

Consumer Fraud: An Empirical Perspective Summary

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U. S. Department of Justice
Law Enforcement Assistance Administration
National Institute of Law Enforcement and Criminal Justice

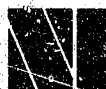


**Consumer Fraud:
An Empirical Perspective**
Summary

by
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and
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with the assistance of
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June 1979

U. S. Department of Justice
Law Enforcement Assistance Administration
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This project was supported by Grant Number 76-NI-99-0122, awarded to American Institutes for Research, by the National Institute of Law Enforcement and Criminal Justice, Law Enforcement Assistance Administration, U. S. Department of Justice, under the Omnibus Crime Control and Safe Streets Act of 1968, as amended. Research on this project was completed in February 1979. Points of view or opinions stated in this document are those of the authors and do not necessarily represent the official position or policies of the U. S. Department of Justice.

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ACKNOWLEDGEMENTS

Consumer Fraud: An Empirical Perspective has been a three-phase study that began in September 1976. The project, sponsored by the Law Enforcement Assistance Administration (LEAA), Community Crime Prevention Division, represents a combined effort of the American Institutes for Research (AIR), Washington, D.C., and the National Consumer Law Center (NCLC), Boston, Massachusetts.

As with any project this size, the products reflect the contributions of many individuals. We are grateful to each of them.

A panel of experts which represents law enforcement agencies, consumer organizations, and private sector groups met periodically, both to review project plans and accomplishments and to advise project staff about priorities and directions. The following individuals attended one or more meetings of the Advisory Panel.

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During the course of this study, we received frequent and thoughtful input and direction from Dr. Fred Heinzelman, Director, Community Crime Prevention Division, LEAA and Mr. Bernard Auchter, Project Monitor.

Mr. Jonathan A. Sheldon, Project Coordinator, was responsible for the daily technical direction and management of NCLC's activities. Overall supervision for technical and administrative matters was held by Mr. Mark Budnitz, Executive Director of NCLC. Mr. George J. Zweibel worked with the project staff in AIR's Washington Office as an on-site advisor on matters that required legal expertise. Other NCLC participants on short-term tasks were: Lynne B. Adams, Richard Alpert, Geraldine Azzata, Robert J. Hobbs, Mark Leymasters, Kenneth Reeves, and Wendy Schiller.

The AIR Project Director was Dr. Jane G. Schubert, who supervised on-going technical and administrative activities on a daily basis. Dr. Robert E. Krug served as the Principal Investigator and was responsible for all technical aspects of the project. He succeeded Dr. David J. Klaus, Principal Investigator during Phase I. The Network Approach and other creative concepts were contributed by Dr. Andrew M. Rose. Several analytic procedures such as cluster analysis and the log-linear technique were applied to the data base. They were suggested by Dr. Paul N. Fingerman, who also designed the appropriate computer programs and assisted in the interpretation of the data. Other staff members participated in numerous tasks: Ms. Adele Gill conducted the literature search; Ms. Teri Knotek constructed and maintained the data file; Ms. Tania Romashko conducted site visits; Mr. William Trencher contributed to the development of the intervention strategies.

This summary report, the sixth major product of this research, was prepared by Dr. Robert E. Krug and Dr. Jane G. Schubert, with the assistance of Dr. Andrew M. Rose. As with all other reports, the opinions expressed are those of the authors. They do not represent the opinions or policies of LEAA or other contributors to this project.

Additional reports are:

Schubert, J. G., Rose, A. M., Zweibel, G. J., & Klaus, D. J. *Consumer Fraud: An analysis of impact and opportunities for intervention*. Technical report: Phase I. Washington, D.C.: American Institutes for Research, December 1977.

Sheldon, J. A., & Zweibel, G. J. *Consumer Fraud: An analysis of impact and opportunities for intervention*. Survey of consumer fraud law. Washington, D.C.: American Institutes for Research, September 1977.

Schubert, J. G., Krug, R. E., & Rose, A. M. *Consumer Fraud: An analysis of impact and opportunities for intervention*. Technical report: Phase II. Washington, D.C.: American Institutes for Research, June 1978.

Sheldon, J. *Consumer Fraud: An analysis of impact and opportunities for intervention*. Consumer fraud intervention strategies. Washington, D.C.: American Institutes for Research, June 1978.

Zweibel, G. *Federal agency-by-agency analysis*. November 1978.

PROLOGUE

Two years ago, we set out to study consumer fraud. We actually studied a much broader range of transactions. Many of the events on which this report is based are cases of clear fraud. Many others involve merchant practices which are questionable, but for which a verdict of fraud is debatable. And a few involve a consumer complaint for which there may be no legitimate claim against the merchant. This expansion in scope was not planned at the outset; it occurred naturally in the first phase of the project and was thereafter maintained as intentional policy.

We began by asking agency* representatives to select examples from their case files which they believed to involve consumer fraud. We assembled 383 such cases in our first phase data collection. Our analysis of these cases indicated that

- we were tapping into a serious and pervasive phenomenon that was harmful to a very large number of people, and
- the domain included cases which could not satisfy all legal requirements for proof of fraud.

We decided to be led by our data, hence the claim of an *empirical perspective*. We might have titled our study *Consumer Abuse*, which accurately describes our total sample of some 1,147 cases; but that title would miss the point. An empirical perspective on fraud turns up many instances of abuse which may not support a court verdict of fraud. The domain we studied might be described as that which violates

"... the contract which the law always implies, that every transaction is fair and honest." (Blackstone's Commentaries)

The overwhelming message of our data is that fraudulent and quasi-fraudulent events appear at the outset to be normal, everyday transactions. There are exceptions, but for the most part there are no signals to the consumer that he or she is about to be taken. This appearance of normalcy is a serious obstacle to the design of remedies. Most transactions are fair and honest, and correcting or preventing those which are not, must not place an unreasonable burden on the honest merchant.

Consumer abuse is pervasive, produces a very large aggregate loss, and is intolerable for the individual victims. Our assessment of possible intervention offers no panacea. Our hope is that the assessment will be used and be useful to those engaged in the continuing effort to reduce the perils of the marketplace.

* See Appendix A and Appendix B for a list of the agencies.

HISTORICAL PERSPECTIVE

1. HISTORICAL PERSPECTIVE

1.1 Overall Objectives of the Study

The general plan for the Consumer Fraud project was quite straightforward, consisting essentially of three steps. The purpose of the first phase was to describe the nature, scope, and characteristics of consumer fraud, and of the laws and regulations intended to control it. The second phase was to expand on the first by collecting a larger and more focused set of consumer fraud events and by examining the effectiveness of existing control mechanisms. The purpose of the second phase was to determine the requirements for new or modified prevention and control efforts. The product of the third phase would be a set of recommended approaches or strategies to protect consumers from fraud.

