



AN ECONOMIC ASSESSMENT OF PROPOSED AMENDMENTS TO THE TELEMARKETING SALES RULE

by

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I. Introduction

Capital Economics and LECG Economics-Finance have been retained by the Consumer Choice Coalition to assess the economic impact of the Federal Trade Commission's ("FTC's") proposed amendments to the Telemarketing Sales Rule, 16 CFR Part 310 ("TSR"). The TSR became effective on December 31, 1995 pursuant to the Telemarketing Consumer Fraud and Abuse Prevention Act signed into law on August 16, 1994 ("the 1994 Act"). The 1994 Act was further expanded by the USA PATRIOT Act of 2001 to cover charitable solicitations. As mandated by the 1994 Act, the FTC completed a review of the TSR and has proposed to amend and extend its coverage.

In this study we address the more significant proposed changes to the TSR on both the telemarketing industry and consumers. The key proposed changes are: (a)

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creation of a national "Do Not Call" ("DNC") list, (b) expansion of the definition of an outbound call, (c) possible prohibition of "dead air" caused by predictive dialers, (d) prohibition on the transfer of consumers' billing information, and (e) extension of the express verifiable authorization rules and removal of written transaction verification. In performing the analysis, we rely on publicly available data as well as proprietary data provided by members of the Consumer Choice Coalition ("Coalition").

We find that some of the proposed amendments vary in their net impact and thus the reasonableness of their rationale. Our principal findings are as follows:

1. The DNC proposal appears to be a cost-effective means of enabling those who wish to block calls from telemarketers, *provided* that this national system pre-empted the plethora of state DNC regimes. Otherwise, use of devices which consumers can attach to their telephones and the current company-specific DNC regulations would be a better approach.
2. A "zero-abandonment rate" requirement for predictive dialers would deny the benefits of this technology altogether and raise costs to consumers. The optimal balance between costs to consumers and costs to telemarketers (eventually passed on to consumers) is a rate higher than zero, but lower than 18 percent – with the common standard of 5 percent appearing reasonable.
3. Restricting the transfer of billing information would deny consumers and producers alike a simple, fast, and accurate means of facilitating a market transaction. The costs associated with the proposed amendment are likely to be substantial; the evidence on benefits appears to be speculative.
4. Disallowing written confirmation to the consumer as a means of verifying an authorization would raise costs to a portion of outbound telemarketers and almost all inbound telemarketers, and eventually would raise prices to consumers – without evident offsetting benefits.
5. Applying to inbound "upsells" the same rules that now apply to outbound sales (DNC "scrubbing," restrictions as to time of sale, and [as proposed] prohibitions on transfer billing and limits on methods of authorization) is not appropriate, based on any

reasonable assessment of benefits and the substantial costs to telemarketers, and ultimately to consumers.

In short, there are actions that the Commission might take to amend the TSR that may enhance the efficiency of the marketplace, but other actions that would clearly impose significant costs on the industry – and ultimately consumers – which would not be offset by consumer benefits.

II. Overview of the Telemarketing Industry

Telemarketing – using the telephone as the principal means of marketing to consumers and establishing a sale – consists of two types of services: outbound calling and inbound calling. In outbound calling a telemarketer initiates a call to a consumer to promote and facilitate the purchase of goods or services. In the case of inbound calls a telemarketer promotes and facilitates the sale of goods or services in the course of a telephone call initiated by a consumer.

Inbound telephone services are typically classified into five principal categories, based on the types of calls with which they deal: direct TV response, customer services, banking/financial customer services, catalog response, and reservation services.¹ In the course of the call a telemarketer may offer the caller goods and services to purchase or the caller may be transferred to another telemarketer who will offer such sales. This practice is known as “upselling.”² Upselling may also take place

¹ Direct TV response is a service in which telephone operators take orders from consumers who are responding to TV advertisements for goods and services. Customer service is a service in which telephone operators handle consumer inquiries or requests for help in using goods or services (for example, consumers might call the customer service number requesting help in operating their computer). Banking/financial customer services provide consumers with information on or assistance with banking or financial products (for example, consumers might call their credit card company to find out their credit card balance). Catalog response takes orders from consumers who wish to purchase goods or services from a catalog. Reservation services make reservations for consumers (for example, lodging or car rentals).

² Upselling is not necessarily limited to inbound calling: if a consumer were offered another good or service in the course of an outbound call, it would also be considered upselling. Obviously the term “upselling” is to be distinguished from the unethical and unlawful practice known as “bait and switch.”

in those cases where the inbound call is not for the purpose of purchasing goods or services.

The telemarketing industry represents a significant and growing part of the U.S. economy. According to a forthcoming study, outbound consumer telemarketing generated \$274.2 billion in product sales in 2001, representing almost 4 percent of all U.S. consumer sales.³ The same study estimates that product sales will grow by 8 percent annually, reaching \$402.8 billion in 2006. Employment is equally significant: the study estimates that some 4.1 million Americans were employed in telemarketing in 2001.⁴

Industry figures for inbound telemarketing are not readily available. However, using information from Datamonitor on the ratio of inbound to outbound calls⁵, and information from Coalition members on the typical percentage of inbound calls that are offered upsells, the value of sales from inbound calls is estimated to be around \$1,228 billion for 2001.⁶ Under the proposed amendments upselling would be subject to the TSR. Inbound upselling alone is estimated to represent around \$180 billion of the total

³ Two starting sources – the WEFA Group’s estimate of the value of outbound telemarketing sales and the FTC’s estimate of the number of outbound calls – are available from which sales and cost figures can be derived. Members of the Coalition inform us that the sales and cost estimates derived by WEFA are more accurate; accordingly, we use those figures. If the FTC’s estimate were used as the starting point, the derived sales, cost, and call figures would be 53 percent lower.

⁴ Forthcoming study by the WEFA Group, *Economic Impact: U.S. Direct and Interactive Marketing Today, 2002 Forecast*. A March 27, 2002 *New York Times* article stated that “[a]ccording to industry estimates at least 3.5 million people work at call centers, ... [but the] total is probably higher, perhaps as many as 6 million, according to estimates cited by Call Center Magazine, including one estimate from Datamonitor, a research firm.”

