide-ranging rule, apparently aimed at fraud, but that instead would have adversely affected millions of self-employed workers and the consumers they serve. Based on the public comments and the need to proceed under Magnuson Moss, the Commission has now sensibly proposed a much more targeted rule that addresses fraud without regulating legitimate businesses. Although the Commission may have retreated

[19] Although within the Commission these procedures are uniformly referred to as "Magnuson Moss," in fact, the procedures are contained within Title II of the Magnuson Moss Warranty - Federal Trade

without the threat of hearings and cross examination, those threats undoubtedly helped to influence the Commission's deliberations.

The FTC has successfully used Magnuson Moss Rulemaking in the past. Several of the rules proposed in the 1970s were eventually promulgated. Some rules, like the two involving eyeglasses, were well conceived initially and concluded expeditiously. More recently, the Commission has used these procedures to amend the Franchise Rule, and is well on its way to concluding the Business Opportunity Rule successfully.

The Commission's most prominent rulemaking endeavor, the creation of the National Do Not Call Registry, could have proceeded in a timely fashion under Magnuson-Moss procedures. It took two years from the time the rule was first publicly discussed until it was implemented. Although it would have been necessary to structure the proceedings differently, there would have been little, if any, additional delay from using Magnuson Moss.

C. Magnuson-Moss Procedures Should Be Retained.[20]

The problems that resulted from FTC rulemaking in the 1970s are not just that the agency needed "better" regulators. Instead, the problem is one of incentives and constraints. We are in a period of unusual government activism. Numerous groups will press the Commission for immediate action, whether or not the proposal is well thought

Commission Improvement Act of 1975. Only Title I involved the Magnuson Moss Warranty Act, but I use here the conventional designation of Magnuson-Moss procedures.

[20] The administration's proposal would do more than just change the procedures used in rulemaking. It also would eliminate the requirement that unfair or deceptive practices must be prevalent, and eliminate the requirement for the Commission's Statement of Basis and Purpose to address the economic effect of the rule. It also changes the standard for judicial review, eliminating the court's ability to strike down rules that are not supported by substantial evidence in the rulemaking record taken as a whole. The current restrictions on Commissioners' meeting with outside parties and the prohibition on *ex parte*

out. In the short run, Congress may push hard for action as well. Without the constraints of the Magnuson-Moss procedures, the potential for mischief and long run harm to the Commission and to consumers is enormous. Although Congress and the courts eventually may restrain the Commission, it would be far better to avoid these costs from the beginning.

It is true that part of the problem from the 1970s has been addressed with the Commission's adoption of the Deception Policy Statement and the codification of the definition of unfairness. Nonetheless, the Commission's authority remains extremely broad. The procedural safeguards of Magnuson Moss create a strong need for the Commission to develop clear theories and strong incentives to develop a firm evidentiary base early in the rulemaking proceeding. When these requirements are met, Magnuson Moss rulemaking is workable.

In a number of areas, the FTC has engaged in rulemaking, pursuant to congressional direction, using APA procedures. Congressional directives avoid a significant part of the problems that bedeviled the FTC in the 1970s, as they provide explicit political "cover" for the specific rulemaking at issue. That cover may subside, however, as the political tides shift or as the specific parameters of the proposal prompt fierce industry resistance. Moreover, congressional directives often remove the question of what constitutes a violation, which proved to be one of the most contentious issues of many 1970s rulemaking. Even with congressional authorization, I would retain

communications with Commissioners also are eliminated. These sensible and important protections should be retained.

Magnuson-Moss procedures when a rulemaking is major and when Congress has not specifically defined the violation.

IV. Safeguards Should Accompany Any Expansion of State Enforcement Authority

As discussed above, the state Attorneys General have been important partners of the FTC in fighting fraud. From personal experience, I can attest to the diligence and professionalism of those with whom we worked in Attorneys General offices across the United States. Nevertheless, it is important to recognize recent problems that have arisen in a few states involving the outsourcing of enforcement responsibilities.

Some in Congress want to grant greater authority to state Attorneys General to enforce federal law. If you choose to extend such authority to the states, I respectfully urge the Committee to consider adding safeguards to ensure that such authority is exercised in a uniform, transparent, and impartial manner.

In recent years, Congress has enacted several statutes that expand the authority of state and local governments to enforce federal laws into new areas. For example, state Attorneys General are now empowered to enforce federal laws governing diverse issues such as telemarketing, online gaming, and transportation of household goods – to name a few. Indeed, in the past few months alone, Congress authorized state Attorneys General to enforce the federal Health Insurance Portability and Accountability Act, the federal Truth in Lending Act, and any mortgage loan rules promulgated by the FTC.

Delegating federal enforcement power to state actors gives rise to two important and related problems. First, federal regulatory regimes are at a significant risk of being enforced in an inconsistent and unfair manner. Numerous safeguards ensure that federal prosecutorial efforts are consistent, fair, and free from outside bias or interference. Those safeguards include statutes prohibiting bribery, ethics rules governing political activities of anyone retained by the government to assist in enforcement efforts, and Executive Order 13433, which limits the use of contingent fee arrangements with private attorneys retained by the government. By contrast, states are generally not subject to such safeguards. As a result, granting federal enforcement authority to the states can result in haphazard prosecution efforts and opportunities for public corruption.

Second, state enforcement is likely to result in an increase in contingency-fee contracts between states and private attorneys. Contingency fee agreements by their nature often operate to the detriment of the general public. In the public litigation context, contingency fee arrangements create significant conflicts of interest. A basic principle of good government is that public actors should not participate in decisions in which they have a financial stake. Deputizing plaintiffs' attorneys with contingent fee contracts to serve as private attorneys general flouts this fundamental principle, because those attorneys get paid nothing unless they win – and they have no chance of winning unless they decide to prosecute claims. Accordingly, such attorneys have a clear incentive to litigate (and to continue litigating) even when doing so is not in the public interest.

For all of these reasons, Congress should approach the expansion of state authority to enforce federal laws with care – and ensure that any such expansion is accompanied by some or all of the following sensible safeguards to ensure that federal laws are enforced in an open, impartial, and ethical manner:

- **Require Disclosure of Private Attorney Retention Agreements.** State officials who retain private attorneys to enforce federal law should be required to disclose the arrangement to the federal government for publication in the Federal Register. Requiring transparency will improve federal oversight of state enforcement efforts, which will help ensure the objective, consistent implementation of federal laws.
- **Prohibit "Pay-to-Play" Arrangements.** Congress should sever the connection between campaign contributions and "private attorney general" retentions by prohibiting state and local government officials from rewarding substantial campaign contributors with potentially lucrative contracts to enforce federal laws.
- **Prohibit Contingent Fee Arrangements Absent Necessity.** Under Executive Order 13433, federal agencies using private attorneys to assist in the enforcement of federal law may use contingent fee arrangements only where it is cost effective and consistent with the public interest. Congress should apply these same standards to state and local governments' efforts to enforce federal law.

Although these safeguards would promote transparency and reduce ethical concerns about the use of contingent arrangements to reward political donors, they would *not* diminish the capacity of state and local governments to make independent, objective judgments about the best course of action in each case involving enforcement of federal law. In short, if Congress wishes to delegate federal enforcement authority to non-federal actors, these safeguards increase the likelihood of obtaining any benefits from such delegation without incurring adverse consequences.

V. CONCLUSION

Once again, thank you for the opportunity to testify today. I would be glad to answer any questions.