Very early in the effort, we recognized that our attention was being directed by the accumulating data to phenomena which could not be encompassed by accepted legal definitions of fraud. We decided to follow the route indicated by the data. Our study therefore covers a domain which includes, but is not limited to, consumer fraud as currently defined.

A summary of Phase I and Phase II activities follows. The efforts of AIR and NCLC are treated separately; each organization worked concurrently on essentially independent tasks during the first two phases.

1.2 Phase I: AIR

1.2.1 GOALS

The tasks assigned to this phase were (1) a collection of case histories that represented examples of situations in which a consumer was allegedly defrauded by a merchant, (2) the development of a descriptive classification scheme of consumer fraud offenses based on those histories, and (3) the creation of a data-based definition of consumer fraud.

1.2.2 ACTIVITIES AND ACCOMPLISHMENTS

With the help of the Advisory Panel, we selected 11 agencies as sources for the case histories.* The sources represented law enforcement agencies, consumer groups, and regulatory agencies, believed to represent the types of offices that handled most consumer complaints and therefore, would provide broad coverage of the kinds of events which might be considered fraudulent. Agency

* A table identifying and characterizing each participating agency appears as Appendix A.

employees who handle consumer cases supplied samples of events where they believed consumer fraud had occurred. We collected 383 cases from the 11 sources. Each case history contained a description of the consumer complaint, an explanation of the investigation conducted by the agency, and a report of the outcome. The cases were summarized into abstracts of one or two pages in length.

The following brief abstracts give some of the flavor of the cases.

- A \$22 check accompanied my order for six Bicentennial gold plated dollars . . . acknowledgement of my order and notice of six-month delay in shipment accompanied another offer for more coins . . . eight months following original order, a court-appointed receiver for the company informed me that the company's funds were exhausted and solicited my order of silver plated coins (\$33 plus a money-back guarantee) as a first step toward ultimate receipt of my set of gold plated dollars.
- The unusual plants for which I paid \$26, were almost dead when they arrived . . . balance of order never received . . . my mail order was prepaid . . . four years later the merchant has not fulfilled the balance of my original order . . . the same ad I responded to still appears in national publications.
- I ordered a radio, stereo, and turntable at a tremendous discount from an incentive program offered through the local educators association . . . mailed a personal check for \$267.45 with my order . . . seven months of delays and promises have resulted in no merchandise . . . now there is no phone listing for this "program" organization.
- I have not received my home office storage unit which I ordered by mail six months ago. . . phone calls of inquiry resulted in empty promises of delivery when they caught up with large number of orders received . . . paid special sale price of \$395 (reduced from \$445) plus \$25 shipping charge . . . confirmation received acknowledging payment.
- I purchased an electric clock on sale (\$30) because the store was relocating . . . the clock had a one-year guarantee . . . when it stopped running after three days I contacted the new store and was asked to return the clock so it could be sent to the manufacturer for repair . . . six months later I still had no clock . . . during my last conversation with the manager he refused to take action because the clock was purchased on sale . . . he was not responsible for any statements made by the clerk.
- I responded to a telephone solicitation offering brand-name vacuum cleaner bags for a special price prior to an increase . . . I paid in full on delivery . . . when I later opened the package I discovered the bags were of an inferior quality, and were not the brand name offered.

Some of the events are fraudulent. Some violate existing laws, but may not be classed as fraud. Some may not even be illegal. But in each case, a consumer suffered some "hurt", spent additional time and energy, and sometimes additional money in the attempt to obtain satisfaction, and was often unsuccessful. Abuse of the consumer in the marketplace is pervasive, places unreasonable burden on the individual victims, and produces very large aggregate loss. Confronted with these findings, we designed our second phase of data collection to continue to seek examples of fraud, but to accept cases which were turned up by the case selection process, even if they did not satisfy a narrow definition of fraud. We studied abuse of the consumer.

1.2.3 PRODUCT

The major product of this phase was a technical report that detailed the objectives, data collection procedures and analyses, a list of 24 descriptive dimensions, and a refined definition of consumer fraud. The report included sample abstracts, descriptions of each agency source, a bibliography containing 225 entries, and a list of the Advisory Panel members. It also included a preliminary analysis of three classification schemes which would be given a more thorough test in Phase II.

1.3 Phase I: NCLC

1.3.1 GOALS

The Phase I objective was to compile and organize relevant statutes, regulations, and ordinances from federal and representative state and local jurisdictions which attempt to establish certain kinds of behavior as fraudulent.

1.3.2 ACTIVITIES AND ACCOMPLISHMENTS

Several surveys of existing laws which have a bearing on consumer fraud were conducted. In addition to addressing civil and criminal laws at the three government levels, the surveys encompassed administrative regulations and case law.

The federal survey entailed comprehensive research of all federal laws and agencies charged with consumer fraud functions. Preliminary research suggested that 40 federal agencies might have some involvement in consumer fraud. The survey was focused on 20 agencies whose statutory powers and regulations promulgated under them, merited detailed research. Federal Trade Commission law warranted more thorough inspections; therefore, FTC legislation, rules, guides, caselaw, enforcement statements and various secondary materials were scrutinized. For each agency, charts were developed which delineated prohibited practices under the agency's consumer fraud functions and specified remedies for violations.

The state law survey consisted of three major components: (1) an examination of laws prohibiting unfair or deceptive acts or practices (UDAP statutes) in all states, including the District of Columbia; (2) an analysis of all other forms of consumer fraud laws in 12 states and the District of Columbia which collectively represent typical state consumer fraud law;* and (3) a review of the legislation and regulations adopted by approximately 30 licensing boards in a subsample of five states. The 13 jurisdictions provide an adequate cross-section along three variables: geographic location; form of UDAP statute; and amount of state resources devoted to consumer protection. States were chosen from the Northeast, Midwest, South, and West. The states also represent, in approximately correct proportions, the various forms of UDAP statutes enacted throughout the country and include the one state that has not enacted such legislation. In addition, one of the few Uniform Consumer Credit Code states was also selected. Various forms of private and state UDAP remedies and powers are represented in roughly proportional numbers.

The local consumer fraud law survey included two or three towns or counties within each of the 12 target states. The jurisdictions were chosen to provide representation from urban, suburban, small town, and rural areas. Since almost all localities have very limited consumer fraud legislation, a disproportionate number of localities with more extensive consumer fraud laws was selected to allow adequate comparison of various approaches, even if infrequently enacted.