⁵ Datamonitor is a business information company that collects and reports data on a range of industries. In a recent report, *Customer Relationship Outsourcing 2000-2005*, Datamonitor estimates that around 65 percent of telemarketing calls are inbound and around 35 percent are outbound.

⁶ This figure seems high, constituting over 17 percent of personal consumption expenditures in 2001. (See Council of Economic Advisers, *Economic Indicators*, April 2002, at 1.) Nonetheless, it is uncontested that the volume of calls affected by the proposed amendments is very substantial.

value of sales from inbound calls for 2001.⁷ Clearly, inbound calling and inbound upselling are also significant parts of the U.S. economy.

The success and growth in consumer telemarketing is evidence that it constitutes an efficient method of promoting and facilitating the buying and selling goods and services. Telemarketing can inform consumers of goods and services about which they have little or no knowledge, and consumers can make purchases from the comfort of their own homes. Moreover, consumers can ask questions and get answers about the product or services being offered. Telemarketing enables firms to sell goods and services directly to consumers without the expense of establishing and maintaining a physical retail presence. Telemarketing is also a cost-effective method of direct marketing. For example, while the cost of contacting a consumer is lower using direct mail, the likelihood of a positive response through telemarketing is typically very much higher.⁸

III. The Current TSR

The current TSR, which implemented the 1994 Act, is intended to improve consumer welfare by prohibiting specific telemarketing acts or practices considered to be deceptive and/or abusive. The key elements are as follows:

- Telemarketers are required to make specific disclosures of material information regarding the sales transaction (for example, the terms and conditions of any refund, cancellation, exchange or repurchase policy) (§310.3(a)(1));
- Telemarketers are prohibited from misrepresenting material information (for example, the performance or efficacy of a product) (§310.3(a)(2));
- Telemarketers may only call consumers between 8:00 a.m. and 9:00 p.m. (§310.4(c));

⁷ Attachment 3 contains further details of the calculations used to derive an estimate of the total value of inbound telemarketing and inbound upselling.

⁸ Edward Nash, *Direct Marketing: Strategy, Planning, Execution*, 2000, at 467.

- Telemarketers may not call consumers who have asked not to be called again (§310.4(b)(ii)); and
- Telemarketers must obtain express verifiable authorization for payments that involve any form of negotiable paper (for example, a check or draft) drawn on a person's checking, saving, share or similar account (§310.3(a)(3)).

Under the 1994 Act both the FTC and state attorneys general are authorized to enforce the TSR in federal court. As of January 2002, the TSR had resulted in judgements amounting to more than \$152 million in consumer redress and \$500,000 in civil penalties.⁹

Telemarketers are also subject to FCC rules that went into effect in 1992 implementing the Telephone Consumer Protection Act ("TCPA") of 1991. These rules are concerned with how the telephone can be used for the purpose of selling goods and services. The most significant elements require that telemarketers: (a) observe strict limits on calling hours, (b) maintain a DNC list, (c) have a telemarketing policy, (d) maintain a training policy, and (e) disclose name and contact information.

The FCC's rules are consistent with the TSR. For example, the DNC list required by the FCC is company-specific. Telemarketers must maintain lists of the numbers of all individuals who request not to be called, and once an individual has requested not to be called, the telemarketer must refrain from calling that individual for a period of 10 years. The TCPA directed the FCC to explore the possibility of establishing a nation-wide DNC list. However, after assessing the proposal, the FCC concluded that it "is not an efficient, effective, or economic means of avoiding unwanted telephone solicitations."¹⁰

⁹ FTC Press Release, January 22, 2002.

¹⁰ FCC Report and Order (FCC 92-443), September 17, 1992, at 15.

IV. Proposed Amendments to the TSR

Pursuant to an extensive review, the FTC has proposed amending the current TSR, increasing the level of restrictions on telemarketers' operations and extending the TSR's reach. The principal proposed amendments are as follows:

- Creation of a national "Do Not Call" ("DNC") registry for consumers to supplement the current company-specific DNC provision;
- Modification of the definition of an outbound telephone call to include those situations in which a consumer on an inbound call is either transferred to a separate telemarketer for the purpose of being offered another good or service, or is offered a good or service from a different seller by the same telemarketer ("inbound upselling");
- Extension of the express verifiable authorization rule to cover all transactions in which the payment mechanism lacks dispute resolution protection or protection against unauthorized charges comparable to those available under the Fair Credit Billing Act and the Truth in Lending Act, and removal of the provision allowing telemarketers to obtain express verifiable authorization by confirming the transaction in writing prior to submitting the customer's billing information for payment;
- Prohibition of the practice of receiving any consumer's billing information from any third party for use in telemarketing, or disclosing any consumer's billing information to any third party for use in telemarketing, and a requirement that the customer must receive additional information for an authorization to be deemed verifiable: the name of the account to be charged (e.g., "MasterCard") and the account number, which must be recited by either the consumer or the telemarketer; and
- Clarification that the use of predictive dialers resulting in "dead air" violates the Rule.

V. Impact of Proposed Changes

While the proposed changes to the TSR are designed to benefit consumers by circumscribing certain telemarketing practices, they would have significant impacts on telemarketing firms' costs, which would then lead to higher prices and/or reduced availability for consumers. The relevant concern, then, is assessing these respective impacts. The impacts of the proposed changes with respect to outbound and inbound telemarketing are assessed in the next two sections.

The proposed changes may have other impacts not directly affecting costs and prices. For example, they may also increase the risk of identity theft by exposing telemarketing operators to consumer account information for the first time – a concern that is real, though difficult to measure. In the main, these possible adverse impacts are not addressed in this report.

Outbound Telemarketing

For outbound telemarketing, which involves telemarketers initiating calls to consumers, the key element driving the direct cost of selling goods or services is the number of calls made per hour. Telemarketing firms' principal direct inputs for making calls are telephone lines and telephone operators. Given a particular rate for converting calls into sales, the more calls that can be made per unit of time, the lower the cost per sale. Because the proposed amendments would slow down the number of calls per unit of time, they would have a significant impact on the cost per call. In addition to direct call costs, telemarketing firms have to purchase customer lists and various state DNC lists, against which their calling lists have to be checked (a process known as "scrubbing"). The proposed changes would also raise these costs.