1.3.3 PRODUCT

The document produced at the conclusion of this phase is unique in its class. The five-part volume contains the following sections: 1. Historical Development of Consumer Fraud Law, historical monographs, treatises, and other secondary materials; 2. State Law, an analysis of 67 consumer fraud practices states have targeted for regulation and 33 strategies used to prevent these prohibited practices; 3. Local Enforcement, identifies the various approaches that municipalities and counties take in policing consumer transactions; 4. Federal Law describes both the fraud practices of concern to federal agencies and the strategies utilized to prevent them; it also contains an agency-by-agency analysis summarizing important consumer fraud laws and remedies administered by 28 federal agencies; 5. Foreign Approaches, sets out innovative strategies that foreign jurisdictions have utilized to combat fraud in the marketplace.

* These states are: Alabama, California, Colorado, Georgia, Illinois, Massachusetts, New Jersey, New York, Ohio, Pennsylvania, Texas, Wisconsin.

1.4 Phase II: AIR

1.4.1 GOALS

The principal aim was to develop quantitative profiles for each pattern of consumer offense. Measurement techniques that might be used to monitor consumer abuse were sought as a secondary objective.

1.4.2 ACTIVITIES AND ACCOMPLISHMENTS

The emphasis shifted from a qualitative phase to a quantitative phase; we collected and processed 942 additional consumer complaints from ten new law enforcement and consumer agencies.* The knowledge gained in Phase I provided a better understanding of information requirements and therefore permitted greater efficiency in data collection. Attention was directed to individual complaint data from files closed less than two years; assembling fractional data from numerous sources permitted the aggregation of data into useful composites. Project staff visited the sites and randomly selected cases from the files; cases that did not contain a description of the transaction between the merchant and the consumer were passed over.

Case data were recorded on a Data Acquisition Form derived from the classification schemes developed in Phase I; each scheme focused on the nature of the *process* of the transaction between merchant and consumer. The process-oriented approach permitted examination of how an abuse was perpetrated by identifying (1) the actions and circumstances which characterized an offense, (2) the sequence of events that set it apart from other types of abuses, and (3) the conditions which allowed a particular type of offense to succeed. Each type of offense would be analyzed as a *profile* of consumer abuse; the profiles were then to be used in generating ideas for intervention strategies.

Although our original intention was to develop one classification scheme using the Phase I data base, we actually developed three schemes, each employing a substantially different approach to analyzing the process of a consumer transaction. We deferred the selection of one scheme until the reliability and utility of each system could be judged with the expanded data base. Consequently, the Data Acquisition Form reflected the distinguishing features of each classification scheme.

The three classification schemes are briefly described on the following page.**

* A table identifying and characterizing these sources appears as Appendix B.

** Detailed descriptions appear in the Phase I (AIR) report.

A *thematic* approach categorizes the cases into 15 inductively generated groups based on characteristic merchant actions. As an example, one theme, *Gilded Lily*, contains 39 cases in which claims are made which lead the consumer to believe the product or service will result in more benefits than actually will be received. Because many factors affect outcomes, these claims are difficult to disprove. The key features of this category are that:

- claims typically are implied rather than explicit, and the ads may be literally true;
- the product or service is provided and, generally, the cost is not enormously excessive for what actually is received; and
- although the product or service often has some value, it probably would not have been purchased in the absence of misleading claims.

A *transactional* approach created prototypic transactions from the sequence of events believed to characterize business transactions between a merchant and a consumer. The three major components of a transaction are:

- an inducement: refers to the appeal or the attraction offered by the merchant that led to the consumer's interest;
- an obligation: refers to the action by the consumer that demonstrates a commitment;
- an outcome: refers to the final event which, from the consumer's viewpoint, identifies the major grievance in the transaction.

Each of the major components contains subcategories derived from an iterative process of sorting elements of the cases into similar clusters. For example, all cases were examined for an inducement; similar inducements (such as business opportunity or a substantial savings) were grouped together until all cases had been assigned to a cluster. The same cases were then re-examined for the consumer's obligation to the merchant (such as prepayment prior to delivery or signed agreement with the merchant); similar behaviors were assigned to a cluster until all the cases were used. The data determined the number of piles. The sorting procedure was then repeated to identify outcomes to the transaction. Each case was thus described as an inducement-obligation-outcome combination.

A *network* approach is structured around the characterization of a consumer-merchant transaction in terms of a sequential network of questions and answers. Significant nodes (with respect to both loci of potential countermeasures and critical exchanges in the transaction) were identified from a review of the 383 cases. These nodes were translated into binary questions; a logical sequence for addressing these questions was developed. Each node does not define a type of consumer abuse; we assumed

that specific cases had patterns of answers, and that different types of abuse would manifest themselves as distinctive patterns.

The network approach is illustrated below.

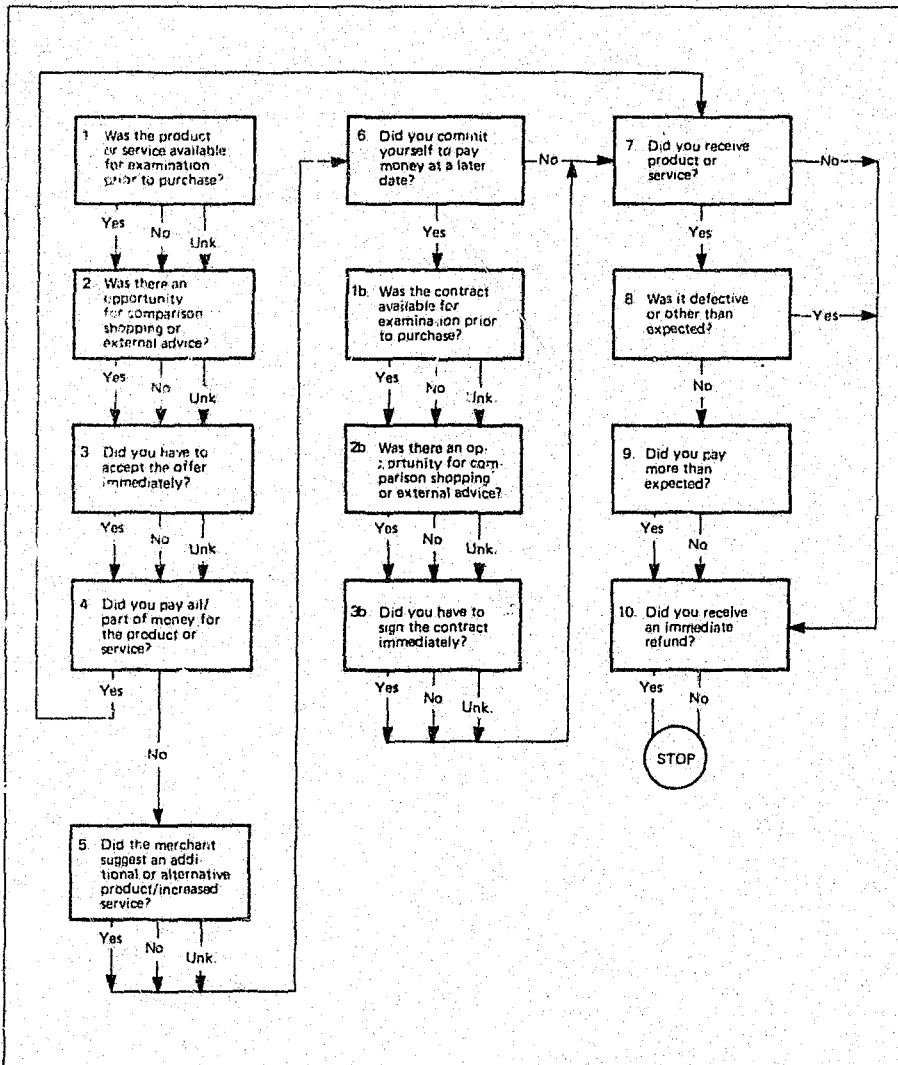


Figure 1. The Network Approach

The 942 cases collected from the ten additional agencies which participated in Phase II fell short of our goal of 1,000 cases, so 252 cases were added from the Phase I data base. Our new data set contained 1,194 cases, after editing and cleaning the data, the usable base consisted of 1,147 cases. Is this data set *representative* of what occurs in the marketplace? The clear answer is "no" for two reasons. First, we have no basis at all for estimating the frequency of abuse as a percentage

of all transactions. A *victimization survey* designed to provide such an estimate would require resources which far exceed those available in this study. Consideration of resource requirements leads us to recommend that surveys would be cost effective only as before and after measures for pilot tests of planned interventions.

Second, we cannot use our data to infer the frequency of some type of abuse, such as auto repair fraud, as a percentage of all abuses. Cases within agency files were selected randomly; the agencies themselves were not selected randomly from a master list of all agencies. We believe our set of agencies to represent a broad coverage for all forms of consumer abuse; but there is no basis for statistical inference from our sample of cases to the population of all cases. We believe our sample to be fully adequate for the purposes intended; we do not claim more than that. The data reflect two general types of information--descriptive and process-oriented. Both were necessary for developing comprehensive patterns of abuse. Our overall impressions of the data are summarized below:

- elegant, ingenious, or complex schemes were noticeably absent from the cases; most events were unimaginative in planning and execution;
- merchant excesses often led to the complaint being filed; many schemes would have "worked" better if the merchant had been less greedy or careless;
- in outward appearances, most cases are indistinguishable from normal, everyday transactions; there are few clues to warn the consumer that he or she is about to be taken;
- the illegality of such behaviors as mislabeling, failure to disclose, or refusing a guaranteed refund, did not deter merchants from using them;
- resolution (if it occurred at all) usually required substantial investment of consumer time and energy; some consumers were extraordinarily patient in trying to get satisfaction from a merchant; complaints to consumer agencies are not made precipitously; and
- while the typical transaction is small (53% of our cases involved less than \$100), the aggregate is very large: our 1,147 transactions involved more than \$700,000.

The task of choosing the classification scheme which held the most promise for devising intervention strategies still remained. Each of the three systems was analyzed, using the complete data base. An exhaustive discussion of the analyses is contained in the Phase II (AIR) report; briefly, the outcomes were that:

In the *thematic* approach, only 473 (41%) of the cases were uniquely defined by one of the 15 themes. Ninety-three cases (8%) received multiple assignments and the remaining 581 (51%) were not accommodated by the system. As formulated, the thematic approach did not provide an adequate framework.

The primary analytic procedure applied to the *transactional* sequence was to cross-tabulate Inducement x Obligation x Outcome to identify patterns. Nine patterns out of a possible 54 accounted for 67 percent of the cases. In most of the cases, the existence of "warranty" (express or implied) emerged as the inducement for purchase. This really suggests the absence of an external stimulus and indicates that most of our cases began as normal business transactions that turn sour, resulting in a consumer grievance. Warranty was considered as an inducement largely because of the absence of other more specific inducements. There is a qualitative difference between purchase based on a "special opportunity" to save money and one based on the existence of an implied or express warranty. We therefore directed our attention to the remaining two transactional components--obligation and outcome.

In the *network* analysis, it was essential to know something about the patterns of answers to the ten questions. A cluster analysis was performed that grouped "similar" cases by their responses to these questions. Statistically, this was a very successful cluster solution, in that very few patterns could account for practically all of the cases.

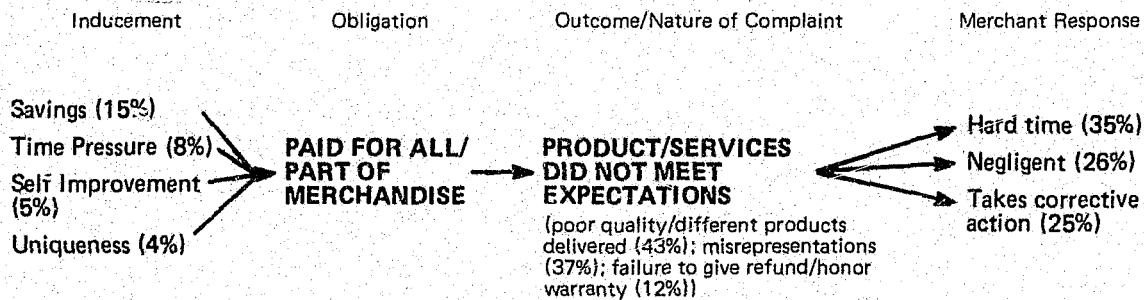
The outcome of the analysis was that the transactional sequence and the network approach seemed to convey similar information; the general summaries were essentially identical. Before proceeding to Phase III tests of utility, a more formal, but simple analysis of similarity between the two approaches was conducted. Based on that analysis, we generated 23 profiles of consumer abuse (9 transactional sequences and 14 network clusters), each set using approximately 90 percent of the 1,147 cases. Each pattern is accompanied by both descriptive and process variables. The significance of the descriptive variables was tested by a likelihood ratio chi square.