Proposed National DNC list

Many people do not want to be bothered with calls from telemarketers. Creating a DNC program is one way of serving this objective. However, other approaches do

exist. Electronic devices that attach to a telephone line can either block telemarketing calls (e.g., the "Telezapper") or enable an individual to screen their calls (e.g., caller ID). Assuming that 10 percent of the (approximately)¹¹ 115 million households in the United States wished to block calls from telemarketers, the cost of their purchasing a device, using the \$50 cost of a Telezapper as an example, would be approximately \$77 million per year, assuming the device had a 10-year useful life.¹²

Services such as caller ID have a monthly charge in addition to the up-front cost of the device: equipment costs can be as low as \$9.99, while monthly fees are around \$7.50.¹³ Caller ID does not stop a call, but does allow call screening, giving an individual the option of whether or not to take a call. However, it is not always possible for an individual to determine whether a call is from a telemarketer, and caller ID is not available in all regions. Another solution for those not wishing to receive telemarketing calls is to make use of a service offered by some local telephone companies which enables a household to restrict the calls it receives to only those from people who have been given the household's pass code. Telemarketers are necessarily blocked because they would not have access to the pass code. This service costs around \$3 monthly.¹⁴

Yet another approach is the simple answering machine, which consumers can use to monitor incoming calls and refuse to "pick up" at their option. The cost of a

¹¹ The current DMA DNC list includes approximately 4 million registered names (FTC Notice of Proposed Rulemaking at 72). That is less than 4 percent of the number of households in the United States. Conservatively, we assume that under a national DNC program more than twice that number of households would wish to block calls.

¹² $115 \text{ million} \times 0.1 \times \$50 \text{ per Telezapper} \times (1.03)^{10}$ [real rate of interest compounded over 10 years] \div 10 years useful life. With economies of volume, one could anticipate the unit cost to fall. Thus the figure cited might be considered an upper bound on the cost of taking this approach.

¹³ \$9.99 is the lowest price for a Caller ID device on BestBuy.com; \$7.50 is the monthly fee for Caller ID from Verizon.

¹⁴ \$3.00 is the monthly charge for this service from Verizon (there is also a one-time charge of \$2.50).

usable solid-state answering machine (one that should work for several years) is approximately \$20.¹⁵

A national DNC list is the approach to preventing unwanted telemarketing calls that would be mandated by the proposed amendments.¹⁶ Although the exact details of how such a national DNC list would operate for the consumer have not been spelled out, it is likely that it would involve consumers' registering their desires not to receive telemarketing calls (except for possibly those from a selective list) with the FTC, most likely via a 1-800 telephone number. These DNC numbers would be maintained in a database, which would then be accessed by all telemarketing service bureaus selling either their own firm's or a third party firm's goods or services.

Under the proposed rule, user fees imposed on telemarketers would fund the national DNC program.¹⁷ The fees would be based on the number of different area codes of data a telemarketer uses annually. Each telemarketer would be charged \$12 per year for each area code of data they use. The annual fee would be capped at \$3,000, which would be charged for using 250 area codes of data or more. The FTC estimates fees totaling approximately \$3 million would be needed in Fiscal Year 2003 to cover part of the cost of operating a national DNC program.¹⁸ Based on the number of telemarketers that access the various state lists, the FTC estimates that 3,000 telemarketers would pay for access to the national DNC registry. This implies that the FTC anticipates receiving an average annual fee of \$1,000 from each telemarketer.

In addition to the costs the FTC would incur operating a national DNC registry, a number of telemarketing firms would have to invest in equipment to enable them to

¹⁵ The lowest price for a digital answering machine on BestBuy.com is \$19.99.

¹⁶ It is worth noting that personal devices block all unwanted calls and are not just limited to those within the scope of the FTC rule.

¹⁷ FTC Notice of Proposed Rulemaking: Telemarketing Sales Rule User Fees.

¹⁸ The FCC has proposed a total budget of \$5 million for the first year of a national registry. This may turn out to be an insufficient sum: we understand that the attorney general for California has recently asked for a budget increase of \$8.2 million for a proposed DNC program (American Teleservices Association).

comply with the proposed DNC program. While almost all outbound telemarketing firms presently have equipment enabling them to comply with state DNC registries (this is discussed below), a large number of firms specializing in inbound telemarketing do not. As discussed in greater detail in the next section, significant expenditures for new equipment would be required to comply with the proposed rule.

Given that the objective is enabling those who do not wish to receive telemarketing calls, the national DNC list approach would be appropriate only if the associated costs were less than the costs of various self-help alternatives (e.g., Teleshopper and caller ID). There are two complications in this straightforward calculation. The first is that as many as 24 states have enacted laws to create and enforce their own DNC lists. Because telemarketing is not carried out on a state-specific basis, telemarketing firms are subject to a plethora of different DNC restrictions and have had to invest in technology that allows them to meet all such DNC requirements. In addition to these technology costs, telemarketing firms face the ongoing costs of purchasing each state's DNC list (most states require firms to purchase updated lists regularly to ensure that they are current), and every call list has to be checked, or scrubbed, against every DNC list to remove any listed number. Thus, for each new DNC list telemarketing firms face the cost of the fee to purchase the DNC list and the cost of the additional processing. Further, a new DNC list will not necessarily use the same database software as other DNC lists (the 24 states do not all use the same software). This imposes additional costs on telemarketing firms which must purchase a range of software packages in order to comply with every DNC list, due to the incompatibilities and inconsistencies among the various lists.

A federally-imposed, national DNC program that simply added to the current array of state DNC schemes would be one more, albeit huge, list that telemarketing firms would have to obtain and process, adding to their costs. In addition to the \$1,000 per year that the FTC estimates each telemarketer would pay on average to access the registry, we understand that telemarketers would require around two hours of processing time to scrub the lists, at a cost of around \$50 per hour. Under the proposed national DNC program, a telemarketer would be required to reconcile his lists

on at least a monthly basis. Assuming that 12 updated national DNC lists were obtained per year and given the average annual fee of \$1,000, this would imply a total annual cost of \$2,200 for each telemarketer to comply with the national DNC program. Given the FTC's estimate of 3,000 telemarketing operations, this would imply a total annual cost of \$6.6 million.¹⁹ Again, if the national program were *in addition* to the current plethora of state programs, the overall cost of the DNC approach could be quite exorbitant.