Examples of two profiles follow. Statements such as "more than--fewer than--more often", etc., refer to frequencies which differ in a statistically significant manner, from the overall frequencies.

Profile AC
 No. of Cases 311
 Percent of Total 24

The consumer paid for all or part of the merchandise or service at the time of the purchase. Upon receipt examination of the goods revealed that they did not correspond to the original offer or the consumer's expectations.

Transactional Sequence



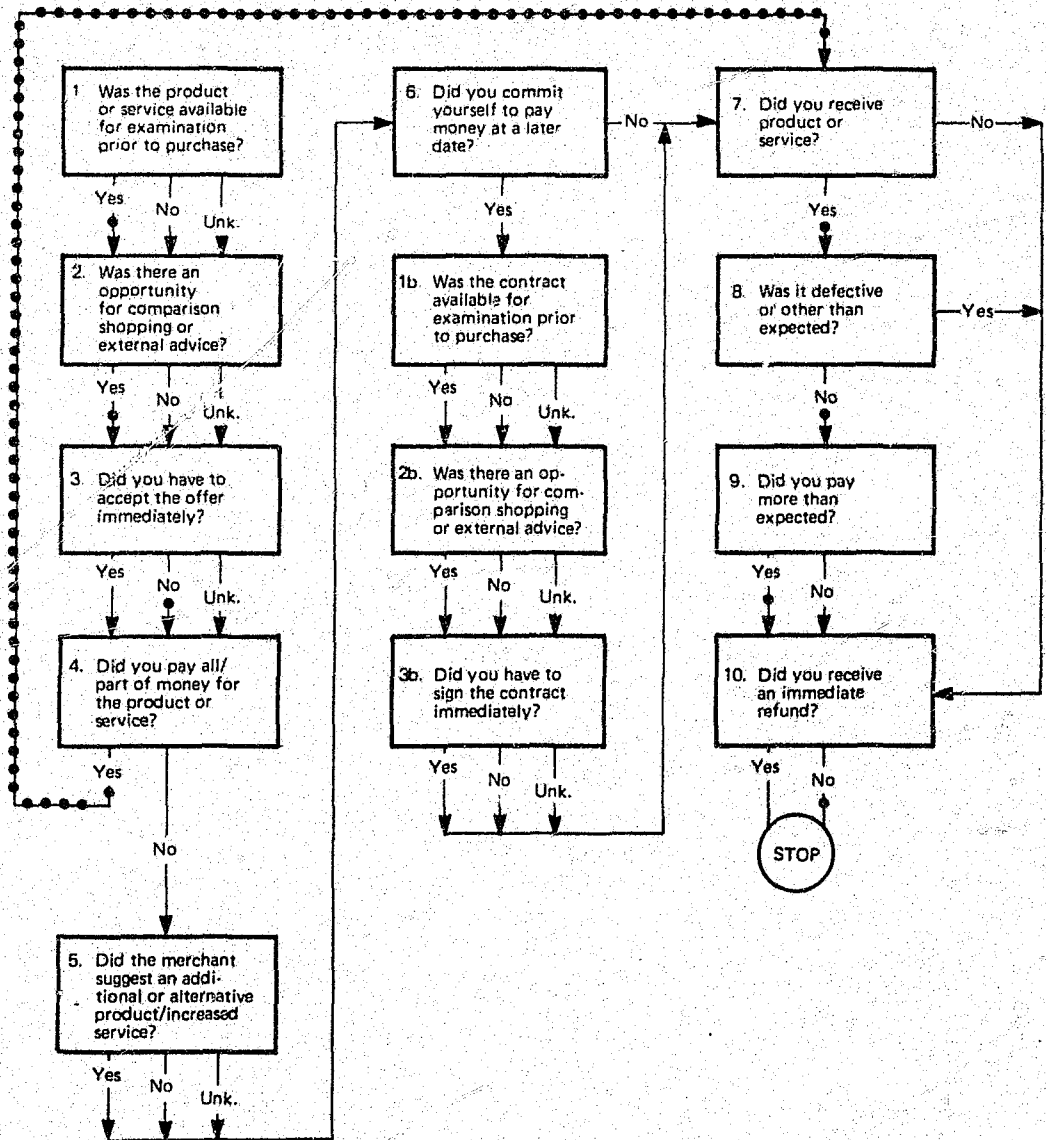
Descriptive Data

- The following products or services were more (+) represented than expected:
 - Automotive products (+)
 - Home Furnishings (+)
- More sellers appeared in the reported transactions.
- More initial contacts between the merchant and the consumer were made at a business establishment of another involved party.
- The following complaints were over (+) or under (-) represented.
 - Unavailability of products or service (-)
 - Merchant misrepresented benefit(s) of product or service (+)
 - Consumers reported receipt of poor quality products (+)
 - Consumers reported receiving a product different from the one purchased (+)
- There were more reported cases of oral representation as the primary medium used to perpetrate the fraud than expected.
- The records revealed that there were more cases in which the source of the consumer complaint was unknown than expected.
- There were more cases in which the consumer sought relief for the reported grievance by exchanging the merchandise than expected.
- More consumers reported that merchants argued about 'product claims' when confronted with the complaint than expected.

Profile 7
 No. of Cases 116
 Percent of Total 10

The product or service was available prior to purchase, comparison shopping was not precluded, and the consumer did not have to accept the offer immediately. The consumer paid for all or most of the product or service at the time of purchase. A product or service was received that did match the consumer's expectations; however, the consumer paid more than anticipated. The consumer did not receive an immediate refund.

Network Analysis



Descriptive Data

- The complaint of overcharging or charging hidden costs was overrepresented.
- The incidence of no money being involved in the transaction was overrepresented.
- The merchant response of arguing price claims was overrepresented.

The Measurement of Consumer Fraud. In our original proposal, we viewed the measurement problem as "one of the most difficult issues to be resolved before consumer fraud can be attacked systematically". We have not resolved the measurement issue, but we believe that fraud can be attacked systematically, nonetheless. How can this be?

As planned, we gave most of our attention to "hard" data consisting of reported instances of fraudulent events. We had been concerned that these data might "overrepresent offenses leading to the largest losses, affecting more articulate victims, and representing the emphasis of the agencies supplying the data." It must be true that our data sources, and all existing sources, overrepresent the better educated and more articulate consumer. Pursuing a complaint when satisfaction is not obtained from the merchant, requires the consumer to (a) know the avenues available, (b) have the time and resources to file and follow-up, and (c) believe that the expenditure of time and resources is worthwhile. Lower income and less educated consumers are disadvantaged in all three areas--they may not know where to file a complaint, they may be unable to take the time to file, and they will often believe that it won't do any good in any event. We are not concerned about bias in our selection of sources; our coverage was sufficiently broad to avoid the special emphasis that one agency might show. And our first concern--that we would get only the dramatic, large loss events--was not substantiated by the data. As noted elsewhere, our data are characterized by the apparent normalcy of the transactions described.

It is this last fact which reduces our concern with more precise measurement. We know that there is a very large and relatively homogeneous set of events which damage consumers. Whether our data sources reveal 20 or 50 percent of this mass seems relatively unimportant.

We were unable to estimate the magnitude of the unreported events which occur, because agencies do not routinely collect descriptive data which would permit estimates to be generated. We seldom know anything about the socio-economic status of the victim; the records are generally mute concerning age, type of household, income, and the like.

We were equally unsuccessful in discovering unobtrusive indicators of fraud. We made no investment, other than a search of the literature, in the attempt to identify such measures. We doubt seriously that any major effort is justified. Our one recommendation regarding measurement is to encourage the widespread adoption of a standard complaint form, with accompanying manual of instructions for completing the form. A very large scale data base could be created at relatively low cost through such a device.

1.4.3 PRODUCT

A technical report details the data collection procedures and data analysis. A large portion of the document is devoted to the profiles generated by the results. Extensive tabular data are included which show the frequency distributions of all variables, the data collection instrument and companion guide, comprehensive descriptions of the three classification schemes and cross-tabulations of all 40 variables by each of the 23 profiles.

1.5 Phase II: NCLC

1.5.1 GOALS

The primary task was to assess the status and application of existing consumer fraud legal sanctions by surveying law enforcement and criminal justice officials.

1.5.2 ACTIVITIES AND ACCOMPLISHMENTS

The survey of existing intervention strategies utilized both primary and secondary sources. Primary sources were 112 enforcement officials and consumer experts from four states* and the District of Columbia; these interviewees represented federal enforcement officers (26), state prosecutors, members of consumer protection boards, judges, and legislators (35), local district attorneys and consumer protection board members (25), and private attorneys, law professors, and others (26). The secondary sources were drawn from relevant literature - books, journals, legal publications, and the like.

Twenty-two illustrative and commonly used intervention strategies are disclosed in the findings; these 22 approaches are organized into seven overall categories of enforcement. The results describe the state-of-the-art in enforcement mechanisms and do not attempt to recommend any new strategies. Summaries of the findings are discussed on the following pages, according to the seven categories.

Deterrence employs the technique of putting sellers on notice that fraudulent conduct will be penalized; the threat of prosecution deters merchant misconduct. The effectiveness of this approach may be measured by sellers' response to the threat of such prosecution though no such data were uncovered. A deterrence program is cost-effective if a few prosecutions prevent most sellers from engaging in consumer fraud. Four strategies are suggested within the general mechanism of deterrence:

1. Criminal sentences. These are effective if the threat of prosecution and harsh sentencing is real enough to the merchant. The impact is greater on mainstream businesses than fly-by-night sellers. Criminal

* California, Georgia, Massachusetts, and New York.

prosecutions are rare events for numerous reasons; when brought to court, long prison sentences seldom result.

2. Injunctions, cease and desist orders. This strategy attempts to deter the merchant being prosecuted from future frauds. Prosecution is eased by using civil procedures and more liberal standards of actionable merchant misconduct. Injunctive orders cannot be obtained easily or quickly; when obtained, the documents are quite narrow in scope and do not result in merchant compliance.
3. Fines, penalties, and license revocations. Implementation of such strategies requires simple standards and procedures to penalize sellers for initial violations, although "fines that hurt" are seldom used. License revocations, although harsher, are rarely imposed.
4. Private Attorneys General. Although theoretically an option, most consumers lack the incentive to serve as a private attorney general. It is not practical to consider private actions, independent of outside support.

Compensating victims provides an opportunity for the offending merchant to return the defrauded consumer to the status quo, redressing wrongs suffered. But, since no available strategy returns all defrauded consumers to the status quo, this approach must be viewed as a partial solution, compensating as many victims as possible. There are three important strategies utilizing this approach.

5. Private damage actions. Injured consumers can ask the court to order the offending seller to pay damages. Since traditional actions are not practical to redress small frauds, states have developed a number of innovations. Special damage awards, attorney fees, small claims courts, and class actions attempt to make fraud actions easier and cheaper to bring. While successful to some extent, all of these innovations have significant weaknesses.
6. Restitution. Government prosecutors can request a court to order restitution to all consumers defrauded by a seller. This strategy is similar to a private class action, sharing its strengths and weaknesses, but it also has advantages and disadvantages of its own.
7. Complaint mediation. This is a voluntary process of government agencies mediating disputes between sellers and buyers. Many defrauded consumers do not complain, agencies refuse to mediate certain complaints, and certain merchants refuse to participate. But for a large number of consumers, complaint mediation results in at least partial compensation.

Self-enforcing remedies allow consumers to red
deter fraud with little or no intervention from the
mediator. Three strategies emanate from this approach.

8. Withhold payments. Consumers buying on credit to pay the remaining amount due on fraudulent. This partially compensates the consumer and no affirmative action. Creditors utilize techniques to discourage consumers withholding. Consumers who do default on their debts are in defending debt collection actions. But manage to retain an attorney, defrauded consumer in a powerful position raising fraud defense creditor's collection action.
9. Automatic remedies. Rejecting non-conform cancelling contracts, and retaining unsold are available and effective in certain contexts often rely on government action to insure compliance with them.
10. Consumer demonstrations. This is the most interesting remedy, using publicity to attack defrauders. If the demonstration discourages the seller may negotiate. Legal and practical prevent widespread use of this remedy.

Controlling seller behavior directly. Instead of satisfying past victims or relying on a few prosecutions for fraud, the seller's conduct of his business is limited in ways. This approach entangles the government in day to day business, increasing costs both to the regulator, but its prophylactic nature may be superior to other approaches.

11. Licensing. This strategy restricts entry into markets and controls licensed sellers' behavior. Existing licensing boards are often developed to control competition, not fraud. Industry domination, lack of resources and enforcement authority reduce effectiveness.
12. Limit sales approaches and advertising practices. Specific regulations are rarely effective against by-night sellers but, if drafted carefully, against mainstream sellers. The more restrictive the more effective and costly to legitimate sellers. Numerous obstacles to effective advertising makes it a questionable intervention strategy.
13. Controlling contract language. Contract terms that aid and abet fraud schemes. Substantive regulation of standard form contracts has clear advantages but is strongly opposed by business interests.