On the other hand, if the national DNC list preempted the state lists, the cost of a national DNC program would be much more reasonable and would appear to be the least costs method of enabling those who wished to avoid calls from telemarketers.

The second complication to the straightforward calculation of the cost-effective means of eliminating unwanted calls from telemarketers is that in some respects a DNC regime is an advantage to telemarketers: it is not in their interest to spend time calling households that do not want to be called. To this end the Direct Marketing Association established a voluntary DNC list on which households can register. The list is available to all telemarketers, and all members of the DMA are obliged to comply with the list and typically do so. (A shortcoming of the DMA list is that its enforceable reach is limited to those firms that are members of DMA.)

To sum up, it would appear that the cost-effective strategy of enabling those not wishing to receive telemarketing calls is to have a national DNC program that *pre-empts* the various state DNC programs. The *least* cost-effective strategy is a system of multiple (national, state) DNC regimes. In between lies the use of personal devices such as Telezapper and caller ID.²⁰

¹⁹ With each update requiring two hours of processing, 12 updates per year would require a total of 24 hours of processing time. At \$50 per hour, this represents a total processing cost of \$1,200. With the additional \$1,000 annual cost of obtaining a national DNC list, this gives a total annual cost of \$2,200. \$2,200 multiplied by 3,000, the number of telemarketers, gives a total industry cost of \$6.6 million.

²⁰ We note that one alleged advantage of the personal device approach is that it would place the cost on those not wishing to receive telemarketing calls, whereas the DNC approach would place the cost on *all* telemarketing consumers, as the increased costs to telemarketers would eventually be passed on to consumers in a non-discriminatory fashion.

Zero abandonment rate for predictive dialers

The most significant development in the outbound telemarketing sector in the past decade has been the introduction of predictive dialer technology. In contrast to traditional outbound telemarketing in which operators dial telephone numbers from a list, predictive dialers automatically dial telephone numbers ready for operators to pick up. Mathematical algorithms, based on dialing time, the expected time for a household to answer the telephone (pick-up time), the expected length (of time) of an outbound call (call length), and the number of operators available, are used to determine the frequency with which calls are made. The goal is to ensure that as soon as an operator is finished talking to one person, another person is waiting to be spoken to.

Predictive dialer technology has reduced the cost of outbound calling dramatically, because it reduces the amount of "dead time," which is the sum of dialing time and pick-up time. Dead time is costly because telemarketing firms pay operators by the hour regardless of whether they are talking to prospective customers or waiting for a connection. By reducing the amount of operator dead time, predictive dialing has enabled operators to increase significantly the number of calls per hour they handle, and thus has led to significant reductions in the cost per call.

There are other costs to consider. In a general sense, the more predictive dialing saves telemarketing firms, the more costs it imposes on households. Because pick-up time and call length are random variables, predictive dialer technology will on occasion lead to a consumer's answering a call but having no operator available to take the call. In these instances the predictive dialer terminates the call.²¹ This is a cost to the consumer in terms of the wasted time she spends answering the call and the distress caused by receiving an apparent nuisance call. The relative frequency with which this occurs is known as the abandonment rate. Predictive dialer technology allows telemarketing firms to adjust the abandonment rate, but this affects the number

²¹ If an operator is not available immediately, it is often the consumer who terminates the call before the predictive dialer.

of calls an operator can handle per hour. The higher the abandonment rate the more calls operators can handle per hour and thus the lower the per-call cost. The lower the abandonment rate the fewer calls operators can handle per hour and thus the higher the per-call cost.

The ideal solution to this matter involves a balancing of the costs faced by households and the cost savings realized by telemarketing firms. Or, alternatively, a balancing of the cost savings to consumers from a reduction in the abandonment rate versus the cost increases realized by telemarketing firms.²² It is possible to ascertain some boundaries here. Given the technology of predictive dialing and the distribution of variables mentioned above, we understand from Coalition members that the number of calls per hour that can be achieved increases with the abandonment rate up to about 18 percent; beyond that level, little increase in calls per hour is achieved. Thus, telemarketing firms have little incentive to set the abandonment rate above 18 percent, and most telemarketers follow the DMA guidelines, which call for an abandonment rate of 5 percent. This does not give telemarketers the lowest possible calling costs, but does not unduly overburden households with abandoned calls.

The Commission proposed that it be a violation for a telemarketing firm to generate *any* abandoned calls. Given the technology and the randomness of key variables, if this were enforced the rule would *terminate* all predictive dialing, and thus all of the benefits of this technology would be lost. Because of variations in human behavior, so long as predictive dialers are used, there will always be some instances in which calls are terminated because they cannot be matched with operators. This does not reflect a faulty algorithm, but is the consequence of the randomness of the underlying input variables (pick-up time and call length). The abandonment rate can be reduced (with an associated reduction in calls per hour, as discussed above), but it cannot be set to zero without disconnecting the unit. That is, to achieve a zero abandonment rate the equipment would no longer be able to "predict" when to make a

²² What the analysis requires is minimizing the *sum* of the two costs.

call: the equipment would first have to make sure that an operator was available to answer a call.

Again, if zero abandonment were enforced, the predictive dialing technology would have to be abandoned. This would lead to a substantial increase in the telemarketers' cost per call and, consequently, increases in costs to ultimate consumers. We understand from Coalition members that, on average, using predictive dialing set at an abandonment rate of 5 percent a telemarketing operator can handle around 13 to 14 consumer contacts per hour.²³ Without predictive dialing, the number of consumer contacts an operator can handle per hour falls to around eight.

The average dollar value of an outbound telemarketing sale varies considerably depending on the product being sold. On average we understand the dollar value of a sale is around \$85. Given 2001 total sales of \$274 billion, this means that around 3.2 billion sales were completed. Assuming a contact-to-sales conversion rate of 20 percent, the number of sales implies that approximately 16 billion consumer contacts were made (around three contacts per household per week). Using a predictive dialer with a 5 percent abandonment rate, it would take around 1.2 billion man-hours to make the contacts. If a zero abandonment rate were used, it would take around 2.0 billion hours, an increase of 67 percent. This would increase outbound telemarketers' calling costs by around \$19 billion, given a typical hourly direct cost of \$22 per hour. The average cost of a sale would increase by around \$6. (See Attachment 1 for further details on the calculation.)