Improving consumer decision-making results in better consumer purchases, with fewer resulting in fraud. This approach has the advantage of interfering with seller decisions and practices only to the extent necessary to improve consumer purchase choices. The approach can be seen as just insuring that the free market operates properly.

14. Pre-sale disclosures. This strategy requires sellers to inform consumers of specific information before the purchase is finalized. Disclosures are designed to make consumer choices more effective, allowing buyers to avoid being defrauded. But merchants may not make ordered disclosures; if they do, it may be in a manner or in language that insures consumers will not read or understand them.
15. Cooling off, trial periods, and affirmation. This restructures the purchase decision to give consumers longer to ponder the sales transaction, and cancel with no financial obligation. These techniques assist some consumers, but others do not know how to use them or are frustrated by merchant devices nullifying the remedy's benefits.
16. Consumer education. These efforts provide information to help consumers avoid or remedy fraud. Government or private consumer agencies use a variety of techniques to try to meaningfully reach the public. The effectiveness of these efforts has not been adequately measured.

Minimizing fraud losses by restricting the amount of money at stake in the transaction is another approach. Even if the consumer is defrauded, the loss is small. Since the consumer injury is minimal, seller's profit and his consequent incentive to defraud is decreased. The survey reveals two strategies.

17. Price limitations. Refund standards and contract limitations can limit the cost of future service contracts for consumers who cancel early. This type of price regulation minimally impedes sellers while offering consumers protection against fraudulent sales.
18. Escrow. Such accounts do not limit a transaction's price but restrict the seller's receipt of payment until the consumer determines absence of fraud. A third party only makes payment to the merchant if the escrow agreement is satisfied; otherwise, the money is returned to the consumer. Effective use of escrow requires a clearcut method of determining which party should receive payment. It also restricts merchant's cash flow and increases administrative costs.

Third parties, such as creditors or insurance companies police merchants and/or bear fraud losses. Sometimes third

parties can perform these tasks better than consumers or even government enforcement agencies. However, third parties are also expert at avoiding this responsibility and turning it back over to consumers. We identified four candidates for positive action.

19. Limiting defense cut-offs. This strategy allows consumers to raise fraud defenses against third party creditors in debt collection actions. These creditors, facing losses due to the merchant's fraud, are encouraged to screen out potentially fraudulent sellers from credit arrangements or establish recourse arrangements that pass the fraud loss back to the seller.
20. Bankruptcy. This occurs when the defrauding seller has insufficient assets to pay off creditors and consumers. Present procedures result in consumers receiving nothing. Proposed reforms would shift some of these bankruptcy losses to creditors who are in a better position to evaluate sellers' solvency than consumers.
21. Hold corporate officials liable. This strategy calls for shifting the burden of policing a corporation's fraud to shareholders, directors, and officers of the corporation. But, in practice, this rarely happens. Both practical and legal factors immunize corporate officials. Even when they are found personally liable, liability insurance can further protect these officials.
22. Bonding and insurance. This shifts consumers' fraud losses to surety companies. These surety companies have a profit incentive to screen out and refuse bonds to potential fraud offenders, limiting their ability to continue in business. Unfortunately, the same profit incentive encourages bonding companies not to pay out on consumer claims. Other types of insurance schemes such as government run insurance pools and private, insured-funded insurance plans, have advantages over bonding in this regard, but have other drawbacks.

1.5.3 PRODUCT

A report on consumer fraud intervention strategies presents a detailed analysis of each of the 22 remedies.

This concludes the historical perspective and sets the stage for a blending of AIR and NCLC's findings during Phase I and Phase II. Our work had resulted in two major outcomes--effectiveness of intervention strategies currently practiced by many law enforcement agencies and consumer affairs offices throughout the United States, and 23 profiles of consumer abuse. Our next and final task was to use these products to pinpoint areas of significant need for intervention strategies and to assess the probable value of alternative remedies.

**OPPORTUNITIES FOR
INTERVENTION**

2. OPPORTUNITIES FOR INTERVENTION

The objective of Phase III, and the ultimate objective of the entire project, was to develop strategies which would be effective in combatting abuses of the types revealed in our data. The basic materials for this development consisted of

- the systematic descriptions of patterns of consumer abuse, and
- an analysis of current potential effectiveness of existing interventions,

both of which were products of the projects's second phase. The essential task was to conjoin these materials and to evaluate the adequacy of each intervention as a response to the patterns of abuse. There is no precise technology which supports tasks of this kind; reliance must be placed on a logical analysis of the apparent match or mismatch between a "problem" and a "solution." In order to make our reasoning open to public examination, AIR developed rationales which link each proposed intervention strategy to the problem area it is intended to remedy. In this report, these rationales appear in abbreviated form, but in sufficient detail to present the skeleton of each argument. Some will disagree with our reasoning; in dealing with complex issues, difference of opinion is both desirable and inevitable. Debate should be encouraged; our principal goal is to present our logical analysis with sufficient clarity to permit informed debate on the central issues of concern.

Before presenting the interventions which we believe to be worthy of consideration, two principles which influenced our selection should be made explicit. Both derive from the data on consumer abuse, but neither are *ordained* by those data. First, for this domain which is characterized by *a very large number of small losses*, we believe the court system to be of limited utility. It is an already overburdened system with elaborate rules or procedures which discourage its use by the individual consumer. We consider class actions and small claims proceedings among our interventions, but we have emphasized approaches which avoid the courts.

Second, we view the government role as that of *court of last resort*. Government should stimulate, persuade, influence and twist arms if necessary, to see that mechanisms for consumer protection are present and operating effectively. But the government should be the operator only as a last resort. Our recommendations for government action are governed by the least drastic

alternative principle. We assign to government only those functions which cannot be managed effectively by the individuals and institutions of the private sector.

We also wish to give some mention to intervention strategies which we rejected, indicating the bases for rejection.

First, we pay almost no attention to *criminal sentences, fines, and penalties*. Advocates of criminal sanctions believe that sentencing offenders may have a powerful deterrent effect on other merchants. They may well be correct. The absence of widely accepted and demonstrably adequate measures of deterrence for any area of criminal offense makes the point difficult to prove or refute. But our neglect of criminal sanctions does not stem from the conflicting views of its effects. We reject it because we do not believe that it can be applied seriously in the broad domain with which we are concerned. Hard core fraud schemers will be sent to prison whenever the evidence is sufficient to warrant a verdict of guilt. "Respectable" merchants generally will find the court merciful. The fines levied will seldom be punishing. The sequence is: few will be apprehended by any law enforcement agency, few of those apprehended will be prosecuted, few of these will be found guilty, and for the infinitesimal few who are so judged, suspended sentences, probation, and token fines are the norm. We see no signs that these realities are changing.*

We make no mention of *economic crime units* as a force against consumer abuse. We strongly endorse the Federal, state, and local support of such units and are very encouraged with their achievements and potential. They have had impact on auto-repair fraud in at least one city, and that model is clearly replicable.** But we believe that they will have very little impact on many of the types of consumer abuse which were frequent in our data. The sad truth is that such events are just not exciting enough to hold the attention of economic crime units. The events are pedestrian, the losses are numerous but small, and there are no interesting or challenging themes to unravel. Compared to computer-based fund transfers, large-scale embezzlement, political corruption, or even employee theft, consumer abuse is small potatoes. Economic crime units will concentrate on the big action.

* This will strike some as an overstatement, and perhaps it is. Certainly there will be some highly publicized exceptions, where the full resources of the law enforcement community are brought to bear on a flagrant abuser. But the available resources are insufficient to provide across-the-board protection for all victims.

** In Philadelphia, AUTOTAP (an industry sponsored panel) provides an inspection service for consumers with automobile repair complaints. The service is explained more fully in the Phase II Report (NCLC), p. 57.

Consumer demonstrations and picketing are ignored. We have nothing sensible to say on these devices. They are extremely difficult to mount and maintain, and the results have seldom been satisfactory to the campaigners. Demonstrations may be useful as an education device, to call attention to some abuse or abuser. But we are unable to design a strategy based on demonstrations which we believe would be both implementable and effective.

We also say nothing about *bankruptcy actions by the consumer* as a mechanism to thwart collection of payments following a fraudulent transaction. This device is inexpensive, relatively simple, and extremely effective for the low-income consumer who has no assets worth protecting. But it is a basically negative approach which removes a symptom without touching the underlying problem. We favor instead, a strategy of creditor liability which attacks the problem directly.

We do not treat *consumer education* as an independent strategy, though we believe it to be the most powerful mechanism available in the long term. We view consumer education as an essential component of every strategy, not as an approach which can stand on its own. We would advocate thirty-second spots on television, tied to a particular type of transaction, or intervention, or consumer right. We would advocate educational materials, such as checklists, pamphlets, jobs aids, being available at the scene of a transaction. We advocate the widespread explanation--in simple English--of the real costs and benefits of alternative cans of peaches. Each of these educational efforts would support a specific strategy designed to control some specific pattern of fraud or abuse. Our data do not provide the ingredients for a generalized consumer education curriculum.

In the following section, we will present analyses of sixteen approaches, organized into six areas. The six are:

Payment Planning. The purpose is to restructure payment procedures to allow the consumer leverage when the transaction turns sour. The four strategies suggested are new applications of existing mechanisms; each is focused on a transaction-in-progress.

Post-Sale Alternatives. There are many occasions when a consumer legitimately reverses a decision to purchase a product or service and wants to back out, but the merchant refuses. Four options are offered for improving the situation by giving consumers the opportunity to exercise automatic cancellation rights: rejection of goods or revocations of acceptance; cooling-off periods following written agreement to a transaction; warranty rights that permit remedies following expiration of the cooling-off period or inapplicability of rejection; and refund standards useful for many future service contracts.

Complaint Mediation. The need that generated this recommendation is the lack of success experienced by consumers in attempting to seek redress for a grievance. Three types of change are considered: making the mediator more available; increasing the probability that merchants become involved in the mediation; and improving the quality of the actual mediation.

Private Remedies. Consumers have options for initiating proceedings against fraudulent merchants without involving a third party. Consumers often are unaware of these options. Furthermore, there are serious obstacles to their use at the present; they more often serve the merchant than the consumer. Modifications are recommended to redress this imbalance in small claims courts. Class action proceedings are also considered.

Coverage for Consumer Loss. Providing coverage for loss is the most general of the six areas; it is potentially applicable to any pattern of fraud. Strategies considered include bonding, insurance, creditor liability, and consumer priority in bankruptcy proceedings.

Document Simplification. This intervention is designed to produce a balance of knowledge between the merchant and the consumer in all transactions where print media are involved. The focus is on the pre-transaction period.

Each approach will be evaluated against a standard set of criteria. In terms of these criteria, an ideal strategy is one which:

Requires minimal investments by both merchant and consumer. Some existing mechanisms place an unreasonable burden on the consumer; hiring an attorney to recover a small dollar loss is one example. But legislative and regulatory remedies may place equally unreasonable burdens on non-offending merchants. Escrow, for example, is an effective and powerful protective device for consumers. But its broad application in the marketplace would create untenable cash flow problems for many merchants.

Is easy to implement. An approach which requires legislation will find the road to implementation a long, poorly marked, and uncertain one, with many detours along its course. Producing an administrative guideline to implement an existing legislative mandate is easier. A consumer education effort faces still fewer obstacles to implementation.

Has low administrative and enforcement costs. An approach might require the creation of a new bureaucratic entity at state and/or federal level. Another might add a function to an existing unit. A third might substitute a new function for an existing

one, and thereby add little or no administrative expense. An approach might place an administrative burden on the private sector rather than on government. The criterion is the magnitude, not the location of the costs.

Has low susceptibility to abuse by consumers. For some programs, detection of abuse is relatively simple; for others it is very difficult. Some implementing guidelines almost "invite" attempts to abuse; others discourage such attempts by making their detection devices highly visible.

Does not adversely affect other interventions. Increased consumer protection which is offered as a "free good" will decrease consumer vigilance in the marketplace. Concurrent attempts to educate consumers will thereby be weakened. One-by-one approaches to our society's problems too often ignore these unintended effects.

Provides adequate scope. There are two issues here. The first concerns the adequacy of coverage for the population at risk. Some approaches "miss" the population most in need; the consumer education efforts of PBS have been criticized for this deficiency. Approaches also vary in their coverage of the market. Some are narrow in focus, applying to one segment such as auto repair; some cover all transactions which involve a specified mechanism, as door-to-door sales; others are still more general, applying to almost any transaction. We will refer to these two issues as Scope: General and Scope: Specific.

Has significant pay-off in reducing consumer loss. This is the bottom line in evaluating the effectiveness of an intervention. It transcends all other criteria. Truly significant pay-off might justify a program of relatively narrow scope.