The analysis just described assumes that telemarketers have the additional capacity available to accommodate the additional time needed to make the calls. Assume for the moment the extreme case where there is no additional capacity and the number of hours is limited to 1.2 billion. At a zero abandonment rate, only 9.2 billion consumer contacts would be made. At a 20 percent conversion rate, there would be 1.8 billion sales, which at the \$85 average value per sale yields total sales of around

²³ The number of calls an operator can handle varies considerably, depending on the product being sold. For example, technical products typically take longer to sell, so fewer calls can be handled per hour.

\$157 billion. In other words, there would be around \$117 billion in lost sales. (See Attachment 1.)

Restrictions on transfer of billing information

The key input that allows companies to sell goods and services via telemarketing is a list of potential customers to call. Obtaining these lists can be a significant expense. In addition to the cost of renting or purchasing a list, substantial effort has to be undertaken to look up missing numbers. Some companies specialize in matching telephone numbers with names, charging between 7 cents and 10 cents per name.²⁴ A widespread method companies use to obtain lists without incurring these up-front costs is to agree to share revenue with another company in return for using their list, which incorporates consumers' billing information as well as their telephone numbers. This practice is known as pre-acquired account telemarketing. Many banks, oil companies, department stores, and Internet-access providers have made their lists available on this basis.

By agreeing to share revenue the telemarketing company reduces the risk of investing in a list that may turn out to generate little revenue.²⁵ Moreover, by also acquiring customers' billing information, telemarketing firms are able to process payments more efficiently. Typically, pre-acquired accounts do not provide telemarketing operators with access to customers' billing account details (e.g., account numbers) but provide only a code that allows them to make charges against a customer's account. Pre-acquired account telemarketing has been used by the telemarketing industry for over two decades. It provides both firms and consumers with a method of completing sales transactions that is both quick and accurate. Further, since consumers' billing details are not provided to operators, the opportunities for account theft are minimized.

²⁴ Edward Nash, *Direct Marketing: Strategy, Planning, Execution*, 2000, at 467.

²⁵ The price of avoiding that risk is that any revenue generated must be shared.

The proposed changes to the TSR would prohibit telemarketing firms from using consumer lists with billing information attached (i.e., pre-acquired accounts). Moreover, the proposed changes would require customers purchasing products to recite their billing information to the operator, regardless of whether the customer has bought goods from the merchant before and so has account details on record with the merchant. The rationale for the proposed changes is to reduce costly errors: that consumers are less likely to purchase goods or services without having realized they had made a purchase if they were required to locate and read out their billing information.

We are unaware, however, of strong evidence that consumers are confused by the current system and are more likely to purchase goods and services in error if they are not required to provide their billing information. In fact, a focus group survey carried out by Luntz Research for MemberWorks, designed to assess public opinion on telemarketing, found that 85 percent of those polled said the billing methods currently used were understandable.²⁶

In effect, the rule change would remove a convenient and quick way for consumers to complete a transaction. The increased time it would take to complete a transaction would add to the costs of telemarketing – costs that would be passed on to consumers. We understand from Coalition members that the additional disclosure would likely add between 60 and 90 seconds to the length of a typical transaction. Given direct hourly costs of around \$22 and using the mid-point of the estimated time increase range (75 seconds), around \$0.46 would be added to the cost of completing a sales transaction. For the estimated 3.2 billion annual sales calculated in the previous section, this implies a total increase to outbound telemarketers costs of around \$1.5 billion. (See Attachment 2 for further details.) While it is difficult to estimate, it is also likely that telemarketers would face lost sales because some consumers would not be willing to spend the extra time needed to provide their billing information.

²⁶ Memorandum from the Luntz Research Companies to McIntyre Law Firm dated April 15, 2001.

The relevant question, therefore, is whether the annual cost of consumer errors to which the proposed rule is addressed exceeds or is less than the \$1.5 billion annual cost described above.

Loss of written verification method

The proposed amendments to the TSR would also withdraw one of the three ways currently used to verify an authorization for payments made by methods such as checks, drafts, and other forms of negotiable paper drawn on a person's checking, savings, share or similar account. These approaches are known as "novel" payment methods. The current TSR identifies three ways to obtain express verifiable authorization: (1) written authorization by the customer, including signature; (2) tape recorded oral authorization; and (3) written confirmation of the transaction, sent to the customer before submission of the draft for payment. The proposed amendments would delete the third approach.

While almost all outbound telemarketing firms have the capability to tape record sale transactions (this is usually done for credit card transactions, although it is not required by the TSR), we understand that a large number of telemarketing firms also send out written confirmation as back-up verification. Should the recording device malfunction or a problem arise with tape retrieval, the telemarketer has an additional verification method to fall back on should a dispute with a customer arise. This back-up practice would be lost under the amended rule.

Moreover, a significant number of outbound telemarketers only use the written confirmation method for non-credit card transactions. Typically, it is the in-house telemarketing operation of merchants (for example, a bank's telemarketing operation) and smaller telemarketers that use only written confirmation, rather than the large telemarketing service companies. If this method were to become unavailable, these telemarketers would have to use one of the more expensive methods. Most likely they would tape record transactions, which is the next most cost-effective, and workable, method. However, this would require significant up-front investment in the equipment

necessary to record transactions. We understand from Coalition members that the set-up costs would be around \$500 to \$1,000 per telemarketing operator's seat, plus additional direct costs would be incurred taping and managing a storage and retrieval system. Third-party solutions we understand cost \$1 to \$2 per transaction. These are costs that would ultimately be passed on to consumers.

Thus, the question is whether the "abuses" to which the proposed amendments are addressed in some way impose more costs on consumer than the costs just described.

Summary on outbound calls

The proposed changes to the current TSR would increase substantially the costs of outbound telemarketing – costs which in a competitive telemarketing industry would be passed on to consumers. Direct costs for outbound calling would increase by an estimated \$20 billion per year, or \$6.35 per sale transacted, which represents just over 7 percent of total annual outbound sales. Additional annual costs totaling at least \$6.6 million would also have to be incurred to comply with a national DNC list, unless it preempted the state DNC regimes that currently exist.²⁷

Inbound Telemarketing

In contrast to the outbound variety, inbound telemarketing does not involve operators calling households to offer them goods and services. Rather, inbound telemarketers respond to calls initiated by households. Frequently individuals initiate calls for the purpose of purchasing goods and services; for example, a consumer might call to purchase a product he has just seen advertised on TV. At other times, individuals initiate calls for other reasons, such as requesting information or contacting customer service; for example, a computer owner may call customer service for assistance in operating her computer. Inbound calls can be categorized based on the

²⁷ In which case the costs of meeting DNC requirements might be lower than at present.

purpose of the call; typically, the calls fall into the following categories: direct TV response, banking/financial customer service, customer service, catalog response, and reservation services.

Regardless of whether the call is initiated for the specific purpose of purchasing goods or services, the caller may be offered a (further) good or service. This is a practice known as "inbound upselling." Industry figures for inbound telemarketing tend to be harder to obtain than for outbound telemarketing. However, some data on the volume of inbound calling compared to outbound calling are available from Datamonitor,²⁸ which reports that approximately 65 percent of telemarketing calls are inbound, while approximately 35 percent are outbound. Out of the total number of inbound calls, only around 35 percent are for the specific purpose of purchasing goods or services, and of outbound calls around 85 percent are sales-oriented.

Based on the 16 billion outbound calls estimated to have been made in 2001, these figures suggest that around 35 billion inbound calls were made, and that around 12 billion of those calls were acquisition-related. Information from Coalition members suggests that around 40 percent of inbound calls are offered at least one upsell. This implies that around 14 billion upsells were made in 2001. (See Attachment 3 for further details.)

Inbound upselling is an efficient way of selling goods and services via telemarketing because it allows inbound calling operators to take advantage of the fact that they have already incurred the fixed costs necessary to receive incoming calls (the cost of office space, telephone equipment, etc.). The main cost of upselling is then the incremental cost of handling a longer call. An additional saving is that inbound calling operators do not have to incur the expense of purchasing or renting lists of consumers to call, nor incur the costs associated with making the calls (predictive dialer equipment costs and/or costs of dialing numbers and waiting for a response). For the consumer, upselling informs them of products – typically relevant to the purpose of their call – that they might not otherwise find out about.

²⁸ Datamonitor, *Customer Relationship Outsourcing 2000 – 2005*.

The economics of inbound calling are not dissimilar to those for outbound calling. Because direct calling costs are incurred on a per unit time basis, the key cost driver is the time it takes to complete calls. The greater the efficiency with which calls can be dealt (the more calls that can be accommodated per hour), the lower the cost incurred for each call. Similarly, the quicker an upsell can be made, the lower the cost of the transaction.

Inbound calls and inbound upselling are not covered by the current TSR. But under the proposed amendments, inbound upselling would be covered by the TSR because the amended rule would turn an inbound upsell into an outbound call for the purpose of regulatory compliance. This would mean that all of the regulations that apply to outbound calls would apply to inbound upsales. As with the impact of the proposed changes on outbound calling, the impact on inbound upselling would be to increase costs and reduce revenue-generating opportunities. Furthermore, the majority of inbound telemarketers do not have the equipment necessary to comply with the regulations, and so significant up-front cost would have to be incurred to obtain such equipment – costs that would be passed on to consumers.

Applying DNC lists

As with outbound calling, inbound upselling would be subject to the proposed national DNC list. This means that before an operator could make an upsell, he would have to verify that the number from which the person called was not on the national DNC list. This would require inbound telemarketing firms to invest in new equipment that enabled them to do this. We understand from Coalition members that the cost of such equipment is considerable, running into millions of dollars per facility. There would also be on-going administration and maintenance costs incurred to ensure that the DNC list was kept current and the equipment operated properly. As discussed above for outbound calling, the direct compliance cost alone would likely be around \$2,200 per year for each telemarketing operation – a cost that would be passed on to consumers.

In addition to the up-front equipment costs and on-going administration and maintenance costs that complying with a national DNC list would involve, compliance would also increase the length of time it would take to make an upsell. Because an operator would have to ensure that the caller was not on the national DNC list before he could offer an upsell, he would have to wait while a computer cross-checked the caller's ID with the DNC list. This is not something that can be done beforehand, as it is in outbound telemarketing, because it is the consumer, not the telemarketer, who has initiated the call.

Information provided by Coalition members indicates that the time it would take to check whether or not a caller is on the DNC list would add approximately 50 percent to the time required to complete an upsell. The average length of time spent on an upsell is approximately two minutes; checking against a DNC list would therefore add another minute to the time it took to complete an upsell. Given direct costs (around \$25 per hour) and 14 million annual upsells (2001 estimate), total annual calling costs would increase by around \$6 billion, or \$2.78 per sale, assuming no reduction in sales volume. (See Attachment 4 for further details.) In reality, however, we understand it is unlikely that that many consumers would be unwilling to wait while their details were cross-checked against a DNC list. Thus sales would fall, perhaps precipitously, unless equipment was found that could expedite the checking process. Likely, such equipment would cost considerably more than the equipment currently used in outbound calling, where telemarketers have the luxury of time to check their lists.

The above analysis assumes that inbound telemarketers have the additional capacity that would be necessary to spend the extra time on the making an upsell. If no additional capacity were available, the number of upsells made would be reduced, leading to lower revenues. With a 50 percent increase in the time required to make an upsell, on average a third less upsells could be made in the same amount of time – and in the extreme case of no additional capacity being available this would imply \$60 billion in lost sales annually. (See Attachment 4.)

Time restrictions

Under the amended TSR, inbound upselling would also become subject to calling hour restrictions. The current TSR limits outbound calling to the hours of 8:00 a.m. and 9:00 p.m.; inbound upselling would also be restricted to these hours. While this would not add directly to the telemarketing firms' costs of handling calls, it would significantly limit firms' revenue opportunities. Coalition Members estimate that some 30 percent fewer upsells would be made due to the time restrictions. Given that around \$180 billion in sales are generated annually from upselling (estimated for 2001), a 30 percent reduction implies lost sales of around \$54 billion annually.

Calling hour restrictions for outbound telemarketing are justified on grounds that between certain hours the vast majority of households do not want to be disturbed by calls from telemarketers. However, since an individual initiates an inbound call it is reasonable to interpret that action as an indication that he is willing to deal with a sales offer, at that particular hour. Given that individuals thus signal that the hour is not a "protected zone," applying the calling hour restrictions to such calls would seem to have little, if any, justification.

Cost of taping equipment (written verification will be lost)

The proposed amendments to the TSR would also eliminate written confirmation sent out to the consumer as a means of express authorization of so-called novel payments (checks, drafts and other forms of negotiable paper drawn on a person's checking, savings, share or similar account).

Although not required, many inbound telemarketers use the written confirmation method to verify sales transactions. Under the proposed rule, they would have to obtain written authorization from the consumer or tape record an oral authorization. Of the two, taping the sales transaction would appear to be the more cost-effective choice. But at present, few inbound telemarketers have the equipment required to tape sales transactions. Information from Coalition members suggests that the set-up costs would

be between \$500 and \$1,000 for each telemarketing operator's seat, plus additional direct costs would be incurred taping and managing a storage and retrieval system.

As discussed above, third-party solutions to taping cost around \$1 to \$2 per transaction. Given that there are around 2.1 billion upsell sales (2001 estimate), total industry costs would increase by around \$3 billion if a third-party solution were used, at a cost of \$1.50 per transaction – costs that ultimately would be passed on to consumers.

Restrictions on transfer of billing information

Although inbound telemarketers do not require call lists, they still enter into agreements with other companies to obtain consumers' billing information. These are often referred to as affinity relationships. For example, a merchant may enter into an agreement with a credit card company to allow it to offer upsells to the credit card holders. A customer calling the credit card customer service center might be offered an upsell, and if she accepts the upsell, the merchant would bill the account pre-acquired from the credit card company.²⁹ As discussed above, this practice offers an efficient method by which telemarketers and customers can complete a sales transaction. Additionally, a merchant typically does not have access to customers' actual account details, but using a code is able to bill customers' accounts if a sale takes place.

The proposed amendments would prohibit pre-acquired account telemarketing. Consequently, customers would be required to recite their billing information to the telemarketer in order to complete a transaction. Moreover, under the proposed changes, customers would have to recite their billing information for each additional upsell purchase, despite having just given this information to the telemarketer. It would

²⁹ There are three main types of billing information transfer: (1) when an inbound operator sells one merchant's product (and so obtains the customer's billing information) and then upsells another merchant's product, the customer's billing information will be transferred to both merchants; (2) when the inbound operator already has a customer's billing information (e.g., a bank's customer service center) and upsells a merchant's product, the customer's billing information will be passed on to the merchant; and (3) when an inbound operator hands on a customer to another operator for an upsell, the customer's billing information is passed on to the second operator.

not be permissible under the proposed amended rule, for example, for the telemarketer to say, "May I charge the purchase to the credit card you just gave me?"

The prohibition on using pre-acquired accounts and the additional disclosure of billing information would significantly increase the cost of upselling, and would increase the opportunity for billing information fraud by requiring more operators to obtain payment details. As discussed above for outbound telemarketing, the additional disclosure would likely add between 60 and 90 seconds to the length of a sales transaction. Given direct hourly costs of around \$25, and using the mid-point of the estimated time increase range (75 seconds), around \$0.52 would be added to the cost of completing a sales transaction. For the estimated 2.1 billion annual upsell sales, this would increase telemarketers total calling costs by around \$1.1 billion annually – costs that would be passed on to consumers. (See Attachment 5 for further details.)

Summary of impact on inbound upsells

The proposed changes to the current TSR would substantially increase the cost of inbound upselling. Direct costs would increase by an estimated \$7 billion, or \$3.30 per upsell sale transacted (assuming consumer would be willing to wait the extra time while they are checked against a national DNC list), which represents just under 4 percent of total annual inbound upsell sales. Additionally, substantial costs would have to be incurred for new equipment required to comply with a national DNC list and to tape record transaction. If the cost of a third-party solution to tape recording is used, the total cost increase would be an estimated \$3 billion, or \$1.50 per transaction. These cost increases – which would ultimately be passed on to consumers – must be weighed against the alleged benefits to consumers (net of the additional time *they* must spend in making the transaction).

Conclusion

The proposed changes to the TSR are intended to increase consumers' protection from abusive and deceptive telemarketing practices. Further protecting

consumers through increased regulation, however, imposes significant costs on businesses – and ultimately on consumers – using telemarketing. These costs need to be weighed against the consumer benefits in order to draw conclusions about the reasonableness of the various proposed amendments.

On the basis of the analysis just described, it appears that a national DNC program would be a cost-effective way of enabling consumers who wish to avoid receiving telemarketing calls, *provided* the national DNC program pre-empted the various state DNC programs. Otherwise, leaving it up to consumers to attach blocking devices to their phones would be a more cost-effective approach.

Other provisions are more difficult to defend. Applying the same rules to “upsells” that now apply to outbound calls would increase costs to telemarketers – and ultimately to consumers – without significant benefits. So it seems with proposals to restrict the transfer of billing information and disallowing written confirmation as a means of verifying a sale. While some consumers might benefit from these proposed changes, it appears that the overall cost – and resulting price – increases would be much more than offsetting.

Finally, there is one provision that cannot be justified on the basis of any reasonable assessment of benefits and costs, and that is the proposal to define any “dead time” associated with predictive dialers a violation of the TSR. Use – not misuse – of this technology results in substantial reductions in real costs to consumers (including costs of waiting time). Setting a zero tolerance for “abandoned” calls would deny the application of this technology and cause significant harm.

ATTACHMENT 1

A zero abandonment rate rule would increase the cost of outbound telemarketing calls.

Annual number of consumer contacts

Total value of outbound telemarketing sales	\$274,200,000,000	1 (WEFA Group estimate for 2001)
Average value of a sale	\$85	2 (Consumer Coalition estimate)
Implied number of sales	3,225,882,353	3 (1 divided by 2)
Conversion-to-sales ratio	20%	4 (Consumer Coalition estimate)
Implied number of consumer contacts	16,129,411,765	5 (3 divided by 4)

Cost of calls using predictive dialers

Operator contacts per hour	14	6 (Consumer Coalition estimate)
Operator hours spent contacting	1,152,100,840	7 (5 divided by 6)
Direct costs per hour	\$22.00	8 (Consumer Coalition estimate)
Total cost of operator hours	\$25,346,218,487	9 (7 multiplied by 8)
Average costs per sale	\$7.86	10 (9 divided by 3)

Cost of calls with zero abandonment rate

Operator contacts per hour	8	11 (Consumer Coalition estimate)
Operator hours spent contacting	2,016,176,471	12 (5 divided by 11)
Direct costs per hour	\$22.00	13 (Consumer Coalition estimate)
Total cost of operator hours	\$44,355,882,353	14 (12 multiplied by 13)
Average costs per sale	\$13.75	15 (14 divided by 3)

Increase in calling costs

Total increase in operator costs	\$19,009,663,866	16 (14 minus 9)
Average increase in costs per sale	\$5.89	17 (16 divided by 3)
Percentage increase in average cost per sale	75%	18 (17 as percentage of 10)

Lost revenue

Revised number of contacts	9,216,806,723	19 (7 multiplied by 11)
Revised number of sales	1,843,361,345	20 (19 multiplied by 4)
Revised total value of outbound sales	\$156,685,714,286	21 (20 multiplied by 2)
Lost sales revenue	\$117,514,285,714	22 (1 minus 21)

ATTACHMENT 2

Additional disclosure requirements would increase the cost of outbound telemarketing calls.

Increase in calling costs

Number of sales	3,225,882,353	1 (Attachment 1, line 3)
Additional disclosure time (seconds)	75	2 (Consumer Coalition estimate)
Total additional sales time (hours)	67,205,882	3 (2 divided by 3,600 multiplied by 1)
Direct costs per hour	\$22.00	4 (Consumer Coalition estimate)
Total cost of additional disclosure time	\$1,478,529,412	5 (4 multiplied by 3)
Average cost of additional time per sale	\$0.46	6 (5 divided by 1)

ATTACHMENT 3

Inbound upselling is a significant part of the U.S. economy

Annual number of upsells

Number of outbound contacts (calls)	16,129,411,765	1 (Attachment 1, line 5)
Percentage of sales-oriented outbound calls	85%	2 (Datamonitor estimate)
Number of sales oriented outbound contacts	18,975,778,547	3 (1 divided by 2)
Outbound calls as percentage of total calls	35%	4 (Datamonitor estimate)
Implied number of total telemarketing calls	54,216,510,133	5 (3 divided by 4)
Inbound calls as percentage of total calls	65%	6 (100% minus 4)
Implied number of inbound calls	35,240,731,587	7 (5 multiplied by 6)

Value of initial inbound calls

Percentage of acquisition related calls	35%	8 (Datamonitor estimate)
Implied number of acquisition related calls	12,334,256,055	9 (7 multiplied by 8)
Average value of a sale	\$85.00	10 (Consumer Coalition estimate)
Total value of initial inbound calls	\$1,048,411,764,706	11 (9 multiplied by 10)

Value of upsell sales

Percentage of upsells made	40%	12 (Consumer Coalition estimate)
Implied number of inbound upsells made	14,096,292,635	13 (12 multiplied by 7)
Conversion-to-sales ratio	15%	14 (Consumer Coalition estimate)
Implied number of inbound upsell sales	2,114,443,895	15 (14 multiplied by 13)
Average value of a sale	\$85.00	16 (Consumer Coalition estimate)
Total value of inbound upsells	\$179,727,731,092	17 (16 multiplied by 15)

All inbound calls

Total value of inbound calls	\$1,228,139,495,798	18 (17 plus 11)
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ATTACHMENT 4

A national DNC list would increase the cost of inbound upselling

Increase in cost of upsells

Annual number of upsells	14,096,292,635	1 (Attachment 3, line 13)
Average length of an upsell (seconds)	120	2 (Consumer Coalition estimate)
Increase in time for checking DNC list	50%	3 (Consumer Coalition estimate)
Time increase for checking DNC list (seconds)	60	4 (2 multiplied by 3)
Total time increase (hours)	234,938,211	5 (4 divided by 3600 multiplied by 1)
Direct costs per hour	\$25.00	6 (Consumer Coalition estimate)
Total cost for checking DNC list	\$5,873,455,264	7 (6 multiplied by 5)
Annual number of upsell sales	2,114,443,895	8 (Attachment 3, line 15)
Average cost per upsell sale	\$2.78	9 (7 divided by 8)

Lost revenue

Reduction in number of upsells	33%	10 (1.0 minus, 1.0 divided by 100% plus 3)
Number of upsells lost	4,698,764,212	11 (10 multiplied by 1)
Revised number of upsells	9,397,528,423	12 (1 minus 11)
Conversion-to-sales ratio	15%	13 (Consumer Coalition estimate)
Revised number of inbound upsell sales	1,409,629,263	14 (13 multiplied by 12)
Average value of a sale	\$85.00	15 (Consumer Coalition estimate)
Revised value of inbound upsell sales	\$119,818,487,395	16 (15 multiplied by 14)
Original value of inbound upsell sales	\$179,727,731,092	17 (Attachment 3, line 17)
Lost sales revenue	\$59,909,243,697	18 (17 minus 16)

ATTACHMENT 5

Additional disclosure requirements would increase the cost of inbound upsells

Increase in calling costs

Number of inbound upsell sales	2,114,443,895	1 (Attachment 3, line 15)
Additional disclosure time (seconds)	75	2 (Consumer Coalition estimate)
Total additional sales time (hours)	44,050,914	3 (2 divided by 3,600 multiplied by 1)
Direct costs per hour	\$25.00	4 (Consumer Coalition estimate)
Total cost of additional disclosure time	\$1,101,272,862	5 (4 multiplied by 3)
Average cost of additional time per sale	\$0.52	6 (5 divided by 1)